

**THE REAL ECONOMY AND THE PERCEIVED ECONOMY IN
POPULARITY FUNCTIONS:
HOW MUCH DO VOTERS NEED TO KNOW?
A STUDY OF BRITISH DATA, 1974-1997**

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In a recent paper, Nannestad and Paldam (1998) demonstrated that Danish voters are remarkably ignorant about the condition of the macro-economy. Given the high levels of education in Denmark, it seems likely that this factual ignorance is paralleled in other advanced industrial countries. Nannestad and Paldam's findings raise an obvious difficulty for vote and popularity function analysis. If voters are so ignorant about the state of the economy, how can economic conditions apparently exert such profound effects on patterns of democratic party support? This paper considers this puzzle in the context of time-series data drawn from the United Kingdom over the 1974-1997 period. It is argued that although voters may have only a hazy factual knowledge about the state of the economy, their overall sense of macro-economic improvement and decline is remarkably acute and that it is this general sense of improvement or decline that matters electorally. In these circumstances, voters do not need to know precise "economic facts" in order to make reasonably well-informed judgements about the state of the economy -judgements which in turn exert a powerful influence on their party political preferences. The empirical analysis that is conducted shows that British voters' general perceptions about unemployment and inflation correspond, with a considerable degree of accuracy, to actual variations in unemployment and inflation levels over time. It is also shown that unemployment and inflation perceptions -along with other theoretically-relevant economic perceptions- relate to patterns of party support in consistent and theoretically predictable ways.

Part 1 of the paper reviews the main theoretical arguments that link the performance of the economy to the electoral standing of government and opposition parties. Part 2 specifies a series of models that operationalise the effects both of the objective condition of the economy and voters' subjective economic perceptions on patterns of support for the governing party. Part 3 tests these models empirically against British data. The results demonstrate that it is voters' *perceptions* of the macroeconomy, rather than the objective economy as measured by unemployment and inflation, that matter most in the formation of partisan preferences. Crucially, the final section of Part 3 shows that voters' perceptions of the seriousness of unemployment and inflation as issues are strongly related to objective variations in unemployment and inflation. Voters do not need detailed factual knowledge in order to have a broad sense of what is happening to the economy. Indeed, as long as voters have a general sense of what is happening to the economy -and most do- they are perfectly capable of using that general sense in order make judgements about the relative merits of rival political parties. This simple mechanism helps to explain why vote and popularity functions continue to have explanatory force in spite of the existence of an electorate that is largely ignorant of precise economic facts.

1. THE THEORETICAL BACKGROUND

[a] Government popularity and the objective economy

There are four main sets of arguments which link macroeconomic performance directly to patterns of partisan support. The most straightforward -and dominant- account is the *reward-punishment hypothesis* (Goodhart and Bhansali, 1970; Pissarides, 1980; Lafay, Lewis-Beck and Norpoth, 1991; Norpoth, 1992; MacKuen, Erikson and Stimpson, 1992). On this account, voters examine the macroeconomic record of the incumbent party in terms of its performance on the two major indicators of economic success: unemployment and inflation. They then reward or punish the incumbent government in direct proportion to its success in keeping either or both of these macroeconomic undesirables at relatively low levels. In short, it is hypothesised (H_1) that governing parties gain

support as unemployment and inflation fall and lose support as they rise; that there should be a *negative relationship* between government support on the one hand and unemployment and inflation on the other. Note, however, that two ancillary assumptions underpin the reward-punishment hypothesis: (1) that there is "clarity of responsibility" in terms of which party (or parties) is (are) responsible for macroeconomic policy and performance (Powell and Whitten, 1992; Anderson, 1998); and (2) that there is a viable and politically credible opposition party or coalition to which voters can transfer their allegiance if the governing party's performance is deemed inadequate.

A second set of arguments which link partisan support patterns to the macroeconomy is a variant of the reward-punishment thesis: the *differential partisan capability* approach (Hibbs 1987). The core argument in this context is that voters have differential expectations of left- and right-wing governments and thus make differential judgements about their macroeconomic performance. As part of their ideological make-up, left-wing parties prioritise low unemployment while right-wing parties prioritise low inflation. Voters are accordingly less likely to punish left-wing governments in periods of high unemployment (inflation) on the grounds that the alternative right-wing government would be less disposed even to address the unemployment problem. By the same token, and for the same reason, voters are less likely to punish right-wing governments that preside over periods of high inflation. The empirical predictions (H_2) that follow from this analysis are straightforward. Support for leftist governments should correlate negatively with inflation but should be uncorrelated or even positively correlated with unemployment. Support for rightist governments should correlate negatively with unemployment but should be uncorrelated or even positively correlated with inflation.

The third approach to the macroeconomy-support relationship involves relaxing either or both of the ancillary assumptions noted above. If it is unclear to voters which party is responsible for macroeconomic performance -as it may well be with coalition governments- then there is no obvious reason why voters should base their electoral judgements on macroeconomic conditions. In other words, without clarity of responsibility, there is no reason to suppose that there should be any correlation between party support patterns and unemployment and inflation. Note however, that in Britain clarity of responsibility is almost invariably very high (and was so even during the period of the 1977/8 Lib-Lab Pact). This implies that this particular subhypothesis does not need to be considered in the present context.

