How Presidents Make Economic Policy in Times of Crisis

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The Problem I

- How do leaders (presidents or prime ministers) structure and manage economic policymaking in times of macroeconomic crisis?
- Two standard responses:
  - Personality: it defines the need for control
  - Institutions: they define the set of tools for unilateral decision-making
- But…

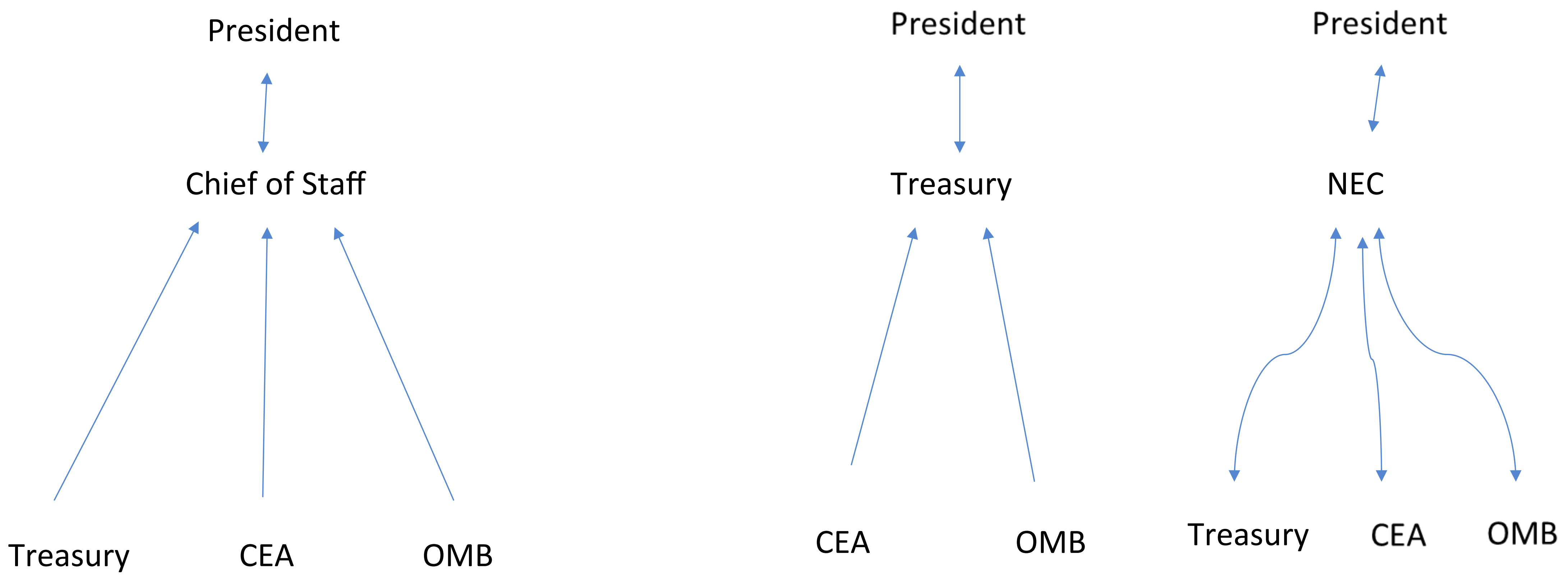
The Problem II

- Neither personality nor institutions adequately correlate with specific advisory structures and practices, or their relative stability
- The literatures on presidential management practices and on foreign policy decision-making under crisis show there are tradeoffs among
  - Level of control over decision-making;
  - Information; and
  - Speed of response
- Insights from cognitive psychology and organizational theory have not yet been applied to economic policymaking

