

JANUS-FACED POLITICAL COMPETITION

Exploring the Effect of Political Competition on Economic Policy

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ABSTRACT

The aim of this paper is threefold: first, it aims to build an integrated theoretical framework that is able to deal with both the ‘good’ (incentivizing) and the ‘bad’ (hampering) effect of political competition, from the perspective of economic reforms. Second, it aims to formulate the conditions of a political situation that is conducive to reform – I argue that reforms are possible if there is *enough* political competition, but there is not *too much* of it. Third, it also attempts to contribute to resolving an empirical puzzle: why it happened that the Hungarian government after 2010, even with unprecedented power and dominance, did not implement growth-enhancing economic reforms – though conventional wisdom concerning competition and reform would have predicted it?

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INTRODUCTION

1. Introductory Thoughts and the Aims of this Paper

It is the common field of interest of political scientists and economists why certain countries are able to implement economic reforms while others are not. Moreover, the topic is of special interest for anyone engaged in the social sciences in the post-communist region of Europe. This is so, as the life of us Eastern and Central Europeans when it comes to politics has been very much centered around the permanent need and struggle for, and conflicts about economic reforms in the past twenty-two years – that has been gone since the transition from state socialism to democratic capitalism. I am no exception, and therefore, along my intellectual curiosity, I have a personal motivation to understand the necessary and sufficient conditions for a successful economic reforms.

One of the main problems of the politics of economic policy is how political competition affects policy-making. There is a conventional wisdom in certain circles of social science that sees competitive forces (which constitute one of the central element of the specific logic of democratic politics) as something evil that hinders the implementation of policies based on long-term economic rationality. As I see it, the problem of politics of economic policy is much more complex than that, as competitive forces can also serve as an incentive for good economic policy. My ambition in this paper is to contribute to a deeper understanding the politics of economic policy-making, specifically economic reforms – and in a way, contribute to an evolution of a fairer attitude of science to politics and the problems of politicians.

In my thesis, I would like to contribute to the political economy literature with an analytical framework that scrutinizes the relationship between political competition

and economic reforms. More specifically, the aim of this paper is threefold: first, it aims to build an theoretical framework that is able to deal with both the ‘good’ (incentivizing) and the ‘bad’ (hampering) effect of political competition, from the perspective of economic reforms. Second, it aims to formulate the conditions of a political situation that is conducive to reform – I argue that reforms are possible if there is *enough* political competition, but there is not *too much* of it. The relationship between political competition and economic reforms is therefore curvilinear. And finally, this paper also attempts to contribute to resolving an empirical puzzle: why it happened that the Hungarian government after 2010, even with unprecedented power and dominance, did not implement growth-enhancing economic reforms – though conventional wisdom concerning competition and reform would predict it?

2. The Role of Social Science in Explaining Complex Phenomena

In my understanding, the role of social science in explaining highly complex social or political phenomena is to find simple logical structures that account for a part of the explored mechanisms. As the reality we social scientists aim to understand is so complex that one is not able to explain what happens in its totality – social science hence attempts to find a balance between parsimony and scientific validity. Certainly, we want our models and frameworks to capture reality as much as possible, but we very well have to be aware of the context (and limitations) of our endeavor.

The situation of economic reform is no exception: in my view, economic reform, and economic policy as a whole are again highly complex phenomena. What is the exercise of the political economist here then? In my interpretation, it is to find simple causal mechanisms that as elements constitute a larger picture. Every framework and

model political economists build are attempts to find these elements – and this paper aims to find one that has not been looked at in greater depth, an element that in some of its specificities can be a small, but genuine contribution to the literature.

3. Methodological Remarks

In this paper, I attempt to carry out an analysis using the methodology of analytical positive political economy. This methodology, that is situated in the world of rational choice, has been gaining popularity in political economy (economics and political science) in a past two decades.

In this field of political economy, in my understanding, two notions are the most fundamental. On the one hand, it is highly important, that in this realm, every phenomenon is understood through actions of specific actors – this is what is often called *methodological individualism*. Nothing that is happening in this world can be considered in this world to be explained, if there is no human actor behind it, carrying out some specific action. On the other hand, the paradigm I am working in assumes that the actors I have introduced just before, are *rational*. Their rationality means that they act along their preferences and available information, and (predictably) react to the incentives their surrounding environment (institutional, informational, power structure) gives them.

It is important to note that there is another conceptualization of rationality than the one I have referred to above. This second understanding of rationality, often called as ‘thick’ rationality means the following: behavior is seen not just as acting along ex ante given preferences, whatever they are, but interpreted as acting along ‘materialistic’ preferences. Voters and politicians are thought of agents whose

rationality means that they seek for the greatest amount of rents possible within the constraints they face. In this paper, both conceptualizations of rationality will be used.

I am aware of the fact, that outside economics, in the theoretically more heterogeneous political science world this rational choice framework has been under severe criticism (Green and Shapiro 1994). Nevertheless, I still intend to remain in the rational choice framework, even being aware of its limitation. This is so, as if it is not interpreted regardless of its inherent flaws, its results are not taken more seriously than it is appropriate, rational choice is a fruitful device in the social scientific endeavor of finding the harmony between parsimony and validity. Rational choice forces the scholar to think in precise terms, forces her to carry out perfectly logical mechanisms.

Derived from this meta-paradigm, my methodology in this paper will be to build a rational-choice analytical framework where the causal mechanism I would like to display is in the focus. The framework uses the assumptions of the framework I circumvented above.

4. Structure

This paper is organized as follows. Chapter 1 presents the theoretical context of this paper, displaying other scholars' contribution to the understanding of the politics of policy reform – both from the field of formalized and non-formalized political economy. Chapter 2 presents the analytical framework of this paper, scrutinizing the relationship between political competition and reforms. Chapter 3 presents three brief case studies from Slovakia and Hungary to show the empirical relevance of the framework. Conclusion finishes the paper. In the Appendix, I outline a simple

probabilistic voting model to show how the ideas of this paper can be presented in a formal model setting.

CHAPTER ONE: THEORETICAL CONTEXT

The topic of political economy of policy is covered by a vast amount of academic literature, and within it, the specific problems of the political economy of reform are researched extensively. This chapter of my thesis aims to present the theoretical context of the mechanism and model I am going to display. Let me stress again, that in my understanding, this political economy of reform literature aims to identify specific mechanisms that are elements of the politics of reform policy-making and does not aim to capture the phenomenon in its completeness. The question always is: why and how reforms can occur?

In this paper, I will present works of political economy from the realm of rational choice, as this is the meta-paradigm my analysis is situated in. The rational choice literature dealing with the political economy of reforms can be divided into two major branches, along the lines of two traditions in political economy. On the one hand, political economists with origins in political science tend to focus on the institutional environment of policy, and use the terms of classic political science (e.g., polarization, institutional heritage) to explain variations in policy. Parallel to this, however, political economists with origins in economics tend to offer formal models in which the actual decision problems of reforming politicians are scrutinized given specific constraints. It is important to stress that the division between the two traditions are not crystal-clear, but I believe it is a useful heuristics to structure the knowledge on the political economy of reforms.

In the following two sections, I will present works of representatives of the two traditions.

1. Non-Formalized Political Economy

First, let us begin with the tradition of the non-formalized, political science-type of political economy. In these scholarly works, reforms are explained without explicitly reducing all that happens in the models to individual decision-makers. Still, these are valuable analyses that reveal important causal mechanisms (or at least hypothesize them), and (though sometimes implicitly) rely on the assumptions of rational choice. While their theoretical clarity is sometimes questionable, they are more sensitive to empirics than formalized political economy.

The classics analyzing first-generation reforms. In the past decades, two massive waves of economic transformation occurred, one in Latin America in the 1980s (from import substitution to export-oriented development) and one in Central and Eastern Europe in the 1990s (from state socialism to market capitalism). In both processes, economists played an active role, and the two waves of transformation induced a significant amount of social scientific work. These analyses – unlike the one I would like to offer – focused on the so-called first-generation reforms (meaning that these reforms were aimed to produce extraordinary, systemic transformations [Kornai 2000]), but still, they are very important, as to a great extent they determined the way we think about the politics of reform.

First of all, in his seminal book (1991), Adam Przeworski introduced the famous J-curve hypothesis. The central claim of his theory is that reforms are difficult as bearers of their costs are concentrated and strong while their beneficiaries are diffused and weak, and as a consequence, reforms are politically very costly. In this theoretical framework, reforms are conceptualized as similar to a J-shaped curve as they are costly in the short run and beneficial in the long run, economically and therefore politically. Still in this paradigm, Gerard Roland (2002) identifies *ex ante* and *ex post*

constraints of reform (which occur mainly as reform policy has its losers), using a very similar logic concerning the politics of reform: they are politically costly, so there are constraints for the politician to get over in order to be able to implement them. Przeworski hypothesized, relying on the experience of the reforms in Latin American countries, that the political solution required to be able to implement the reforms (economically) needed, will be an insulation executives from political pressures. Or to put it differently, he expected a democratic decline in the reforming countries in postcommunist Europe. This expectation was proved not to be completely accurate by Fish and Choudry (2007), who found that the countries that implemented the deepest reform program were in fact the ones with the strongest democratic institutions. Nevertheless, the logic of reform politics, that is, that reforms are costly on the short-run and beneficial on the long-run presented by Przeworski (and Roland) are still very powerful in everyday political thinking in postcommunist Europe. I will also use this conceptualization in the analytical framework presented in the second chapter.

The other seminal work is Joel Hellmann's (1998) theory concerning partial reform equilibrium. Disagreeing with Przeworski, Joel Hellman concluded that it is not the potential losers, but the winners of the early phases of reforms that constitute the political obstacles to reform. His main argument is that as the process of systemic transformation begins, specific groups will gain substantial economic power (for instance, early privatizers), and as their fortune depends on the status quo, they, as an organized, wealthy group, oppose further phases of reform. If they are able to form an effective anti-reform opposition, that is what Hellman calls partial reform equilibrium. Besides theory, Hellman offers empirical evidence of the existence of this equilibrium,

and concludes that if their democratic institutions are strong enough, countries can avoid it, so strong democracy is in fact conducive to reform.