This limitation does not apply, however, to the relaxation of the second ancillary assumption. If, for whatever reasons, voters believe that the main opposition party or parties fail to offer a credible alternative to the incumbent government, then, regardless of the political complexion of the incumbent party, poor macroeconomic performance need not necessarily damage the government. This implies (H_3) that in conditions of non-credible opposition there should be *no correlation* between governing party support and movements in unemployment and inflation. There are certainly *a priori* reasons to suppose that this sort of situation might have existed in Britain during the 1980s and 1990s. After 1981, when a substantial part of Labour's right-wing deserted the party to form the SDP, Labour shifted its ideological centre of gravity dramatically to the left (Gamble 1990, Shaw 1994). In so doing, it appeared to alienate itself from a substantial part of the UK electorate, resulting in successive election defeats in 1983, 1987 and 1992 (Heath *et al* 1985, 1991 and 1994; Sanders 1999). It is clear that from the early 1980s until Tony Blair dragged Labour firmly back into the centre-ground in 1994 (Seyd 1997), Labour had a serious credibility problem among British voters as a potential governing party. Put simply, large numbers of voters did not believe that Labour could manage the economy effectively in times of economic difficulty (King 1997). This implies that, at least during the 1982-1994 period, the popularity of successive Conservative governments should have remained unaffected by either unemployment or inflation.

A fourth set of arguments which links party support patterns to the macroeconomy sees a substantial role for political discourse as a mediating variable between the objective economy and political preferences. On this account, politicians themselves are capable of changing the way that voters think about economic changes. By implication, politicians are in principle capable of convincing voters that what was previously an indicator of macroeconomic failure (which in turn merits electoral "punishment") is now a measure of the government's determination to pursue "tough" policies that will eventually resolve long-standing economic weaknesses. This argument has considerable resonance in the context of Britain during the 1980s. An important part of the Margaret Thatcher's (and John Major's) discourse was consciously aimed convincing voters not only that unemployment was more of a personal than a government responsibility but also that a high level of unemployment was a price worth paying for the reinvigoration of Britain's enterprise economy (Wickham-Jones 1995, Gamble 1996). Thatcherite discourse, in short, sought to neutralise unemployment as a source of political support. Note, however, that no such effort was made with regard to inflation; on the contrary, the defeat of inflation was expressly regarded as key objective of macroeconomic policy. These rather different discursive strategems for unemployment and inflation imply two very different predictions for the way that these variables should have related to government support during the Thatcher and Major administrations: governing party support during the Thatcher and post-Thatcher period should have been unrelated to unemployment but negatively correlated with inflation (H_4).

[b] The importance of voters' subjective economic perceptions

It is almost a platitude to observe that voters' perceptions of the economy constitute an important intervening variable between objective macroeconomic conditions (as reflected in, say, unemployment and inflation) and voters' political preferences. If these perceptions can be measured, moreover, there is no need to make *assumptions* about the intervening role that they play. On the contrary, the connections (1) between objective conditions and economic perceptions and (2) between perceptions and support patterns can be explicitly *tested*.

There are in principle four main sorts of economic perception that might affect patterns of party support. The first is what journalists sometimes label as the "feelgood factor": the general sense that current economic conditions are buoyant and are likely to remain so for the medium-term future¹. This general sense of economic buoyancy is hypothesised to relate to government support through a simple rational choice mechanism. To the extent that voters are optimistic about their own and their country's economic prospects, they will wish to preserve the political *status quo* that has created their optimism and therefore be more inclined to support the incumbent government (Sanders, 1991 and 1995). In short, aggregate economic expectations should be positively correlated with incumbent party support (H_5).

A second dimension of economic perceptions is the question of culpability -whether or not government is held responsible for economic outcomes and performance. Clearly, if voters do not hold the domestic government responsible for a particular set of economic outcomes, then there is no reason to suppose that their support for it will be affected by those outcomes. Note that the simple reward-punishment hypothesis outlined above *assumes* that voters *do* hold governments responsible in this way. Indeed, without some notion of culpability, empirical evidence that supported the reward-punishment hypothesis would not make sense. Unfortunately, the necessary data that would permit the explicit evaluation of hypotheses about perceptions of culpability are not available. As a result, the present analysis makes no explicit tests for the effects of perceptions of culpability -other than to note that a

rejection of H_1 above would be consistent with the idea that voters do not necessarily hold government responsible for macroeconomic performance.

A third set of economic perceptions relates to voters' views of the relative economic management capabilities of rival parties. Voters may feel inclined to punish a particular governing party for its poor macroeconomic performance but may continue to support it (just) because they no confidence whatsoever in the economic management capabilities of the government's rivals. Perceptions of economic management competence, in short, may be an important predisposing condition which allows governments to benefit from good macroeconomic performance and oppositions to benefit from bad. There is clear evidence from Britain that management competence perceptions were decisive in determining patterns of party support during the 1990s (Sanders, 1996). Suitable data, however, are not available for the period before 1991. As a result, the analysis here is obliged to eschew efforts formally to test for the effects of voters' economic management perceptions.

The final set of economic perceptions relates to voters' views of specific macroeconomic variables -in particular, to their perceptions of inflation and unemployment. Here we can revert to classic reward-punishment logic, using voters' perceptions rather than "objective" macroeconomic measures. To the extent that voters *believe* that inflation or unemployment have increased sharply in the recent past, they will punish (reward) the incumbent party by reducing (increasing) their support for it (H_6).

[c] How much factual information do voters need to know in order to make political and economic judgements?

In his seminal study of political rationality, Downs (1957) placed considerable emphasis on the "standing vote". This referred to the propensity of large numbers of voters to remain loyal to the same party over long periods of time. This sort of loyalty, Downs argued, was in part a way of reducing the transaction costs of political participation. Most voters did not assemble all the relevant political information about the rival political parties and candidates at each election and then carefully weigh that information in order to arrive at a voting decision. Rather, they developed a generally favourable image of one particular party at an early stage of their political lives and only changed that image radically as a result of a major external shock. Once broad loyalties had been established, voters certainly did not need continually to acquire detailed information about the parties in order to make judgements about their competing merits.

