The London School of Economics and Political Science

Public Budgeting and Electoral Dynamics after the Golden Age.

Essays on political budget cycles, electoral behaviour and welfare retrenchment in hard times.

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A thesis submitted to European Institute of the London School of Economics for the PhD degree, London, August 2013

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Acknowledgements

This thesis is the product of a five-year effort at the European Institute of the London School of Economics and Political Science. Its completion would not have been possible without the intellectual and academic environment that accompanied my work throughout these years.

First and foremost, I am particularly grateful to my supervisors who helped me develop, transform and perfect the ideas that led to the completion of this thesis. I would like to express my appreciation, in no particular order, of Willem Buiter's and Claire Gordon's early guidance as well as Waltraud Schelkle's and Joachim Wehner's subsequent help that they provided. In different aspects and angles, they all provided the time, support – both academic and psychological – and commitment that made this PhD possible. By now, I have realized how time-consuming and even distractive it might be to engage in iterative circles of feedbacks for PhD-candidates to help them improve their work; For this reason, I owe special thanks to Waltraud Schelkle, whose incredibly thorough reading of all my drafts – footnotes included – sometimes made me wonder whether she had a secret source of extra time that most of us just don't possess.

In addition, I would like to say thank you for much of the additional help I have received along the way. Special thanks to my summer school teachers, Bernard Kittel, Thomas Sattler and Chris Adolph whose incredibly useful econometrics classes in Ljubljana and Colchester greatly helped the empirical parts of my work. Moreover, I have received loads of useful comments and suggestions at conferences, workshops and upgrades that drew attention to the limitations of my works in progress. I would particularly like to thank Bob Hancke, Marco Simoni, Helen Wallace, Simon Glendinning, Bela Greskovits, Zsolt Enyedi, Isabelle Stadelmann-Steffen, Staffan Kumlin, Christian Elmelund-Præstekær, Gijs Schumacher, Rafael Hortala-Vallve and Stephanie Rickard in this regard.

Last but not least, plenty of useful input has been offered by my peers at the European Institute. Especially, but by no means exclusively, my deepest gratitude goes to Timothee Vlandas, Zsofia Barta, Niclas Meyer, Mireia Borrel-Porta, Sonja Avlijas and Raphael Reinke who witnessed and helped the development of my thesis throughout much of the time.

I dedicate this thesis to my mother, Zsuzsa, my father, Gabor, my sister, Nora and her daughter (my niece), Mira.

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Introduction

I.1. Electoral politics and the rise of the fiscal state

The uneasy co-existence of capitalist economies and democratic politics has inspired some of the best-known works in political economy since the discipline's inception. Periodic crises in the classical era followed by the near-collapse of the international capitalist system in the interwar period generated a loud chorus of pessimistic predictions on the system's viability. While the direst predictions on capitalism's demise inspired by the Marxist tradition were not fulfilled, re-embedding laissez-faire capitalism in a democratic society (Polanyi, 1944) by the state taking on a pro-active, stabilizing role (Keynes, 1937) was one of the most lasting transformations in modern economic history (Gourevitch, 1986; Hall, 1989; Kurth, 2011). Nowhere is such transformation more manifest than in the expanding role of the public economy (Cameron, 1978) during the post-war era. Defying early warnings on the tax-state's limited capacity to expand (Schumpeter, 1918), developed economies today tax and redistribute around half of national income. Fiscal policy and public budgeting have thus become one of the central roles of the modern state.

Beyond its systemic function in responding to economic shocks, fiscal policy has been one of the most studied areas in political economy because of its highly political nature. As Wagner (1890) already correctly predicted in the 19th century, growing affluence has been associated with a growing provision of goods, services and welfare because the public demand for them is income-elastic. Moreover, the agents of the pro-active state, national bureaucracies have simultaneously vied for increased funding because of what Niskanen (1971) somewhat pejoratively described as the self-aggrandizing incentive of the bureaucrat in his budget-maximizing model. The modern state's budgeting procedures also contributed to these trends as incremental budgeting (Wildavsky, 1964) builds on last year's budget as a benchmark; as cutting funds for certain state activities is more difficult than adding to them, incrementalism further adds to the secular expansion of the public economy. To the extent that the government is not a unitary actor but composed of various parties and spending ministers, the competition between these actors for a limited fiscal pool can create a common pool resource problem (von

Hagen and Harden, 1995; Hallerberg et al, 2009) further putting an upward pressure on government expenditures and taxation.

Of the various sources of political influences on the state's fiscal activity, however, electoral pressure has perhaps been the most relevant one in the last three to four decades. As the Keynesian era gave way to a much diminished role in activist fiscal policy-making starting from the late 1970s (Iversen and Soskice, 2006), electoral constituencies and organized groups with vested interests in public programmes continued to shape the discourse on public budgeting; in the new era of "permanent austerity" (Pierson, 1994; 2001) redistributive conflicts between competing claims on the public budget (Cox and McCubbins, 1986) made electoral trade-offs even more pertinent for re-election seeking incumbents. Such trade-offs will be especially relevant in today's fiscal environment as the Western world is simultaneously experiencing low growth, strains on public budgets and popular discontent with austerity politics. It is likely, therefore that the electoral arena will continue to be of paramount importance in mediating conflicting interests and claims on the limited fiscal resources of the state (Streeck, 2011).

However, contrary to the post-war "democratic class struggle" (Korpi, 1983) that led to the crystallization of today's welfare states, the current European debt-crisis risks pitting electoral demands on competing political parties against the imperatives of fiscal sustainability and debt-reduction. While mature welfare states have already proven to be unexpectedly resilient in the face of economic shocks and ideological offensives (Pierson, 1994), much of what Castles (2007, p.5) coined as "core expenditure" – essentially non-social expenditure – have already been squeezed under fiscal pressure from the past. Today's fiscal dynamics, however, are unlikely to be reversed by such measures as cutting defence spending or limiting waste in public administration. To the extent that much of what the public economy provides to its beneficiaries is under attack, understanding the electoral dynamics behind fiscal policy is essential for a broader account of the future of the democracy-capitalism nexus. More specifically, in times of fiscal strain, can incumbent governments employ the public budget for electoral purposes? How do they distribute the pains of austerity when cuts must be made? Does the electoral response to fiscal decisions follow from a straightforward

characterization of voters' exogenous preferences or are such preferences contingent and varying over time?

These are the broad questions that the essays in this thesis engage with. Building on a large body of literature on the broad relationship between fiscal policy and electoral politics, they enter various scholarly debates by simultaneously building on and challenging a number of past findings and theoretical propositions. Adopting a rational choice framework, the thesis will be built upon two major, overarching themes that travel across the essays. First, not only did the post-Golden Age era of advanced economies starting from the 1970s result in radical changes in the dominant economic paradigms of the day (Hall, 1989), it also implied a significant transformation in the way policy-makers (governments and political parties in office) and voters interact. Second, a number of important and seemingly straightforward propositions in political economy will be refined by introducing context-conditionalities (Franzese, 2007) in the way of such interaction. Fiscal policy decisions and fiscal considerations of the vote choice will be argued to depend on a number of conditions that vary over space and time.

The rest of the introduction to this thesis will run as follows. In section 2 I will discuss three separate research areas in political economy that my contributions build upon. Section 3 will motivate these contributions and outline their main arguments by highlighting some of the gaps, shortcomings or inconsistencies in existing research. Section 4 will discuss the common theoretical framework of the essays and their respective empirical research designs as well as data-related considerations in more detail. The final section of this introduction will provide some descriptive statistics on fiscal and electoral data to contextualize the essays that follow.

I.2. Three worlds of research on the budgeting-electoral politics nexus

Political budget cycles

Ever since fiscal policy's role in stabilizing economic activity by influencing aggregate demand gained traction among policy-makers during the post-war Keynesian era, political economists have suspected that governments are unlikely to follow the "Keynesian textbook" by consistently conducting counter-cyclical fiscal policies. The discovery of the Phillips Curve (Phillips, 1958) and the unemployment-inflation trade-off gave Keynesian-minded governments an all too tempting tool to exploit for political purposes. Following the stagflationary period of the 1970s and the rational expectations revolution in economics, discretionary fiscal policy fell out of favour; lags in fiscal policy (Friedman, 1953; Creel and Sawyer, 2008) the primacy of monetary policy – especially after the spread of independent central banks across the developed world eliminated the time-inconsistency problem in monetary policy (Kydland and Prescott, 1977) – and the general suspicion of government in the neoliberal era elevated automatic stabilization to the forefront of the new policy paradigm (Schelkle and Hassel, 2011). Yet, given the real rigidities in economies that new-Keynesian models have captured, governments still often departed from the passive role that Barro's tax-smoothing model (1979) relying on automatic stabilization ascribed to them. Fiscal policy remained a highly politicized tool in the hands of government to employ for re-election purposes.

During the Keynesian golden-age paradigm, these insights of opportunistic politicians employing fiscal policy to boost their re-election chances were first captured by political business cycle theory. Early theorists – Nordhaus (1975);Lindbeck (1976) – postulated adaptive expectations on the part of economic agents and opportunistic incentives on the part of incumbent governments. By engineering fiscal stimuli prior to the elections, the inflation surprise allowed governments to lower unemployment and increase growth that the electorate would presumably reward at the polls. While theoretically compelling and empirically plausible based on early evidence mainly from the US (Tufte, 1978) political business cycle theory suffered from an obvious

limitation: to the extent that fiscal illusion is ascribed to an electorate that fails to fully understand the future fiscal implication of current deficits (Alesina and Perotti, 1994, p.9), one was left wondering how long it would take before electorates start to decipher the rules of the game. Moreover, to the extent that expectations on inflationary policies get built in wage bargainers' and other economic agents' behaviour (Lucas, 1972), it would seem highly dubious that incumbents can systematically engineer economic expansions before elections.

Especially this second critique prompted the next generation of scholars to build political business cycle models that are consistent with rational expectations. Cukierman and Meltzer (1986), Rogoff and Sibert (1988), Rogoff (1990) and Persson and Tabellini (1990) put forward competence models in which asymmetric information between the electorate and incumbents on the latter's competence in running the economy/limiting waste in the budget process prompts incumbents to run expansionary fiscal policies in the pre-electoral period as a signalling device. The theoretical innovation of these second generation models is that they do not rely on a rather extreme form of voters' naivety to give rise to political business cycles. That said, the subsequent empirical scrutiny of political business cycle models produced far from conclusive results: the evidence provided by Alesina et al (1992; 1997) suggests that there is only weak, if any, link between real economic variables – GDP, disposable income, unemployment etc. – and the electoral timetable.

The weak empirical underpinnings of political business cycles did not distract scholarly attention from opportunistic motives of incumbent governments, however. As Alesina et al (1997) summarized the next empirical turn in political business cycle scholarship:

"Some policies, such as a tax cut or an increase in transfers may have a direct beneficial effect for the incumbent government at the polls. Thus, electoral manipulations of policy instruments could be observed even without any effect on the aggregate economy" (p.185)

Moreover, to the extent that the role of demand-management that had been assigned to fiscal policy in the Keynesian era was largely side-lined in the new economic paradigm, policy-makers gained a somewhat paradoxical leverage in employing fiscal policy for

re-election purposes. Freed from the task of stabilizing aggregate demand according to the turns of the business cycle, they could focus on the redistributive allocation of public goods and services for important electoral blocs.

Accordingly, the idea that the business cycle may or may not follow the electoral timetable hand in hand with fiscal aggregates gave rise to the notion of *political budget cycles.* Instead of focusing on economic aggregates, fiscal policy variables – government spending, taxation, deficits, change in debt levels etc. – became the key dependent variables in these works. Moreover, more attention was directed towards the "right-hand side" of the equation: which country groups (Brender and Drazen, 2005, Shi and Svensson, 2002, Block, 2002), what constitutional/electoral rules (Persson and Tabellini, 2003; Chang, 2008) what budgetary rules and institutions (Alt and Lassan, 2006, Rose, 2006; Wehner, 2010; Hallerberg et al; 2009) and what exchange regimes (Hallerberg et al, 2002) may give rise to larger/smaller political budget cycles. The vast array of context-conditionalities (Franzese and Jusko, 2005; Franzese, 2007) that this literature engaged with indicates that political budget cycles are far from universal, regularly occurring in some contexts but not in others. Most fundamentally, political budget cycles require a responsive electorate that reward politicians when they deliver the desired redistributive or economic outcomes. This is the next topic that I turn to.

Economic voting and the electoral response to fiscal policy

Just as government's opportunistic motives in economic policy-making inspired a large body of literature in political economy, the electoral consequences of economic outcomes have been studied at depth in the last 40 years. Since the early 1970s, political business cycles and economic voting have come into some sort of symbiosis under an apparently straightforward formulation. On the one hand, voters, beyond other admittedly important motives, such as class-identity (Evans, 2000; Evans and Tilly 2012), partisanship (Green et al, 1998; Pickup, 2010), post-material values (Inglehart, 1977) etc., systematically reward good economic performance at the polls. On the other hand, incumbents who recognize this electoral mechanism attempt to engineer favourable economic performance in the run-up to elections. Moreover, just as political budget cycle research resonated well with the reduced responsibility of governments for

economic performance in the post-Golden Age economic paradigm, scholars of economic voting came to realize that the electoral response to economics is more complicated than it may first appear.

The seemingly uncontroversial insight that a favourable economic landscape helps incumbents' re-election chances has long masked a number of controversies. Perhaps most fundamentally, the level at which economic voting should be studied marked a clear separation across contributions to the field. Initially, macro-level data relying on the vote share or the popularity rating of incumbent governments gave rise to the so-called vote-popularity function (see Nannestad and Paldam (1994) for an older and Lewis-Beck and Paldam (2000) for a more recent review) wherein economic voting was assessed. Numerous country-case studies (see Mueller (1970); Goodhart and Bhansali (1970); Lafay (1977); Kirchgassner (1985); Amor Bravo (1987) for a non-exhaustive list) followed by cross-national pooled studies (Bellucci and Lewis-Beck, 2011) investigated whether macroeconomic data (GDP growth, income growth, unemployment and inflation in particular) predict incumbents' electoral fortune accurately. The results were overall supportive of the notion that voters, on the aggregate, do reward politicians that deliver favourable economic outcomes. Which specific aspects of the macro-economy voters care about and the strength of the results across contexts (countries), however, differed a lot between the findings, giving rise to what Nannestad and Paldam (1994, p. 214) referred to as the "predicament of instability". In other words, the electoral response to economics seemed to be more complex than the simple reward-punishment hypothesis that motivated the earliest empirical studies (Key, 1966; Goodhart and Bhansali, 1970; Kramer, 1971).

In an attempt to disentangle the micro-logic between voting decisions and the economy, beginning from the 1980s scholars turned to the burgeoning collection of electoral surveys that asked voters their economic perceptions/evaluations and their vote choice. The turn towards the micro-level allowed scholars to address criticism referring to the ecological fallacy, whereby macro-level findings may erroneously suggest micro-level implications (Kramer, 1983). Similar to their macro-level counterparts, single-country studies (e.g. Fiorina, 1981; Kiewiet, 1983) followed by cross-national survey research (e.g. Lewis-Beck, 1988; Duch and Stevenson, 2008; Nadeau et al, 2012) confirmed that voters do indeed care about the state of the economy when casting their vote. More

specifically, retrospective evaluations of socio-tropic economic performance[1] proved rather strong predictors of the vote choice in most contexts. The differences in the strength of the link across national electoral contexts, however, remained.