Timothy Frye (2002) presents a third, distinct theory, that offers a different understanding of the variation of economic performance in post-communist Europe (and not in reforms, but good economic performance is treated as a consequence of successful reform agenda) than the J-curve hypothesis or the theory of partial reforms. In his interpretation, economic policy is a battlefield between ex-communist and anti-communist forces, and on that battlefield, there is some form of ‘war of attrition’. Economic reforms are only possible if one group is able to achieve dominance over the other, while no reform will occur if the political situation reflects a ‘hurting stalemate’. His example of an anti-communist victory is Estonia, for a post-communist victory it is Uzbekistan while for the stalemate it is Ukraine.

Analyses of second-generation reforms. Besides the classical political science literature concerning the economic transformation following the fall of the Berlin Wall, there are more recent studies focused specifically on second-generation reforms. The specific meaning of second-generation reforms will be more precisely specified further, but it is important to note at this point again that second-generation reforms are reforms of ‘normal’ economic types (Roberts 2010, Labanino 2011), which means that they are not part of a systemic transformation (Kornai 2000) as first-generation reforms, but they are instruments of tackling ‘normal’ problems of a capitalist economy. This means, that the basic structures and institutions of capitalism already work, so reforms are not aimed at creating these basic institutions and minimizing the transformational crisis (Kornai 1994), but at increasing efficiency and competitiveness. These ‘normal’ problems are most of the times country- and region-

specific, but still, the distinction between first- and second-generation reforms is straightforward.

Among the scholarly works focusing on specifically second-generation reforms, let me start off with presenting the analysis of Kovalcik and O'Dwyer (2007). In their article, the authors argue that the most robust factor in explaining the variation in the degree and timing of second-generation economic reforms in postcommunist East and Central Europe is the degree of institutionalization of the party system. In the analysis Kovalcik and O'Dwyer offer, reform policy is only possible if the executives are insulated from political pressures (similarly to the logic of Przeworski and Roland). For this, an under-institutionalized party system is needed: an under-institutionalized environment reduces vertical accountability, as the anti-reform social forces cannot form a credible political opposition. In addition, O'Dwyer and Kovalcik argue that having a conservative party is also conducive to reform. They present the Estonian and the Slovak cases as examples of reforms, while the Czech and the Hungarian case as the no-reform examples. The theory of Kovalcik and O'Dwyer is strongly criticized by Györffy (2009) and Labanino (2011) as an analysis lacking external validity: they argue that the examples of successful reforms in Western Europe show that reform is in fact possible even in an institutionalized party environment.

Besides her criticism, Györffy presents a somewhat more complex theory that also aims to explain the variation in the policy paths the postcommunist countries (more specifically, Slovakia and Hungary) took. Györffy's starting point is again similar to the previous authors in saying that reforms are politically costly. She, however, argues that there is another important characteristic of reforms that needs to be taken into account: namely, that the outcome of the reform is uncertain. As a consequence, there is a required degree of trust in the political system for reforms to be possible, as

without trust, all actors in the society will only care for the very short-term future. Györfy argues that Hungary, contrary to Slovakia, got into a low-trust ‘vicious circle’ after the successful first decade of transition as its political elite was unable to overcome the credibility problems successful reforms would have required.

2. Formalized Political Economy

The second branch of political economy literature that is important to (very briefly) display in order to contextualize the analysis of this thesis is the formalized political economy tradition concerning the politics of reform. This literature very much resembles economics: in these works, a strict methodological individualism is used, and the (thick) rationality postulate is unquestioned. This tradition of political economy values theoretical clarity more than empirical validity, so various abstract modeling techniques are used. However, as I already stressed, these models are useful: on the one hand, they force scholars to present their ideas in a very precise way, and on the other, using these models it becomes visible how far social scientific theories can be stretched.

The core theoretical problems formalized political economy aims to address are the following: first, we know that politicians pursue their own interest, so some form of constrain mechanism is needed to force politicians to act along the interests of the community (society). The problem gets more complex as in addition to this, the activity of the politician is only partly observable, so an information asymmetry problem has to be overcome, too. Moreover, politicians cannot commit to comply with a contract that would somehow regulate their behavior as they have the power to change the rules. These core findings constitute a special institutional environment,

and the question then becomes the following: in this environment how and when is it possible that politicians implement policies that are in the interest of their electorate?

Out of the literature focusing on the possibility and characteristics of policy reforms, a few are mentioned in this paragraph. The state of the art in political economics is represented by the two mainstream textbooks, Persson and Tabellini (2000) and Drazen (2001), and Besley (2006) is also significant. As far as works addressing specific reform-related problems, the following studies are important. In one branch of works, the main problem of reform is how its costs will be distributed among the different groups of society. Alesina and Drazen (1991) argue that the politics of reform is similar to a war of attrition, and reform is not possible until one group considers the cost of waiting in the no-reform situation greater than the (uncertain) cost of reforms. Furthermore, in the analysis of Fernandez and Rodrik (1991), the implementation of policy reform is politically difficult as reforming politicians cannot credibly commit to compensate losers of the reform. Similarly, Besley and Coate (1998) argue that reforms fail as the present majority cannot impose its will to future majorities. Coate and Morris (1999) identify the pitfall of reform in the phenomenon where winners of reform cannot credibly promise that they won't use their better position for lobbying for a policy that is harmful for other groups of the society.

In another branch of the research program, reforms are problematic due to informational problems: voters cannot observe the 'true' type or activity of the politicians. An example of this is the recent paper by Bonfiglioli and Gancia (2011), where voters cannot decide that the worsening economic situation that they observe is due to reform or bad governance.

3. Theoretical Similarities and Differences in the Two Traditions

Besides their different perspective concerning methodology, the formalized and non-normalized political economy literature have other similarities and differences as well. Concerning electoral competition, both traditions assume some sort of economic voting, so hypothesize that at least some of the voters care primarily about the economy. Apart from this, both branches of political economy conceptualize reforms as political actions that are (for some reason) politically costly but in the long run, lead to increased economic performance.

Their main difference, in my understanding, is that formalized works of political economy of reforms focus more on the problem that politicians' objectives may be different than those of the society (that is, reforms benefitting the whole society in the long run); while non-formalized works focus more on the political problems concerning the implementation of these reforms, once a politician attempts to implement a pro-reform political agenda. In this paper, more in the fashion of the formalized tradition, I will present a theoretical framework that conceptualizes the problem of policy reforms from the perspective of the politician's decision problem.

CHAPTER TWO: POLITICAL COMPETITION AND REFORMS – A THEORETICAL FRAMEWORK

1. Janus-Faced Political Competition: Two Perspectives in Social Science

This paper aims to present the relationship between political competition and the possibility of reforms. In the wider context of the social sciences, political competition is conceptualized as having two, contradicting effects: in the pluralistic tradition of comparative political science and in many of the works of economists, competition is represented as a ‘good’ force, while in some of the political economy of reform literature and in the political business cycle models, competition is thought of as a ‘bad’ phenomenon. To be more precise, it is important to note that the point of view of these (vague) normative terms is the long-term general welfare of society, so ‘good’ effects are those that increase it, while ‘bad’ ones are those that decrease it.

Positive interpretation. Let us begin with the first tradition that interprets competition as a phenomenon with positive effects. I believe that there is no need for a very strong argument that social science, especially post-war political science and economics do trust competition as a force of constraining power (for instance: Dahl 1989, Lijphart 2008, and Varian 1992). In politics, political competition, competition between parties or competition between candidates is considered to be essential for a healthy political life: it ensures that the incumbent cannot abuse power. In addition, through the selective force of competition, only the better politicians will be successful, so competition can guarantee that the more competent politicians will be selected. In economics, competition is equally essential: competition is the force that keeps prices low and quality high – as companies compete in price and in quality, consumers will be better off eventually. In both disciplines, dispersed power (may it be political or economic) is thought to be better than unified power: democracy leads to a better

social outcome than autocracy or dictatorship, economic competition leads to a better social outcome than monopoly (at least in most cases).

Apart from this general pro-competition attitude, there are authors in the specific context of political economy of policy that interpret competitive forces in politics as conducive to something positive: for instance, Grzymala-Busse (2007) and O'Dwyer (2006) both emphasize the power-constraining role of, what they call, "robust competition". They argue that where the political environment is more competitive, incumbent parties are incentivized to create good institutions in the process of post-communist state-building. Even more specifically, in their paper, Besley, Persson, and Sturm (2010) present an empirically robust theory that political competition leads to pro-growth economic policy (at least in the U.S. South). To stress it again, it is a strong tradition in social science (both in political science and in economics) that political competition is interpreted as something good (something the enlightened watcher of politics wants).

Negative interpretation. The other branch of the literature analyzing the characteristics of political competition, that considers competition as something negative, is much less salient in the social sciences on a general level. However, it is important to note that this branch of literature is rather significant in the context of the research program aiming to understand specifically the political economy of policy reforms. As it has already been noted in the previous chapter (Przeworski 1991, Roland 2002, Györffy 2007, etc.), the conceptualization of reforms as policy actions that are costly in the short run is quite widespread in the scholarly works concerned with the politics of reform. If this is so, then political competition is in fact a threat to reforms, as well-designed but unpopular policy actions may fail if a credible opposition can be formed on the grounds of this unpopularity. Consequently, if the

outcome of reforms, or reforms themselves are the things that are considered as desired, or positive, then political competition as something that may be the obstacle to the realization of these reforms will be regarded as undesired, negative forces. Or to put it differently: competition is interpreted as something bad since it does not allow reform-minded incumbents to do good for the economy.

Besides the literature analyzing the political economy of reforms, there is another part of social science studies that is concerned with the consequences of political competition: political business cycle (PBC) models. In PBC models, the relationship of political and macroeconomic variables is scrutinized. It is important to mention Nordhaus (1975) and Hibbs (1977), who are classic representatives of the PBC literature. Nordhaus and Hibbs, while assuming that voters are irrational (consequently they can be ‘fooled’), argue that politicians, in order to fulfill their goals, will distort public policy (for instance, speed up inflation to ‘buy’ lower unemployment). These models are important from the perspective of this thesis, as in these PBC theories, competition is conceptualized as having ‘bad’ consequences: politicians are willing to sacrifice the public good as a result of competitive forces.

