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Introduction

It is virtually a universal belief among politicians, political commentators, and even voters that elections are referenda on the economy. Politicians fill their speeches with economic rhetoric; political commentators generate endless streams of economic analysis, and high-paid consultants base their statistical predictions on little else. The extent and depth of this belief is revealed most starkly when it appears to have been violated. When incumbents win despite a bad economy or lose despite a good one, we observe in the postelection hand-wringing a concerted search for *ad hoc* explanations that preserve the more fundamental belief that the economy matters. Perhaps voters' perceptions of the "real" economy were distorted; foreign policy issues may have overshadowed its effects; or, maybe, ineffective campaign strategies undermined the expected economic vote.[1] Ultimately, however, in most elections, the economy is thought to be determinate.

Popular beliefs, of course, are not social science laws and exceptions to economic determinism are easy to find, even if they are often explained away as idiosyncratic. More generally, the systematic empirical work on economic voting, conducted in most of the advanced democracies over the last thirty years, reveals not a universal law of economic voting but, rather, a conditional one. Economic voting *is* very likely widespread and often important; but, its magnitude and nature across elections is almost certainly variable (Duch, 2001; Lewis-Beck and Stegmaier, 2000, 2006). There are limits, however, to the guidance the extant empirical literature can give us. The description of economic voting that it provides across countries and over time is at best a sketch. In some countries and in some

[1] Examples in which each of these three excuses were prominent are the 1992 U.S. presidential election, the 2002 German Parliamentary elections, and the 2000 U.S. presidential election, respectively.

periods, there are simply no data with which to describe the economic vote. In other cases, data exist but awaits a systematic analysis. In many other cases, the published estimates of the extent and nature of economic voting are simply not comparable to each other.[2] Overall, the vast amount of data relevant to economic voting in the world's advanced democracies has not yet been leveraged to describe variation in economic voting across countries and over time. Consequently, one of the major goals of this book is to provide a more complete and reliable description of the magnitude and nature of economic voting across a large number of countries (eighteen) and a long time period (1979–2001). With this goal in mind, our study for the first time reliably compares the extent and nature of this economic vote across a large number of cases, confirming that the economic vote is both widespread and variable.

If our description of economic voting reveals a conditional law, we do not yet know its conditions. Why was the effect of the economy so pronounced in the 1980 American presidential election and so surprisingly absent twenty years later? Why is it consistently more important to the electoral fortunes of British prime ministers but not their Dutch counterparts? Why, in short, does economic voting vary as it does? The second goal of this book is to answer these questions. We do this by offering a theory of how different political and economic institutions condition the economic vote and by testing hypotheses drawn from our theory. Our explanation is built on a long tradition of theoretical work that suggests economic voting is the result of instrumentally rational voters trying to use their votes to achieve the best possible economic future.

Within the family of rational choice explanations of economic voting, our contextual theory is a generalization of the competency model of rational retrospective economic voting that has been used informally by many scholars and formally by theorists studying political business cycles in the United States (e.g., Alesina and Rosenthal, 1995). The competency model suggests that rational voters condition their vote on the incumbent's record of economic performance because this is the optimal way to identify and elect competent economic managers under conditions of uncertainty. Our generalization of this model explores how political and economic institutions alter the quality of the signal that the previous economy provides about the competence of candidates. Thus, both the rationality of voting in the competency model and its focus on the voter's

[2] This murkiness is because much of the empirical literature consists of independent studies produced by researchers working with very different data and methodologies.

desire for competent economic management lead to a set of theoretical propositions (and empirical hypotheses) that link variation in economic and political institutions to variability in the economic vote.

Overall, our contextual theory of rational economic voting provides a rigorous theoretical foundation for generating hypotheses about the kinds of political and economic contexts likely to condition the economic vote. Furthermore, our empirical map of economic voting provides the raw material for testing these hypotheses. In the rest of this chapter, we preview the potential usefulness of these contributions both to the study of comparative political behavior and to the understanding of specific elections, review the theoretical and empirical work that motivated the project and that define its contribution, describe the general theoretical approach that we take to explain economic voting, and give an overview of the organization of the rest of the book.