The first seminal contribution that purported to address this instability is generally credited to Powell and Whitten's (1993) clarity of responsibility hypothesis. Constructing an additive index of institutional policy-making fragmentation for different governments[2], the authors find that where policy-making power is more concentrated and therefore the responsibility for economic outcomes is presumably higher, economic voting is stronger than in weak clarity of responsibility contexts. The underlying clarity of responsibility model was furthered developed by other authors (Whitten and Palmer, 1999 and Duch and Stevenson, 2008) who provided further evidence for the notion that voters do seem to distinguish between governments with different degrees of responsibility for economic outcomes. The apparent instability of economic voting across nations, therefore, appears to partly result from the fact that different electorates assign credit/blame differently depending on the institutional/political complexity of their political elites. That said, the clarity of responsibility model failed to address other important aspects of responsibility: even when they have a high degree of concentration in policy-making power, to what extent can governments steer the economy on its desired path?

This omission presented an inconvenient disjuncture between political budget cycle theory and economic voting research. While the shift in the former literature from economic outcomes to tools of demand management – fiscal policy in particular – reflected the diminishing influence of governments over the macro-economy, economic voting research continues to use macroeconomic indicators as the key dependent variable. Specifically, to the extent that the rise of non-electorally accountable decision-makers, such as independent central banks (Duch and Stevenson, 2008), the spread of globalization (Hellwig, 2001; Hellwig and Samuels, 2007) and a general emphasis on a non-activist government with regards to business cycle fluctuations have weakened the

[1] The retrospective vs. prospective and the ego-tropic vs. socio-tropic distinctions refer to the much-debated questions whether voters primarily assess past or future (expected) performance and whether they primarily care about their personal finances or the wider health of the economy , respectively.
[2] Specifically, the authors included the following aspects of policy-making fragmentation: bicameralism, minority status in legislature and coalition governments.

link between governments' domestic economic policies and economic outcomes, the economic voter should have less and less interest in the macro-economy per se when assessing incumbents' performance in office.

This recognition prompted a number of scholars outside the traditional economic voting literature to turn to fiscal variables' explanatory power over electoral fortunes. The default expectation given political budget cycles' continued relevance has been that the electorate, in the aggregate, rewards governments for expansionary fiscal policies. Most empirical findings[3], however, fail to validate this expectation. If anything, voters appear to be "fiscal conservative" to the extent that they punish incumbents for high deficits. Moreover, related studies on fiscal consolidation episodes where electoral punishment would appear to be the most likely have found no systematic punishment effects. By using large changes in the cyclically adjusted primary budgetary balance to identify adjustment episodes, Alesina et al (1998; 2011) find no systematic relationship between adjustment episodes and re-election prospects. The least evidence for any punishment effect is found exactly for those adjustments where the "most politically sensitive budget items" are tackled: transfers and the public wage bill (Alesina et al, 1998, p. 198). This finding is confirmed by Van Hagen et al's (2002) duration analysis on fiscal adjustments: episodes relying on spending cuts in these items tend to last longer than other types of adjustment, highlighting their relative political viability.

In a related manner, social policy research has undertaken similar investigations on the electoral consequences of welfare retrenchment. Since Paul Pierson's seminal works on the new politics of the welfare state (1994; 1996; 2001), social policy scholars have often highlighted the electoral dangers that welfare retrenchment may entail:

"Retrenchment entails a delicate effort either to transform programmatic change into an electorally attractive proposition, or, at the least, to minimize the political costs involved. Advocates of retrenchment must persuade wavering supporters that the price of reform is manageable – a task that a substantial public outcry makes almost impossible" (Pierson, 1996, p. 145)

[3] see Eslava, 2006 for an extensive review on single-case studies and cross-national empirical works as well as Brender and Drazen (2008) and Sattler et al (2010) for more recent contributions.

Yet, empirical research on this question reveals that only under certain circumstances do voters actually penalize welfare cutbacks. Armingeon and Giger (2008) and Giger (2010) show that retrenchment becomes electorally hazardous only if the opposition manage to increase its salience in the campaign. Schumacher et al (2013) find that only parties with a positive welfare-image lose votes when implementing welfare retrenchment in office. Giger and Nelson (2011) demonstrate that some parties (liberal and religious parties in particular) even gain votes after welfare retrenchment. The overall thrust of the welfare retrenchment literature thus complement empirical findings from the fiscal adjustment debate: contrary to what one would expect from the perspective of the economic voter, reining in deficits and public expenditure seems to have no clear implications for electoral fortunes.

As highlighted by some of the aforementioned works, partisanship is a highly relevant aspect of incumbents' electoral incentives. Perhaps nowhere is this more evident than in times of austerity when different socioeconomic groups' may have diametrically opposite interests towards the welfare state; to the extent that a trade-off must be found between fiscal sustainability, the tax burden and welfare generosity, welfare retrenchment, by its very nature, will be highly politicized, pitting different groups' welfare-related interests against each other. Since incumbent governments generally owe their governing mandate to and therefore represent different socioeconomic groups, the partisan identity of retrenching governments surely matters. This insight inspired the partisanship literature in welfare state studies, to which I will now turn.

The partisanship-welfare state nexus in times of austerity

Even before fiscal pressures on the welfare state started to dominate the academic agenda, partisan dynamics underlying fiscal policy-making had emerged as an important research paradigm. Douglas Hibb's seminal contribution (1977) on partisan macroeconomic cycles was the first complement – or one might say alternative – to the emerging political business cycle literature at the time. Recognizing that different partisan governments rely on different constituencies, Hibbs suggested that they should be preoccupied with fundamentally different policy goals. In particular, left-wing voters tend to be of lower socioeconomic status hence job security (ie. low unemployment)

should be their primary policy concern. By contrast, right-wing voters tend to be of higher socioeconomic status with relatively safe job-prospects and high savings; their major concern is thus price stability so that the real value of their savings is not eroded by inflation. Accordingly, Hibbs showed that during Democratic presidencies in the US, unemployment was lower than average, whereas Republican presidencies appeared to prioritize inflation control. Similar to the underlying inflation-unemployment trade-off in opportunistic political business cycle models, Hibb's formulation assumed that the US executive can easily choose its optimal point on the Phillips curve. In response to objections deriving from rational expectations, Alesina (1987) followed up with his rational partisan model where uncertainty regarding the partisan identity of the next administration – ie. the competitiveness of the electoral race – generates short-lived partisan cycles in macroeconomic outcomes.

Empirical evidence on significant partisan differences between macroeconomic outcomes has not been overwhelming, however (Alesina et al, 1997). That said, just like the political budget cycle literature recognized that regardless of its impact on the macro-economy the electoral timetable could still exert a sizeable impact on budgetary outcomes, partisan theory remained relevant as far as fiscal policy was concerned. Cusack (2001), for instance, shows that the left continued to attach priority to high-unemployment by conducting more aggressive counter-cyclical measures to fight it than the right. Moreover, as the accumulating debt burden in rich economies over the 1980s became a policy concern for all governments across the partisan spectrum, a number of scholars began to look at the partisan determinants of government response to this challenge. Specifically, the primary focus narrowed down on the largest and in many places the institutionally most resistant[4] part of the government budget: social security, or what we conventionally refer to as the welfare state. As mature welfare states entered the post-Golden Age era where public deficits were seen with increasing suspicion, the dominant scholarly expectation at a time was one of welfare state retrenchment; scholarly attention accordingly shifted towards whether partisan differences would play in a consistent way with partisan theory: would the political left (social democrats, labour and to some extent Christian democrats as well) remain the defender of the

[4] As many welfare programmes, such as public pensions, sick pay, unemployment benefits etc. take the form of legislated entitlements often under the control of the social partners, they are more resistant to change than discretionary fiscal measures that governments can employ at will.

welfare state even as the right (conservatives and liberals) are trying to shrink it down to size?

The partisan roots of the welfare state were first captured by the power resource approach. Power resource theory (Korpi, 1983; 2006) argued that the historical and organizational dominance of the labour movement through trade unions and social-democratic parties endowed it with sufficient power resources to impose their preferences on employers by extending social insurance to the socially vulnerable groups of the population[5]. Variation in labour strength gave rise to distinct worlds of welfare-capitalism (Esping-Andersen, 1990) with varying degrees of decommodification of the labour force. To the extent that welfare retrenchment aims at partially reversing these trends, left-wing partisanship, according to this "old-politics"/power-resource approach should be conducive to higher resistance to welfare cuts. Empirical evidence for this perspective has been provided by a voluminous literature including such seminal contributions as Korpi and Palme (2003), Allan and Scruggs (2004), Swank (2005), among others. Relying on direct measures of retrenchment efforts by looking at changes in the program parameters as opposed to social security spending[6], the overall message of these works is that the left, on the balance, has been relatively successful at halting welfare retrenchment compared to the right.

A number of other welfare state studies challenged these findings, however. Inspired by the surprising resilience of the welfare-state during conservative ascendency in a number of important countries during the 1980s – notably, the US, the UK and Germany – Paul Pierson (1994; 1996; 2001) argued that the politics of retrenchment is qualitatively different from the era of welfare expansion. In particular, welfare programmes have created their own clienteles who are prepared to defend the welfare state; as dismantling welfare programmes imposes concentrated costs in exchange for dispersed and uncertain benefits in the future, no partisan government should have an electoral incentive to launch radical attacks on them. This prediction on diminishing partisan differences in the era of "permanent austerity" was confirmed by the empirical works of Huber and Stephens (2001) and Kittel and Obinger (2003). According to this

[5] However, see Swenson (1991) and Hall and Soskice (2001) for an alternative, firm-centred account.
[6] See Green-Pedersen (2004) for a detailed discussion of the "dependent variable problem".

New Politics perspective, therefore, the conventional understanding of partisanship with regards to welfare outcomes needs profound reconsideration.

One particular source of such reconsideration has been offered by yet another school of welfare state studies. Formal modellers have been long interested in unexpected partisan dynamics in various policy domains. Inspired by Richard Nixon's unexpected overture towards Maoist China in a historical turn of US foreign policy, these models (Cukierman and Tomassi, 1998; Cowen and Sutter, 1998) provide theoretical intuitions why these unexpected political actions may occur. The underlying idea of welfare credibility and trust prompted Ross (2000) to apply these insights in the welfare state domain by arguing that left-wing governments are better situated to inflict pain on their "natural" constituencies through welfare reform. In a related argument, Levy (1999) shows how left-wing governments managed to undertake welfare reform in Christian-democratic welfare regimes by highlighting some of the inequities that the regime had produced over several decades. Moreover, in his comparative work on social policy reform, Kitschelt (2001) likewise emphasized welfare-credibility of opposition parties as an important condition for the political viability of welfare retrenchment. These perspectives share the notion that welfare retrenchment is more than a static policy-choice that incumbent governments choose either voluntarily or under serious problem pressures on the welfare state[7]. Whether they are able to do so may largely depend on their welfare credibility that they had accumulated over the past.

This plethora of perspectives on the partisanship-welfare state debate has greatly enriched our understanding of a number of issues relevant for welfare state research. Amidst the cacophony of often conflicting empirical evidence, however, we still lack a coherent account of the partisan dynamics driving welfare state retrenchment. Just like important issues remained unsettled on the political budget cycle-economic voting relationship, the partisanship-welfare state nexus needs further refinement. The following section will provide a summary of my essays that contribute to these debates.

[7] Various sources of these pressures include globalization (Swank and Steinmo, 2002), deindustrialization (Iversen and Cusack, 2000) and demographic changes (Huber and Stephens, 2001)

I.3. Summary of main findings

Even as the role of fiscal policy in dampening business cycles has diminished in the post-Golden Age paradigm, its politicization for redistributive means has arguably increased. In fact, as the discussion above has shown, various constituencies' demands on fiscal redistribution have been widely acknowledged to push governments to spend beyond their means, resulting in debt accumulation over time. These demands lie at the heart of political budget cycle theory in that the proximity of elections increases the pressure on governments to run higher deficits in an attempt to cater for different constituencies. The political economy of fiscal policy has accordingly established a broad link between the electoral influence of these constituencies and debt. In fragmented political settings where multiple parties in government represent a large number of constituencies, the common pool of fiscal resources is likely to result in higher debt accumulation over time (Roubini and Sachs, 1989; Von Hagen, 1992; Kontopoulous and Perotti, 2002; Wehner 2010) and delays in fiscal adjustment (Alesina and Drazen, 1991). To the extent that this pressure is expected to increase with the proximity to elections, such multiple settings are expected to increase political budget cycles as well; not only do governments want to open up the purse in their bid for re-election, but they also have to satisfy multiple constituencies' demands at the same time to do so.

While theoretically compelling, this perspective ignores another important aspect of intra-governmental dynamics. Coalition partners in multi-party governments – who often represent distinct constituencies with specific programmatic demands on the public budget – are not merely additional actors who vie for the common pool of fiscal resources failing to internalize the cost it entails for the whole community, as the common pool approach suggests. They are also veto players in the budget process (Tsebelis, 2002; Tsebelis and Chang, 2004) with whom other coalition members need to bargain to agree on the aggregate budget. Moreover, their electoral incentives may run counter to other coalition partners' incentives, especially if the latter are seen to derive disproportionate electoral benefits from a proposed budget plan. The electoral competition between these coalition partners could thus moderate, rather than increase

political budget cycles, contrary to what a common pool-based perspective would predict.

The first essay in this thesis explicitly incorporates the bargaining power of coalition partners in a political budget cycle framework. In line with previous findings that have shown that electoral systems are important conditioning factors of political budget cycles (Persson and Tabellini, 2003, Chang, 2008), I will argue that it is the government structures that different electoral systems are bound to give rise to that are the primary determinants of the magnitude of the cycle. In particular, single-party governments that are unhindered by coalition members to draft their pre-electoral budgets will be shown to display higher propensities to electioneer. Moreover, power-distribution in coalition settings is another important determinant of political budget cycles. The essay will show that in contexts where the two most important cabinet players in the budget process – the prime minister and the finance minister - are delegated by the same party still experience budget cycles, albeit smaller ones that single-party settings. However, when one of the coalition members is strong enough to delegate one of the two important actors to government, intra-governmental bargaining will eliminate budget cycles.

The second essay is motivated by the "demand-side" of the budgeting-electoral politics nexus. As highlighted above, economic voting has been an important complement to political budget cycles in this regard; the major motivation for election-induced fiscal expansion is a responsive electorate that rewards favourable economic outcomes and distributional benefits – public goods, social insurance, public employment etc. – delivered by governments. However, a major shortcoming of economic voting research is that it continues to assume an electorate which attributes a high degree of responsibility to governments for domestic economic outcomes. While it is ultimately an empirical issue what aspect of the economy voters credit/blame governments for, it is theoretically compelling to assume that rational voters would come to recognize the diminishing importance of domestic economic policies over macroeconomic outcomes in an era of international interdependence (Hellwig and Samuels, 2007), central bank independence and a generally non-activist fiscal-policy paradigm. Although varying degrees of responsibility attribution depending on institutional and partisan fragmentation have been noted, the underlying link in economic voting research is still

the one between macroeconomic outcomes and the micro-level vote choice. In other words, economic voting failed to reflect on the theoretical turn in political budget cycle theory from macroeconomic to budgetary outcomes as the chief object of investigation.