Janus-faced political competition. All in all, political competition, as sometimes labeled, is a Janus-faced phenomenon: it can have two effects, antagonistic to each other – as it can be seen intuitively, but as it is also represented in the social science literature. On the one hand, it can be an *obstacle* to reform, but on the other, it can also be an *incentive* to reform as incumbents under competitive pressure try to secure their survival through innovation. In this essay, my aim is not to show that one branch of literature is right and the other is wrong. On the contrary: the aim of this thesis is to present an integrated analytical framework that is able to deal with both the good and the bad ‘side’ of political competition at the same time. In the following chapters, this

analytical framework will be presented: I will display the relationship between political competition and economic policy in a setting where (again, in a rational choice fashion) all mechanisms are derived from the individual motivations of politicians.

2. Political Entrepreneurship

After taking into account the two different perspectives on the characteristics of political competition, the next step in building the analytical framework of this thesis is to take a closer look at the actions of politicians (which are the dependent variable in this analysis). In the previous chapter, I already indicated that there is a difference in the literature dealing with the political economy of policy reforms between the formalized and the non-formalized traditions: namely, that the explicit decision problem of the politicians is only in focus among formalized works. In this paper, I follow the practice of the formalized tradition, and present a framework where the explicit decision problem of the politician is scrutinized.

Political actions and political entrepreneurship (first interpretation). To be able to capture the actions politicians may undertake in an analytical way, the concept of political entrepreneurship has to be introduced. The term of political entrepreneurship is not used unambiguously, so in this essay, I shall follow the lead of Austrian economics scholar Randall G. Holcombe (2002). In his interpretation, “[p]olitical entrepreneurship occurs when an individual observes and acts on a political profit opportunity. As with market entrepreneurship, entrepreneurial actions require, first, that a profit opportunity exists, second, that someone is alert enough to spot the opportunity and recognize the opportunity for profit, and third, that the individual is

willing to act on the opportunity once it is spotted” (Holcombe 2002:143). In this sense, political actions (such as adopting and implementing any policy) can be interpreted as acts of political entrepreneurship. This theoretical move from political action to political entrepreneurship is needed to show that in the framework of this thesis, political actions are rational and intentional actions, and are analogous to economic actions (certainly, very much in line with the assumptions of the rational choice paradigm outlined in the introductory chapter).

Neutrality. In addition, it is also important that the specific interpretation of political entrepreneurship used in this thesis (following Holcombe) implies a certain neutrality concerning the substantive content of political actions. This neutrality means that there is no further assumption about politicians other than they will act along their interests (given their constraints and incentives) – so, this thesis does not assume that politicians are *a priori* pro-reform. This is so, let me stress again that (in line with the formalized works of political economy mentioned in the chapter about the theoretical context of the analysis carried out in this paper), any policy decision is derived from the individual goals of political decision-makers.

Types of political entrepreneurship. In the terminology Randall Holcombe introduces, there are two types of political entrepreneurship, and I will use his terminology for the analytical framework of this thesis. The two types of political entrepreneurship Holcombe identifies are called *productive* and *predatory* political entrepreneurship. In his interpretation (using the terms of welfare economics) the two types mean the following: an act of political entrepreneurship is productive if it leads to a Pareto improvement (some of the members of the group are better off as a consequence of the act while no-one is worse off), and it is predatory if it is an act of redistribution of wealth from one individual or group to another individual or group (which means that

some of the members of the group are better off as a consequence of the act but there are others who *are* worse-off also as a consequence of this act).

The normative difference between the two types of political entrepreneurship is straightforward (as it is already implied in the terms ‘productive’ and ‘predatory’): the former means the ‘good’, while the latter means the ‘bad’ form of political entrepreneurship, one leads to a desired social outcome, while the other leads does not. Furthermore, in order to be able to use this terminology in the context of policy reforms (and specifically, second-generation reforms), the meaning of the two types of political entrepreneurship has to be amended at one point, quite substantively. As I already indicated, Holcombe’s terminology works in the context of welfare economics (as it is centered around the the term Pareto optimality), and this limits its usability. The logic behind the Pareto rule cannot be used in the context of political economy of reforms, since at most of the time, policy reforms mean exactly to hurt someone’s interest in order to put the economy onto a sustainable path of growth – by abolishing rent-seeking or doing away with welfare structures that create bad incentives (and debt, certainly). Besides this amendment, it is important to keep the normative hierarchy, so furthermore, I will use the term ‘productive political entrepreneurship’ to describe political actions that *enhance* economic growth, and use the term ‘predatory political entrepreneurship’ to describe political actions that *hinder* economic growth. This is important for theoretical clarity of the terminology as well as for its correspondence with (at least stylized) reality. I believe the terminology is flexible enough to make this amendment, and with it, the terms of productive and predatory political entrepreneurship can be interpreted in the realm of political economy of reforms (and not only in the realm of welfare economics).

3. Motivations of Politicians

To build the next block of the theoretical framework of this thesis, it is necessary to present a framework concerning the motivations of politicians, as in the realm of rational choice, actions are derived from motivations and goals.

General assumptions concerning the motivations of politicians. To be able to do this, it is necessary to move away from the absolute neutral or empty formulation of the politician's objective (or as the economists would say, 'utility function') and we need to have some specific assumptions about it. Generally, four different archetype of motivations politicians are assumed to have: first, it is possible to assume that politicians in fact care about the welfare of the citizens they govern. This assumption is typical in classic political thinking (in the Antiquity, for instance), especially because prior to Machiavelli, normative and positive thinking concerning politics was not distinguished from each other (Strauss 1953). To put it differently, this is the assumption concerning politicians where they are imagined as 'good' or 'benevolent planners', in the language of welfare economics.

Second, it is also possible to conceptualize politicians as actors that pursue their own material or power interests, they can be thought as *self-seeking* individuals. This conceptualization means that not only an analytical (thin) concept of rationality is on the table, but also a substantive (thick) one: political actors are thought to be rational in this framework not just because they pursue their goals (whatever they may be), but they pursue specific material goals (in contrast with normative or emotional goals). If a self-seeking politician is in power, then he or she will use it not to serve the interests of the community they govern (as the benevolent one would), but, again, to carry out their own goals. Corruption is a quite widespread example for the realization of self-seeking motivation in politics.

Third, apart from the benevolent and the self-seeking motivation, politicians can be conceptualized as actors that care about the welfare of the group they belong to. This assumption is quite straightforward: *group-affiliated* politicians will use power to increase the well-being of their specific group, and not to increase the well-being of the whole society they govern. And finally, the fourth archetype of political motivation is *power-seeking*. The power-seeking motivation is somewhat different than the other three archetypes: it does not concern what power can do, rather, it concerns the process of acquiring power. While the benevolent, the self-seeking and the group-affiliated motivations conceptualize power as a mean to an end, the power-seeking motivation focuses on power in itself.

Politicians' motivation in a democracy. Democracy has its own logic and terminology, so it is needed to interpret the general notions concerning politicians' motivation in the specific context of democratic politics. This means that some of the terms used in the general argument have to be adjusted. To be precise, the first and the second archetypes presented above (benevolent and self-seeking motivation) can be used without any further problem, so I will focus on the third and fourth archetypes (group-affiliation and power-seeking motivation), as they need further interpretation.

In the context of modern-day democratic politics, the archetype of group-affiliation can be interpreted as *party-affiliation*. I believe it is fair to say for the purposes of this paper that the principal embodiments of the groups in a society in democratic politics are parties. This means that in democratic politics, politicians who care about the welfare of their own group will care about that of the voters of their own party, and will use power to carry out group-specific goals represented by parties. One of the classics using the assumption of party-affiliation is the political business cycle model of Hibbs (1977), that has already been mentioned, and for a review of literature

concerning the effect of parties on policy, see Schmidt (1996). It is important to note that the substantive content of the motivation does not change with this minor adjustment (party-affiliated political motivation means to desire a group-specific outcome as opposed to benevolent or strictly self-specific outcome), but with it, the term is more useful for interpreting the events in democratic politics.

Moreover, the power-seeking archetype of political motivations can be interpreted as *office-seeking* motivation. The difference in terminology is needed to show that in democratic politics, the only way to acquire power is to take part in the competition for public office, and for instance, the use of violence or physical force is unacceptable. The content of the political motivation does not change in this case either: for an office-seeking politician, power with all its attributes is an end itself, and not a means to an end. The assumption of office-seeking is a powerful tradition both in economics and political science, and some of the classic studies work with this conceptualization, for instance Downs (1957) and Riker (1962). Additionally, among the political business cycle theories cited above, Nordhaus (1977) also starts off with his analysis using this *office-seeking* assumption.

Relations of the motivations. This paper does not aim to argue theoretically or empirically in favor of any of these conceptualizations concerning the motivation of the political actors. On the contrary, in the analytical framework I use to analyze the relationship between political competition and public policy, all the different archetypes of assumptions concerning politicians' motivation are salient. To put it more simply, I work with the assumption that politicians care about the welfare of the society, pursue their own goals, try to implement policies that increase the well-being of the group they belong to, and seek office for itself and *at the same time*.

Moreover, I argue that the four archetypes of political motivation are not equally strong, but they have a special hierarchical relationship. First, there is a hierarchy between office-seeking and the other three archetypical political motivations, as if the politician is not in power, he or she cannot implement any policy (derived by whatever motivation). To put it another way, office-seeking is *primary* to the other motivations because it is the one that is concerned with power itself and not the political goals politicians can achieve while in power. Second, self-seeking and party-affiliation are on a higher level in the hierarchy than the benevolent motivation, so they are secondary political motivations. (I believe this is a realistic assumption.)