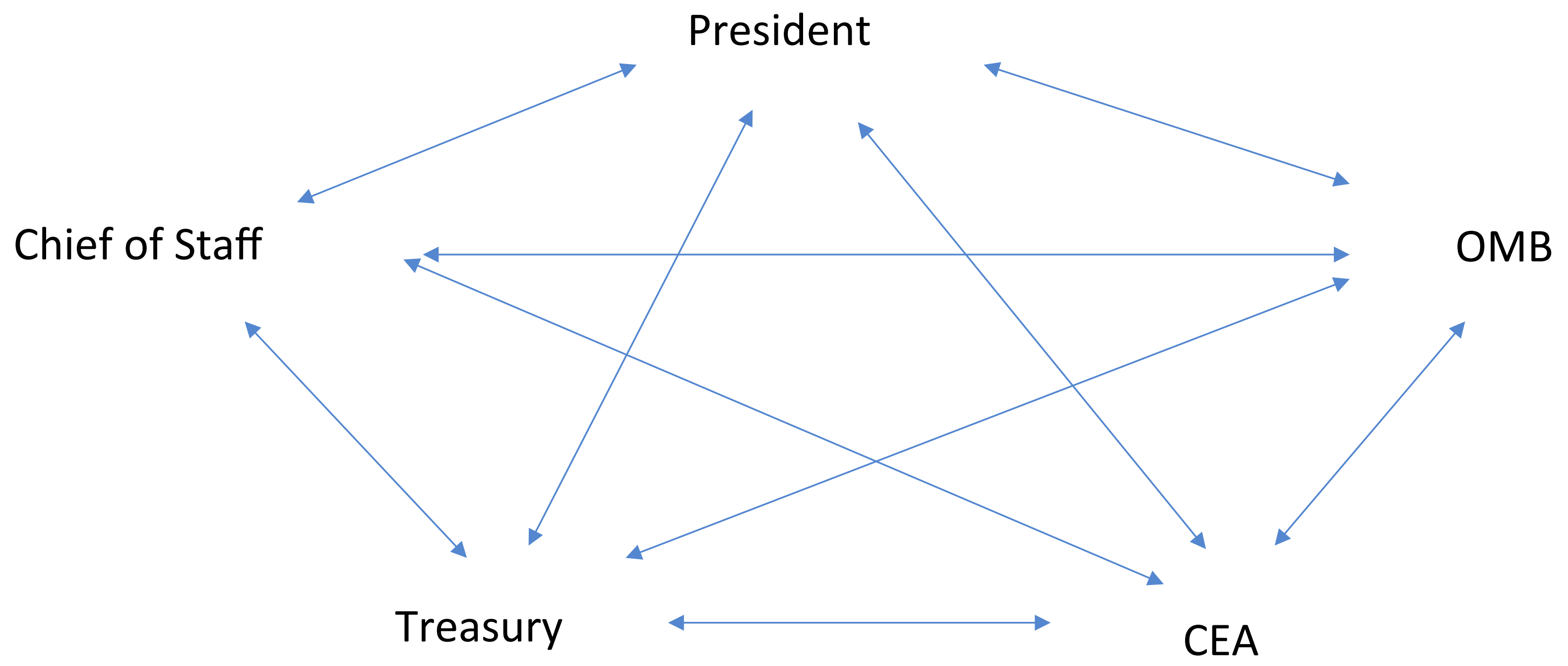
The Argument – in a Nutshell

- Presidents/Prime ministers change advisory structures and practices according to the cognitive contexts they face
- In contexts marked by **certainty** they typically choose ***hierarchical*** arrangements, that maximize control and speed over information
- In contexts marked by **uncertainty** they typically choose ***collegial*** arrangements, that maximize information over speed and control
- In contexts marked by **controversy** they typically choose ***competitive*** arrangements, that maximize control over information and speed

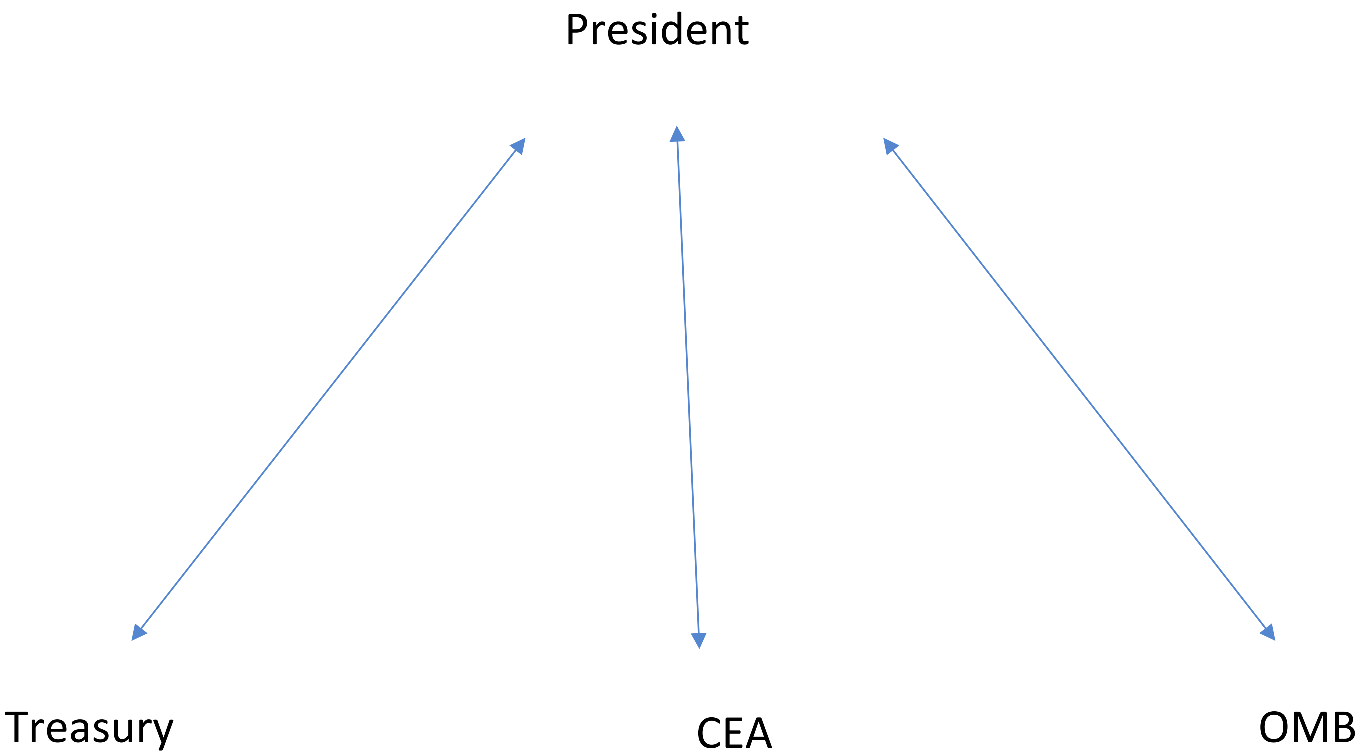
Hierarchical Arrangements



Collegial Arrangements



Competitive Arrangements



Caveats

- These arrangements are ideal types that typically overlap in reality
- Presidents usually
  - get information from diverse sources,
  - may solicit advice simultaneously from different agencies or actors, and
  - even meet with these agencies collectively on a more or less regular basis
- However, specific arrangements may be identified as predominant
  - By analyzing organizational design and types and frequencies of interaction between leaders and advisers

Choices I

- Leaders choose arrangements according to their cognitive context
- The baseline arrangements vary per country and presidency due to:
  - Inherited arrangements, and
  - The country's experience with crises
- Crises are shocks that trigger change in cognitive contexts by generating or dissipating uncertainty

Choices II

- Unexpected or confusing aspects typically generate uncertainty >>
  - Collegial arrangements become more likely
- Previous experience with crises may dissipate (some) uncertainty >>
  - Hierarchical arrangements become more likely
- If neither of these vectors prevails, controversy ensues >>
  - Competitive arrangements become more likely

Type of Variable	Independent	Dependent
Variable	Cognitive context of leaders	Predominant arrangement type
Indicators	Frequency of macroeconomic crises: • Average number of macroeconomic disturbances (devaluation, inflationary upsurge, hyperinflation) per decade since 1945 • Share of presidential economic speech using "crisis" or equivalents	• Organizational Design • Frequency of policy memos directly addressed to the President • Authorship of policy memos • Frequency of individual/collective policy meetings with the President

Methods and Sources

- Qualitative comparative analysis
- Based on process-tracing of leaders' organizational choices
- Using primary and secondary historical sources:
  - Archives: memos to and from leaders and economic advisers
  - Memoirs of leaders and economic advisers
  - Oral histories
  - Historiography