ECONOMIC VOTING IN RECENT ELECTIONS: THE IMPORTANCE OF A COMPARATIVE PERSPECTIVE

Although the main goal of this project is to produce a set of theoretically driven empirical generalizations about the nature and sources of economic voting in different contexts, we hope that it will also help us to better understand (and predict) the role of the economy in specific elections. Our premise, however, is that a proper understanding of specific elections requires that they be viewed in a comparative perspective. As an illustration, this section briefly compares two recent German and Italian parliamentary elections (held in September 2005 and May 2006, respectively) and asks what we can learn about them (and similar cases) from the kind of comparative analysis offered in the chapters that follow.

Economic performance leading up to the elections in both Germany and Italy had been quite poor. Despite turning in slightly improved performance over previous years, the 2005 German economy still grew by only a percentage point in real terms and unemployment rates were persistently above 10 percent. Similarly, real GDP in Italy actually contracted in 2005, while the country registered the lowest level of working-age employment in Western Europe (58 percent).[3] Furthermore, as Figure 1.1

[3] Just before the Italian elections, *The Economist* noted, "But the biggest difference from the past is that the economy over which Mr. Berlusconi has presided has done so badly. Last year GDP growth was near-zero; this year's forecast has just been cut from 1.5% to 1.3%. Italy deserves its title as the new sick man of Europe. It is in far

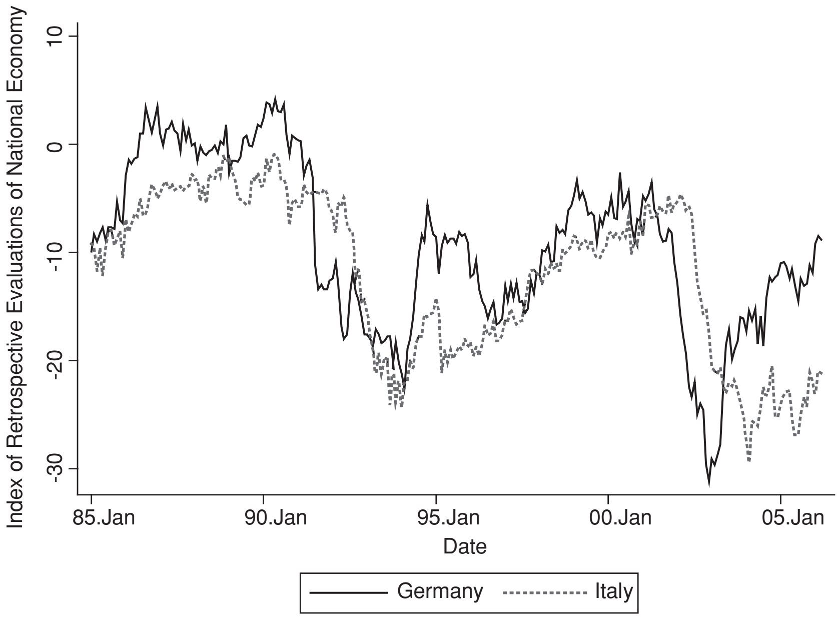

Figure 1.1. Retrospective economic evaluations for Germany and Italy.

shows, voters were clearly aware of these trends. Public sentiment about the economy dropped precipitously in both countries after 2001. But German sentiment rebounded before the 2005 election, whereas Italian sentiment remained at historically low levels as the 2006 election campaign began.

Before the elections, pundits argued that these records of economic performance would result in a strong rejection of the incumbents.[4] As it turned out, however, the German SPD trailed their CDU/CSU challengers by less than a percentage point (34.3 percent and 35.2 percent, respectively) and Italian Prime Minister Berlusconi's incumbent coalition

worse shape than Germany or France. And the pressing need to find a cure for that sickness means that the outcome of next week's election matters" (*The Economist*, April 18, 2006, 28).