Furthermore, I assume that a political motivation can only have its effect if it is not in conflict with another motivation that is on a higher level in the hierarchy. Thus, self-seeking and party-affiliation can only prevail if they are not in conflict with office-seeking, and the benevolent motivation can only have its effect on action if it is not in conflict with the other motivations. Besides this, I also assume – since I argued that all types of political motivations are salient in the political decision-making – that politicians prefer a situation where motivations on a lower level of hierarchy can have their effect. This means, that if it is possible, they want the self-seeking and party-affiliated motivations to have their effect, and if it is possible, they want the realization of the benevolent motivation. Table 1 summarizes:

Table 1. Politicians' motivations

General level	benevolent	self-seeking	group-affiliated	power-seeking
Democracy	benevolent	self-seeking	party-affiliated	office-seeking
Position	tertiary	secondary	secondary	primary

4. Political Actions

The next element of the analytical framework presented in this paper is the specific interpretation of political actions. More precisely, it is necessary to create the theoretical link between the political motivations outlined above and the political actions derived from them. I argue that each of the four archetypical political motivations has a political action that is its equivalent. This means, that if one of the archetypical goals gets to a 'dominant position' the process of political decision-making, a specific political action is selected, determined by the dominant political motivation.

Archetypical political actions. The archetypical political actions are the following. First, the action-equivalent of the benevolent political motivation is what we may call *reform*, as reform aims to enhance the long-term growth of the economy, which is quite arguably in the interest of the whole society. Second, the action-equivalent of self-seeking political motivation is *private rent-seeking* (or corruption). Private rent-seeking means that public money is spent for the private purposes of the incumbent politician. The third archetype of political action, that is the equivalent of party-affiliated political goal is called *own-group spending*. If a politician decides for the option of own-group spending, he or she does so with the aim of redistributing resources to the social group he or she belongs to. Finally, the action-equivalent of the political motivation of office-seeking is what I will call, in this paper, *welfare spending*. Welfare spending is here defined as the political action that specifically aims to ensure the re-election of the incumbent, using the resources of the state (which ultimately belongs to the public).

The archetypical political actions have specific time and cost-benefit structure, derived from their own special logic. Benevolent political action, reform is costly in

the short run and beneficial in the long run, and its costs are specific, while its benefits are universal. In contrast with this, private rent-seeking, own-group spending and welfare-spending are beneficial in the short run and costly in the long run, and their benefits are specific and costs are universal.

Political actions and political entrepreneurship (second interpretation). In addition, it is important to link the archetypical political actions to the types of political entrepreneurship outlined earlier in this chapter. Reform is a productive form of political entrepreneurship, as it aims to increase the general good of the society, through enhancing long-term economic growth (through a productive investment). As opposed to reform, private rent-seeking, own-group spending and welfare spending are considered to be predatory forms of political entrepreneurship as their goal is to increase the well-being of a specific individual or group through unproductive spending of public resources, and therefore they decrease the well-being of the general public in the long-run.

This specific interpretation of political entrepreneurship has another consequence. If productive interpretation means reform (the time and cost/benefit structure of which is outlined above), then it is also necessary to mention that implementing an action of political entrepreneurship requires a certain *risk-taking*. Only those politicians will reform who trust that their political investment will pay off, so they are willing to pay now for a higher return in the future. This logic of investment and risk-taking means that productive political entrepreneurship is close to a thinner understanding of entrepreneurship where entrepreneurship does not only mean to capture a profit opportunity, but also to be willing to take the risk and invest.

For a summary of the arguments in this section, see Table 2.

Table 2. Political motivations and their action-equivalents

Political motivation	benevolent	self-seeking	party-affiliated	office-seeking
Position in hierarchy	tertiary	secondary	secondary	primary
Political action	reform	private rent-seeking	own-group spending	welfare-spending
Time structure	t ₁ : costly t ₂ : beneficial	t ₁ : beneficial t ₂ : costly	t ₁ : beneficial t ₂ : costly	t ₁ : beneficial t ₂ : costly
Cost/benefit structure	costs: specific benefits: universal	benefits: specific costs: universal	benefits: specific costs: universal	benefits: specific costs: universal
Political entrepreneurship	productive	predatory	predatory	predatory

At the end of this section, it is necessary to make a remark. From now on, I will leave out the political action of private rent-seeking (corruption) from the analysis as an autonomous item – as this paper does not focus on the specific problems of the private-oriented behavior of politicians. I believe this is legitimate as though corruption and politicians' private rent-seeking activity is a rather widespread phenomenon in basically all political system, in the rather limited political space of

consolidated democracies (which this analysis is concerned with), its magnitude in terms of the amount of money in question is incomparable to other sorts of political action. As a consequence, analytically, the self-seeking motivation is integrated into the group-affiliated (party-affiliated) motivation, and subsequently private rent-seeking is integrated into own-group spending.

5. Political Competition and Political Action

In this section of the chapter, I will interpret the relationship between political competition and political action in the analytical framework outlined in the paragraphs above. As it has already been explained, political competition is thought to have two opposing effects: it can have a ‘good’ as well as a ‘bad’ effect. Let me specify these normative terms in the context of economic policymaking. Good effect can be defined as an effect that *constrains* political actors in their egoistic behavior, or to put it differently, provides an *incentive* for benevolent action. This is so, as if there is political competition, the threat of a credible opposition potentially winning the next election forces incumbent politicians to act along not their own, but the interest of the general public. As opposed to this, bad effect can be defined as an effect that *hampers* political actors from benevolent action, as these require initial investment, and the threat of losing the elections discourages politicians to take these investments.

How do these forces work in the context of policymaking? I assumed that that politicians care about the general public, their own group and their staying in office at the same time. However, I argued further that the environment determines which ‘heart’ of the politician will eventually get to dominate, and consequently, what sort of political action he or she will implement.

Low level of political competition. Let me start with the case where there is basically no or very little political competition, so the incumbent politician can almost absolutely be sure that he or she (or his or her party) will not be voted out of office in the next elections (this is an unlikely but possible option even in a consolidated democracy). In this case, neither of the effects of political competition will be present as a consequence of the lack of it. I argue that in this situation, the most prominent political motivation will be the archetype of party-affiliated political motivation. This is so, as the office-seeking motivation can be regarded as irrelevant, since the question of staying or leaving office is simply not on the table – the politician almost surely wins the election. The benevolent motivation is ruled out in this situation as well, because it is in conflict with the party-affiliated objective. If the party-affiliated political objective dominates, then in the analytical framework of this paper, the political decision-making process will result in the political action of own-group spending.

Moderate level of political competition. The next step is to turn to the second situation, in which there is a moderate amount of political competition. In the moderate-competition case, among the two effects of political competition, the *constraining/incentivizing* effect will be salient and be the determinant of events. If there is a moderate amount of political competition, then the incumbent politician faces some threat of losing the next elections, so his or her situation is not that easy as in the no-competition case. Consequently, other than the party-affiliated motivation, the office-seeking objective appears in the decision-making process. This means, that in order to secure re-election, the incumbent politician has to take into account other people's interests other than his or her group. The benevolent motivation is always there, and the question is whether it is in conflict with the emerging office-seeking

objective. I argue that in a situation with a moderate level of political competition, the office-seeking and the benevolent motivation determines the politician's behavior together. This is so, as reform, which is the action-equivalent of the benevolent objective has positive effects on re-election in the long run (since the results of reform are beneficiary for the majority of the general public). Therefore, in the moderate-competition case it is possible to implement a reform policy. However, I do not argue that this relationship is a deterministic one: since, as already mentioned, implementing reform requires a certain risk-taking (a thinly interpreted entrepreneurial spirit), a moderate level of political competition is only a necessary, but not a sufficient condition for reform. For reform, it is also important that the incumbent politician should take the risk implementing such a policy requires – but this is not determined by his or her direct political environment.

In the third case, where there is strong political competition, it is clear that the most dominant political objective is office-seeking. (Note that in some of the highly competitive polities, especially in the ones that are polarized, the costs of losing office are usually higher.) The problem is, again, whether the benevolent and the office-seeking motivations are in conflict. As the level of political competition increases, so does their conflict: as the stakes get higher, the possibilities for any policy involving time delay and risk are reduced. Consequently, the prevailing option for action for the politician will be welfare-spending. In this case, both the constraining/incentivizing and the hampering effect of competition determine the behavior of the political actor, but it is clear that it is the hampering effect that is responsible for the move to the changing results.

Table 3 summarizes:

Table 3. Political competition, political motivations and actions

Level of political competition	none/low	moderate	high
Effect of political competition	none	constraining/incentivizing	obstacle
Dominant political motivation	party-affiliated	office-seeking benevolent	office-seeking
Political action	own-group spending	reform	welfare spending
Form of political entrepreneurship	predatory	productive	predatory

The overall picture that emerges from these mechanisms is the following: if we interpret the events from the perspective of reforms (which is the dominant perspective in the political economy of reform literature), the conclusion is that the relationship between political competition and reform is curvilinear. (1) In the situation where there is no or very low political competition, there will be no reform – in this case, there is *not enough* political competition, so the incumbent's behavior is not constrained whatsoever. (2) Furthermore, in the situation in which there is a moderate amount of political competition, there can be reform – in this case, there is enough competition for the incumbent to be constrained. (3) And finally, in the situation of high level of political competition, there will be no reform – as in this

case, there is *too much* competition, so while the incumbent is constrained, he or she is also hampered by competition.

6. Discussion

The theoretical framework concerning political competition and reforms presented in this chapter relies on the assumption that the political system the politician operates in is isolation – or to put it more precisely, any potential external effect has been ruled out so far. This is clearly an unrealistic assumption – however it has been needed to identify the core internal mechanisms. In this section, I briefly discuss a possible direction in which this analytical framework can be advanced once this assumption is relaxed.

Before this, it is important to note that the problem of external effects on economic policy is a significant topic in the literature dealing with policy reforms, most notably in the works analyzing first-generation reforms, the policy measures that aimed to create the institutions of capitalism in transition countries. This is so, as East and Central European transitions happened with a continuous assistance of Western governments, international organizations and think tanks. For a review of literature concerning the external influence on policy in postcommunist countries, see Jacoby (2006), while for a general theoretical framework concerning policy diffusion, see Dobbin et al (2007). In the terminology used by Dobbin et al, policy diffusion can be explained in four different ways: (1) with a constructivist approach, assuming that policy diffusion is the consequence of the existence of epistemic communities defining the dominant narratives concerning what is considered to be good policy; (2) with an approach focusing on power-relations, assuming that international political

forces can coerce specific policies; (3) with an approach focusing on competition between countries, assuming that policies in different countries affect each other as countries compete for international capital; and (4) with an approach focusing on learning, assuming that countries can learn from the successes and failures of others.