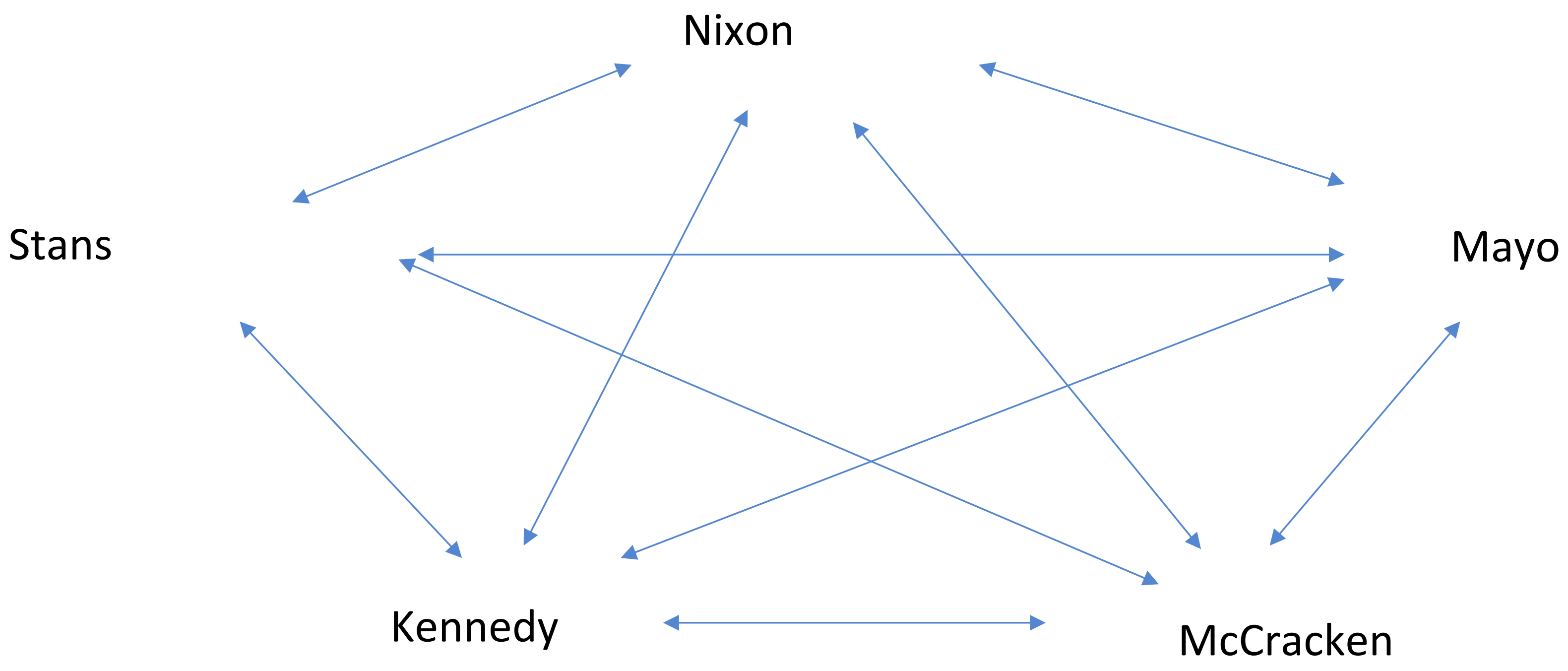
Cross-Country Comparison and Case Studies

Frequency of Crises	Low (US 2008-09 Spain 1959-2008)	Increasing (US 1970s UK 1940s-60s)	High (Argentina 1970s-1980s UK 1970s)
Predominant Arrangement Type	Collegial	Competitive	Hierarchical
Case Studies	US: Bush, Obama Spain: Franco, Suarez, Zapatero	US: Nixon, Carter UK: Attlee, Wilson	Argentina: Videla, Alfonsin, Menem UK: Wilson, Callaghan

Nixon: Initial Context

- Certainty on inflation
  - Nixon wanted to bring inflation down without generating a recession >>>
  - Gradual restraint in monetary and fiscal policy
- But controversy over Bretton Woods and long term fiscal issues
  - Dissenting opinions in Treasury and Fed over how to deal with dollar competitiveness and strain in Bretton Woods system
  - Differences among Treasury, CEA, Defense, and BoB (OMB) over size and allocation of "peace dividends"

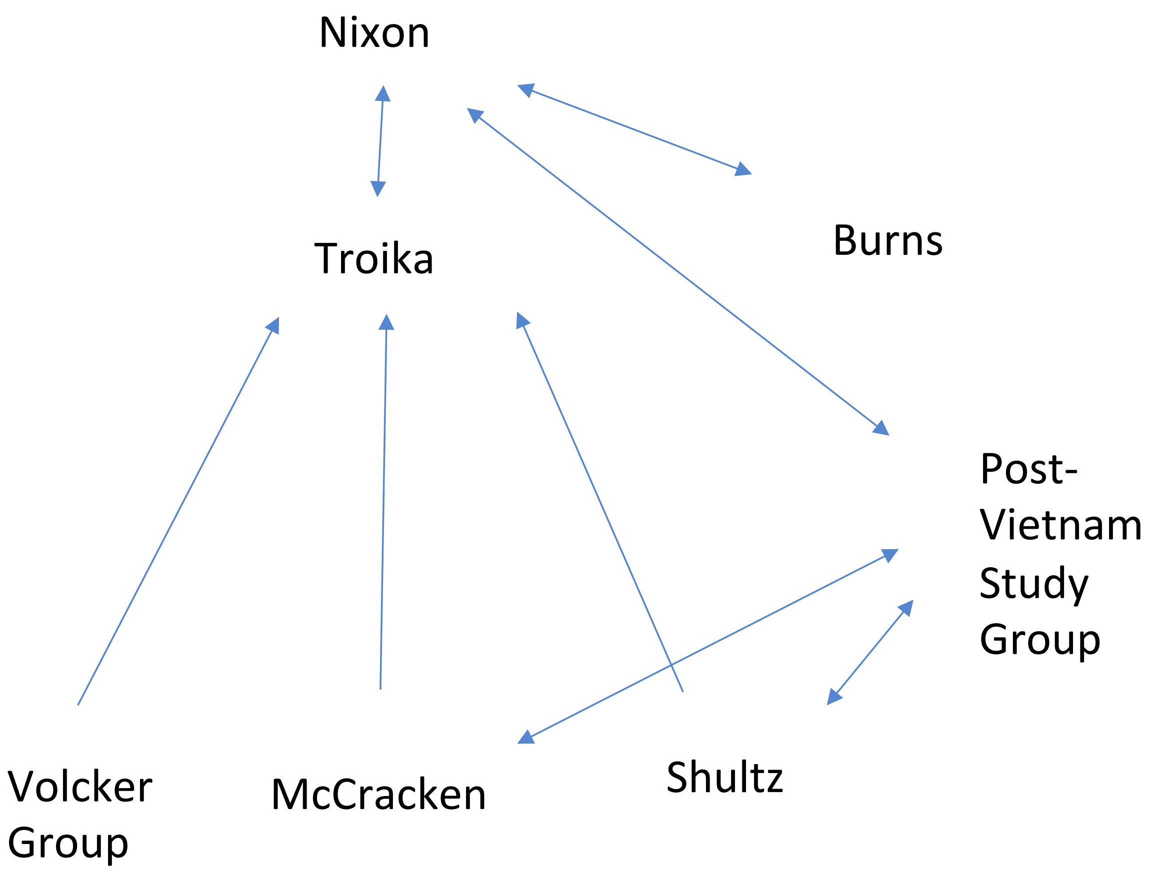
Nixon I: Cabinet Committee for Economic Policy (1969)