It seems likely that, even in an age of partisan dealignment (Sarlvik and Crewe 1983; Franklin 1985), many voters in contemporary advanced democracies continue to keep the transaction and opportunity costs of participation low by acquiring only a minimum amount of factual information about political parties. The 1997 British Election Study, for example, asked respondents a short battery of six factual questions about the policy positions of the major parties that were standing in the election. Only 27% of respondents answered all six questions correctly; 46% scored four or more correct answers. Over 21% answered no more than two of the questions correctly. Yet, in spite of this high level of factual ignorance, most voters appeared to hold quite firm views about the qualities of the different parties and their leaders²; many cared about the outcome of the election³; and most were ready to declare a distinct party preference⁴. In essence, despite knowing very little about the formal positions of the parties, voters appeared to be able to use what limited knowledge they had to form fairly clear political preferences. Given the rather good record of democracies (in comparison with non-democracies) on war-avoidance, sustained long-term economic growth and

comparative civil order (Olson, 1982), it seems plausible to argue that, over the long-term, factually ignorant voters probably end up making rather good decisions about which party should govern them.

What appears to be true for the acquisition of political information is also likely to be true for economic information -perhaps even more so given that citizens act as consumers far more frequently than they act as voters. Just as they seek to minimise the transactions costs of acquiring political information, voters are also likely to seek to minimise the costs of acquiring and processing economic information. They will accordingly be less interested in the precise facts about inflation, unemployment and growth and more concerned with the general trends in these variables and the likely prospects for the future. This overall awareness of the general extent of the problem is all that voters need to know in order to inform both their economic judgements as consumers and their political judgements as voters. To acquire more sophisticated factual information would be (continuously) expensive and probably unproductive; it would, in psychological terms, be cognitively inefficient (Sniderman, Brady and Tetlock, 1993).

Note, however, that even if voters need to know only the broad picture about unemployment and inflation, the broad picture that they perceive needs to be a reasonably accurate representation of what is actually occurring. Indeed, if we are plausibly to explain why changes in macroeconomic conditions are related to changes in party support patterns (if we are to resolve Nannestad and Paldam's puzzle), this consideration suggests a straightforward hypothesis about the character of the economic information possessed by voters. This can be expressed formally in H_7 : There should be a strong correlation between objective levels of unemployment and inflation and voters' *perceptions* of the extent to which unemployment and inflation have risen in recent months.

2. MODEL SPECIFICATION AND OPERATIONALISATION

The general model specification employed here follows standard approaches adopted in popularity function analysis (Paldam, 1981; Norpoth, 1987; Clarke, Mishler and Whiteley, 1991; Price and Sanders, 1993). I focus on the popularity of the governing party only (Labour or Conservative) though note that in the British context this implicitly involves modeling the popularity of the main opposition party as well (Sanders, 1999). In the absence of more precise theoretical expectations, exogenous variables are initially entered into the specification at lags of 0, 1 and 2.

I begin by specifying popularity as a function of the objective economy and a series of "event dummies" for the 1974-1997 period. A large number of event dummies were included in the initial analysis, including controls for changes in government, elections, the 1976 IMF loan crisis, the 1978/9 "winter of discontent", the 1982 Falklands war, the 1984-5 miners' strike, the March 1990 Poll Tax, the removal of Margaret Thatcher in November 1990, the 1992 ERM crisis, and the effects of Tony Blair's post-1994 transformation of the Labour Party into New Labour. In the models reported, only dummies that proved significant in at least one of the models estimated are reported. The 1974-1997 period is used for reasons of data availability: it maximises the possibilities for testing hypotheses about the role of economic perceptions.

The initial specification is:

$$\begin{aligned} \text{Gov}_t = & a + b_1 \text{Gov}_{t-1} + b_2 \text{dun}_t + b_3 \text{dun}_{t-1} + b_4 \text{dun}_{t-2} + \\ & b_5 \text{dinf}_t + b_6 \text{dinf}_{t-1} + b_7 \text{dinf}_{t-2} + b_8 D_1 + \\ & \dots b_k D_k + u_t \end{aligned} \quad [1]$$

where Gov_t is percent government support at time t ; un_t is the monthly change in unemployment (percent, seasonally adjusted) at t ; inf_t is the monthly change in inflation at t ; $D_1..D_{K_1}$ are event dummies; d is the difference operator; and u_t is a random error term. Unemployment and inflation are used in differenced form as Dickey-Fuller tests indicated that, without differencing, the series were non-stationary. Equation [1] provides a straightforward test of H_1 . If inflation and unemployment do exert direct effects on government popularity in reward-punishment fashion, then at least one of b_2 - b_4 and at least one of b_5 - b_7 should be significant and negative.

Hypothesis H_2 above suggests that unemployment and inflation should exert differential effects on government popularity during (a) left-wing (Labour) and (b) right-wing (Conservative) periods of government. This hypothesis can be tested quite straightforwardly by estimating [1] separately for the periods of Labour (March 1974 to May 1979) and Conservative (June 1979 to April 1997) government. If the differential partisan capability thesis represented in H_2 is correct, the following coefficient pattern should be observed. First, during the 1974-1979 period, (Labour) government support should be unaffected by unemployment (b_2 , b_3 and b_4 should non-significant) and negatively affected by inflation (at least one of b_5 , b_6 or b_7 should significant and negative). Second, during the 1979-1997 period, (Conservative) government support should be unaffected by inflation (b_5 , b_6 and b_7 should be non-significant) and negatively affected by unemployment (at least one of b_2 , b_3 or b_4 should significant and negative).

Hypothesis H_3 refers to the consequences of a non-credible opposition party for relationship between government support and unemployment and inflation: a non-credible opposition implies that the governing party will neither punished nor rewarded for its unemployment and inflation records. The simplest way of testing this proposition in the UK context is to subset the period from 1982 to 1992 when Labour was led, successively, by Michael Foot and Neil Kinnock. H_3 can then be tested directly by re-estimating [1]: it predicts that b_2 - b_7 will all be non-significant for this period.