The problem of external influence is an important problem also because what is happening now in Europe. The financial and subsequent debt crisis has resulted in a strengthened cooperation between European countries – so the assumption that there is no external influence on a country's policies is becoming even more unrealistic.

From the perspective of the analytical framework presented in this paper, the most important approach concerning external influence on policy is the second approach of Dobbin et al, that focuses on coercion. In this approach, international organizations or other political forces can influence the policies of a country by virtue of their power. A potential direction for advancing the analytical framework formulated above if some notions of the coercion approach is integrated into it. In my understanding (in line with recent European politics), an important first step is to assume that external political/economic forces can ensure that no country can increase its budget deficit and national debt. This means, that the set of political actions has to be changed, as both own-group spending and welfare-spending result in increased deficit. If this is the case, namely that the political context is characterized by externally induced budgetary pressure, then the core question of policy will be the distribution of the costs of fiscal consolidation. I believe that the logic of my analytical framework can prevail even in this context, as the three different political motivation can result in three different policy package. Party-affiliation and office-seeking may lead to a consolidation with short-term measures with specific distribution, and benevolent motivation may lead to a more extensive restructuring of state finances.

CHAPTER THREE: CASE STUDIES FROM HUNGARY AND SLOVAKIA

In the last chapter of this paper, I will present three brief case studies to show how the analytical framework corresponds to reality. As I have pointed out in the Introduction, the analysis of this thesis does not aim to show a relationship between two variables that are universal regardless of time and space, rather, it aims to display an effect, a specific mechanism that may help our understanding the politics of policy-making. Similarly, it is also important to note that this empirical investigation is used strengthen the intuition of the theoretical chapter, and it does aim to be a general empirical confirmation.

In the second chapter, I offered an analytical framework that claims that productive political entrepreneurship, or reform, can only be expected if there is enough, but not too much political competition, and the incumbent politician is willing to take risk. In these situations, politicians are incentivized to take prudent political action in order to secure re-election, but they are still able to take the risk that is involved in implementing such policies – unlike situations of low political competition, where there is no constrain on incumbents; or those of with high level of political competition, where competition hinders the implementation of productive policies. It is also important to stress that the mechanism under scrutiny in this paper is conceptualized in the realm of consolidated democracies.

In this chapter, I will present three political situations from recent Central European history. First, I will display the case of the first socialist-liberal government of Prime Minister Péter Medgyessy between 2002 and 2004 in Hungary, which is a good example of strong political competition and welfare spending. Second, I will show the situation of Prime Minister Mikulas Dzurinda's second government between 2002 and 2006 in Slovakia, which is an example of moderate political competition and

reforms. And finally, I will present the case of Prime Minister Viktor Orbán's government in 2010-11 in Hungary, which is the example of low level of political competition and own-group spending.

1. Methodological Remarks

The aim of this chapter is to show the empirical relevance of the analytical framework presented before. To make the connection between theory and reality, it is necessary to give a more substantive interpretation of the terms used analytically. As the empirical investigation is not a quantitative cross-country analysis, but a few brief case studies, it is possible to establish this connection in a more qualitative way than it would necessary be if I followed the former path.

Political competition. The first variable to be specified and substantively interpreted is the independent (or explanatory) variable, political competition. Following the concept-building hierarchy of Adcock and Collier (2001), the process of conceptualization is necessary before the operationalization of the used variables is possible. In the context of this analysis, this means that it has to be cleared which aspect of political competition is under scrutiny. In line with the theoretical chapters, from the perspective of this paper, the most important aspect of political competition is that how threatening competitive forces are for the politician, how great fear of losing the office he or she perceives. The most important measure of this is certainly the proportion of power in and structure of government-opposition relations.

This means, that political competition will be specified in the following way: to capture the power position of the incumbent party (or parties), (1) the distribution of parliamentary seats will be investigated, and (2) the structure of relations of the

government and opposition will be scrutinized. The first element is rather straightforward, but the second element needs some consideration. Loosely following O'Dwyer (2007)¹, I will investigate whether the government and the opposition side is divided or unified in terms of organization. Furthermore, I will also examine whether the government party (or parties) are in a central position (having ideologically divided opposition) or in a side position (having ideologically close opposition). In summary, the effect of these factors on the strength of competition:

Table 4. Indicators of political competition

Majority of government		Organizational division of opposition		Ideological division of opposition	
greater	weaker competition	unified	stronger competition	close	stronger competition
smaller	stronger competition	divided	weaker competition	divided	weaker competition

Economic policy. In order to capture the dependent (response) variable of this paper, it is also important to substantively interpret the different economic policies politicians may implement. In the analytical framework, I identified three different types of political action (policy package): (second-generation) reform, own-group spending, and welfare spending.

First, a policy package will be interpreted as (second-generation) reform, if it consists of policy steps that aim to enhance competitiveness through attracting foreign and

¹ O'Dwyer also gives an extensive review of the different measures political scientists use to capture political competition, including the classics, for instance Peter Mair's works.

supporting domestic business – by reducing the administrative and tax burden on corporations. Besides this, it is also important that reform packages also include measures that aim to restructure public services to do away with welfare dependency and to consolidate state finances in the long run. Second, a policy package will be interpreted as own-group spending if it consists of policy steps that principally aim to redistribute income to the core support group of the incumbent party (parties). These measures can be direct (transfer) or indirect (tax benefit). And finally, a policy package will be interpreted as welfare spending if it contains policy steps that provide direct or indirect benefits either all voters in the society or specifically those who are known to be very active voters.

No external effects considered. In line with the analytical framework, I will leave out the potential effects of external factors of the empirical analysis as well. Though this certainly raises some problems, I believe it is acceptable for the purposes of this paper: in the case of the Medgyessy and the Dzurinda government (both after 2002) the international economic conditions were quite favorable, which gives freedom to leaders to make independent decisions. Additionally, in the case of the government of Viktor Orbán (after 2010), it was the government's specific goal to carry out its own policy as independently from external forces as possible (Barta 2011).

2. Hungary 2002-2004: The Government of Prime Minister Péter Medgyessy

The first short case-study I will present in this chapter is about the socialist-liberal government of Prime Minister Péter Medgyessy between 2002 and 2004.

A bit of political history. Péter Medgyessy became prime minister in 2002 after beating the incumbent Viktor Orbán's center-right coalition in the elections, after a rather heated election campaign (Labanino 2011).

To describe the political situation in Hungary between 1998 and 2010, a catchphrase widely used in the Hungarian press is quite useful: it is 'cold civil war' (in an English-language context, see Schöpflin 2006). While this term is specifically used to describe political polarization, and not competition, it is still important as it shows the context of Hungarian politics. The degree of polarization could have emerged to this high as Hungarian politics was characterized by the competition of two quite equally strong political camp, the right (led by Fidesz–MPSZ) and the left (led by MSZP). Table 5 presents the results of elections of 1998, 2002, and 2006 – the stability and dominance of the two camps are straightforward (governing parties are indicated with italic formatting).

Table 5. Results of Hungarian elections 1998, 2002, 2006.

PARTY	1998	2002	2006
Fidesz-MPSZ – Hungarian Civic Union (Christian Democrat)	<i>148</i>	164	164
MSZP – Hungarian Socialist Party (social democratic)	134	<i>178</i>	<i>190</i>
SZDSZ – Alliance of Free Democrats (social liberal)	24	<i>20</i>	<i>20</i>
MDF – Hungarian Democratic Forum (conservative)	<i>17</i>	24	11
FKGP – Independent Smallholders' Party (traditionalist-agrarian)	48	-	-
MIÉP – Party of Hungarian Life and Justice (radical right)	14	-	-

Source: valasztas.hu/National Elections Office of Hungary

Generally assessing this political situation, it is possible to say that between 1998 and 2010, all actors in Hungarian politics perceived the situation as a harsh struggle between the two camps, each with roughly the same size. As an indication: the effective party number (Laakso and Taagapera 1979) in 1998 was 3.45, but in 2002 and 2006, it was 2.5 and 2.35, respectively. This means that the Hungarian political scene was characterized by a quasi two-party system with the two opposing blocks. This means, that any incumbent in the Hungarian political scene was perfectly aware that he has an equal opponent, and has to take his actions in accordance with this situation.

Political competition – facts and interpretation. Let me turn my attention to the political actions under scrutiny, namely, the policy of the government led by Prime Minister Péter Medgyessy between 2002 and 2004 in Hungary. This government operated in the ‘cold civil war’ context discussed right above, but it is important to assess the political competition with the specification formulated earlier. (1) As far as the distribution of parliamentary mandates are concerned, it is quite clear that the facts direct us to interpret the situation as great competition: out of the 386 parliamentary mandates, 198 belonged to the government (MSZP and SZDSZ), and 188 belonged to the opposition (Fidesz-MPSZ and MDF). (2) Regarding the division of the government and the opposition, as I have already mentioned, the two sides were almost entirely unified: the two political sides could have been interpreted as opposing cultural-economic camps (Labanino 2011), Fidesz and MDF officially participated in the elections together (the two parties had a shared party list), and MSZP and SZDSZ actively supported each other in the second rounds of the elections. From these facts, we should consider the situation to be great competition. (3) And finally, concerning the ideological division of the opposition, it is quite clear that the

left-liberal government had a side position, as its opposition consisted of two center-right parties. This is also a sign of greater competition.

As a consequence of these three findings as well as the qualitative assessment, it is possible to conclude that after the 2002 elections, the political situation in Hungary was characterized by *great competition*.