4 Some representative (English-language) headlines: "Economy to dominate German election" (Deutsche Presse-Agentur, August 22, 2005); "German election boils down to jobs, economy" (Associated Press, September 18, 2005); "As Germans look toward national election, economy remains key issue" (Associated Press, September 11, 2005); "German jobs the focus of tight poll race: Unemployment and welfare state dominate election campaigns as Europe's economic miracle turns sour" (*The Guardian*, September 9, 2005).

garnered 49.7 percent of the popular vote compared to the 49.8 percent obtained by Prodi's alternative center-left coalition. As a result, and in stark contrast to preelection commentary, discussion of the economy was essentially absent from most of the postelection analyses offered by the press.

But did the economy play an important role in these elections or not? To answer this question definitively, we need a statistical analysis that estimates the impact of the economy on the election while controlling for other influences. Furthermore, because our interest is in exploring these specific elections, we need individual-level measures of economic perceptions and vote choice.[5] We conducted surveys previous to both elections (see Chapter 6 for details) that included these data (as well as relevant controls) and were able to produce estimates of the importance of economic voting in each case.[6] These estimates reveal that, contrary to the impression that may have been created by the relatively strong performance of the incumbent parties, voter perceptions of economic performance in fact played an important (and perhaps decisive) role in both elections. In both the German and the Italian elections, our estimates indicate that the prime minister's party (the SDP and Forza Italia, respectively) would have gained between 6 and 7 percent of the vote had perceptions of the economy improved moderately.[7] Furthermore, it is likely that this increase in strength would have been enough for both incumbent parties to retain the prime ministry.

So what can we learn from estimates such as these? First, they provide a much clearer picture of whether, and to what extent, economic voting was actually important in a given election. Accordingly, they can help correct misconceptions about the role of the economy in specific elections that are typified by the journalistic accounts of the recent Italian and German elections. Of course, this is not new. Social scientists have been producing well-specified statistical models of individual-level vote choice and economic voting for many years. What is different about these examples, however, is that they were produced using methods that allow

[5] Alternatively, one could examine the role of the economy in a single election using aggregate data at the regional level.

[6] These were produced using the methods described in Chapter 2. However, they are simply intended as illustrations here and they are not included in the data used in the rest of the book (they fall outside the time period covered in our data). Details about the data and the specific models estimated are available at http://www.nuffield.ox.ac.uk/economicvoting.

[7] We define "moderately" in Chapter 2.

us to systematically compare them to one another.[8] Thus, based on our estimates, we can confidently assert that economic voting was about as important in the 2005 German election as it was in the 2006 Italian one.

Should we expect to see very similar levels of economic voting in these two countries? And if so, why? Perhaps the similar levels of economic voting result from some fundamental and general characteristic of individuals that applies to all voters across contexts, even those as different as Italy and Germany. Norpoth (1996a) may be correct in asserting that economic voting is "hardwired into the brains of citizens." Alternatively, and much more likely, these cases may be similar because of corresponding similarities in context. What might these be? Well-motivated answers to this question must await the theory and analysis in the rest of this book. However, one possibility that has been suggested in the previous literature is that the distribution of policy-making power among incumbent parties was similar in the two cases: the German SPD and Italian Forza Italia were both dominant parties in their respective ruling coalition governments. Thus, voters interested in punishing an incumbent party for poor economic performance faced a roughly similar challenge in identifying whom to blame. Although this may or may not in fact be the appropriate explanation, it illustrates the importance of comparable estimates of economic voting across elections and national contexts. Having estimates of the magnitude of the economic vote from multiple elections – admittedly in this example only two cases – is what leads to speculation about the interaction between the economic vote and the structure of power sharing across parties. No analysis of a single election could hope to produce a similar insight.

These two elections are even more informative when viewed comparatively. Specifically, as we show in Chapter 3, the typical size of the economic vote over the last two decades in Germany was about 5 percent, whereas in Italy it was about 2.5 percent.[9] This comparative perspective makes it clear that although economic voting in the 2005 German election was only slightly more important than usual, in the 2006 Italian election it was dramatically so. Again, a great benefit of being able to make this (somewhat richer) empirical conclusion is that it stimulates us to ask why. What has happened to cause Italians in 2006 to weight

8 Indeed, the whole point of the first part of this book is producing, for the first time, a large set of comparable estimates of economic voting at the individual level.