Hypothesis H_4 focuses on the capacity of political discourse to negate the effects of specific macroeconomic variables. In the Thatcher and Major periods, the dominant discourse sought to neutralise the effects of unemployment but continued to stress the need to conquer inflation. Success in this area would imply that from the early 1980s (by which time Thatcherite discourse had had the opportunity to embed itself in British voters' minds) through to 1997 unemployment should exert no effect on government support while inflation should exert a negative effect. As with H_3 , H_4 is tested most effectively by re-estimating [1] for a subset of the sample period -in this case, for 1982-1997.

Hypotheses H_5 and H_6 address the possibility that economic *perceptions* are more central to voters' electoral preferences than raw macroeconomic "realities". As noted earlier, direct measures of voters' perceptions of parties' economic management competences and of government "culpability" are not available for the lengthy time period analysed here. However, courtesy of Gallup, aggregate measures of economic expectations and of inflation and unemployment perceptions are available for much of the 1974-1997 period. The analysis of expectations conducted here focuses on *personal* (egocentric) economic expectations ("pexp")⁵. This is partly because previous research has shown that personal expectations correlate more strongly with incumbent support than general expectations, and partly because in the later part of the 1979-1997 period, Gallup ceased to collect general expectations data. The measure of inflation perceptions used ("infperc") is the monthly percentage of Gallup respondents who believe that inflation has risen "sharply"⁶. There is no directly equivalent time-series available for unemployment. However, Gallup do ask their respondents an open-ended question which requires respondents to identify "the most serious problem facing the country". The responses are coded by interviewers into pre-set categories which are unseen by

respondents; two of the response categories since the early 1960s have been "unemployment" and "cost of living/inflation". There is a very strong correlation over time ($r=.78$) between the percentage of respondents who consider that inflation has risen sharply and the percentage who consider inflation to be the most serious problem facing the country. In view of this high correlation between perceptions of the extent to which inflation has risen and perceptions of its "seriousness", it seems reasonable to assume that a similar linkage operates with unemployment. In the absence of a direct measure of unemployment perceptions, therefore, perceptions of unemployment's "seriousness" can be used as a surrogate for voters' aggregate perceptions about the extent to which unemployment has risen in recent months ("unperc").

Equation [2] allows for the simultaneous evaluation of hypotheses H_5 and H_6 :

$$\begin{aligned} \text{Gov}_t = & a + b_1 \text{Gov}_{t-1} + b_2 \text{dpexp}_t + b_3 \text{dpexp}_{t-1} + \\ & b_4 \text{dpexp}_{t-2} + b_5 \text{dunperc}_t + b_6 \text{dunperc}_{t-1} + \\ & b_7 \text{dunperc}_{t-2} + b_8 \text{dinperc}_t + b_9 \text{dinperc}_{t-1} + \\ & b_{10} \text{dinperc}_{t-2} + b_{11} D_1 + \dots b_K D_K + u_t \end{aligned} \quad [2]$$

where Gov, D and u_t are defined as in [1]; dpexp is the monthly change in aggregate personal expectations; and dunperc and dinperc are, respectively, the monthly changes in the extent to which voters perceive unemployment and inflation to have risen sharply. If H_5 is correct, at least one of the expectations coefficients (b_2 , b_3 or b_4) should be positive and significant. If H_6 is correct, at least one of the subjective unemployment coefficients (b_5 , b_6 or b_7) and at least one of the subjective inflation coefficients (b_8 , b_9 or b_{10}) should be negative and significant⁷.

3. Empirical Results

Tables 1 and 2 report the results of estimating a series of models which assess the effects of objective measures of unemployment and inflation on UK government support for 1974-1997 and for specified sub-periods. Estimation is by OLS. Substantively identical results were obtained using levels and second-differenced versions of the exogenous variables, as well as models with additional lagged terms on the right-hand-side. The results in Table 1 suggest that, at the very least, hypotheses H_1 and H_2 should be rejected. The only significant predictors of government popularity in the entire table are the lagged endogenous variable and the event dummies, the latter representing the effects of the Falklands War in May-June of 1982 and the removal of Margaret Thatcher as Prime Minister in November 1990. Unemployment and inflation simply fail to exert significant effects on government support (column 1), a pattern which continues even when allowance is made (as it is in columns 2 and 3) for the possibility that voters reward and punish the unemployment and inflation records of right- and left-wing governments differentially.

The model reported in column 1 of Table 2 tests the claim (H_3) that in periods of non-credible opposition government support should be unrelated to macroeconomic performance. The non-significant coefficients on the unemployment and inflation terms are certainly consistent with H_3 . However, the evidence reported in the equation would only support the non-credible opposition thesis if there were *other* evidence to indicate that unemployment and inflation affected government support when the opposition *was* credible (in this case, before 1982 and after 1993). As we saw in relation to the models estimated in Table 1, however, there is no evidence to suggest that unemployment and/or inflation directly affected government support at any stage during the 1974-1997 period. In these circumstances we cannot conclude that the Table 2, column 1 model corroborates H_3 , since it also corroborates

the idea that government popularity is entirely unrelated to changes in the macroeconomy, whether or not there is a credible opposition.

Column 2 of Table 2 seeks to assess hypothesis H_4 , the idea that Conservative discourse during the 1980s and 1990s served to neutralise the effects of unemployment on government support but not those of inflation. As with the other results reported in Tables 1 and 2, it is evident that unemployment exerted no significant effect on government support. Unfortunately for H_4 , there are two good reasons for supposing that it was *not* Conservative discourse that was responsible for the absence of a relationship between unemployment and government support after 1982. First, as we saw in Table 1 column 2, unemployment was unconnected with government support during Labour's period in office in the 1970s: if Thatcherite discourse had played a significant transforming role, we would have expected unemployment to be related to government support in the pre-Thatcher period. Second, as the Table 2 column 2 model indicates, inflation also failed to affect Conservative support after 1982: if discourse had been so important, Thatcherism's emphasis on the central importance of defeating inflation should have invoked a strong connection between variations in inflation and the electoral fortunes of the government. In these circumstances, we can have little confidence that it was Conservative discourse -as opposed to anything else- that successfully neutralised the potentially damaging effects of rising unemployment during the 1980s and 1990s: we cannot regard H_4 as being corroborated by the data.