Economic policy – facts and interpretation. It is indicative concerning the economic policy of the Medgyessy government that its program was entitled as ‘The Program of Welfare Regime Change’ (*‘A jóléti rendszerváltás programja’*). The economic policy of the newly elected government was characterized by massive government spending that resulted in a 9.2 per cent budget deficit in 2002 (in terms of GDP), and 5.6 per cent in 2003 (OECD Economic Survey, 2004). This fiscal expansion was due to mainly two elements of economic policy: first, the government did not balance (and in some cases, increase) the expansionary actions of the last (campaign) period of the previous government led by Prime Minister Viktor Orbán (1998-2002), that consisted of increasing pension benefits, minor tax cuts and the increasing of tax advantages, and a major home loan program with interest subsidies from the state. Second, it introduced the ‘Program of Hundred Days’ (*‘Száznapos program’*) that included a fifty per cent (!) increase for all state employees, a one-off pension supplement, a special increase in pension benefits (for the recipients of the lowest pensions), and an increase in the stipends of university students (Petschnig 2006).

How can we interpret the economic policy implemented by the government of Prime Minister Medgyessy using the terms of the analytical framework of this paper? As it clearly was not an ambitious reform program (the big systems such as pension, health care or education were left untouched, foreign business attraction was not in focus), it is possible to say that this policy package was an example of predatory political

entrepreneurship. Within this category, I would like to argue that the economic policy of the Medgyessy government was in fact *welfare spending*. This is so, as the main elements of the policy package was targeted at basically all societal groups – and not just the core voters of the social-liberal coalition (people living in Budapest and in the North-Eastern part of Hungary, and people from lower social strata), and a specific attention was paid to voters who are known to be active: (1) even though its fiscal risk was clear, it did not stop the home loan program of the Orbán government, that is a classic political action supporting the middle class, (2) it included a wage increase for *all* state employees, (3) and it also included a universal pension supplement.

Conclusion. The case of the Medgyessy government, and its policy package in 2002 serves an example where in a situation characterized by strong political competition, incumbent politicians decide for predatory political entrepreneurship, more specifically, welfare spending.

3. Slovakia 2002-2006: The Second Government of Prime Minister Mikulas Dzurinda

The second short case-study I will present in this paper is about the center-right government of Prime Minister Mikulas Dzurinda between 2002 and 2006.

A bit of political history. Slovakia nowadays is known as the great reformer country of Central Europe, which is quite a change after its isolated position and economic difficulties in the 1990s. The political and subsequent economic change was brought about as the consequence of two elections, in 1998 and 2002. The 1998 election is considered ‘pivotal’ as it meant the end of Vladimir Meciar’s long and unsuccessful rule and made way for the new government (the first one led by Dzurinda) to put

Slovakia back on the ‘European track’ (Labanino 2011), and as I will show below, the 2002 election resulted in the political situation that enabled the implementation of reform agenda.

Table 6 and 7 show the results of the 1998 and 2002 elections (the governing parties formatted in italics):

Table 6. Results of the 1998 Slovak election

PARTY	1998
HZDS – Movement for a Democratic Slovakia (nationalist)	43
<i>SDK – Slovak Democratic Coalition (multiparty coalition)</i>	42
<i>SDL – Party of the Democratic Left (post-communist)</i>	23
<i>MKP – Party of the Hungarian Coalition (ethnic, liberal conservative)</i>	15
SNS – Slovak National Party (ultra-nationalist)	14
<i>SOP – Party of Civic Understanding (liberal)</i>	13

Source: Nohlen and Stöver (2010)

Table 7. Results of the 2002 Slovak election

PARTY	2002
HZDS – Movement for a Democratic Slovakia (nationalist)	36
<i>SDKU – Slovak Democratic and Christian Union (conservative)</i>	28
Smer – Direction (social democratic) (Smer – Social Democracy after 2004)	25
<i>MKP – Party of the Hungarian Coalition (ethnic, liberal conservative)</i>	20
<i>KDH – Christian Democratic Movement (Christian Democrat)</i>	15

<i>ANO – Alliance of the New Citizen (liberal)</i>	15
KSS – Communist Party of Slovakia	11

Source: Nohlen and Stöver (2010)

As it is clear from the results of the elections, the Slovak political context is rather different from the Hungarian one, as in Slovakia, there are no strong and powerful blocks. This is the reason why O'Dwyer and Kovalcik (2007) argues that the most important characteristic of the Slovak political scene is its under-institutionalization – though Labanino (2011) convincingly argues that it is still possible to characterize the Slovak political situation after 2002 as a relatively stable political system with two opposing sides, with SDKU as the leader of the right-wing side, and Smer – Social Democracy as the leader of the left-side (which structure lasted until the 2012 elections).

Political competition – facts and interpretation. How does political competition look like in the years between 2002 and 2006 in Slovakia? First, the distribution of parliamentary seats is the following: the government had 78 seats while the opposition had 72, so this indicator shows strong competition. Second, regarding the organizational division of the political side, it is visible that both sides (government and opposition) were divided, which is a sign of weaker competition. It is also important that HZDS and Smer were in a race not just with the government, but also with each other for the position of the opposition's leadership (subsequently finished with Smer's almost absolute victory) (Labanino 2011). Third, the government is in a side position as far as ideological position of the government and opposition are concerned, which is a sign of stronger competition.

From these three indicators, and from the general assessment of the political situation, it is possible to conclude that the political competition in Slovakia between 2002 and 2006 can be considered as *moderate* (especially in contrast with the situation in Hungary).

Economic policy – facts and interpretation. After a successful macroeconomic stabilization in the 1998-2002 period, the second government of Mikulas Dzurinda implemented an ambitious economic policy package. According to Labanino (2001) and Fisher et al. (2007), Györffy (2009), Kovalcik and O'Dwyer (2007), this policy package consisted of the following elements: (1) introduction of a 19% flat tax, (2) cutting unemployment benefits, (3) increasing retirement age and introduction of private pension schemes, (4) opening the health care insurance market for private investors, (5) providing tax incentives for foreign investments.

Interpreting the facts, I agree with Labanino that this policy package was the one of the textbook-like examples of second-generation economic reforms (resulting in unprecedented rates of GDP growth, 8.5 per cent in 2006 and more than 10 in 2007 – source: IMF) – both in the substantive and in the analytical sense of the term. The policies implemented by the second government of Mikulas Dzurinda are examples of productive political entrepreneurship.

Conclusion. The case of the second Dzurinda government, and its policy package after 2002 serves an example where in a situation characterized by moderate (enough but not too much) political competition, incumbent politicians have the *option* for deciding to implement growth-enhancing economic reforms. Additionally, the thin-sense entrepreneurial spirit of Mikulas Dzurinda was also needed for a policy package of productive political entrepreneurship.

4. Hungary after 2010: The Second Government of Prime Minister Viktor Orbán

The third short case-study I will present in this paper is about the center-right government of Prime Minister Viktor Orbán in Hungary after 2010.

A bit of political history. Viktor Orbán became prime minister second time after eight years of socialist-liberal rule in 2010. The second part of these eight years (after the implementation of a severe austerity package, and after then-Prime Minister Ferenc Gyurcsány admitted that he lied in the election campaign concerning the real state of public finances), following the summer and fall of 2006, was characterized by massive popular dissatisfaction. This was worsened by the fact that due to the 2008 financial crisis, to avoid default, Hungary had to turn to the IMF and had to implement another severe austerity package in 2009. As a consequence of this, Viktor Orbán led his party, Fidesz-MPSZ and its satellite party, KDNP (Kereszténydemokrata Néppárt – Christian Democratic People’s Party) to a two-third, constitutional majority at the 2010 elections. This unprecedented majority meant that the government started its work among great expectations: its landslide victory was widely interpreted as a good opportunity for painful but necessary reforms. These results substantively changed the political landscape of Hungary, that had been characterized by the struggle of two, mainly equal opposing blocks before, as the right-wing bloc acquired an unprecedented two-third majority and the left-wing block was almost devastated, and two new parties received enough votes to be represented in the Parliament. Table 8 shows the distribution of parliamentary mandates:

Table 8. Results of the 2010 Hungarian election

PARTY	2010
<i>Fidesz-MPSZ – Hungarian Civic Union (Christian Democrat)</i>	227
MSZP – Hungarian Socialist Party (social democratic)	59
Jobbik – Movement for a Better Hungary (radical right)	47
<i>KDNP – Christian Democratic People’s Party (Christian Democrat)</i>	48
LMP – Politics Can Be Different (green-liberal)	16

Source: valasztas.hu/National Elections Office of Hungary

Political competition – Facts and interpretation. Using the three indicators of political competition, the situation in Hungary after the 2010 elections can be characterized as follows. First, the distribution of parliamentary seats shows that the two governing parties, Fidesz and KDNP have quite a dominance in the Parliament, as they have the 68% of all seats. This certainly is a sign of weaker competition. Second, concerning the organizational division of the opposition, it is clear from the table that the opposition consists of three parties – this is also a sign of weaker competition. And third, regarding the ideological position of government and opposition: the opposition is ideologically divided, so the government has a central position, having both right-wing and a left-wing parties as its opponents. This is also a sign of weaker competition. Consequently, it is possible to conclude that the political situation in Hungary after the 2010 elections was characterized by weak political competition.

Economic policy – facts and interpretation. The economic policy of the second Orbán government, according to its self-definition, is ‘unorthodox’, which means that it did

not follow the recipes domestic or foreign economists, specifically the IMF offered. The main elements of the second Orbán government's economic policy were the following (Barta 2011): (1) introducing a special tax on the banking, the telecommunication, the energy and the food retail sector, (2) increasing the value-added tax, (3) increasing the excise tax, (4) cuts in unemployment benefits and special pension benefits, (4) nationalization of private pension schemes, (5) introducing flat income tax, (6) abolishing income tax benefits for the poorest, (7) introducing major income tax benefits for families with children, (8) lowering corporate tax for SMEs, (9) nationalization of the health care and education (from local governments), (10) labor market deregulation.

How can we interpret this policy package? Although some elements of reform are identifiable (flat tax or labor market deregulation), but these measures are together with actions that are clearly not conducive to long-term growth, such as the special taxes. However, what is more characteristic, that during a macroeconomic stabilization, the government introduces income tax cuts, that are not entirely balanced by measures from the expenditure side of the budget – so one-off measures and new taxes are needed. From this, it is fair to conclude that what the government does is in fact predatory political entrepreneurship and *own-group spending*. The government targets benefits to its core supporters – the middle class, SME owners, families with children; while the costs are distributed among all societal groups, as with increased VAT, all members of society are burdened, with the social benefit and tax benefit cut, poorer members of society have to contribute, and with the special taxes, big business has to have its share.