To the extent that the aggregate electoral response to fiscal decisions has been studied, the findings, summarized above, have been inconclusive. What my second essay aims to achieve is to bring the study of the electoral response to fiscal policy closer to the economic voting paradigm whereby fiscal variables will be added to the "usual suspects" in the vote-popularity function: macroeconomic variables and political/partisan controls. In particular, I will theorize that "fiscal voting" and economic voting interact to give rise to a systematic electoral pattern on the aggregate level. More precisely, I will show that the changing state of the business cycle re-aligns the redistributive preferences of the electoral space, which makes the electoral response to fiscal decisions conditional on the economy. In other words, as will be empirically illustrated in a high clarity of responsibility context such as the United Kingdom, it is neither macroeconomic outcomes per se, nor fiscal variables by themselves that explain aggregate-level electoral results; rather it is the interaction between policy choices and economic conditions that predict the electoral fate of incumbent governments.

The main contribution of this essay will be an extension of the clarity of responsibility thesis. While governments' responsibility for delivering economic benefits has surely weakened in recent decades, fiscal policy continues to be an important tool in the hands of incumbents to provide public or private goods to their constituencies. Redistributive benefits in particular are expected to have a high political salience as they pit different income groups' interest against each other. High salience coupled with the governments' continued influence over the delivery of these benefits and the tax burden/ debt issuance to finance them is thus likely to generate intense debates over government policy. Consequently, putting the emphasis on fiscal policy choices rather than macroeconomic variables as the chief target of responsibility attribution is an important contribution to economic voting research.

While the previous contributions rely only implicitly on different constituencies as the main driving forces of budgetary outcomes and voting decisions, the third and final essay will address constituencies' heterogeneity explicitly from the perspective of

partisan theory. The main motivation behind this contribution is the welfare retrenchment-partisanship debate which has produced a number of often conflicting predictions and empirical results over the last decades (see previous discussion). My starting point will be the New Politics literature's notion of "permanent austerity" (Pierson, 1994, 1996, 1998) which has created intense pressures on governments to prioritize cost-containment in their welfare reform agenda (Pierson, 2001). I will theorize that in contrast to cross-class alliances (Swenson, 2002) that characterized the era of welfare state expansion, "permanent austerity" implies a zero-sum game where the preservation (or further expansion) of certain social programmes must imply significant cuts in other programmes. Consequently, different constituencies' interest regarding specific welfare programmes will be polarized, presenting governments with an unprecedented electoral challenge to balance between the opposing interests.

Incorporating the notion of credibility and trust of different political parties vis-à-vis their commitment to different constituencies and welfare programmes, the main argument of the third essay can be summarized as follows. To the extent that some parties enjoy higher credibility among certain social groups, they have an electoral advantage to reform (cut) the very programmes that these groups – what I will refer to as their core constituencies – are most prepared to defend. Following a vote-maximization strategy, these parties will therefore attempt to shift the burden of "permanent austerity" on their core constituencies and pursue a relatively pro-welfare strategy vis-à-vis other programmes whose beneficiaries they need to sway over to preserve/increase their vote share. My empirical results will show that such strategy is especially pronounced for two important voting blocs that are the main beneficiaries of the welfare state: the pensioner population and low-skilled workers. During the sample period, on average, parties that are relatively well-positioned among the pensioners and low-skilled workers have systematically cut public pensions and programmes catering for the working-age – unemployment programmes, active labour market policies, sick pay etc. – respectively. In times of less budgetary stress, however, this pattern reverses and parties reward their core constituencies. This is consistent with the notion that it is the electoral perception of austerity that allows governments to embark on a Nixon-goes-to-China strategy (Ross, 2000) when distributing the pain of austerity.

In addition to providing the first systematic quantitative evidence on Nixon-goes-to-China strategies, my essay will be an important contribution to partisan theory because of another consideration as well. The traditional partisanship literature, as a rule, has relied on party families to identify which parties represent which constituencies among the electorate. I will argue, by contrast, that the analytical value of party families has been losing relevance in an era of electoral de-alignment (Dalton and Wattenberg, 2002) so it is important to look at the specific constellation of constituencies around different political parties. The main measure I will employ in this study (see the next section for more detailed discussion) relies on group-specific voting patterns assembled from a vast number of electoral surveys. I will argue that such an approach would be a welcome improvement in future partisanship research as well.

I.4. Research design, methodology, data and measurement

As mentioned earlier, the general conceptual framework I adopt for my thesis is one of rational choice. Differently put, my implicit assumption that runs through the essays is that actors (political parties in essay I and III and voters in essay II) make decisions that maximize their utility. For political parties in office, utility-maximization will be understood by vote-maximization which also maximizes incumbents' chances to remain in office after the next general elections. Other motives, such as policy-seeking behaviour (Benoit and Laver, 2006) will thus be relegated to a secondary role in this framework. For voters, in turn, utility-maximization will imply the support of policies which best conform to voters' material/redistributive interest. Again, alternative voting motivations will be only implicitly addressed. For instance, the notion of welfare-credibility that essay III builds upon implies that groups of voters react to welfare decisions differently under different partisan governments. That said, the underlying motive is still one of utility-maximization in terms of expected welfare outcomes. My rational choice framework thus situates my thesis among Peter Hall's "three i's" (Hall and Taylor, 1996) in a straightforward manner. While economic and political institutions and the evolution of ideas have been surely important determinants of budgetary outcomes and electoral dynamics, my thesis favours an interest-based

explanation. These interests are material/redistributive interests for voters and power (being and staying in office) for political parties. These interests will be captured by formal utility/vote-functions for political parties (essay I and III) and a stylized mapping of cost-benefit calculation of the British electorate in response to government spending decisions (essay II).

Turning to my empirical design, I largely followed the comparative political economy literature by adopting a cross-national, quantitative framework. The main motivation was to allow for the greatest possible degree of generalization given the scope conditions of the respective theories. Specifically, electoral considerations of budgeting presuppose democratic accountability, electoral competition and significant risks for incumbents to lose office. The scope conditions are thus delimited by what one normally considers as the universe of "established" electoral democracies. The EU sample in essay I can thus be regarded as representative of this universe with an important caveat: to the extent that coalition dynamics in the executive branch are unique features of parliamentary forms of government, sample restriction to EU member states is justified by the parliamentary form of government that predominates in this country group (unlike Latin-American democracies for instance). Essay III, by contrast, incorporates a wider universe of OECD countries where periodic fiscal adjustment efforts had to be implemented over the last four decades. Finally, essay II is somewhat of an exception in my empirical design in that it focuses on a single case, albeit still in a quantitative framework. A single-case study as opposed to a cross-national design allows me to situate the essay in the clarity of responsibility thesis: my case selection was driven by the highest possible degree of institutional clarity of responsibility where voters have a clear view on whom to credit/blame for redistributive/fiscal outcomes (a more detailed discussion of case selection will be offered in essay II)

With these general considerations in mind, a brief discussion of my quantitative empirical design is in order. As it has become a sort of standard in comparative political economy/comparative politics, I will largely rely on the toolkit of time-series and time-series cross-section (TSCS) analysis for my three essays. More specifically, essay I and III will test the theoretical arguments in a TSCS framework with EU (essay I) and OECD (essay III) member states being the units of analysis, measured over two to four

decades yielding an unbalanced panel of 400-600 country-year observations. While the specifics of estimation issues will be discussed at more length in each respective paper, the general strategy was to rely on the Beck and Katz standard (Beck and Katz, 1995, Beck, 2001) by running OLS regressions on the panels and addressing the violations of the Gauss-Markov assumptions (Kittel, 1999) in various ways. More specifically, where serial correlation has been detected, lagged dependent variables were introduced which also allowed me to pick up dynamics in the dependent variables' response to changes in the main independent variables of interest. Panel-heteroskedasticity and cross-sectional correlation were corrected by panel-corrected standard errors. Unit- and time-specific dummies (fixed effects) to account for unobserved unit- or time-specific variables were introduced when needed. Essay II's aggregate-level analysis was conducted in a time-series framework relying on the Box-Jenkins (ARIMA) methodology (Enders, 2004). As all three main arguments in the essays put forward conditional hypotheses, most of the estimated models relied on interaction effects; beyond the standard tools of regression output tables, I will also exploit the visual power of marginal effects plots as convincingly recommended by Brambor et al (2006).

The main data sources for my empirical analysis are fairly standard for cross-national research. For essay I, fiscal variables were obtained from the European Commission's general government database which collects annual budgetary data according to the standardized Maastricht (ESA 95) methodology. Political data – government types – were obtained from the European Journal of Political Research's annual data yearbook and its corresponding *parlgov* database. Electoral indicators (date and circumstances of elections) were drawn from the Interparliamentary Union's *parline* database. Finally, macroeconomic and structural control variables were primarily obtained from the OECD i.library's database, complemented by IMF and Eurostat when needed.

For essay II, which uses quarterly vote intention data among the British electorate as the main dependent variable, I relied on Ipsos-Mori's monthly survey which provides one of the longest publicly available time-series among British polling firms. Instead of general government data, the main fiscal variable I used here was discretionary spending, obtained from the Treasury's online databases on a quarterly basis. The second part of essay II which analyses the changing tax-spending preferences of

different income groups among the British electorate, I relied on post-election surveys conducted by the British Election Studies series.

For essay III, the main dependent variable of interest was welfare spending on pre-specified constituencies. These were obtained from the OECD's social expenditure dataset which disaggregates welfare spending into various categories. Parties' support base among the constituencies were calculated from moving averages of group-specific support for different political parties, estimated by the Eurobarometer 's and the International Social Survey Program's (ISSP) annual surveys. Fiscal adjustment episodes were identified by changes in the cyclically adjusted primary balance of the general government. These figures were obtained from the OECD's economic outlook database. Finally, control variables were obtained similarly to essay I: OECD i.library being the primary source, complemented by other cross-national databases (IMF, Eurostat etc.) when necessary.

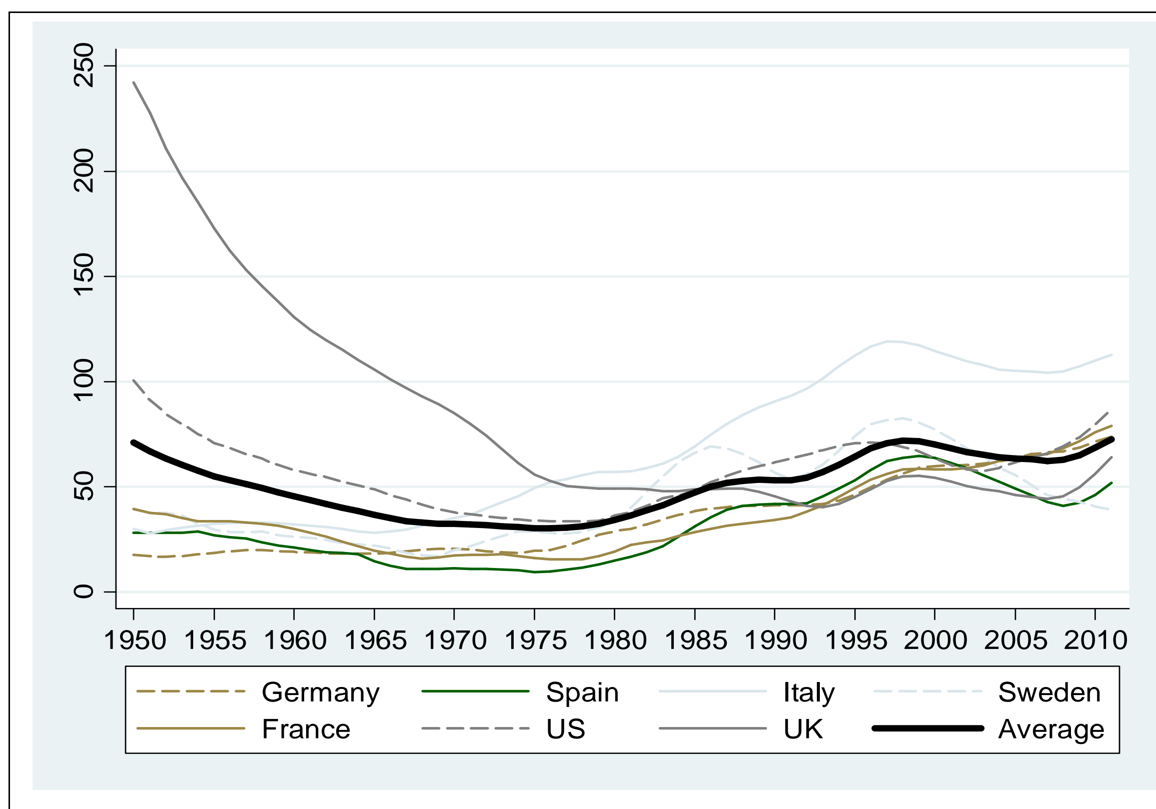
I.5. Setting the scene: fiscal outcomes and electoral competition over the study period

The final section of this introduction will lay out the broad context for the underlying fiscal and electoral developments during the period under study for this thesis: beginning from the early 1970s until the time of writing. In particular, I will select seven OECD countries that are representative of the "universe of cases" that the essays engage with. The first criterion for this selection was size or "importance" in terms of economic power; the second criterion was variation with regards to size of government and production/welfare regime-type (Hall and Soskice, 2001; Esping-Andersen, 1990). Post-communist OECD countries were excluded from this descriptive analysis for their lack of data availability prior to regime change. Accordingly, the following descriptive statistics will trace fiscal and electoral developments in France, Germany, Italy, Spain, Sweden, the UK and the US.

As argued before, political considerations behind fiscal decisions are of paramount importance for understanding budgetary developments in recent decades. As a first tentative illustration of these political influences, it is informative to compare fiscal developments to a pure "Keynesian" benchmark where the fiscal balance is broadly stable around the business cycle: governments react to downturns by running deficits but make up for the fiscal shortfall during economic booms (Barro, 1979). Under this benchmark, debt-levels as a ratio of GDP should be more or less stable over a long-enough window of analysis. A secular rise in the debt ratio, by contrast, should indicate that governments conduct fiscal policy under a deficit bias (Alesina and Tabellini, 1990; Krogstrup and Wyplosz, 2010), failing to fully correct deficits in the long-run. Figure I.1 depicts the long-run evolution of the gross general government debt ratio since the beginning of the Keynesian era[8].

Figure I.1:

The evolution of debt ratios (5-year moving average of gross outstanding debt/GDP, %) in 7 OECD economies in the post-war period.



Source: IMF Historical Public Debt database

[8] To obtain comparable and long time series on debt ratios, I used the IMF's recently published historical public debt database. I smoothed annual fluctuations of debt ratios due to business cycle effects by calculating 5-year moving averages for all series.