The overall conclusion suggested by the findings reported in Tables 1 and 2 is simple. There is no evidence from Britain over the 1974-1997 period to indicate objective macroeconomic measures exerted any direct effect at all on government support. It could be argued, of course, that in view of these results the resolution to Nannestad and Paldam's puzzle that is offered here is *unnecessary*. There is no need to explain how macroeconomic conditions can be linked to party support patterns even when voters are factually ignorant for the simple reason that macroeconomic changes and party support are not linked in the first place. Such an inference, however, would be both premature and unwise, for two reasons. First, although Tables 1 and 2 show there are no direct links between the economy and support, this does not preclude the possibility of indirect links. Second, even though there may be no significant direct links between macroeconomic change and party popularity in the UK, there clearly are such links in other countries. There is still a need, therefore, to understand the mechanisms that underlie those links given that non-Danish voters are in all probability just as factually ignorant about the economy as their better-documented Danish counterparts.

The impact of the subjective economy

But if objective macroeconomic measures fail to exert significant effects on party support, what of the subjective economy? Since 1971, Gallup have asked their monthly sample of British voters the following open-ended question: "What would you say is the most urgent problem facing the country at the present time?" On average, for the 1971-1997 period, over 70% of respondents each month have responded by identifying an *economic* issue as the most urgent⁸. Regardless of the results shown in Tables 1 and 2, this remarkable statistic suggests that British voters clearly think that the economy matters.

The fact that the economy does indeed matter to British voters is clearly borne out by the findings reported in Table 3. Both the full lagged endogenous variable model reported in column 1 and the "abridged" version in column 2 show that voters' subjective economic perceptions are strongly related to government support in theoretically predictable ways. As H_5 anticipates, aggregate personal expectations ($b=.05$ in the abridged model) are *positively* and

significantly related to government support. And as H_6 predicts, unemployment perceptions (abridged model $b=-.07$) and inflation perceptions ($b=-.15$) are *negatively* and significantly related to support. In short, voters reward government with their support if their economic prospects look good and if they perceive that unemployment and inflation are falling; they inflict punishment by withdrawing their support if expectations are falling or if they perceive that unemployment or inflation are rising. These conclusions are further substantiated by the findings shown in column 3 of Table 3, which uses an error-correction specification. Johansen tests were initially employed to establish the fact that government support, aggregate personal expectations, unemployment and inflation constitute a cointegrating set. The error correction term shown in the table is the residual derived from these Johansen tests. The results reported in column 3 also corroborate H_5 and H_6 . The coefficients for expectations, unemployment perceptions and inflation perceptions are all well-determined and correctly signed. The model as a whole (just) passes the standard battery of diagnostic tests. The small but significant negative coefficient on the error-correction term indicates a fairly slow adjustment process back to the long-term equilibrium relationship after each exogenous shock.

The models reported in Table 4 apply the logic of differential partisan capabilities, as outlined in H_2 , to the results reported in Table 3. The Table 4 models incorporate a series of interaction terms which in effect allow the coefficients for unemployment perceptions and inflation perceptions to vary for Labour and for Conservative governments. The rationale underlying the introduction of these terms, following the differential partisan capabilities thesis, is that Labour governments should be undamaged by or even benefit from rising unemployment, while Conservative governments should be unaffected by or benefit from rising inflation. By the same token, higher inflation should damage Labour and higher unemployment should damage the Conservatives.

The results in Table 4 provide some support for a "subjective economy" version of H_2 . The interaction term coefficients measure the extent to which the effects of unemployment and inflation perceptions during periods of Labour government shift away from the effects observed during periods of Conservative government. The effect of unemployment perceptions on Conservative government support in the column 1 model, for example, is significant and negative at $b=-.08$. The corresponding interaction coefficient for the effect on Labour government support is $b=+.08$. Although this latter coefficient is not significant at conventional levels, these two coefficients taken together suggest that the overall effect of unemployment perceptions on Labour government support is null, at $b=(-.08 + .08)=0$. This coefficient pattern is clearly consistent with the idea that rising unemployment damages right-wing governments but does not necessarily harm left-wing ones. In a similar (though not entirely symmetrical) vein, the effect of inflation perceptions on Conservative government popularity is $b=-.11$; the effect for Labour governments is $b=(-.11 + -.20)=-.31$. In short, although Conservative governments are damaged by rising inflation (which would contradict a "subjective economy" version of H_2), the equivalent damage inflicted on Labour governments is almost three times greater. This certainly constitutes support for the spirit, if not the letter, of H_2 . The model shown in column 2 of Table 4 tests the robustness of the estimates shown in column 1 using a slightly different specification. The column 2 model includes a government support_{t-2} term which corrects for the first-order serially correlated error that was evident in the column 1 model. The similarity of the two sets of coefficients attests to the robustness of the effects estimated in the column 1 model.

What all of this suggests is that voters' economic perceptions matter very significantly in the formation of partisan political preferences. Voters do reward and punish governments both on the basis of their past economic performance with regard to unemployment and inflation (H_6) and on the basis of their ability to generate confidence about the economic future (H_5). But in making these calculations, voters' *perceptions* of economic realities -presumably filtered both by the media and by personal experiences (Sanders, Ward and Marsh 1993; Gavin and

Sanders 1996)- are more important than the realities themselves. The crucial question is obviously how far voters' subjective perceptions actually correspond to "objective" reality.

How accurate are voters' perceptions of the "real" economy?