9 That is, a moderate worsening of economic perceptions decreases the prime ministerial party's vote by about 5 percent.

the economy as heavily in their vote as Germans usually do? It is certainly not difficult to think of ways that the electoral situation in Italy has become more similar to that in Germany over the last decade. In contrast to most of the postwar history of Italy, there is now real electoral competition between two well-defined governing alternatives. As a result, Italian votes now matter in the choice of governments at least as much as German votes do. Such changes in the electoral context may well alter the weight that voters give to retrospective economic performance in their vote choice.

This comparison of historical economic voting in these two cases leads to a more general question: Why it is that the economic vote is typically higher in Germany than in Italy? Indeed, extending the basis of our comparison again, we can see that the typical magnitude of German economic voting places it in the middle rank of the Western democracies (higher than Italy, Belgium, and the Netherlands, for example, but less than the United States and the United Kingdom). Thus, our question becomes not just why is the German economic vote typically larger than the Italian one, but also why does it rank in the middle more generally? Understanding why Germany ranks as having an average amount of economic voting will provide insight into the dynamics of the 2005 elections.

Our intuition is that the German economic vote ranks as it does because it has a mix of contextual features that both raise and lower levels of economic voting. Specifically, we have already noted the potentially positive effect that real electoral competition over alternative cabinets can have on economic voting. Furthermore, such healthy competition has been typical of the German case throughout its history and so may be one of the enduring features of the German context that contributes to a fairly large economic vote. However, other factors may well keep economic voting below that of some other countries. For example, a number of institutional features disperse policy-making authority in Germany: a long history of coalition cabinets, a strong federal system of government, and a moderate amount of corporatism. Again, it may be the case that the dispersion of power in Germany reduces the importance that economic performance can play in German voter's decisions – at least in comparison to the highly concentrated distribution of policy-making power in more unitary and noncoalitional systems like that in the United Kingdom. Other explanations for Germany's mid-ranked level of economic voting may be its similarly mid-ranked level of trade dependence. It often has been suggested that voters in countries whose economies are more dependent on international trade are less willing to hold domestic politicians accountable for outcomes (that are not of their making). If this were so, we would expect German voters to be less willing than, for example, American voters to hold politicians accountable for poor performance but more willing than voters in more trade-dependent countries such as the Netherlands or Belgium.

Our speculations about economic voting in the recent Italian and German elections illustrate a central theme of this book: to understand the role that the economy plays in these, or any given election, or to make predictions about its role in future elections, we need to be able to place the voting decision in a comparative context. This does not mean describing everything that is unique about an election but, rather, identifying those features of the context that help explain systematic variation in the economic vote. This, of course, can only be done by building a reliable map of economic voting across countries and over time and by identifying the kinds of contextual variables that condition the economic vote. In the rest of this book, we attempt to accomplish these two tasks. Of course, both our theorizing and our empirical work builds on (and responds to) the literature on economic voting as it has developed over the last forty years. Thus, in the next sections we review the academic work on economic voting that has created both the need for this project and the opportunity for it to be accomplished.

THEORETICAL FOUNDATIONS OF ECONOMIC VOTING

This book explores differences in the way voters condition their vote choice on the economy in different political and economic contexts. Consequently, our theoretical effort begins with a model of the individual voting decision that explains why the economy, or at least perceptions of the economy, matters for the vote. A number of theoretical developments are critically important to our model-building efforts. First, early in its history, the economic voting literature adopted the notion that instrumentally rational individuals make vote choices based on their utilities for competing parties. Second, efforts to specify how economic evaluations enter into the voter's utility function resulted in two modeling approaches: sanction and selection models of vote choice. Third, these sanction and selection models have been adapted to explain how context conditions the economic vote. Finally, if economic voters are rational, then developments in the literature on vote choice imply that strategic context should be one of the factors that condition the economic vote. We now briefly explore the development of these theoretical traditions and how they contribute to our rational model of retrospective economic voting.