Nixon: Cognitive shock I

- No issue proved particularly salient or urgent
  - Wage bargaining still matched inflation
  - Johnson's fiscal legacy enabled short-term control of deficit and balance of payments
  - Peace dividends were already earmarked for Great Society programs electorally impossible to dismantle
  - Gold demands on the US fluctuated
- Controversy prevailed within the CCEP

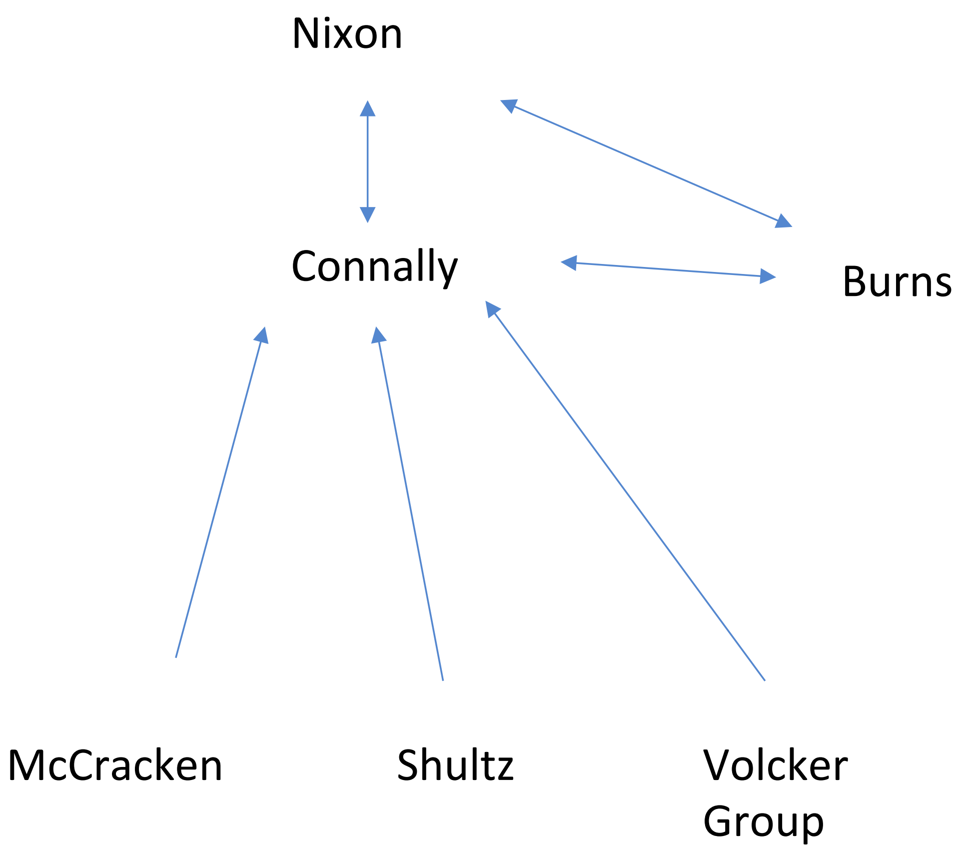
Nixon II: Division of Labor (1970)



Nixon: Cognitive shock II

- Recession and inflation limit Republican gains in 1970 election
- Nixon feared for his re-election prospects
  - Previous conviction of having lost the 1960 election due to recession
- Burns argued for incomes policy to stop inflation
- Volcker Group included exit from Gold Standard scenario
- Connally packaged both recommendations into reelection program
- Nixon's cognitive context shifted towards certainty