Figures 1 and 2 show the relationships between (a) British voters' aggregate perceptions of unemployment and inflation and (b) the actual levels of unemployment and inflation as measured in official statistics. The evidence reported to a large extent speaks for itself. Unemployment perceptions track "real" unemployment and inflation perceptions track "real" inflation very well. British voters, in aggregate, are remarkably astute at recognising the extent to which unemployment and inflation are rising and falling in historical context. They might not know what the precise inflation rate is or how many people are out of work. But they do recognise a rapidly increasing (or falling) inflation or unemployment rate when it occurs.

The models in Table 5 express the connections between economic perceptions and realities more formally. The "abridged" unemployment model shows that there is a time lag of roughly one month between changes in objective unemployment and changes in voters' unemployment perceptions. The "abridged" inflation model suggests that voters incorporate information from both the current month and the previous month in order to determine their inflation perceptions, though it should be noted that the model as whole does not stand up well to standard diagnostic testing. The crucial point, however, is that the two figures and Table 5 strongly bear out hypothesis H7: there *are* strong connections between objective levels of unemployment and inflation and voters' unemployment and inflation perceptions.

SUMMARY AND CONCLUSIONS

Nannestad and Paldam posed an intriguing question. How can voters adjust their political preferences according to changing macroeconomic conditions when their economic knowledge is so sparse? The answer I have provided is that, although voters may not possess much factual economic information, they nonetheless have a good sense of what is actually going on in the "real" economy (see Figures 1 and 2 and Table 5). Voters recognise, moreover, how macroeconomic changes affect them, both directly and indirectly, and are perfectly able to factor their perceptions of these changes into their voting calculations (See Tables 3 and 4). In these circumstances, changing economic conditions can still exert an influence on the electoral preferences of economically ignorant voters. Voters do not need to know precise economic facts in order to know whether the government of the day is making mess of things or doing relatively well. There are always transactions and opportunity costs involved in the acquisition of political and economic information. Rational voters who are seeking to be cognitively efficient may well decide that the costs of acquiring more "economic facts" would exceed any benefits that might thus accrue to them. As a result, they are perfectly content -and rational- to remain factually ignorant. However, this does mean that they do not know broadly what is going on or that they fail to use that broad knowledge to inform their political judgements.

Table 1

Reward-Punishment and Differential Partisanship Models of the Effects of the Objective Economy on Governing Party Support in the UK, 1974-1997

Dependent Variable is Gov(t) (Government support at time t)

	H1 (1974-97)	H2(a) (1974-1979)	H2(b) (1979-1997)
Constant	2.28** (0.79)	14.71*** (4.24)	1.44* (0.67)
Gov(t-1)	0.94*** (0.02)	0.64** (0.10)	0.96*** (0.02)
dun(t)	-0.11 (0.92)	0.18 (1.87)	0.71 (1.38)
dun(t-1)	-1.25 (1.04)	-1.49 (1.96)	-1.18 (1.34)
dun(t-2)	1.18 (0.93)	2.27 (1.98)	-0.42 (1.32)
dinf(t)	0.04 (0.21)	0.27 (0.54)	-0.04 (0.21)
dinf(t-1)	-0.01 (0.22)	-0. (0.56)	0.08 (0.22)
dinf(t-2)	0.04 (0.21)	-0.24 (0.54)	0.08 (0.21)
Falklands-May 1982	8.85*** (2.38)		9.31*** (1.87)
Falklands-June 1982	5.36* (2.38)		5.38** (1.88)
Thatcher removal	7.26** (2.39)		7.33*** (1.89)
Corrected R2	0.87	0.36	0.93
LM serial correlation	23.88 [.02]	11.83 [.46]	18.55 [.10]
Functional Form test	7.67 [.01]	3.98 [.05]	0.19 [.66]
Normality test	55.93 [.00]	0.74 [.69]	3.91 [.14]
Heteroscedasticity test	2.99 [.08]	0.04 [.84]	0.03 [.85]
N	227	62	215
Sample	1974m4-1997m4	1974m4-1979m5	1979m6-1997m4

Key

dun: monthly change in unemployment

dinf: monthly change in inflation

* coefficient significant at .05; ** at .01; *** at 001.

Standard errors in round parentheses; significance levels in square parentheses.

H1 tests standard reward-punishment hypothesis.

H2(a) tests differential partisan capability hypothesis for the period of Labour government

H2(b) tests differential partisan capability hypothesis for the period of Conservative government

Estimation by OLS

Table 2

Further Models of the Effects of the Objective Economy on Governing Party Support in the UK, 1974-1997

Dependent Variable is Gov(t) (Government support at time t)

	H3		H4	
Constant	4.28**	(1.37)	1.60*	(0.72)
Gov(t-1)	0.89***	(0.83)	0.95***	(0.02)
dun(t)	1.58	(1.87)	1.89	(1.58)
dun(t-1)	-2.21	(1.82)	-2.47	(1.59)
dun(t-2)	-0.61	(1.85)	0.31	(1.58)
dinf(t)	0.01	(0.43)	-0.03	(0.38)
dinf(t-1)	-0.10	(0.47)	-0.02	(0.41)
dinf(t-2)	0.01	(0.43)	-0.04	(0.38)
Falklands-May 1982	8.49***	(1.97)	9.11***	(1.94)
Falklands-June 1982	5.03***	(1.88)	4.91***	(1.95)
Thatcher removal	6.65***	(2.01)	7.00***	(1.98)
Corrected R2	.93		.93	
LM serial correlation	17.08	[.15]	17.47	[.13]
Functional Form test	0.16	[.68]	0.09	[.76]
Normality test	4.18	[.12]	2.15	[.34]
Heteroscedasticity test	0.20	[.65]	0.00	[.96]
N	126		184	
Sample	1982m1-1992m6		1982m1-1997m4	

Key

dun: monthly change in unemployment

dinf: monthly change in inflation

* coefficient significant at .05; ** at .01; *** at .001.