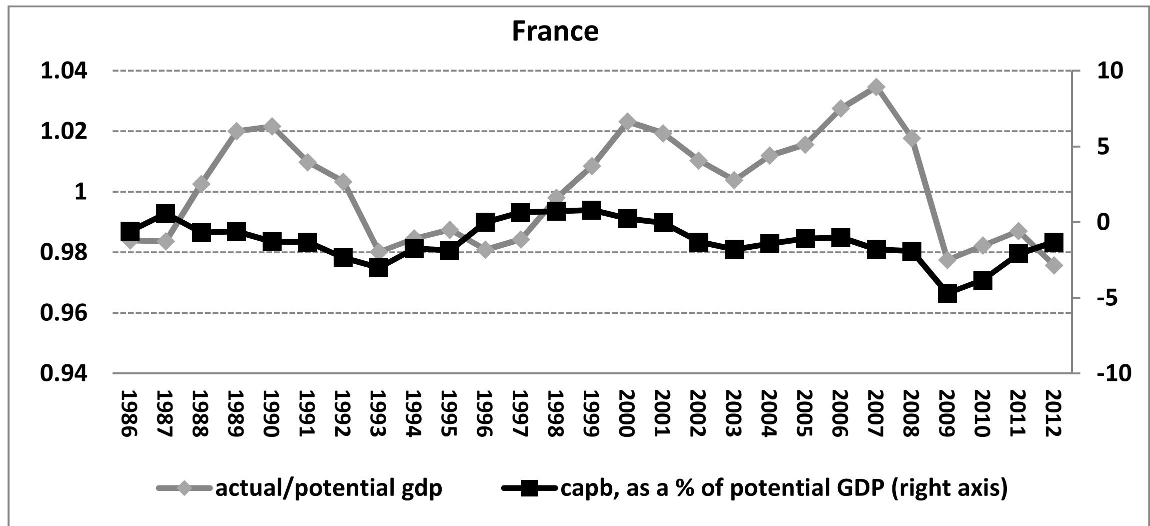
As evident from the chart, debt ratios have been anything but stable over the post-war decades. The Keynesian era saw a gradual reduction of average debt levels, which had been historically at their peak in various countries over the war years, notably in the US and especially in the UK. High growth in the Keynesian golden age allowed governments to reduce debt levels even as the scope of government continued to expand. By the late 1970s, however, the tide began to turn and debt levels began their secular rise, interspersed with periodic consolidations efforts (for example in Sweden Italy, Spain and the UK in the late 1990s and early 2000s etc.) Rising debt in the post-Golden Age period thus presented governments with periodic pressures to put their public finances in order, making this era qualitatively distinct from the previous golden-age boom years where debt-reduction almost automatically followed from the proceeds of high growth rates. Most importantly, however, the thick black line indicates the average evolution of public debt ratios, clearly pointing towards an increasing trend since the late 1970s, the period that this thesis focuses on. It appears therefore that as fiscal policy fell out of favour as a powerful tool of counter-cyclical demand management, political pressures have been pushing debt levels up in the last four decades.

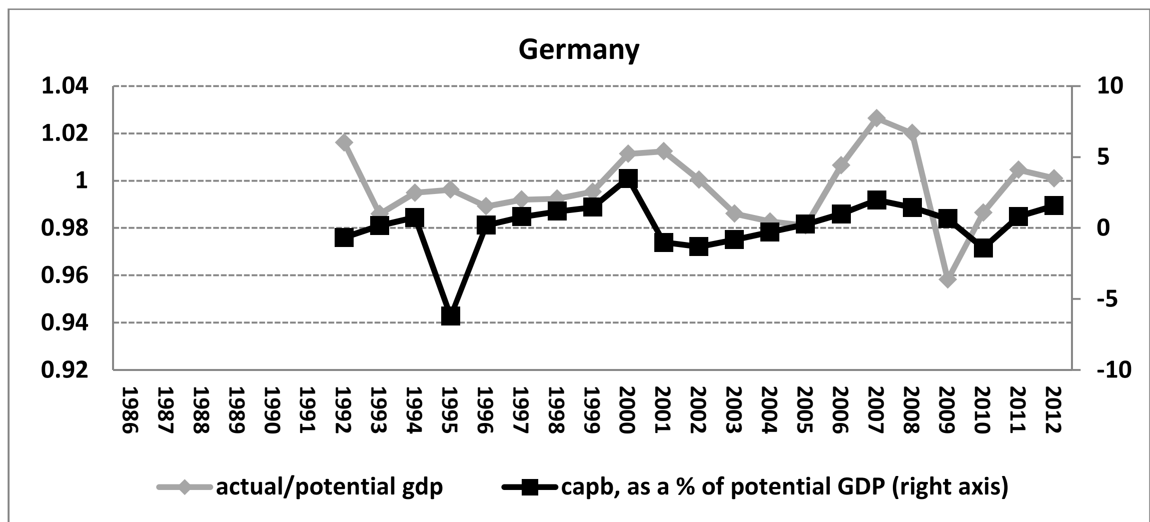
An alternative way to evaluate the extent to which governments have conformed to counter-cyclicality is to compare the cyclically adjusted primary balance to the output gap (the deviation of actual GDP from potential GDP). The cyclically adjusted primary balance (capb) allows one to gauge governments' discretionary actions because this measure filters out the automatic effects of the business cycle (falling tax revenues and increasing social outlays during recessions). A pure "Keynesian" government would run deficits in the capb when actual output is temporarily below its potential and compensate by surpluses when output is above potential to avert overheating and inflationary pressures. Figure I.2 depicts the relative evolution of the capb and the output gap in the selected economies.[9]

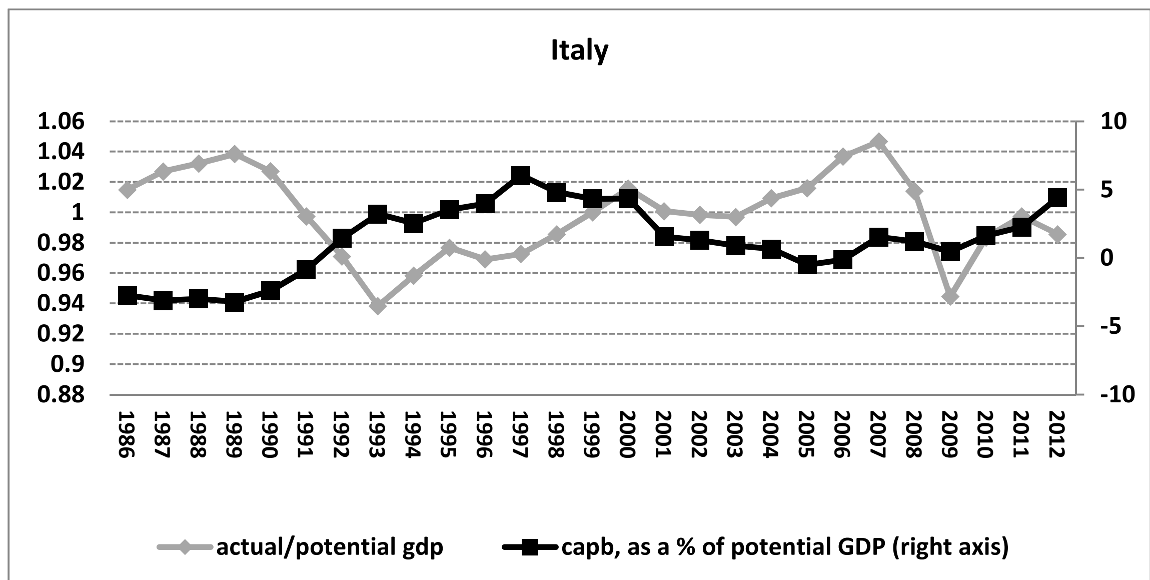
[9] Updated data for cyclical adjustment are available only from the mid-1980s (and early 1990s for Germany). Instead of the output gap, defined by actual GDP minus potential GDP, I use the ratio between the two. Therefore, when the ratio is 1, it indicates an economy that is running at its full potential; when it is below, the economy is in a cyclical downturn; when it is above 1, the economy is running into supply-side constraints and inflationary pressures.

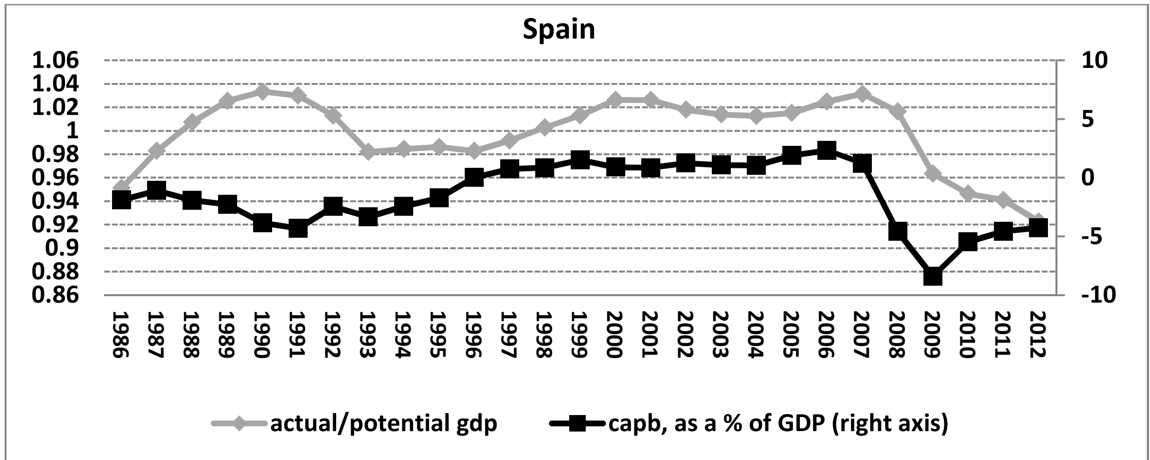
Figure I.2

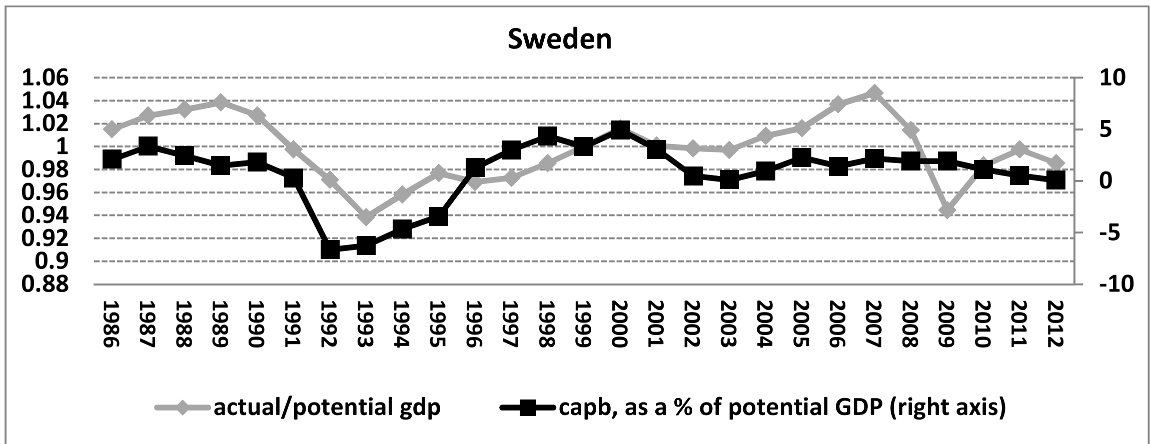
The evolution of the cyclically adjusted balance and the actual GDP/potential GDP ratio over the study period








Spain
1.06
1.04
1.02
1
0.98
0.96
0.94
0.92
0.9
0.88
0.86
10
5
0
-5
-10
1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012
actual/potential gdp
capb, as a % of GDP (right axis)


Sweden
1.06
1.04
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1
0.98
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0.9
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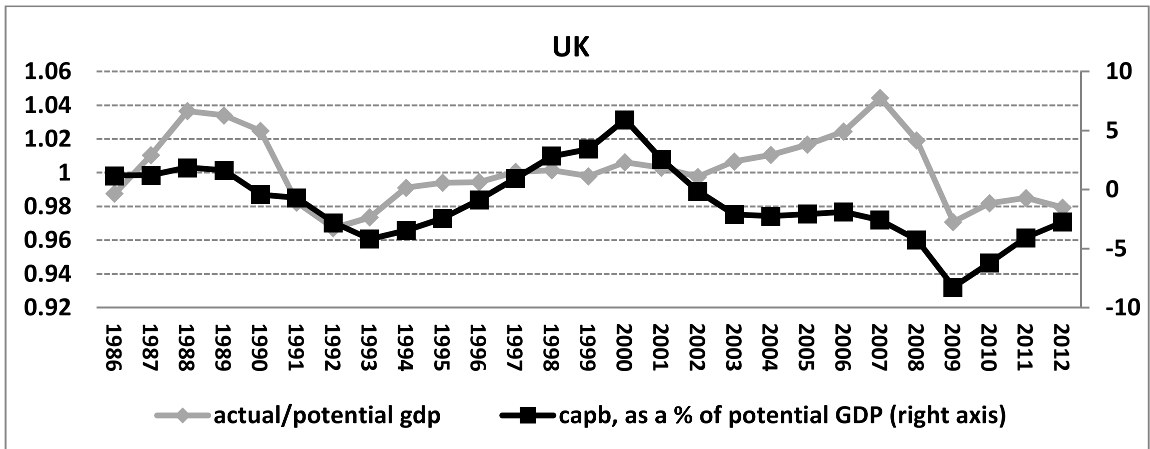
1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012
actual/potential gdp
capb, as a % of potential GDP (right axis)


UK
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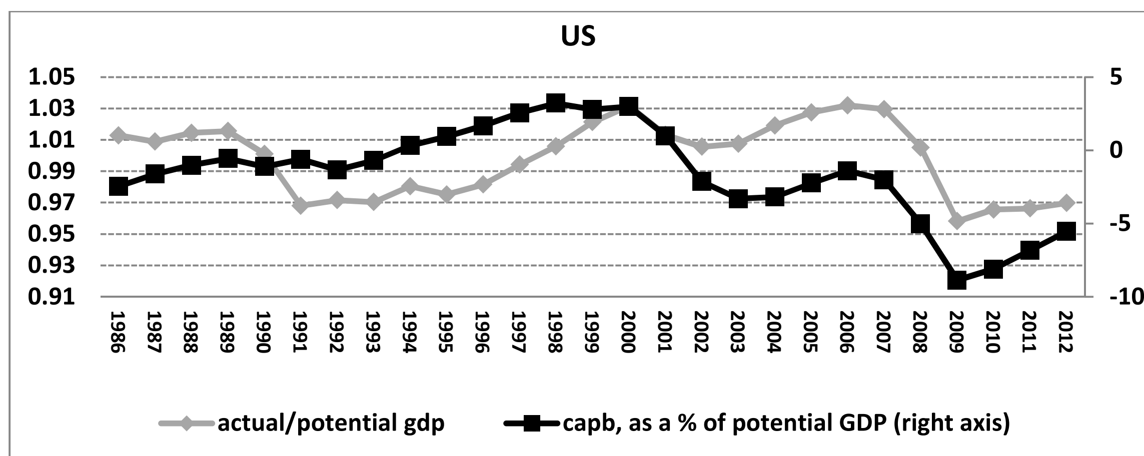
1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012
actual/potential gdp
capb, as a % of potential GDP (right axis)



