Measuring Political Budget Cycles : A Nonlinear DSGE Approach*

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Abstract

Fiscal policy is a consequence of politics. The recent business cycle research pays almost no attention to this fact, while political economics has devoted close attention to a hypothesis that politician has an opportunistic incentive to manipulate fiscal policy prior to his election: political budget cycle. In this paper, to bridge the gap between these two strands of literature, I develop a dynamic stochastic general equilibrium model with politics-augmented fiscal policy block. I estimate the model using the U.S. data, and obtain the following three results. First, political budget cycle is present only in government consumption and government investment, not in government transfer and taxes on consumption, labor and capital income. Government consumption is decreased by electoral concerns, while government investment is increased. Second, since the propagation of political motivation into the economy is limited, political business cycle is not significantly present. Finally, a considerable portion of fiscal foresight should be taken as contributions of political motivation risen in the past.

JEL Classification: D72, E62, D78, E32

Keywords: political budget cycles, nonlinear DSGE modeling, anticipated fiscal policy shocks, the simulated method of moments

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