Standard errors in round parentheses; significance levels in square parentheses.

H3 tests the non-credible opposition hypothesis.

H4 tests the discourse neutralisation hypothesis.

Estimation by OLS.

Table 3

Simple Models of the Effects of Subjective Economic Perceptions on Governing Party Support in the UK, 1974-1997

Dependent Variable is Gov(t) (Government support at time t)

	H5 and H6, Full OLS Model	H5 and H6, Abridged OLS Model	H5 and H6, Error- Correction Model
Constant	1.63* (0.73)	1.59* (0.72)	5.09*** (0.86)
Gov(t-1)	0.95*** (0.02)	0.95*** (0.02)	
dpexp (t)	0.02 (0.03)		
dpexp (t-1)	0.06* (0.03)	0.05** (0.02)	0.05* (0.02)
dpexp (t-2)	0.02 (0.03)		
dunperc (t)	-0.01 (0.03)		
dunperc (t-1)	0.04 (0.03)		
dunperc (t-2)	-0.05* (0.03)	-0.07** (0.02)	-0.07** (0.02)
dinperc (t)	-0.12** (0.04)	-0.15*** (0.04)	-0.12** (0.04)
dinperc (t-1)	-0.03 (0.04)		
dinperc (t-2)	-0.01 (0.04)		
Falklands-May 1982	9.33*** (2.25)	8.24*** (2.10)	
Falklands-June 1982	3.09 (2.29)		
Thatcher removal	6.67*** (2.13)	6.73** (2.11)	
Error-Correction term (t-1)			-0.14
Corrected R2	.91	.91	.26
LM serial correlation	20.09 [.07]	20.67 [.06]	17.27 [.08]
Functional Form test	0.95 [.33]	1.18 [.27]	0.42 [.51]
Normality test	3.51 [.17]	4.55 [.10]	26.40 [.00]
Heteroscedasticity test	3.29 [.07]	3.25 [.07]	0.57 [.45]
N	251	253	251
Sample	1976m3-1997m1	1976m1-1997m1	1976m3-1997m1

Key

dunperc: aggregate perceptions of monthly change in unemployment

dinperc: aggregate perceptions of monthly change in inflation

* coefficient significant at .05; ** at .01; *** at .001.

Standard errors in round parentheses; significance levels in square parentheses.

H5 tests for the effects of aggregate personal economic expectations.

H6 tests for the effects of perceived unemployment and perceived inflation.

Table 4

Models of the Effects of Subjective Economic Perceptions on Governing Party Support in the UK, 1974-1997; coefficients on the perceived unemployment and perceived inflation terms allowed to vary for Labour and Conservative Governments

Dependent Variable is Gov(t) (Government support at time t)

	H2 OLS model with subjective exogenous measures		H2 OLS model with subjective exogenous measures, Gov (t-2)added	
Constant	1.69*	(0.72)	1.42*	(0.72)
Gov (t-1)	0.95***	(0.02)	0.84**	(0.06)
Gov (t-2)			0.12*	(0.06)
dpexp (t-1)	0.05*	(0.02)	0.06**	(0.02)
dunperc (t-2)	-0.08*	(0.03)	-0.09**	(0.03)
dunperc (t-2)*lab	0.08	(0.06)	0.10	(0.06)
dinperc (t)	-0.11**	(0.04)	-0.11**	(0.04)
dinperc (t)*lab	-0.20*	(0.10)	-0.19*	(0.09)
Falklands-May 1982	8.29***	(2.08)	8.43***	(2.07)
Thatcher removal	7.01***	(2.09)	7.40***	(2.08)
Corrected R2	.91		.91	
LM serial correlation	21.96	[.04]	19.04	[.09]
Functional Form test	1.62	[.20]	0.88	[.35]
Normality test	4.49	[.11]	5.	[.08]
Heteroscedasticity test	2.45	[.12]	2.17	[.14]
N	253		253	
Sample	1976m1-1997m1		1976m1-1997m1	

Key

dunperc: aggregate perceptions of monthly change in unemployment

dinperc: aggregate perceptions of monthly change in inflation

dunperc*lab: interaction term for change in unemployment perceptions, Labour government period only

dinperc*lab: interaction term for change in inflation perceptions, Labour government period only

* coefficient significant at .05; ** at .01; *** at .001.

Standard errors in round parentheses; significance levels in square parentheses.

Table 5

Models of Aggregate Unemployment and Inflation Perceptions using Objective Exogenous Variables, 1974-1997

	H7 Full OLS model of Unemployment Perceptions		H7 Abridged OLS model of Unemployment Perceptions		H7 Full OLS model of Inflation Perceptions		H7 Abridged OLS model of Inflation Perceptions	
Constant	-0.06	(0.30)	(-0.02)	(0.30)	-0.07	(0.21)	-0.07	(0.21)
dunperc (t-1)	-0.11	(0.06)						
dun (t)	-1.31	(1.90)						
dun (t-1)	8.80***	(2.25)	8.90***	(1.60)				
dun (t-2)	2.33	(1.99)						
dinperc (t-1)					-0.10	(0.06)		
dinf (t)					0.99**	(0.31)	0.99**	(0.31)
dinf (t-1)					0.78**	(0.34)	0.88**	(0.31)
dinf (t-2)					0.58*	(0.32)		
Corrected R2	.10				.12		.11	
LM serial								
correlation	19.56	[.08]	18.19	[.11]	14.74	[.25]	15.63	[.21]
N	279		279		252		252	
Sample	1974m4-1997m6		1974m4-1997m6		1976m2-1997m1		1976m1-1997m1	

Key

dunperc: aggregate perceptions of monthly change in unemployment

dinperc: aggregate perceptions of monthly change in inflation

* coefficient significant at .05; ** at .01; *** at .001.

Standard errors in round parentheses; significance levels in square parentheses.