Source: OECD Economic Outlook database no. 93

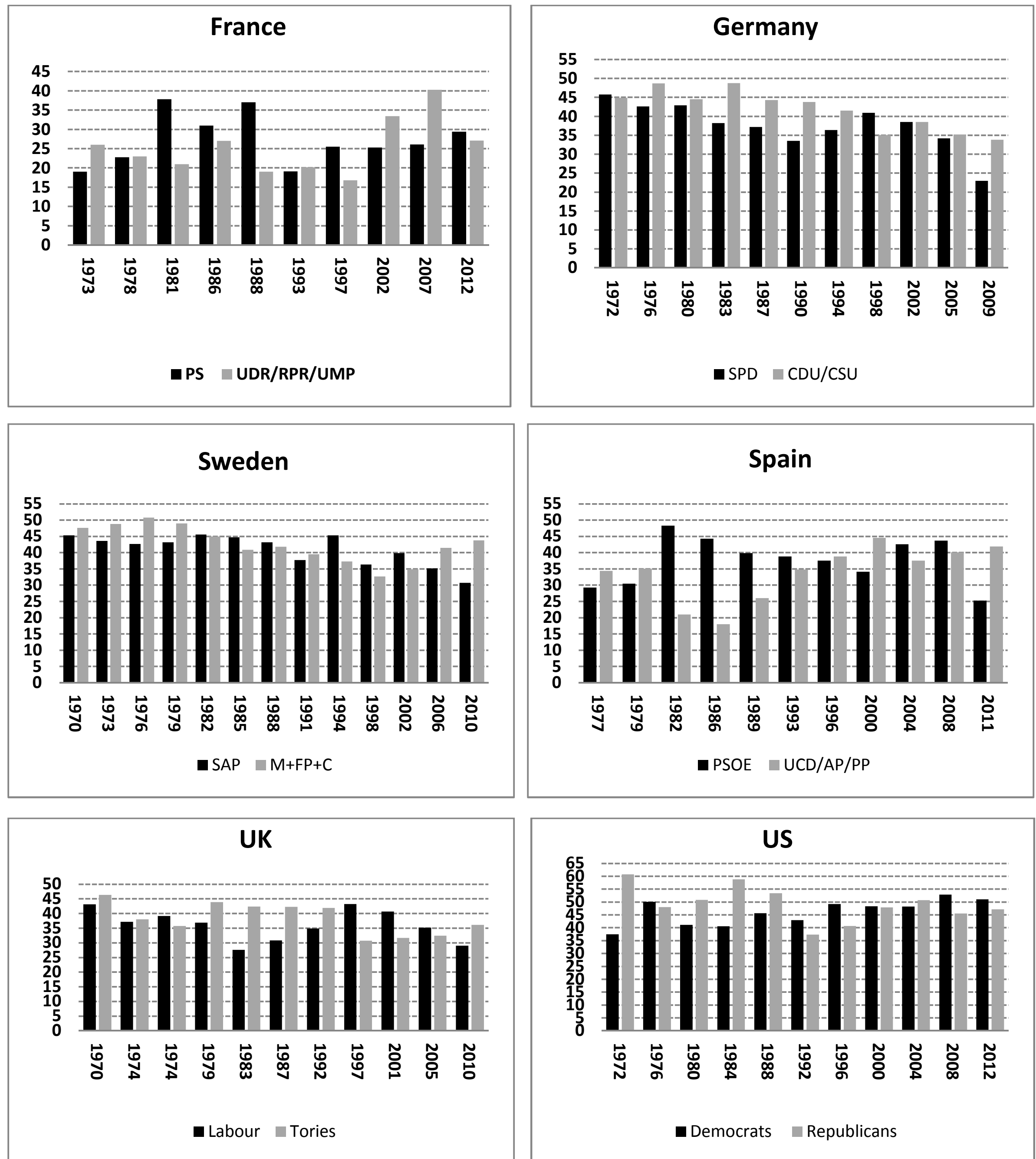
The picture, in this regard, is somewhat mixed. There are many instances in which the relative evolution of the two measures conforms to the "Keynesian recipe". For instance, the parallel movement between the output gap and the capb in the late 1980s/early 1990s in Sweden or since the recession in the early 2000s in the US indicate such counter-cyclical policy-making. However, there are clear instances for the opposite as well. During much of the last decade, for instance, the UK economy has been running above its potential thanks to the housing and credit boom and the government did little to lean against the wind: the capb has been constantly in the negative territory. There are a number of other instances for opposite movement between the output gap and the capb in Italy, Spain and France. It seems therefore that considerations other than counter-cyclical discretionary policy have been on the minds of policy-makers. The first essay will investigate whether electoral considerations can partly account for these developments across different government types in the EU.

Electoral motivations for budgeting presuppose a competitive electoral scene, however. To the extent that governments feel relatively secure in their seats, electoral pressure is unlikely to account for the deviation of fiscal policy-making from its optimum path. Two aspects of electoral outcomes are important determinants for the competitiveness of the electoral scene: relative proximity of competing parties/blocs in terms of electoral support and regular turnover in power. Figure I.3 provides a snapshot of whether the

selected countries satisfy these criteria and hence governments are likely to use fiscal policy-making for electoral purposes.[10]

Figure I.3

Electoral outcomes in terms of national vote share (in %) in the selected countries



Source: Parlgov database

[10] Italy was omitted from this comparison because of the radical transformation of its party-scene in the middle of the study period, making the identification of the two main competing parties/blocs difficult; for the US, only presidential elections were considered as the focus of this thesis is the government, i.e. the executive branch.

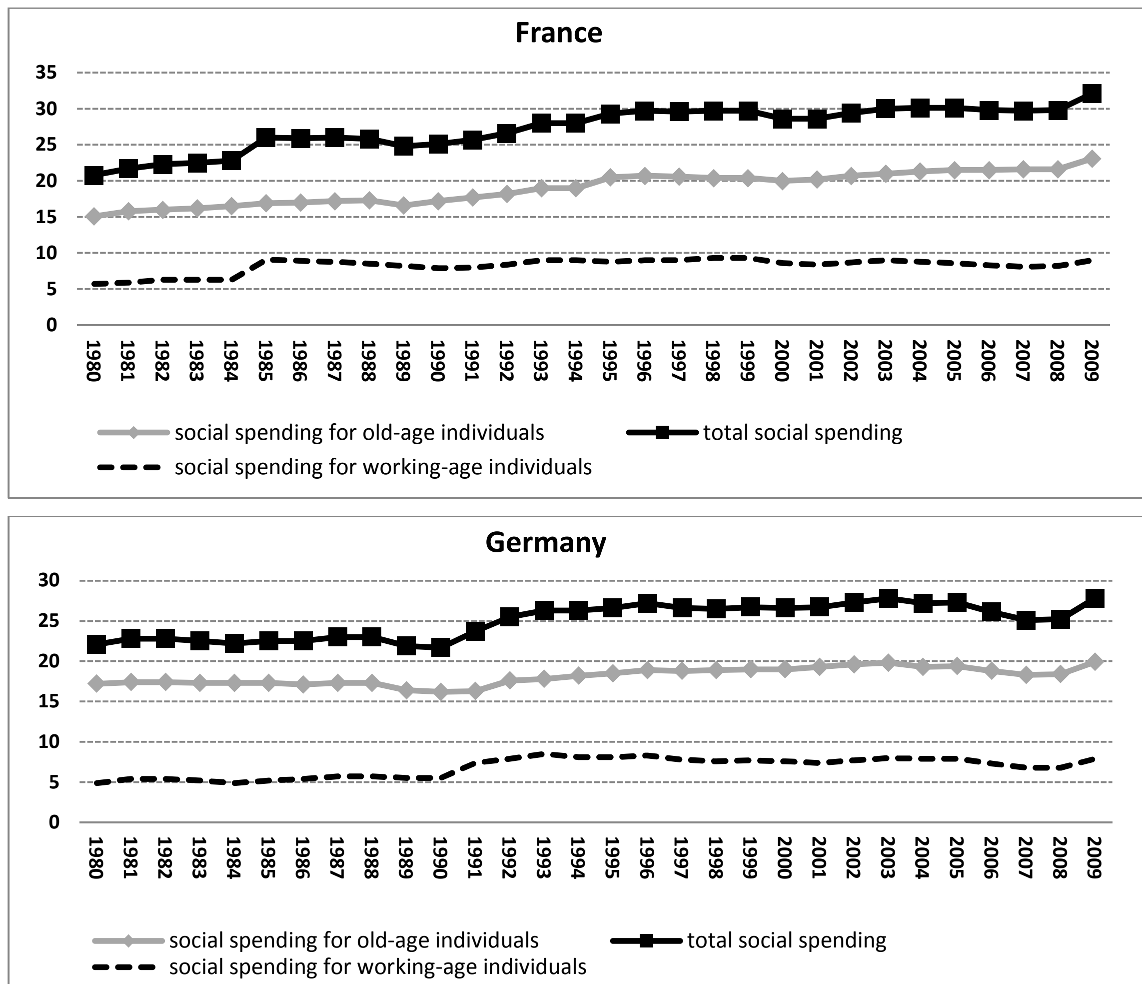
In all six countries, the vote share of the main left-wing, social-democratic party (black column) is compared to its right-wing rival – or block of rivals if they regularly form coalitions together as in Sweden – (grey column). The relative power between the two camps, over the study period, is roughly equal. The average left-right margin over 10-12 elections ranges between -4.17 % in Germany to 3.83% in Spain. While the study period witnessed some landslides, such as the Spanish PSOE's – led by Felipe Gonzalez – two consecutive victories over its conservative rival in 1982 and 1986, extremely tight elections outnumber these landslides. Some of these neck-and-neck elections are well-known (such as George Bush Jr's victory over Al Gore in 2000), others are less so: the vote share of the German SPD and the CDU/CSU list in 2002, for example, were almost identical; the margin of victory of the French Gaullists over the left-wing socialists in 1978 was below 1% of the national vote, just like the Swedish social-democrats victory over the bourgeois coalition in 1982 and the British Conservative Party's victory over Labour in 1974. Surely, the translation of national vote shares to parliamentary seat shares (or Electoral College votes in the US) is less than straightforward in many electoral systems but the overall pattern is clear: the electoral race in these selected countries have been very competitive with frequent alternation in power between the two camps. The fate of incumbent governments can thus hinge on as little or less than 1% of the national vote, which implies that they are likely to attempt to sway over undecided voters by providing redistributive benefits. How the electorate responds to these attempts will be the subject of the second essay in the context of the United Kingdom.

Amidst such competitive electoral landscape, painful budgeting decisions have been taken, however. In particular, the welfare state, often considered as the most popular spending item in the overall government budget, has long been subject to debates on affordability and cost-containment (Pierson, 2002). To the extent that welfare programmes typically target different constituencies, the partisan colour of incumbent governments is expected to be an important determinant of retrenchment efforts. Essay III will take up this task by distinguishing between welfare programmes that primarily cater for the elderly and those that target (low-status) working-age individuals. Figure I.4 below shows the evolution of welfare spending (as a % of GDP) for the two types of

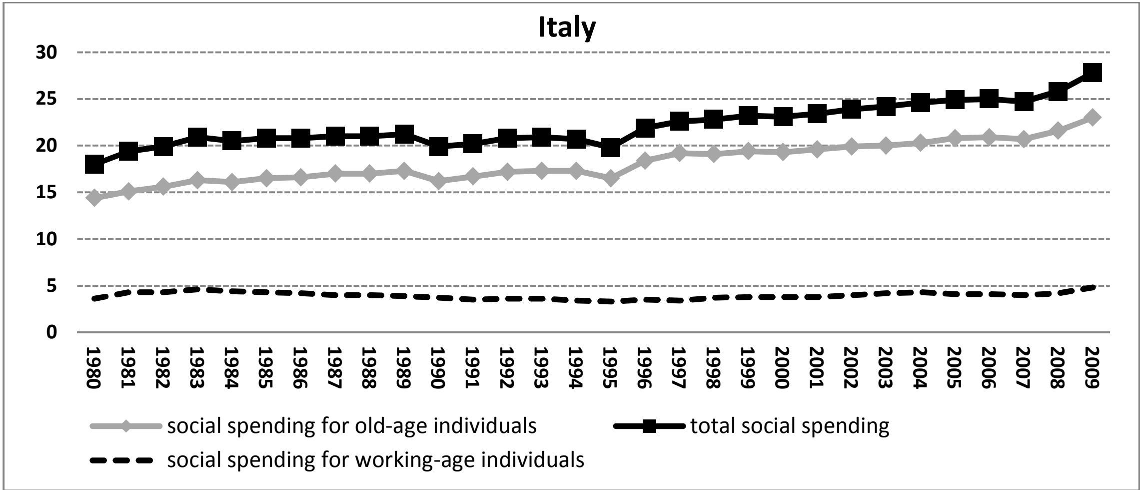
welfare programmes. In particular, programmes targeting the elderly are old-age pension programmes, survivor benefits and health expenditure[11]. Programmes that target working-age individuals in turn comprise unemployment insurance, active-labour market policies, incapacity benefits and family benefits. Although many of the beneficiaries of these programmes are high-skilled/high-status individuals, low-skilled/low-status individuals are expected to be the core constituencies behind such programmes as they bear a smaller share of the tax-burden to ensure their financial sustainability.

Figure I.4

The evolution of social spending in the selected OECD economies (as a % of GDP)



[11] While public health provision covers the entire population, the elderly are typically the most frequent users of health benefits and facilities. Moreover, several programmes exist that provide extensive public coverage for the elderly separately from the rest of the population, Medicare in the US being the most famous example.


Italy
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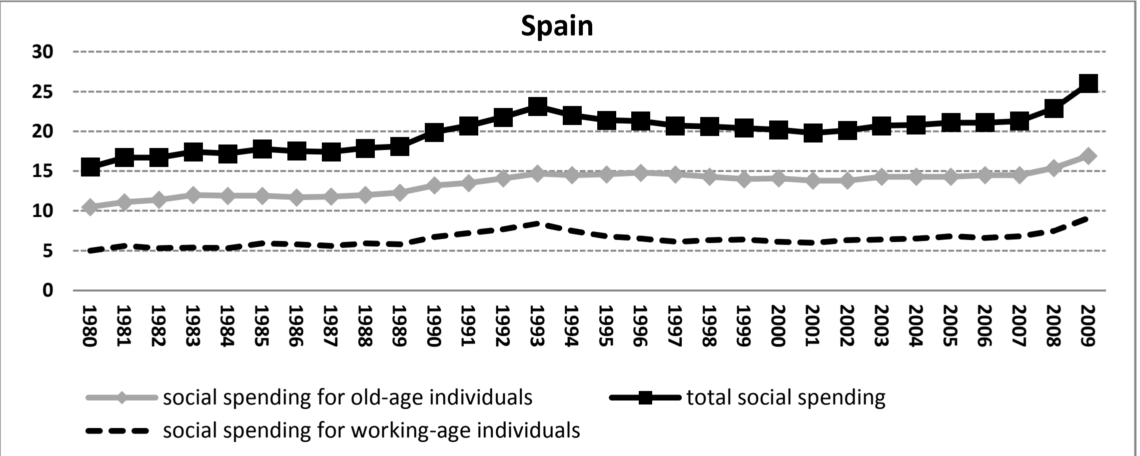
social spending for old-age individuals
total social spending
social spending for working-age individuals


Spain
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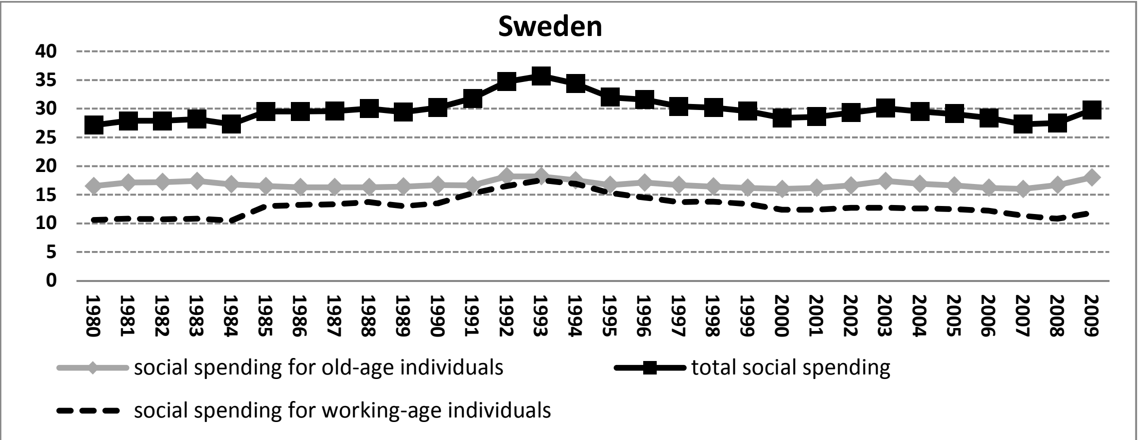
1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009
social spending for old-age individuals
total social spending
social spending for working-age individuals