Conclusion. The case of the second Orbán government, and its policy package after 2010 serves an example where in a situation characterized by weak political

competition, incumbent politicians decide for predatory political entrepreneurship, more specifically, own-group spending. The government did not fulfill the great expectations as having no opponent, it was not incentivized to do so.

CONCLUSION

This paper aimed to achieve three goals: (1) first, to provide an integrated analytical framework that can deal with the dual effect of political competition on economic policy-making – and with this, to contribute to the political economy of reform literature with a complex understanding of politics of reform; (2) second, to formulate one of the necessary conditions of a political situation that is conducive to reform; and (3) third, to present examples that show the empirical relevance of the theoretical framework – and by this, to resolve the puzzle concerning the Hungarian economic policy after 2010.

Analytical framework. Concerning the first element, the analytical framework, I argued that political actions can be interpreted as political entrepreneurship. This means that politicians, conceptualized as rational agents, act along their objectives, constrained by their environment. Political entrepreneurship can be predatory and productive: the former means political actions that enhance long-term economic growth, while the latter means political actions that hinder long-term economic growth.

Digging deeper into the process of political decisions, building on the different conceptualizations concerning the motivations of the politicians, I claim in this paper that politicians' objective function consists of four archetypical motivations that determine political behavior at the same time: (1) benevolent, so concerned with the long-term welfare of the society as a whole, (2) office-seeking, so concerned with staying in office for itself, (3) self-seeking, so concerned with the private welfare of the politician, and (4) party-affiliated, so concerned with a welfare of a specific group of society the politician belongs to. In the process of political decision-making, one of the archetypical goals will dominate, determined by the environment, and political

action is thus determined by objective that is in the dominant position. I also argue that the four archetypical motivations are in a hierarchy: office-seeking is primary, self-seeking and party-affiliation is secondary, while the benevolent motivation is tertiary. A motivation can only lead to action if it is not in conflict with a motivation that is on a higher level on the hierarchy. Furthermore, it is also important that all four archetypical political goals have an equivalent political action: (1) benevolent political motivation leads to reform, (2) office-seeking political motivation leads to welfare spending, (3) self-seeking motivation leads to private rent-seeking, while (4) party-affiliated political goal leads to own-group spending (for specific reasons, private-rent seeking is dealt with as being integrated into own-group spending). It is by definition that the reform is a form of productive political entrepreneurship, while private rent-seeking, welfare-spending and own-group spending are forms of predatory political entrepreneurship.

The effect of political competition on political entrepreneurship is given in the following way: if there is no or very low level of political competition, then the party-affiliated will get to dominate, and therefore the politician will implement the action of own-group spending. As political competition increases, then the office-seeking motivation gets to dominate, and competition is not too great, the benevolent objective can also have its effect, therefore, in a medium level of political competition, the politician has the option to implement reforms, if they are willing to take the risks involved. And finally, if political competition is even stronger, then the benevolent objective cannot prevail – so the politician will opt for welfare spending. From the perspective of reform, the relationship with political competition is thus curvilinear.

Conditions for a political situation that is conducive to reform. In line with the analytical framework and the model presented in this paper, it is possible to argue that

concerning competition, a political situation is conducive to reform if the following condition holds. Political competition should be great enough to constrain the incumbent to prevent pure own-group spending, while it should not be too great to avoid the hampering effect of competition, which would incentivize the politician to implement welfare spending. It is important to stress that a political situation characterized by moderate competition is only a necessary condition for reform, but not a sufficient one. For reform, it is also needed, that the incumbent politician is willing to take the required risks.

Empirical relevance. After formulating the theoretical framework, I presented three brief case studies from recent Central European political history to show the empirical relevance of the theoretical findings of this paper. The examples of the Medgyessy government in Hungary after 2002, the Dzurinda government in Slovakia after 2002, and the Orbán government after 2010 are situations of strong, moderate, and weak political competition, respectively. I argue that the economic policy the three government implemented are in line with the findings of the theoretical findings of the present paper, as they are examples of welfare spending, reform, and own-group spending, respectively. The case study of the Orbán government after 2010 also serves as a contribution to resolving the puzzle concerning why we did not an implementation of an ambitious reform program given the unprecedented power of the Orbán government. I argued that the explanation for this is the following: political competition was too weak, and the government was not constrained enough to prevent predatory own-group spending.

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APPENDIX: A SIMPLE MODEL OF POLITICAL COMPETITION AND REFORMS

In the Appendix, I will present a simple theoretical model of political competition and public policy. It aims to show that it is possible to deal with the two types of effect of political competition on public policy in one, unified analytical framework. Furthermore, I use this model to ‘test’ the theoretical findings of the theoretical chapter, i.e., that low level of competition results in own-group spending, moderate level of competition results in reforms, and higher degree of political competition results in welfare spending.

1. Probabilistic Voting Framework

The framework in context. The model presented in this chapter is a simple model of probabilistic voting. Probabilistic voting models are extensively used in the realm of formal political economy, for a textbook-like formulation, see Chapter 3.4. of Persson and Tabellini (2000: 52-58.) Probabilistic voting models move away from the overly deterministic realm of the Downsian framework of politics – which is the classic conceptualization of voting in political economy.

In the classic Downsian world, two candidates (or parties) compete for the voters in a one-dimensional policy space. Since information is perfect in the political market, the policy position of the two competing parties will be identical, and also identical to that of the median voter. Differently from this, in the probabilistic voting framework, candidates are not fully able to control who will vote for them – they can only influence the probability of their winning the elections. This is so, as there may be

another dimension of the policy space, or there is some noise in the voting process – and the perfect information assumption is relaxed.

A few assumptions. A (somewhat unrealistic) general assumption in the economic theory of voting is that voters vote with instrumental rationality (as opposed to expressive rationality). This means the following: voters cast their vote to the candidate they prefer, and this preference is derived from preferences that concern the consequences of voting, not voting itself. To put it differently, voting is a goal-oriented behavior, where the goals refer to the outcome of the voting. Additionally, it is important to note that it is also assumed that the behavior of voting is sensitive to costs and benefits (Tóka, 2012). Thus, it is fair to say that voting choice is conceptualized as similar to the choice of the consumer. (For a thorough analysis concerning the problem of rationality in the voting process, see Brennan and Buchanan, 1984.)

Furthermore, it is an (again somewhat unrealistic) assumption of the probabilistic voting framework (and not that of the economic theory of voting in general) that promises that politicians make in election campaigns are kept, they can be considered as perfect commitments. This means, that these campaign promises determine policy if the candidate gets elected (Persson and Tabellini, 2000; Beasley, 2006). This assumption is certainly a quite limiting one, but it is needed in order for us to be able to specifically focus on the relationship of revealed policy positions of politicians and their probability of winning the office. (For an eye-opening analysis of the commitment problem of politics and the transaction costs attached to it, see Dixit, 1998.)

2. The Model

The simple probabilistic voting model I will present in this paper builds specifically on the model setting used by Besley (2006), and indirectly to Persson and Tabellini (2000).

Economy and politicians. Let us assume an economy with an aggregate output of Y . With no political (redistributive) effects, all members of the society (voters) have an equal income of y in every time period – the potential effects of income inequality are ignored. The number of voters are normalized to 1. It is also assumed that political life consists of two competing parties (or politicians, used interchangeably): $q_i \in \{q_A; q_B\}$. Politicians are elected by a single majority electoral rule. Politicians compete in a two-dimensional policy space, with one valence issue (economics) and one polarizing issue.

Types of voters. Furthermore, assume that the electorate consists of voters with different types. First, let us distinguish between partisan voters and swing voters. The distinction refers to the that partisan voters primarily care about (derive their utility from political outcome concerning) the partisan issue, while swing voters only care about the valence issue, specifically economic policy. Formally: $v_i \in \{v_p; v_s\}$. The ratio of partisan voters in the electorate is given by ω , and obviously, the ratio of swing voters is given by $1 - \omega$. Among partisan voters, $\left(\frac{1}{2} + \eta\right)$ share votes for q_A , and η is uniformly distributed on $\left[-\frac{1}{2}, \frac{1}{2}\right]$. Assume also that partisan voters *always* vote for their party, regardless of their policy.

Moreover, voters differ from one another in their characteristic of how much they value the future: let us name the two types as sophisticated and myopic. As these name indicates, sophisticated voters value the future more than myopic voters, who

heavily discount it, $v^j \in \{v^s; v^m\}$. The ratio of sophisticated voters is given by x , and consequently, the ratio of myopic voters is given by $1 - x$, and these ratios are uniform among partisan and swing voters.

Types of policies. Politicians are able to choose a policy from a pre-given policy set, $p_i \in \{p_o; p_w; p_r\}$. The substantive meaning the three types of policies are the ones presented in the previous chapter in detail. In summary: first, own-group spending means that the politician redistributes income from the general public to the specific group he or she is affiliated with; second, welfare-spending means a redistribution aiming at securing re-election, and reform means a policy the goal of which is to increase the welfare of the general public through enhancing economic growth. Using the terminology of this model setting, the three types of policies can be interpreted the following way: own-group-spending (p_o) is redistributing income to the incumbent's partisan voters; welfare spending (p_w) is redistributing income to the swing voters, and reform (p_r) is investing income into a policy that is beneficial on the long-run for all members of society. For analytical reasons, let p_n denote the no-politics case where the incumbent does not implement any policy.

Utility of voters. The utilities of the different voters, with respect to these policies are given in the following way. For this, see Table 9.