Figure 1: Subjective Unemployment Perceptions and Objective Unemployment, 1974

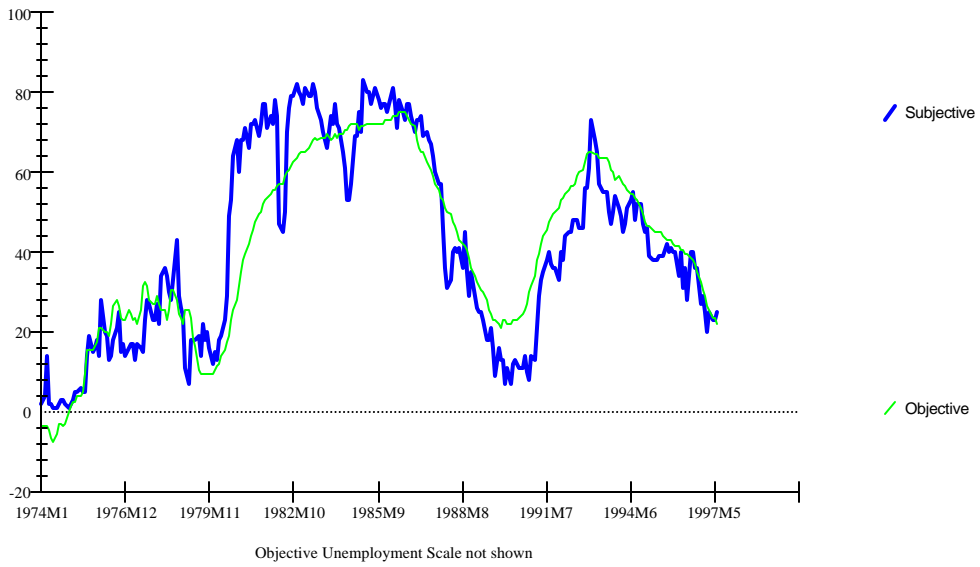
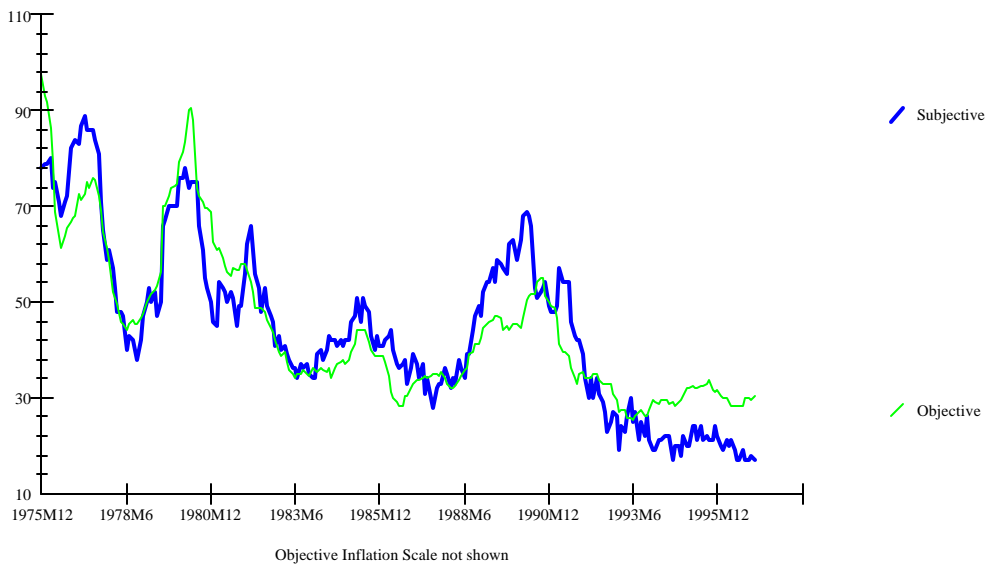


Figure 2: Subjective Inflation Perceptions and Objective inflation, 1975-1997



NOTES

1. Much scholarly debate has focused on whether these feelgood perceptions are best conceptualised as prospective or retrospective, egocentric or sociotropic (Fiorina, 1981; McKuen, Erikson and Stimpson, 1993). The high levels of intercorrelation among the measures makes it difficult to distinguish between them in empirical terms (Paldam and Nannestad, 1998). I focus on prospective egocentric perceptions here because research on UK data has found these "personal expectations" to correlate most strongly with patterns of party support. (Sanders, Ward and Marsh, 1991; Clarke, Stewart and Whiteley, 1997).
2. For example, only 5% of respondents were unable to make a judgement about Tony Blair's leadership qualities.
3. Some 75% of respondents "cared a good deal" about the outcome of the election.
4. Some 79% of respondents expressed a clear party preference.
5. The measure of personal expectations here is derived from Gallup's regular monthly question "How do you think the financial situation of your household will change over the next 12 months?". The response options are: get a lot better, get a little better, stay the same, get a little worse, get a lot worse, don't know/refused. A monthly index score is constructed by subtracting the percentage of pessimists from the percentage of optimists. With minor variations in wording, this question has been asked continuously since 1976. See *Gallup Political Index*, 1974-1997.
6. Gallup's question is "Do you consider that prices in the last 12 months have:
increased sharply
increased moderately
remained much the same
fallen
don't know"
7. It is possible to argue, as we did in relation to H_2 (which referred to the impact of the objective economy), that H_6 (which refers to the impact of the subjective economy) could be extended and refined to accommodate the possible effects of "differential partisan capabilities", a "non-credible" opposition and a "neutralising" political discourse. Rather than overburden the text with additional formal hypotheses, however, I eschew the formalities. Nonetheless, these ideas are briefly explored in a later section.
8. The unseen coding categories that comprise "economic" issues on this definition are: "unemployment", "cost of living/inflation", "strikes", "other economic issues" and occasional economic issues such as the "poll tax" in 1990.

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