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

President → Chief of Staff

Chief of Staff → Treasury, CEA, OMB

President → Treasury

Treasury → CEA, OMB

President → NEC

Treasury, CEA, OMB → President
Collegial Arrangements
Competitive Arrangements

President

Treasury

CEA

OMB
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
<table>
<thead>
<tr>
<th>Type of Variable</th>
<th>Independent</th>
<th>Dependent</th>
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<tr>
<td>Variable</td>
<td>Cognitive context of leaders</td>
<td>Predominant arrangement type</td>
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| 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

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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

Troika

Volcker Group

McCacken

Shultz

Burns

Post-Vietnam Study Group
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)

![Diagram showing connections between Nixon, Burns, Connally, Shultz, and McCracken]
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)

Central Bank President

Economy Minister

Public Works Minister

Foreign Debt Advisor

Planning Secretary

Menem
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)

Menem

Economy Minister

Central Bank President
Planning Secretary
Public Works Secretary
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