Economic Evaluations and the Voter Utility Function

For the most part, the economic voting literature treats voters as instrumentally rational actors. Downs (1957) introduced the notion that individuals make vote choices based on their comparison of expected utilities for each of the competing parties. The notion of voters as utility-maximizing political "consumers" was a significant deviation from widely accepted explanations for vote choice that borrowed from the social-psychological literature (Berelson et al., 1954; Campbell et al., 1960). But it was Kramer's (1971) efforts to "test the Downsian rationality hypothesis" by exploring the link between economic outcomes and U.S. election results that inspired early economic voting research.[10] Kramer in effect argued for the importance of economic well-being in the voter utility function introduced by Downs. Fair (1978) took this argument a step forward by providing a formal statement of how economic performance enters the voter utility.[11] This was an important theoretical advance because it established a foundation for modeling vote choice from a rational utility-maximization perspective that included economic well-being in the utility function. We follow in this tradition. The notion that voters rationally derive expected utilities for competing political parties and that these determine their vote choice is a central feature of our contextual model of the economic vote.

Fair's (1978) effort, though, highlighted theoretical controversies as to exactly how the *economy* enters into the voter's utility function. As Fair emphasizes, theory is a necessary guide in determining how the economy enters into the utility function. Are voters narrowly retrospective and motivated primarily by a sanctioning reflex, which is suggested by the early Kramer (1971) findings? Or do voters gather more extensive information on past economic outcomes in an effort to assess how competing potential governing "teams" might perform in the future, a selection perspective hinted at by Downs (1957) and Stigler (1973)? Both perspectives

[10] That is not to say that the link between the economy and elections had not been explored. In fact, Kramer (1971) does a nice job of summarizing the early efforts in this regard.

[11] As Hibbs (2006) points out, this contribution was also important because it derived an aggregate-level vote equation from this individual-level utility function that could be estimated empirically.

share a model of individual decision making in which instrumentally rational voters are maximizing a voter utility function. The sanctioning perspective has been widely adopted in much of the economic voting literature to date. Although it is much less widely employed in the literature, we will argue that the selection model has advantages for incorporating context into explanations of the economic vote.

The Sanctioning Model (aka the Moral Hazard Model)

The early pathbreaking work of Kramer (1971) and Fair (1978) suggested that vote choice was shaped by the recent economic performance of incumbents rather than by comparative assessments of how competing parties might perform if elected. They concluded that the economy entered into the voter's utility function in a simple fashion: punish poor performance and reward good outcomes. V. O. Key's widely quoted characterization of the economic vote seemed well founded: "Voters may reject what they have known; or they may approve what they have known. They are not likely to be attracted in great numbers by promises of the novel or unknown" (1966: 61). Fiorina's (1981) classic work, *Retrospective Voting in American National Elections*, provided a more general expected utility model of voting that included economic evaluations.[12] And although both retrospective assessments and future expectations of the performance of incumbents (and challengers) figured prominently in Fiorina's models of the vote decision, Fiorina argued that future expectations are, for the most part, simple extrapolations from current trends. This provided further support for the retrospective sanctioning perspective. Hence, early in the history of economic voting, this sanctioning model of voter behavior– either explicitly or implicitly – became the workhorse of models linking the economy and vote choice.

One of the attractions of this stark punishment model was that it demanded relatively little of the average voter, which tended to comport with early empirical findings regarding the political sophistication of the average citizen (Converse, 1964). But did this narrow focus by the voter on retrospective economic performance constitute rational behavior? Should we not expect rational voters to undertake a more comparative assessment of the likely performance of competing candidates, both incumbents and challengers, if elected? Barro (1973) and then Ferejohn (1986) showed

[12] Fiorina stopped short of providing a formal model in which retrospective economic voting emerged as rational behavior.