Sweden
40
35
30
25
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15
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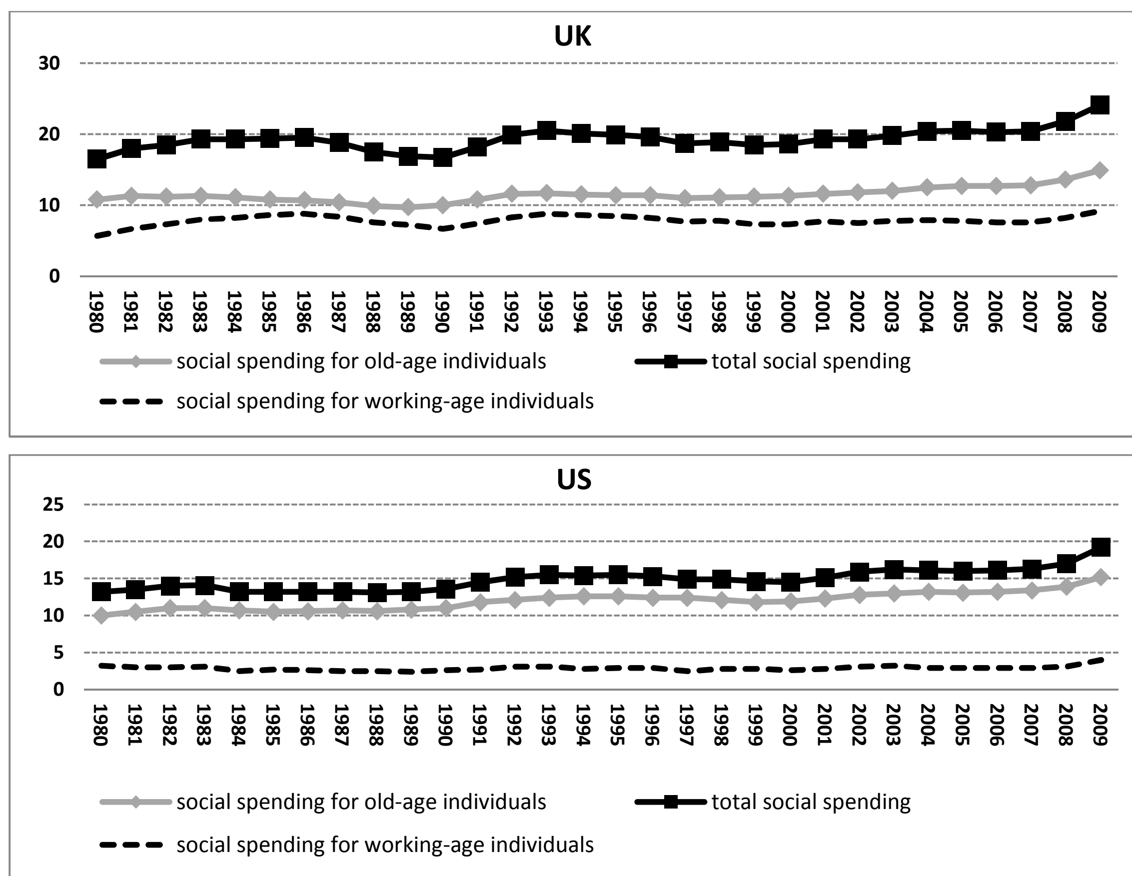
5
0
1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009
social spending for old-age individuals
total social spending
social spending for working-age individuals



Source: OECD Social Expenditure Statistics

The overall trend, across this subsample of OECD universe, is not one of retrenchment. Social spending continuously rose throughout the study period with the notable exception of Sweden which witnessed a protracted retrenchment period after its banking crisis in the early 1990s. Remarkably, however, this rise in social spending has been predominantly driven by old-age spending, in particular by the rise in pension liabilities and healthcare costs. Spending for working-age individuals, in most cases, remained stable by contrast with periodic retrenchment efforts (such as in Sweden, Spain, Italy and the UK). While the size of the welfare state – measured by social spending – has indeed been remarkably resilient to problem pressures as the New Politics predicted, programme-specific retrenchment efforts have been quite common during the period under study nevertheless. Which partisan governments had more political ammunition to undertake retrenchment will be the subject of the third essay in this thesis.

With these overall patterns in mind, I will now turn to the three essays that constitute this thesis, starting with conditional political budget cycles in the European Union, then proceeding to the electoral response to fiscal policy in the United Kingdom and ending with the partisan determinants of welfare retrenchment across the OECD universe.

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Essay I

Intra-Governmental Dynamics in a Political Budget Cycle Setting

The moderating effects of coalition government

Abstract:

Political fragmentation has been widely recognized by political economists as an important cause for fiscal profligacy in democratic market economies because of the common pool nature of fiscal resources. These predictions, however, sit uneasily with the notion of governmental veto players' ability to block each other's spending plans for electoral purposes. Applying the logic of a bargaining-game between veto players in a political budget cycle framework, I first model that multiple players in the budget game are in fact likely to moderate pre-electoral budget outcomes. Empirical results from a cross-section time-series analysis in EU member states provide corroborative evidence that fiscal electioneering is indeed more prevalent among cohesive, single-party settings. The findings are robust to alternative identification of elections, fiscal changes and sample selection.

II.1. Introduction

Just as the explosion of government expenditure and debt during the 1970s and 1980s shaped early theories on the political economy of budgeting[12] the subsequent consolidation period defined the new context in theory building. In fact, current members of the European Union, old and new member states alike, faced considerable pressure to squeeze government expenditures, moderate deficit finance and reduce their debt levels inherited from earlier periods. While the sources[13] of these pressures were largely observable and obvious, the political and institutional capacity of the affected countries to deliver change was much less so.

Explanations on cross-country and temporal differences in budgetary outcomes have largely converged around two theoretical approaches. Suboptimal fiscal performance was predicted to result from fragmentation in government, whereby competing claims on budgetary resources would give rise to a common pool problem. The dynamic dimension of budgeting, on the other hand, invited scholars to look into the changing political pressure that incumbents are under as a function of the electoral timetable. Originating from earlier works on political business cycles, the latter theories predicted that budgetary discipline would suffer as incumbents approached general elections.

The implications that follow from these two themes in the literature point to a theoretical paradox, however. If the root of the common pool problem lies in electoral pressure in a fragmented political context, one would expect the pressure to increase with the proximity to elections. However, fragmented governments are also likely to be hindered by veto players (coalition partners, opposition parties under minority governments etc.) in the budget process to deliver quick and large policy-change that suits their re-election purposes (Tsebelis, 2002). Insofar as these political veto-players

[12] These early theories provided the first systematic account of the growth of government during the post-war period by highlighting bureaucratic incentives (Niskanen, 1971) and incremental budgeting (Wildavsky, 1986).
[13] Beyond ideational impacts of the rational expectations revolution in economics, two simultaneous political projects shaped these trends: EMU and economic transition in the West and the East, respectively.

exercise – or threaten to exercise – their power to constrain the government, opportunistic budgeting in a fragmented setting is thus less likely to occur.

This article will offer a critical evaluation of the common-pool paradigm by taking into account the influence of coalition partners in the bargaining game for pre-electoral budgets. I first model how this bargaining game plays out in a coalition setting vis-à-vis a single-party incumbent government. Secondly, in contrast to the common-pool literature, I will empirically show that political fragmentation is associated with smaller and sometimes opposite swings in the budgetary stance to what political budget cycle theory would predict. This article will demonstrate that the differences in the fiscal swings across the electoral cycle between cohesive and fragmented government settings are statistically significant and substantively important, often in the excess of 1 % of GDP.

The next section will offer a brief literature review and lay out my theoretical model in detail. In the third section, the key concepts and variables for empirical analysis will be introduced. Section four will provide descriptive statistics on the cyclical behaviour of fiscal aggregates followed by an econometric analysis to test my hypotheses. The final section concludes.

II.2: Literature review and theory: government fragmentation and fiscal profligacy

Relating fiscal outcomes to government structures has a long tradition in the political economy of fiscal policy. During the great fiscal upheavals of the 1980s, changing macroeconomic circumstances alone were clearly incapable to explain away large cross-country differences in the evolution of government expenditures and debt accumulation, prompting scholars to turn towards politics in the quest for an answer.

A number of scholars, starting from Von Hagen (1992), culminating in the most extensive quantitative work by Hallerberg et al (2009), attributed cross-country and

temporal variation in fiscal performance to the institutional choice that different countries have adopted. Fiscal institutions, properly designed, were presumed to address the underlying problem that led to overspending and excessive deficits: the common pool resource problem (Von Hagen and Harden, 1995). The budgetary process was modelled as a complex web of fragmented and mutually inconsistent interests where each participant wants to slice their share from the common pool of fiscal resources without internalizing the aggregate costs it would entail for the community. Specifically, spending appropriations benefit only a fraction 1/N of the community with the cost in terms of tax or debt finance being diffused across all N participants[14]. As fragmentation, proxied by N, grows the common resource pool problem would sharpen.

The detrimental effect of political fragmentation chimed in well with earlier accounts of fiscal consolidation (or the lack thereof). In their seminal work, Roubini and Sachs (1989) proposed a weak government account of budgetary explosion: in fragmented governments, coalition partners would attempt to shift the burden of adjustment onto each other's constituencies, resulting in a stand-off and status quo bias. Alesina and Drazen (1991) formally modelled this idea by a war of attrition game, wherein veto players (i.e. coalition parties) in the government veto the other's adjustment plan to shelter its own constituents from the burden of consolidation. What these accounts and the common pool theory share is the notion of fiscal discipline loosening up with fragmentation: strong, single-party governments are expected to run smaller deficits over time than multi-party coalitions and/or minority governments.

In addition to long-run, average outcomes analysed by the aforementioned approaches, the dynamic dimension of budgeting was best encapsulated by political budget cycle theory (PBC hereafter). Opportunistic politicians were hypothesized to depart from the social optimum view of fiscal policy making (Barro, 1979)[15] by relaxing the purse in the run-up to general elections to increase their re-election chances. The origins of PBC theory reach back to the political business cycle literature (Nordhaus, 1975; Tufte, 1978). Extending these early insights on re-election seeking incumbents' behaviour in a

[14] In the empirical literature the notion of N had different meanings. The most commonly used measure is size-fragmentation (Kontopoulos and Perotti 2002; Wehner, 2010) where N stands for the number of actors (parties, legislators or cabinet members) participating in the budget process.

[15] Commonly known as automatic stabilization, Barro's (1979) model described the optimal behaviour of fiscal policy in the face of economic shocks resulting in temporarily higher (lower) revenues - and hence deficits - than in the long-run equilibrium.

world of rational expectations, Rogoff and Sibert (1988) present a model in which asymmetric information between voters and governments on incumbent competence prompts incumbents to engineer economic expansions in election years. Yet, the empirical record of such pre-electoral economic booms is far from overwhelming (Alesina and Roubini 1992; Alesina et al, 1997). Therefore, the scholarly focus has since shifted towards tools of demand management (fiscal policy, in particular), with the implicit assumption of fiscal illusion and myopia on the part of the electorate (Alesina and Perotti, 1994). Opportunistic incumbents, therefore, were predicted to relax fiscal policy in the run-up to general elections with or without any real effects on economic activity. The partisan hypothesis of political business cycles (Hibbs, 1977) was also pursued in the post-rational expectations world (Alesina, 1987) but generally received weaker support than its opportunistic counterparts. Left parties, it seemed, were no more prone to engage in expansionary fiscal policy than their right-wing counterparts.

That said, electioneering is far from universal, regularly occurring in some contexts but hardly ever in others. The recognition of this non-universality prompted different scholars to look for the context-conditionalities (Franzese and Jusko, 2005) that best predict where and when the cycle is more or less likely to occur. Alt and Lassen (2006) show that more transparent budgetary contexts dampen the cycle. In a related a manner, Rose (2006) demonstrates that stringent budget rules in American states have a significant moderating effect on PBCs. Brender and Drazen (2005) argue that new democracies are more vulnerable to electoral pressure because of voter inexperience with the electoral and budgetary process and/or less transparent budgetary settings(Benito and Bestida, 2009). Persson and Tabellini (2003) introduce institutional conditionalities and conclude that majoritarian electoral systems experience greater and more regular cycles.

Most importantly for our present purposes, the implications of the common pool resource theory were also extended to the realm of PBCs. Hallerberg et al (2009) in particular, show that budgetary institutions that were designed to constrain overspending and the deficit bias resulting from the common pool also dampen the cycle. However, such an automatic extension of a long-run account to a dynamic context overlooks an essential feature of party politics: political parties – including

coalition partners – are in competition for a limited number of votes, providing them an incentive to constrain each other's spending plans that are perceived to confer disproportionate electoral benefits on political rivals. The following model will demonstrate this idea by comparing a single-party setting to one with a two-party coalition as incumbents.

Theoretical model

To describe the bargaining game between coalition partners, the following six assumptions are made:

1) Two parties –a large (senior party) and a small (junior party) – are in a coalition bargaining context, where they try to decide on additional budgetary measures for electoral purposes. These measures can take the form of additional spending or tax changes.
2) The parties have different, albeit possibly overlapping constituencies.
3) The budgeting process consists of two stages
    - In the first stage: the senior party proposes budget S, a combination of the proposed spending and tax plans targeting its own constituency.
    - In the second stage: the junior party, knowing S, proposes its own budget, J – a combination of its own spending tax plans targeting its own constituency – to arrive at a final budget, S+J = B.
4) Parties' vote share is linearly increasing in constituency-specific spending and tax measures but is decreasing – quadratically – in the overall budget deficit. This captures the notion of fiscally conservative voters[16] and incumbents who also have to internalize the long-term consequences of budgetary explosion. The quadratic term is justified by the non-linearity associated with fiscal expansion: little deficit spending may pose no threats to debt sustainability, but as the fiscal space vanishes, the associated risks

[16] In fact, the notion of fiscally conservative voters has received increasing support in the empirical literature (Alesina et al, 1998; Eslava, 2011)

(e.g. rising risk premia on government bonds, debt crisis, currency crisis) may exponentially increase.

5) The senior party bears increased responsibility both for the delivery of the targeted budget and for the fiscal profligacy it entails. This assumption follows from the clarity of responsibility hypothesis (Powell and Whitten, 1993; Whitten and Palmer, 1999) that posits that in contexts of clear institutional or partisan responsibility, the electoral response to economic outcomes is stronger.
6) The junior party suffers disutility from budgetary composition overly tilted towards the senior party. This assumption captures the notion of electoral competition between the coalition partners, prompting the junior party to take into account the difference between budget S and J as well as their overall levels. Similarly to Assumption 4), the model will introduce this "competition factor" by a quadratic term: the disutility increases non-linearly with the difference between S and J.