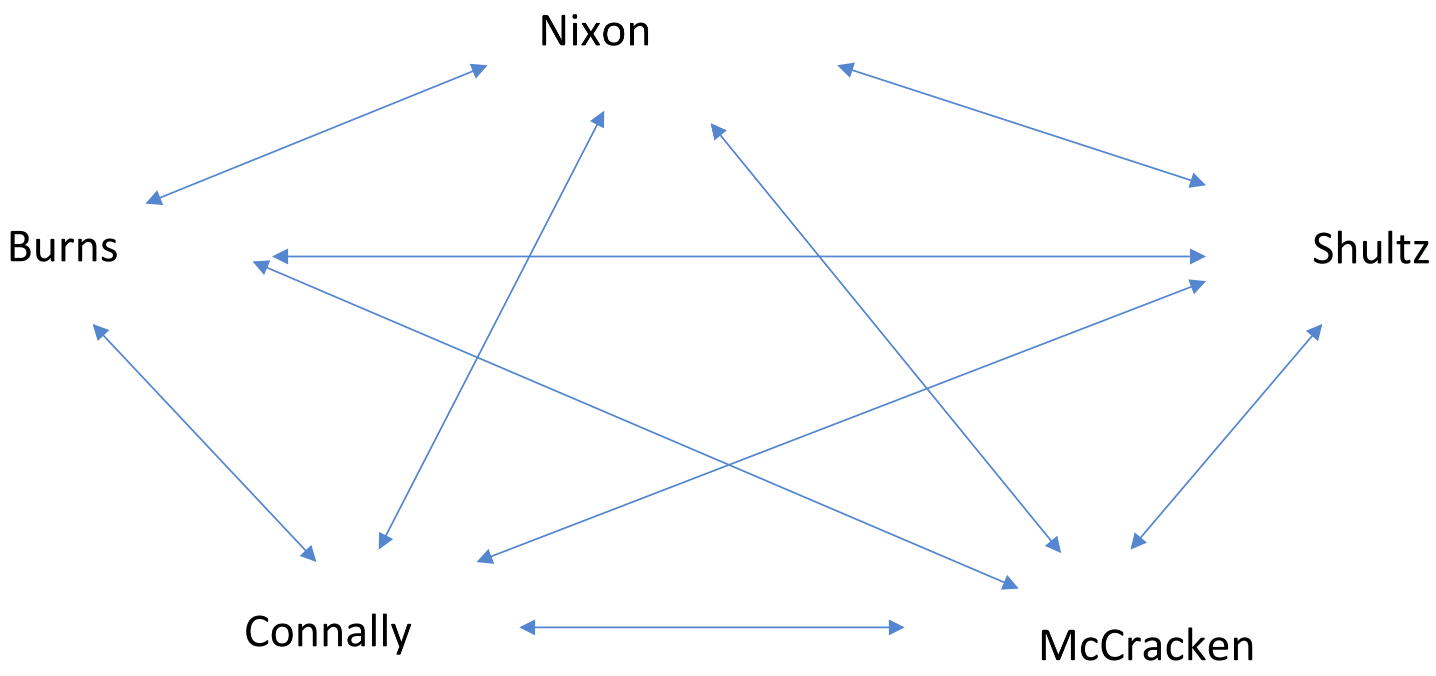
Nixon III: Treasury dominance (January-July 1971)



Nixon: Cognitive shock III

- The run on the dollar eroded US competitiveness and indicated the Gold Standard was increasingly unsustainable
- Nixon was torn between the political advantages and the technical disadvantages of the wage-price freeze
- Nixon's cognitive context shifted to uncertainty on how to deal simultaneously with inflation and the exit from the Gold Standard

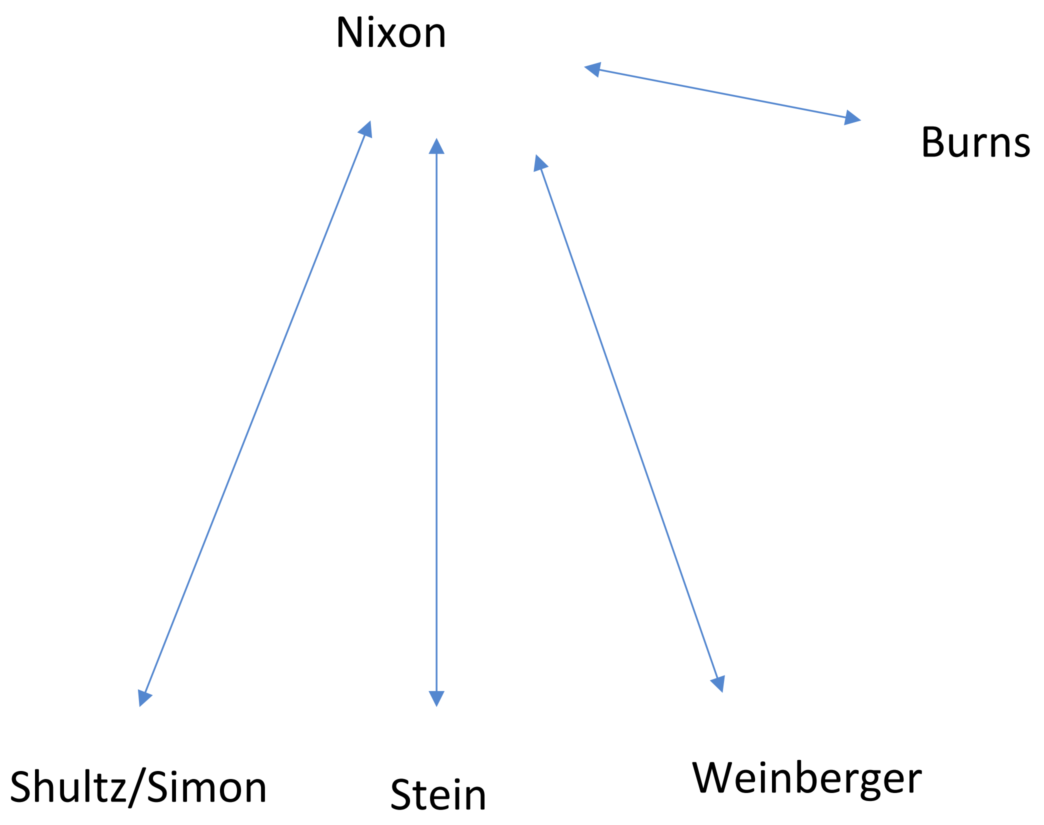
Nixon IV: Camp David Summit (August 1971)



Nixon: Cognitive shock IV

- Inflation resurfaced as wage-price controls were eased
- Treasury and Fed differed on how to re-negotiate Bretton Woods
- CEA, Treasury and Fed differed on how to deal with the tradeoff between liberalization and monetary restraint
- Nixon's cognitive context shifted to controversy