Table 9. Utilities of voters from policies

Utilities of voters derived from own-group spending (p_o)
Partisan A, sophisticated voter: $U_{v_p}^s(q_A) = (y + w) + [y - \left(\frac{1}{2} + \eta\right) \omega(w + i)] =$ $2y + w - \left(\frac{1}{2} + \eta\right) \omega(w + i)$

Partisan A, myopic voter: $U_{v_p}^m(q_A) = (y + w) + (y) = 2y + w$
Partisan B, sophisticated voter: $U_{v_p}^s(q_B) = (y) + [y - (\frac{1}{2} + \eta)\omega(w + i)] =$ $2y - (\frac{1}{2} + \eta)\omega(w + i)$
Partisan B, myopic voter: $U_{v_p}^m(q_B) = (y) + (y) = 2y$
Swing, sophisticated voter: $U_{v_s}^p = (y) + [y - (\frac{1}{2} + \eta)\omega(w + i)] =$ $2y - (\frac{1}{2} + \eta)\omega(w + i)$
Swing, myopic voter: $U_{v_s}^m = (y) + (y) = 2y$
Utilities of voters derived from welfare spending (p_w)
Partisan, sophisticated voter: $U_{v_p}^s = (y) + [y - \omega(w + i)] = 2y - (1 - \omega)(w + i)$
Partisan, myopic voter: $U_{v_p}^m = (y) + (y) = 2y$
Swing, sophisticated voter: $U_{v_s}^s = (y + w) + [y - (1 - \omega)(w + i)] =$ $2y + w - (1 - \omega)(w + i)$
Swing, myopic voter: $U_{v_s}^m = (y + w) + (y) = 2y + w$
Utilities of voters derived from reform (p_r)
Partisan, sophisticated voter: $U_{v_p}^s = (y - c) + (y + r) = 2y - c + r$
Partisan, myopic voter: $U_{v_p}^m = (y - c) + (y) = 2y - c$
Swing, sophisticated voter: $U_{v_s}^s = (y - c) + (y + r) = 2y - c + r$
Swing, myopic voter: $U_{v_s}^m = (y - c) + (y) = 2y - c$

Utilities of voters if there is no politics
Partisan, sophisticated voter: $U_{v_p}^s = (y) + (y) = 2y$
Partisan, myopic voter: $U_{v_p}^m = (y) + (y) = 2y$
Swing, sophisticated voter: $U_{v_s}^s = (y) + (y) = 2y$
Swing, myopic voter: $U_{v_s}^m = (y) + (y) = 2y$

In the utility functions,

- let w denote the targeted welfare transfer (regardless whether it is targeted to partisan voters or swing voters);
- i denote the interest the government has to pay for financing w ;
- c denote the costs attached to reform;
- r denote the benefits of reform;
- and we also know that the concerning the parameters that $r > w > c > i$.

The utility functions are structured the following way: each policy is interpreted in a two-period time horizon (the utilities of the two time horizons are separated by being in different brackets). Sophisticated voters care for both time periods, while myopic voters are only concerned with the first period – from the second, they only perceive y , which is their utility in the no-politics case. Note the time-structure of the different policies: own-group spending and welfare spending is beneficial in the first time period costly in the second, while reform is costly in the first, and beneficial in the second time period. Additionally, in the case of own-group spending and welfare spending, the benefits of the policy are targeted, while the costs are distributed among

all members of the society; while in the case of reform, both the costs and benefits are distributed equally. Table 10 summarizes the structure of the policies:

Table 10. Structure of policies

	Own-group spending	Welfare spending	Reform
Time structure	t ₁ : beneficial t ₂ : costly	t ₁ : beneficial t ₂ : costly	t ₁ : costly t ₂ : beneficial
Distribution of costs and benefits	targeted benefits uniform costs	targeted benefits uniform costs	uniform benefits uniform costs

Utility of politicians. Along the lines of the theoretical framework presented in the previous chapter, the utility of politicians is given in the following way:

$$U_q = \Pr(E + O) + G, \text{ where}$$

- \Pr denotes the probability of winning the elections and thus taking office;
- E denotes a sort of ego rent, derived from being in office itself,
- O denotes the utility of the group the politician is affiliated with (analytically, that of his or her the partisan voters, $U_{vp}(q_i)$;
- and G denotes the general welfare of the society (analytically the total utility ΣU_v).

Probability of winning the elections. Assume that there is some noise in the votes of the non-partisan voters. Using the modeling technique of Besley (2006: 125-126), it is formalized in the following way. There is an aggregate popularity shock δ in favor of

politician A, which is uniformly distributed on the interval $\left[-\frac{1}{2\zeta}, \frac{2}{2\zeta}\right]$, and an idiosyncratic popularity shock i in favor of A, uniformly distributed on $\left[-\frac{1}{2}, \frac{1}{2}\right]$. From this, this the additional utility a swing voter gets as a consequence of the identity (and not the policy) of A is $\delta + i$. Consequently, swing voter supports candidate A if and only if $U_v(p_i^A) - U_v(p_i^B) \delta + i > 0$.

Let us remember that the ω share of partisan voters always vote for their party, and it was assumed that among them, $\left(\frac{1}{2} + \eta\right)$ prefer candidate A. From these two notions, the probability of politician A winning the elections is given by the following equation (probability function):

$$\Pr\left\{\omega\left(\frac{1}{2} + \eta\right) + (1 - \omega)\left[x\left(\frac{1}{2} - (U_{v_s}^s(p_i^A) - U_{v_s}^s(p_i^B) - \delta)\right) + (1 - x)\left(\frac{1}{2}(U_{v_s}^m(p_i^A) - U_{v_s}^m(p_i^B) - \delta)\right)\right] > \frac{1}{2}\right\},$$

which after rearranging, will be

$$\frac{1}{2} + \zeta\left[\frac{\omega}{1-\omega}\eta + x(U_{v_s}^s(p_i^A) - U_{v_s}^s(p_i^B)) + (1 - x)U_{v_s}^m(p_i^A) - U_{v_s}^m(p_i^B)\right].$$

The structure of the equation shows the important points. The parameter ζ (the distribution of δ) can be interpreted as polarization: the greater it is, the greater the differences can be in the variation of winning probability due to the popularity shock. Parameter η captures competition, and its effect is positive in ω , the share of partisan voters. Differences in utilities derived from policy positions are important because of swing voters; the difference between sophisticated and myopic voters are also indicated.

The politician's decision. Let us remember the utility function of the politician, as its maximization determines his or her decision: $U_q = \Pr(E + O) + G$. From this, we will get $U_q = \Pr\left(E + U_{v_p}(q_i)\right) + \Sigma U_v$, where \Pr denotes the probability function. As

this paper scrutinizes the effect of political competition on policy, the decision problem can be formulated in the following way: given different levels of political competition, which policy yields the greatest utility for the politician?

A few assumptions for simplicity. As the only focus of this paper is competition, other parameters will be set to have the simplest results possible. Consequently, let us assume that parameter $\zeta = \frac{1}{2}$. Additionally, suppose that $\omega, x = \frac{1}{2}$, so the groups in the society are symmetrical. Furthermore, assume that opposing politician always promises no politics.

Low competition. The first case under scrutiny is the situation with minimal level of political competition. For simplicity, let us assume that $\eta = \frac{1}{2}$, so all partisan voters prefer candidate A. In this situation, the utilities given by the different policies are the following:

$$U_q(p_o) = \left(\frac{3}{4} - \frac{1}{8}w - \frac{1}{8}i\right) \left(E + 2y + \frac{3}{4}w - \frac{1}{4}i\right) + 2y + \frac{1}{4}w - \frac{1}{4}i$$

$$U_q(p_w) = \left(\frac{3}{4} + \frac{3}{8}w - \frac{1}{8}i\right) \left(E + 2y - \frac{1}{4}w - \frac{1}{4}i\right) + 2y + \frac{1}{4}w - \frac{1}{4}i$$

$$U_q(p_r) = \left(\frac{3}{4} - \frac{1}{2}c + \frac{1}{4}r\right) \left(E + 2y + \frac{1}{2}r - \frac{1}{2}c\right) + 2y + \frac{1}{2}r - \frac{1}{2}c$$

Moderate competition. In the second situation, the level of competition is moderate. For simplicity, let us assume that $\eta = \frac{1}{4}$, so three quarters of the voters prefer candidate A. In this situation, the utilities given by the different policies are the following:

$$U_q(p_o) = \left(\frac{5}{8} - \frac{3}{32}w - \frac{3}{32}i\right) \left(E + 2y + \frac{26}{32}w - \frac{6}{32}i\right) + 2y + \frac{11}{32}w - \frac{9}{32}i$$

$$U_q(p_w) = \left(\frac{5}{8} + \frac{3}{8}w - \frac{1}{8}i \right) \left(E + 2y - \frac{1}{4}w - \frac{1}{4}i \right) + 2y + \frac{1}{4}w - \frac{1}{4}i$$

$$U_q(p_r) = \left(\frac{5}{8} - \frac{1}{2}c + \frac{1}{4}r \right) \left(E + 2y + \frac{1}{2}r - \frac{1}{2}c \right) + 2y + \frac{1}{2}r - \frac{1}{2}c$$

Strong competition. In the third situation, the level of competition is high. For simplicity, let us assume that $\eta = 0$, so half of the partisan voters prefer candidate A.

$$U_q(p_o) = \left(\frac{1}{2} - \frac{2}{32}w - \frac{2}{32}i \right) \left(E + 2y + \frac{28}{32}w - \frac{4}{32}i \right) + 2y + \frac{5}{32}w - \frac{5}{32}i$$

$$U_q(p_w) = \left(\frac{1}{2} + \frac{3}{8}w - \frac{1}{8}i \right) \left(E + 2y - \frac{1}{4}w - \frac{1}{4}i \right) + 2y + \frac{1}{4}w - \frac{1}{4}i$$

$$U_q(p_r) = \left(\frac{1}{2} - \frac{1}{2}c + \frac{1}{4}r \right) \left(E + 2y + \frac{1}{2}r - \frac{1}{2}c \right) + 2y + \frac{1}{2}r - \frac{1}{2}c$$

Interpretation. At this point, the model specification does not allow us to come to definite conclusions. However, a few effects (that are in line with the theoretical framework) are visible: (1) As political competition increases, the content of the probability function becomes more important, which is in line with the hypothesis that welfare spending is the optimal solution in situations characterized by strong competition. (2) In the situation of weak political competition, the probability of winning is high, so what matters is the actual payoff from winning, which is the highest in the case of own-group spending. (3) As political situation increases, the significance of G increases, which makes reform more appealing. (4) If E is bigger, then the probability of welfare spending is higher.