Following from Assumption 4), 5) and 6) the following utility functions characterize the senior and the junior party, respectively.

$$U(S) = [\ S + \alpha J - \gamma(S+J)^2\ ]\theta$$
$$U(J) = J + \alpha S - \gamma(S+J)^2 - \beta(S-J)^2,$$

where for reasons of parsimony, I assumed that the utility functions are symmetric in α and γ . In the utility functions, α, between 0 and 1, captures the vote-share elasticity of a budget targeted at the coalition partner's constituency. It can be conceptualized as ideological proximity, overlap of the two distinct constituencies or electoral volatility among the electorate. A higher α, implies ceteris paribus higher utility for a budget targeted at the coalition partner's constituency. γ, between 0 and 1, can be understood as a parameter for "fiscal conservativeness". A higher γ reflects a higher propensity to take into account the fiscal consequences of the budget deficit, or alternatively, longer time horizons for incumbents. As this time horizon is expected to vary with the electoral timetable, γ is a non-constant term such that $\gamma = F^{-}(t)$:as elections are approaching γ drops. However, since this model captures a one-period (pre-election

budget) bargaining game, the dynamic nature of γ poses no difficulties for analytical purposes. Finally, θ, greater than 1, captures the extent of perceived responsibility for budgetary decisions, whether it is positive (targeted measures) or negative (fiscal profligacy).

One additional relationship that characterizes the model concerns the senior- and junior-specific utility functions, respectively. As stated in Assumption 6), the junior party receives negative utility whenever S exceeds J, captured by parameter β. A higher β implies a higher “competition factor” in the budget game. I assume that β is an inverse function of the responsibility parameter θ for the following reasons. High (low) responsibility for the senior party implies low (high) bargaining-power for the junior party because of the power asymmetry in the coalition. For instance when a dominant senior party is bargaining with a marginal junior party, the former’s responsibility for fiscal outcomes is expected to be high. Under such a scenario, the junior party will have relatively limited bargaining power in the coalition, hence the weight it will attach to disproportionate budgetary composition is expected to be low. In other words, the “competition factor”, β, indicates to what extent the junior party suffers disutility when it “punches below its weight” in the coalition with regards to outcomes in budgetary composition. I thus put forward a third relationship to close the model:

$$\beta = \frac{1}{\theta}$$

Assumption 3) provides the key to understand how the model will play out. The game is best thought of as a Stackelberg game (Gibbons, 1992) with the senior party being the leader (proposer) and the junior party the follower (receiver) First, the senior party proposes budget S, which the junior party incorporates into its own utility function and maximizes U(J) with respect to J. A rational, forward-looking senior party, of course, will anticipate the junior party’s reaction function and, accordingly, proposes S to maximize its own utility function, U(S).

Assuming parties have complete information over each other’s utility functions – a reasonable working assumption for coalition partners – one obtains a unique Nash-

equilibrium for both the total budget and its composition. By backward induction, one first obtains the best-response function of the Junior Party.

$$\frac{\Delta U(J)}{\Delta J} = 1-(2\gamma-2\beta)S-(2\gamma+2\beta)J=0$$

Which yields the Junior Party's best-response function when expressed in terms of J:

Equation 1) J*= $\frac{1}{2\gamma+2\beta}-S\left(\frac{\gamma-\beta}{\gamma+\beta}\right)$

A similar logic is applied to the determination of the initial proposal, S. The senior party maximizes its utility function by anticipating the junior party's best-response. Substituting Equation 1) into U(S), the senior party thus maximizes:

$$\left[S+\alpha\left(\frac{1}{2\gamma+2\beta}-S\left(\frac{\gamma-\beta}{\gamma+\beta}\right)\right)-\gamma\left(S+\frac{1}{2\gamma+2\beta}-S\left(\frac{\gamma-\beta}{\gamma+\beta}\right)\right)^2\right]\theta$$

with respect to S. Rearranging the expression above, one obtains:

$$\left[S+\alpha\left(\frac{1}{2(\gamma+\beta)}-S\left(\frac{\gamma-\beta}{\gamma+\beta}\right)\right)-\gamma*\left(\frac{S^2 4\beta^2}{(\gamma+\beta)^2}+\frac{4\beta}{2(\gamma+\beta)^2}\right)\right]\theta$$

To maximize the utility function, the first order condition yields:

$$\frac{\Delta U(S)}{\Delta(S)}=\left[1-\alpha\left(\frac{\gamma-\beta}{\gamma+\beta}\right)-\gamma\left(S*\frac{8\beta^2}{(\gamma+\beta)^2}+\frac{4\beta}{2(\gamma+\beta)^2}\right)\right]\theta=0$$

After some simplification and re-arranging, the equation to solve becomes:

$$\gamma^2+\beta^2-\alpha(\gamma-\beta)(\gamma+\beta)=S*8\gamma\beta^2$$

Separating the quadratic terms on the left-hand side, we obtain:

$$\gamma^2 (1-\alpha) + \beta^2(1+\alpha) = S * 8\gamma\beta^2$$

Solving for S, we obtain:

Equation 2) $S* = \frac{\gamma(1-\alpha)}{8\beta^2} + \frac{(1+\alpha)}{8\gamma}$

Determining the total equilibrium budget deficit, B*, the primary focus of our enquiry, follows in two steps. First, J* is determined by plugging Equation 2) back into Equation 1). Second, summing J* and S* results in the total equilibrium budget deficit of a coalition bargaining game. J* + S* can be expressed as:

$$\frac{1}{2(\gamma+\beta)} + S * \left(1 - \frac{\gamma-\beta}{\gamma+\beta}\right) = \frac{1}{2(\gamma+\beta)} + S\left(\frac{2\beta}{\gamma+\beta}\right)$$

Which, when expressed in terms of the equilibrium budget solution found for S* (Equation 2), becomes:

$$\frac{1}{2(\gamma+\beta)} + \left(\frac{\gamma(1-\alpha)}{8\beta^2} + \frac{(1+\alpha)}{8\gamma}\right)\left(\frac{2\beta}{\gamma+\beta}\right)$$

After some simplification, the total equilibrium budget deficit, B* solves to:
Equation 3)

$$\frac{1}{2(\gamma+\beta)} + \frac{\gamma(1-\alpha)}{4\beta(\gamma+\beta)} + \frac{\beta(1+\alpha)}{4\gamma(\gamma+\beta)} = \frac{2\gamma\beta + \gamma^2(1-\alpha) + \beta^2(1+\alpha)}{4\beta\gamma\,(\gamma+\beta)}$$

Under complete information sets, the relative budget outcomes of single-party and coalition settings follows from comparing Equation 3) to the single-party solution. The latter is obtained by reformulating the senior party's utility function to a single-party case:

U(S_SP) = $(S - \gamma(S)^2)\theta$

Where all the budget is targeted to constituency S. Again, using the first-order condition:

$$\frac{\Delta U(S_SP)}{\Delta S} = \theta - 2\theta\gamma S = 0$$

Results in:

Equation 4) S_SP* $= \frac{1}{2\gamma}$

Note that while it is not necessarily reasonable to assume identical θs in a single-party setting and in a coalition, θ is irrelevant for finding the single-party equilibrium as it drops out from the equation. To find the conditions for relative budget explosion (moderation) in a coalition, our task is, therefore, to solve the inequality:

B*> S_SP*,
or:
Equation 3) > Equation 4)

Algebraically,

$$\frac{2\gamma\beta + \gamma^2(1-\alpha) + \beta^2(\alpha+1)}{4\beta\gamma(\gamma+\beta)} > \frac{1}{2\gamma}$$

Which, after multiplying both sides by the denominator of the right-hand side as well as simplifying and re-arranging the resulting fraction on the left-hand side, becomes:

$$\frac{2\gamma}{2(\gamma+\beta)} + \frac{\beta(\alpha+1)}{2(\gamma+\beta)} + \frac{\gamma^2(1-\alpha)}{2\beta(\gamma+\beta)} > 1$$

Multiplying through with the common terms in the denominators, $(\gamma + \beta)$ and re-arranging the inequality, we obtain:

$$\frac{\gamma^2}{\beta}(1-\alpha) > \beta(1-\alpha)$$

As α drops out from the inequality, the solution is the conveniently simple:

Inequality 1): $\beta < \gamma$

The verbal interpretation of this simple result is the following. Whenever β – ie. the "competition factor" – is sufficiently low, the senior party can rely on the fiscal restraint of its junior partner and propose a large budget – spending increases and tax cuts targeted at its constituency –, S. In a single-party setting, however, it has to fully internalize the adverse fiscal consequences of a large budget deficit. Conversely, when power is evenly dispersed in the coalition and thus β is high, the senior party has to moderate its spending proposal to accommodate the junior partner's increased bargaining power.

In practice, as stated above, the relative size of our two key parameters is likely to vary across the electoral cycle. In particular, γ, is likely to drop when the coalition is approaching general elections so Inequality 1) is less likely to hold. Therefore, in times of electoral competition, relative spending moderation is expected to result from a coalition setting, especially so under a high "competition factor".

Figure II.1
Relative spending explosion (moderation) for single-party versus coalition governments

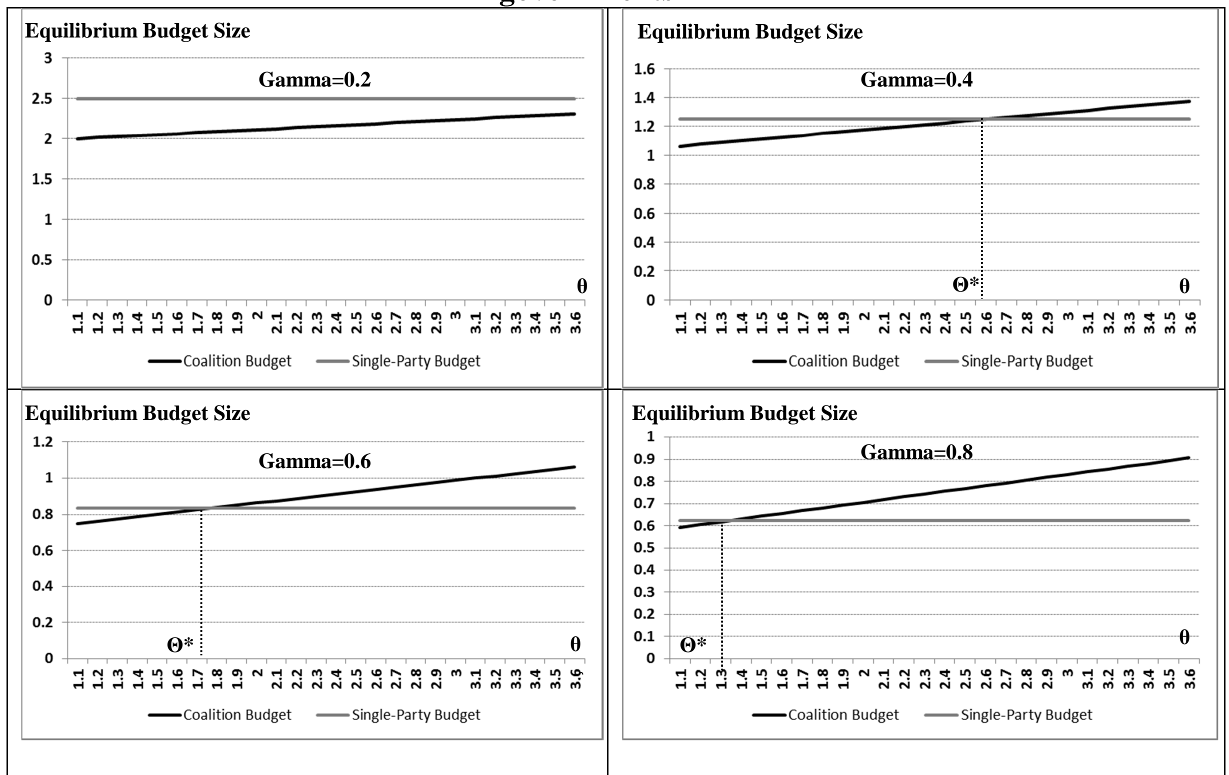


Figure II.1 above illustrates the relative budgetary outcomes between coalition and single-party settings as a function of the two key model parameters. For different levels of γ ("fiscal conservativeness"), the graphs capture the equilibrium budget deficits for both single-party and coalition settings as a function of θ (responsibility, or its inverse, "competition factor"). θ* are the levels of θ at which relative spending explosion begins for coalitions vis-a-vis single-party governments. Two key conclusions can be drawn from the graphical illustration of our results above. First, as γ increases, both the single-party and the coalition outcomes are lower, consistent with the notion that relatively fiscal conservative governments reduce the budget deficit. Insofar as γ varies with the electoral timetable, this illustration also serves as an alternative formulation of PBCs. Second, for any given level of γ, while the single-party outcome is constant, the coalition budget deficit increases in θ. Moreover, for lower levels of γ, the point at which the two lines intersect, θ*, is higher, implying a lower likelihood of relative fiscal explosion in coalition settings vis-à-vis single-party governments. Note that at extremely low levels of γ, a reasonable approximation of the pre-electoral period, this intersection point lies beyond the range of possible θs included in the graphs, implying

relative fiscal moderation for coalition governments regardless of power-dispersion in the coalition.

Two predictions can thus be made for the purposes of our empirical inquiry. First, a coalition setting is likely to be more conducive to fiscal restraint in times of electoral competition. Second, relative fiscal moderation in a coalition setting is more likely when the "competition factor" is high, ie. the junior party has increased bargaining power in the coalition. Stated more specifically, the following empirical sections will test two formal hypotheses:

H1: Coalition governments display lower political budget cycles compared to single-party settings.

H2: The average size of political budget cycles within coalition settings is further conditioned by the intra-coalition bargaining power of political parties. In particular, higher bargaining power of the smaller (junior) party(ies) moderates the effect of coalitions on the size of PBCs.

II.3. Data and variables: Measuring the (conditional) electoral effects on fiscal outcomes

The empirical literature on fiscal policy uses a wide array of dependent variables to test different theories. Examples from the commonly used measures in quantitative studies on public budgeting are as follows: General government expenditure as a % of GDP (Roubini and Sachs, 1989);Central government expenditure as a % of GDP (Volkering, de Haan, 2001); General government deficit (net lending) as a % of GDP (Alesina et al, 1997); General government primary expenditure/net lending as a % of GDP (Freitag and Sciarini, 2001); Change in gross debt as a % of GDP (Franzese, 2002); General government social expenditure as a % of GDP (Careja and Emmenegger, 2009).