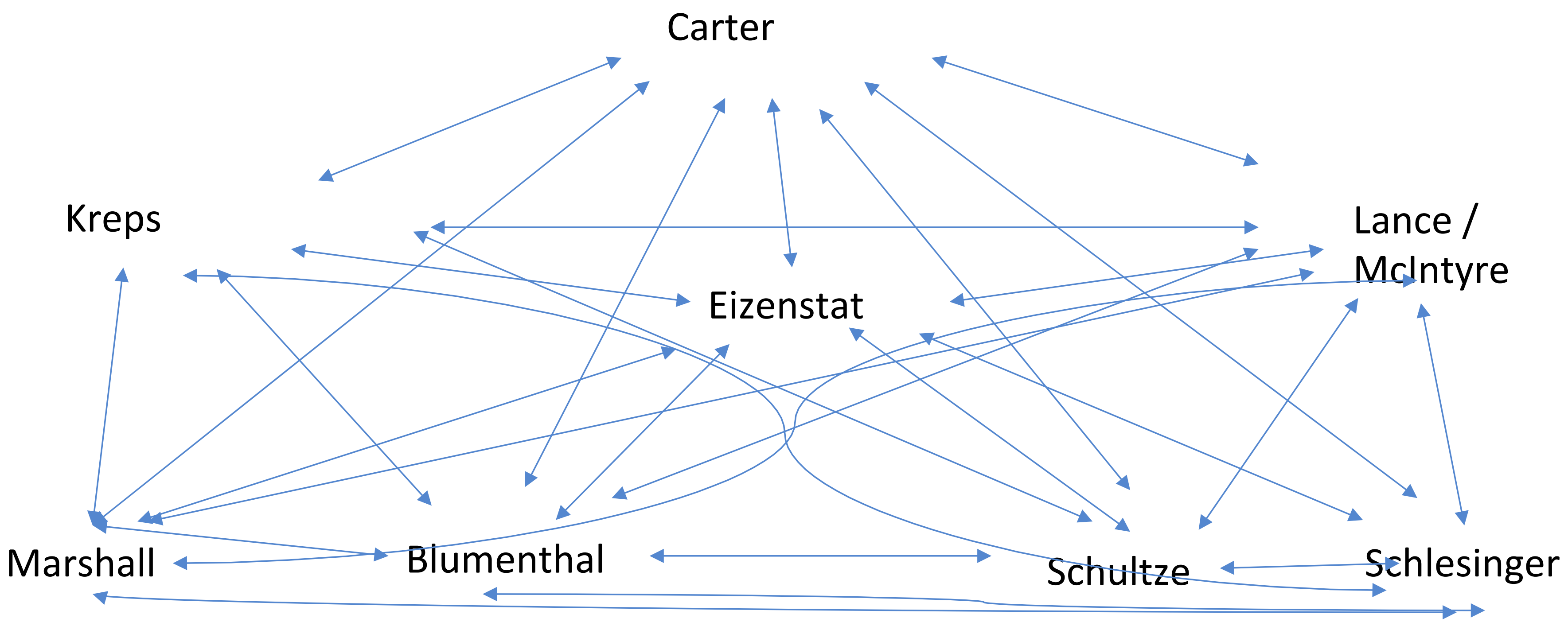
Nixon V: Competition (from late 1972)



Carter: Initial context

- Uncertainty over how to engineer economic recovery without stimulating inflation
- EPG agreed on stimulus, but Carter disliked its size (rebate)
- Treasury and DPS disagreed on tax reform
- CEA and Treasury disagreed with Energy plan

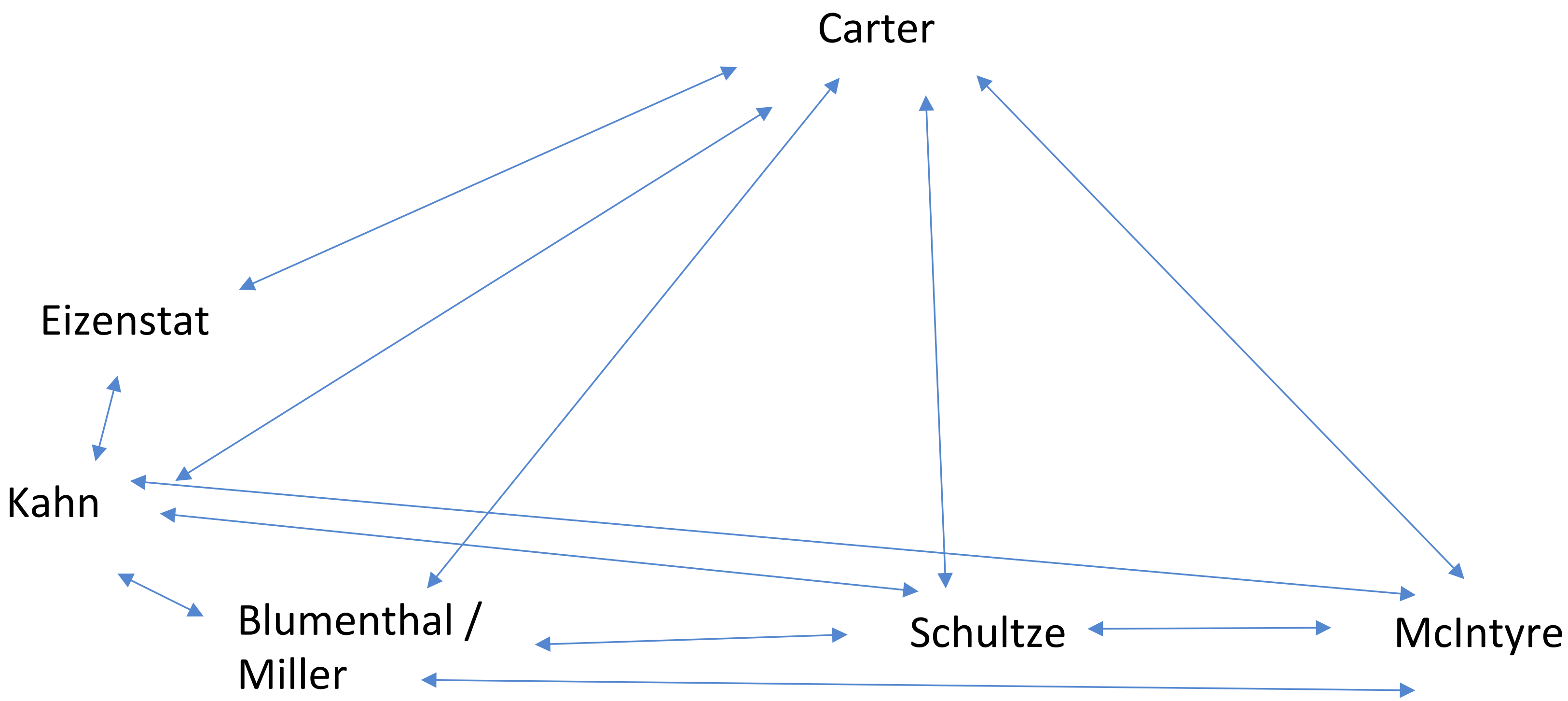
Carter I: Economic Policy Group (1977-78)



Carter: Cognitive shock I

- Economic recovery came with inflationary upsurge
- This ignited debate on how to bring down inflation without recession
- DPS and Inflation Adviser advocated guidelines program, while Troika preferred fiscal and monetary restraint
- Carter’s cognitive context shifted to controversy over tradeoffs of responses

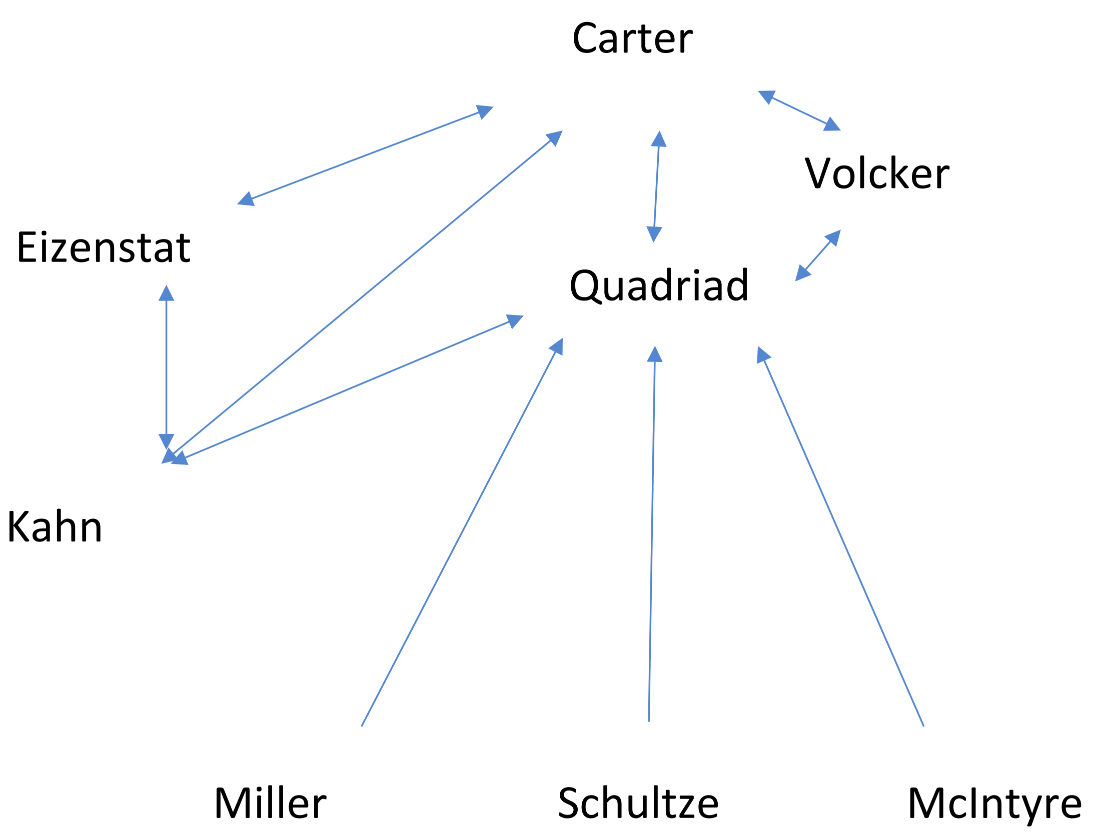
Carter II: Troika v DPS



Carter: Cognitive shock II

- Second oil shock and run on dollar accelerated inflation
- Guidelines proved ineffective
- DPS argued for expansion in election year, but previous commitments to budgetary and monetary restraint threatened credibility gap
- Carter's cognitive context shifted to certainty over prioritizing anti-inflationary objective

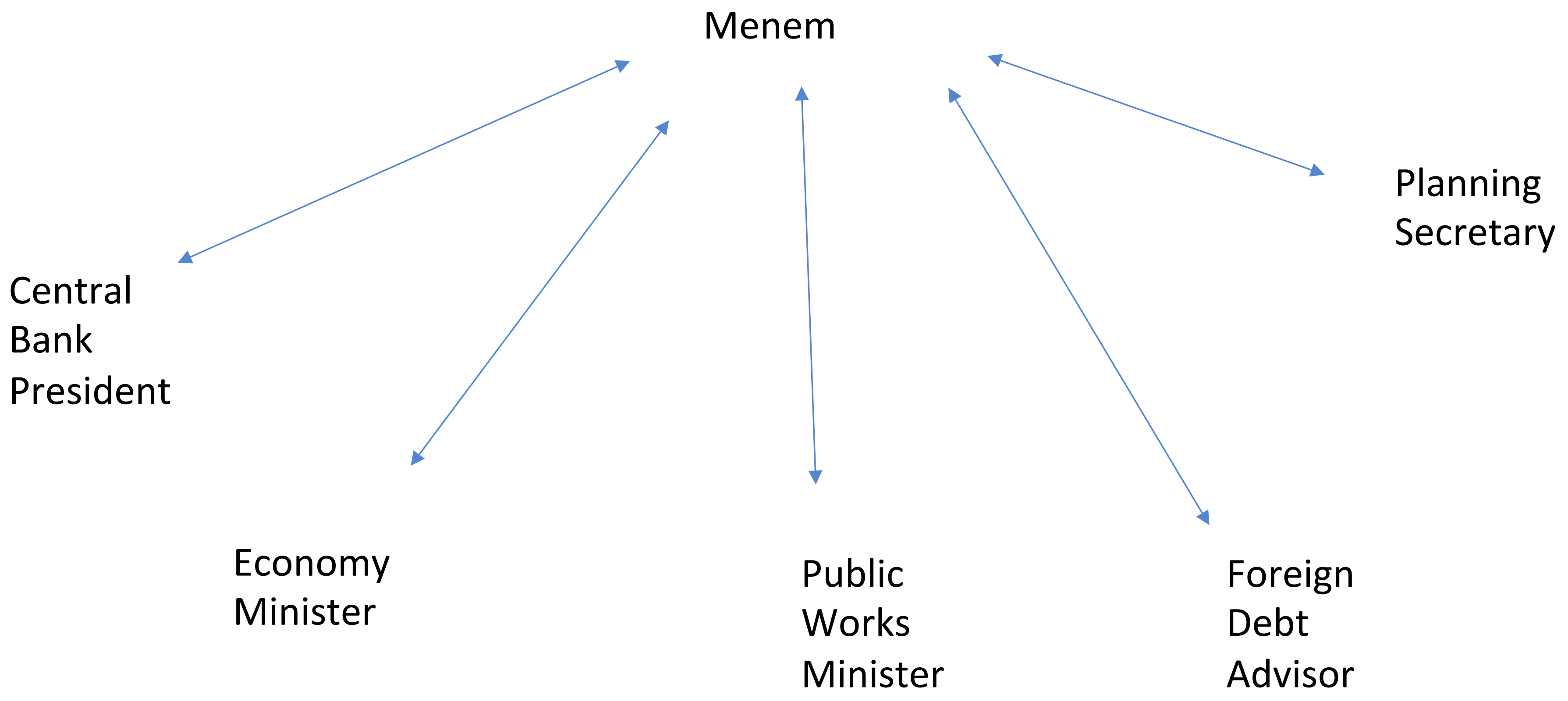
Carter III: Partial Delegation (since October 1979)



Menem: Initial context

- Hyperinflation: 5000% annual CPI rate (July 1989) after 15 years fluctuating between 100% and 400%
- Certainty over monetary policy
  - Competitive exchange rate to boost exports
- Controversy over fiscal policy
  - Breadth and speed of tax reform and privatization program
- Controversy over trade policy
  - Breadth and speed of trade opening

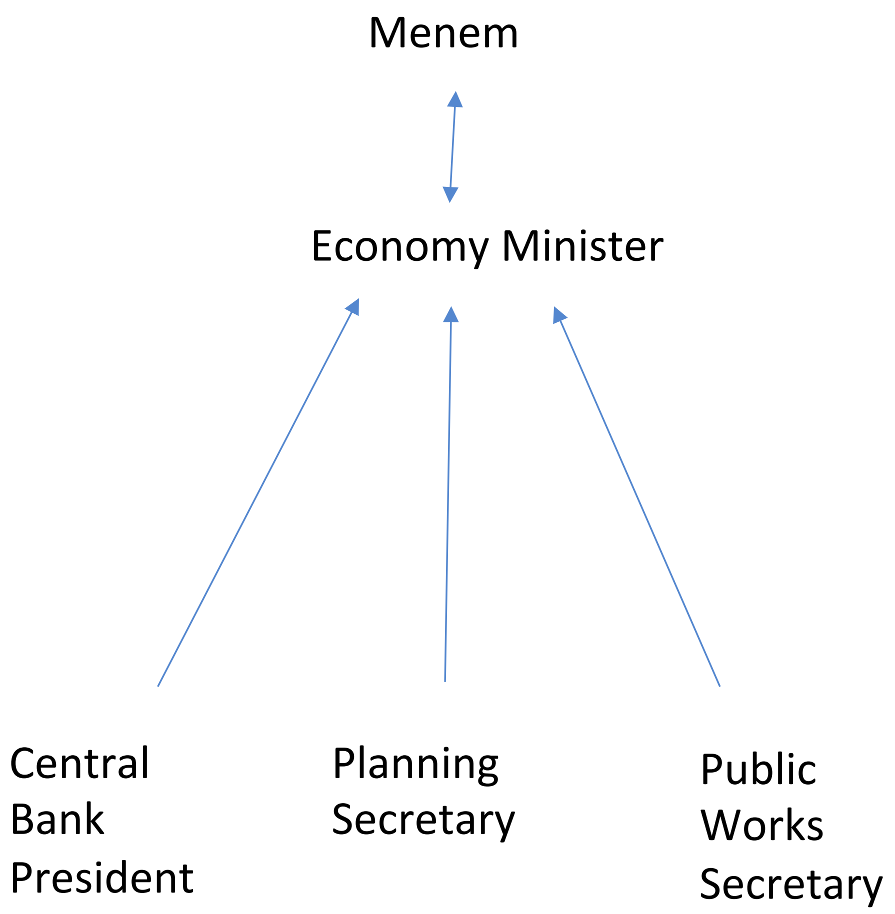
Menem I: Competition (1989-91)



Menem: Cognitive shocks

- Second hyperinflation ensued over uncertainty about tax receipts and privatizations (November-December 1989)
- Third hyperinflation ensued over uncertainty about devaluation and fiscal adjustment (January-March 1991)
- Menem’s cognitive context shifted to certainty over need for consistent fiscal and monetary policies

Menem II: Delegation to Economy (1991-99)



Some (preliminary) implications

- The case studies suggest that advisory structures and practices have conflicting effects on policymaking processes
- They corroborate the tradeoff between information and speed of response
- They indicate a tradeoff between arrangement type and ownership of policies
- They suggest competitive structures may be the best of both worlds, but they cease to be an equilibrium as crises become more frequent
- Leaders appear not to use consistent arrangements across issues

Moving Forward

- The Case of the US Financial Crisis:
  - Highly infrequent event that fell on highly trained but crisis-inexperienced teams
  - Bush shifted from hierarchical to collegial arrangement
  - Obama adopted collegial arrangement from the start

- The Case of Britain:
  - Frequent macroeconomic crises since WW II
  - Most crises managed by the same party (Labour) and team
  - Gradual shift from competitive to hierarchical arrangement

- The Case of Spain:
  - Low frequency of crises since WWII
  - Variation in regime type
  - Recurrence of collegial arrangements