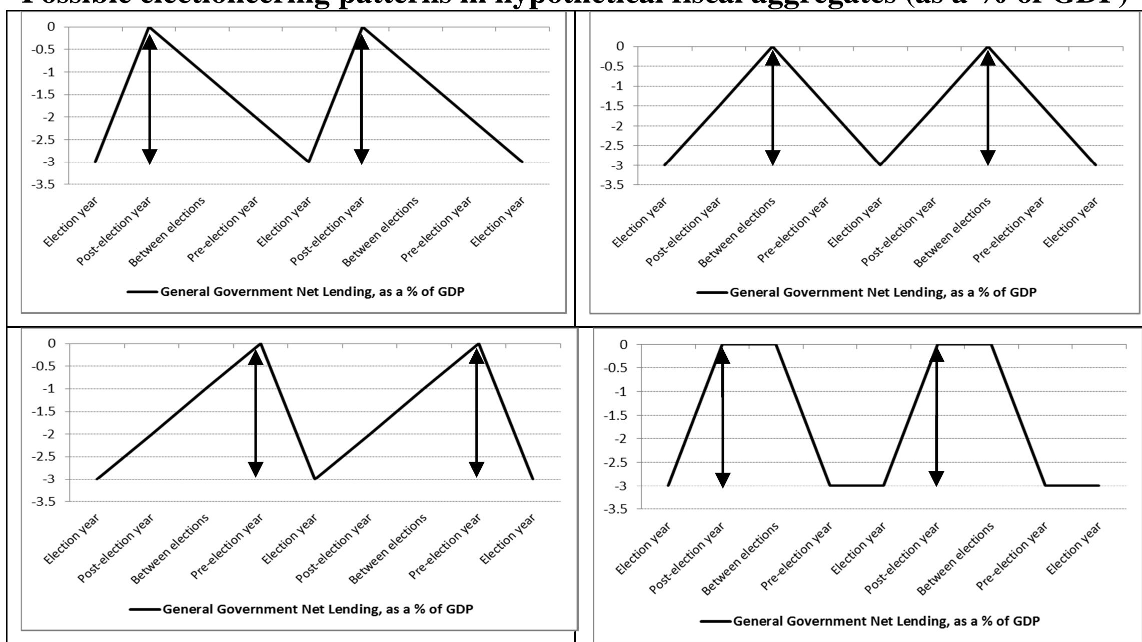
One of the controversies in this and related literature is the appropriate level of government to study. It is certainly true that nationally elected officials have more direct control over the central budget than over the sub-national ones – particularly in federal countries, such as Germany or Spain – or over social security funds managed by the social partners in corporatist systems such as France and Germany (Palier 2002; Starke, 2006). However, to the extent that the management of these parts of the budget are not wholly independent of national politics – in the form of party-political links between municipal and national-level politicians for example – electioneering patterns may show up in these budgets as well. Following from this consideration, the rest of this article will solely focus on general government as it provides a more encompassing measure for fiscal aggregates.

Following the underlying premise of the literature according to which voters value higher spending as well as lower taxes, I adopt budget deficits as my core dependent variable for the analysis. However, my model predicts that government parties attempt to target certain constituencies, so it is also important to focus on fiscal variables that are better suited for constituency-specific targeting (Chang, 2008). As an alternative dependent variable, therefore, I use general government expenditures which allow for greater targeting efforts than revenues. While governments can selectively increase social transfers for certain socioeconomic groups, undertake investment projects in electorally important districts, subsidize loss-making firms to avoid mass layoffs (Rickard, 2012) etc., taxes tend to have a broader base with more uniform effects across the population. I expect, therefore, that electoral effects as a function of government fragmentation are more likely to show up on the expenditure side of public budgets than on the revenue side.

Turning to the main independent variable of the study, correctly specifying the electoral indicator is far from straightforward due to the timing of elections and the theoretically ambiguous fiscal path that leads up to and follows after them. While traditional political budget theory relied on election-year dummies to investigate the election-year affect, other authors recognized its theoretical limitations by allowing for pre-election year effects on the one hand, and post-election consolidation effects on the other. Alt and Lassen (2006), in particular, look at the change between the pre-election and the post-

election period to measure the cyclical behaviour of electioneering. I will expand on their approach by distinguishing between pre-election years, election years, within-cycle years, omitting the post-election/consolidation-year as the benchmark category in the analysis. Distinguishing between these year types allows for different electioneering patterns without imposing unnecessary temporal restrictions on the data. Figure II. 2 captures these different patterns, using hypothetical values for government deficits.

Figure II.2
Possible electioneering patterns in hypothetical fiscal aggregates (as a % of GDP)



Measuring the party-political effects on election-induced fiscal outcomes, I will restrict the multidimensional measures used by the empirical literature to ones that directly relate to my theory on party-political fragmentation. My first key political variable follows from Roubini and Sachs' (1989) government weakness indicator. In particular, I will distinguish between single-party and coalition settings and compare their relative propensities to electioneer.

To capture the idea of bargaining power (or "competition factor ") within a coalition (H2), I will single out the two key players in the budgetary process: the prime minister, whose political leanings set the overall framework for budgetary directions and the finance minister, who has a key role in bargaining for fiscal resources (Jochimsen and Nuscheler, 2011; Hallerberg et al, 2009). I anticipate that the party-political alignment

of these two actors – i.e. when both delegated by the same (senior) party – will substantially reduce the bargaining (and veto-) power of junior parties' ministers. I will thus employ a dummy variable for PM-FM alignment to proxy the junior party(ies)' bargaining (veto-) power in the coalition. The advantage of this simple measure over commonly used alternatives of party-fragmentation (e.g. Laakso and Taagapera's (1979) effective number of parties) is that the control of specific ministries has crucial implications for policy-making leverage, casting doubt on the validity of pure numeric fragmentation measures. To the extent that the prime minister and finance minister have universally influential role over the disbursement of public funds, we can be fairly confident that their party-alignment/non-alignment is a powerful proxy for "bargaining power" of small coalition partners that our theory derives from.

Finally, a host of macroeconomic and structural developments may influence budgetary outcomes which may be necessary to control for to obtain unbiased estimates for the main political variables of interest. I will largely follow the literature (Persson and Tabellini, 2003); (Alesina et al, 1997); (Franzese, 2002) etc. in applying these controls. The rationales for their inclusion in the econometric models are as follows.

GDP growth, beyond the automatic denominator effect[17], provides a proxy for automatic stabilization or occasional counter-cyclical discretionary measures at work. Our theoretical priors thus suggest that government expenditures and deficits should shrink with the cyclical upswing of the economy. As an extension, unemployment rates will also be included to control for their impact on revenues (shrinking tax base) and expenditures (more claimants for social programmes). Moreover, long-term real interest rates will also be included to control for the interest burden that governments need to service. For a similar consideration, debt levels will also be controlled for as a measure for sustainability constraint that governments have to face. These last two measures will be lagged by one year in the empirical models to reflect their constraining effect at the time of budget preparation. I expect higher lagged interest rates and debt levels to have a negative sign in the empirical models. Additionally, I will control for economic openness because it has been shown to have an important effect on the size of government (Rodrik, 1997; Garrett and Mitchell, 2001; Jahn, 2006). Since two

[17] Since fiscal variables are expressed in % of GDP, changes in GDP (the denominator) automatically change the fiscal variables of interest.

competing hypothesis, the “race-to-the bottom” and the “compensation” hypothesis provide two opposite predictions on openness’ effect on changes in government spending, I have no clear theoretical expectation with regards to its influence on budgetary outcomes. To allow for a multidimensional measure of openness, I will use the Dreher index (Dreher, 2006) in my analysis. Finally, I will control for partisanship by a percentage measure of cabinet portfolios held by left-wing parties to capture power-resource arguments of the welfare-state literature (Korpi 1983; Korpi and Palme, 2003; Esping-Andersen, 1990) as well as partisan theory (Hibbs, 1977; Alesina, 1987). The default expectation is thus a positive influence of left-dominated governments over spending and deficit outcomes.

II.4. Empirical analysis: political budget cycles across government types in the EU

The following section will proceed in three steps. First, descriptive statistics will be provided as an initial evaluation of our hypotheses. Second, I will set up an econometric model followed by issues related to the chosen estimation strategy. Third, the results will be evaluated and discussed.

To motivate this empirical strategy, a quick summary of the sample characteristics is in order. My sample consists of 25[18] EU-member states over four decades yielding an unbalanced time-series cross-section structure consisting of over 600 country-years. In the spatial dimension, following Brender and Drazen (2005), the inclusion of new member states broadens most prior research in this area by combining advanced capitalist and transitional economies on the one hand, and mature democratic polities and new democracies on the other. In the temporal dimension, the sample period includes the end of the post-war “golden age”, the consolidation period of the 1980s, the Maastricht process, the post-Maastricht period of “fiscal fatigue”[19], the post-communist transition, a number of emerging market crises etc. Such heterogeneity of

[18] Latvia and Lithuania were excluded from the analysis because of data limitation
[19] As a wide-spread perception, countries qualifying for euro adoption began to backtrack on fiscal discipline once the threat of exclusion from EMU was lifted.

underlying structural conditions reduces the risk of the findings being driven by temporal or spatial idiosyncrasies.

Moreover, as Table II.1 illustrates, my country sample provides sufficient variability in the key political variables. The frequency of political contexts are more or less evenly spread out between single-party governments, coalition governments with PM-FM alignment and coalition governments with PM-FM non alignment[20].Regarding the summary of the dependent variables in Table II.2, one can observe that the average deficit change over the sample period is negative – with negative values indicated larger deficits – or in other words, public finances have deteriorated, on average. This has been accompanied by a steady growth in government, with the increase in expenditures outpacing that of revenues. Finally, the distribution of year-types (not-shown) is again, roughly even, with each year type occurring in around 25% of country-years. As a coding rule, when pre-election and post-election years coincided (when there is only one year between two consecutive elections), I coded these intervening years as pre-election years. By a similar logic, when a pre-election year and an election year coincide – in case of two elections in two consecutive years – both years were coded as election years.

Table II.1
Summary of political variables

	PM-FM alignment	PM-FM non-alignment
Single-Party governments	**30.3%**	**2.1%**
Coalition governments	**30.6%**	**36.9%**

Source: Inter-parliamentary Union, Parline Database; European Journal of Political Research, PARLGOV database

Table II.2
Summary of fiscal variables (as a % of GDP)

Fiscal Measure	Mean	Standard Deviation
Δdeficit	**-0.12%**	**2.32%**
Δexpenditure	**0.24%**	**2.36%**
Δrevenue	**0.12%**	**1.33%**

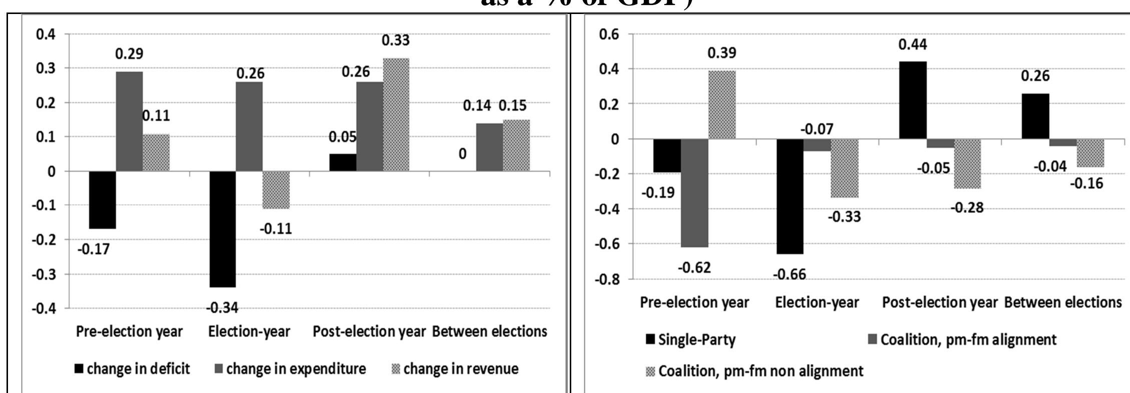
Source: European Commission, ECOFIN, author's calculations

[20] The low frequency upper-right cell of Table 1 covers country-years where single-party governments nominated a non-party member to serve as prime minister or finance minister (typically under caretaker, or technocratic governments).

Descriptive patterns and discussion

As discussed in Section 2 above, there is no theoretically prescribed pattern to the expected behaviour of fiscal aggregates over the electoral cycle. While some governments may decide to undertake expansionary fiscal policy one or two years before elections, others may wait out until the election year itself in the hope of last minute electoral gains. Likewise, consolidation efforts may be more prolonged under some governments compared to others. Hence, the following descriptive summary allows for various patterns by distinguishing between the four year-types over the electoral cycle: pre-election years, election years, post-election years and years in between.

Figure II.3
Average electioneering patterns across the electoral cycle (annual fiscal changes, as a % of GDP)



Source: European Commission, ECOFIN, author's calculations

The left-hand chart of Figure II.3 illustrates the behaviour of fiscal aggregates over the electoral cycle. The main patterns fit nicely with political budget cycle theory. Deficits increase somewhat in the pre-election year, by a larger margin in the election year and stay broadly stable thereafter with a modest consolidation effort in the post-election year. Somewhat surprisingly, however, revenues appear more volatile across the cycle with large consolidation efforts in the post-election year standing out. Focusing our attention to the main dependent variable, the annual change in deficits, the cyclical swings across different political contexts are illustrated on the right-hand chart of Figure II.3. As a first empirical evidence for our theory, single-party governments and to a lesser extent coalition rule with PM-FM alignment appear to electioneer more with

large swings between the electoral period (pre-election and election years) and consolidation periods (post-election years and years between elections).

These initial insights, however, must be treated with caution. First, to the extent that the electoral cycle is correlated with macroeconomic and structural conditions that may impact on fiscal aggregates, differences between year types could result from spurious correlation. Second, descriptive analysis tells us little about the significance in differences between years[21]. Whether the observed variation actually reveals a statistically significant systematic relationship between the electoral cycle and fiscal policy, one needs to test the hypotheses in an econometric framework.

Model set-up

The econometric analysis will proceed in the following manner. First I will set up a benchmark model by using the electoral indicators and GDP growth as explanatory variables for fiscal outcomes. Second, I will test an extended model which introduces the control variables discussed in the preceding section that are used by the literature. I will test the two hypotheses for three alternative dependent variables: annual change in the general government deficit as the core variable of this study and annual changes in general government expenditure and general government revenue to allow for different degrees of cyclicality on the two sides of public finances. As argued earlier, I expect the lion's share of electioneering to occur on the expenditure side. Using first differences (annual changes) for the dependent variables as opposed to levels follows from the conceptualization of political budget cycle as a short term phenomenon; we are primarily interested in the short-term effects of political structure, namely the annual swing in budgetary outcomes as a function of the electoral timetable and government types. The time-series-cross section model to test can thus be generalized as follows:

$$\Delta F_{it} = \beta_0 + \beta_1 E_{it} + \beta_2 X_{it} + \beta_3 C_{it} + \beta_4 (E_{it} X_{it}) + \mu_i + \gamma_t + \varepsilon_{it}$$

[21] Given the non-normal distribution of the dependent variables, ANOVA analysis of differences between means is inappropriate. Non-parametric, Kruskill-Wallis tests, however, do reveal significant differences between subsample medians for different year types across the electoral cycle. These Kruskill-Wallis results are shown in Appendix 3.

Where Y_{it} are the different fiscal variables for country $_i$ at time $_t$, E_{it} are the electoral indicator(s)[22], X_{it} are the two political variables[23] (single party governments and PM-FM alignment) that capture political dispersion, C_{it} is a vector of macroeconomic and structural controls, (E_{it}*X_{it})is the interaction term reflecting the conditional hypotheses, μ_i is a country-fixed effect γ_t is the time-fixed effect[24] for common shocks and ε_{it} is an iid (identically and independently distributed) error term[25]. To test the first hypothesis, a dummy variable for single-party governments was interacted with each year type so β_4 captures the extent to which single-party governments follow different fiscal policy along the electoral cycle compared to coalition governments. To test the moderating effect of policy-making dispersion (PM-FM non-alignment) in coalition settings (H2), a three way interaction was introduced between the year types, single-party governments and the PM-FM alignment dummy. From the three way interactions, marginal effects were calculated for each year type under three possible constellations of political dispersion: single-party governments, coalition governments with PM-FM alignment and coalition governments with PM-FM non-alignment.

As table II.3 indicates below, the hypothesis (H1) that political budget cycles are more prevalent under single-party governments receives strong support. In both the extended and the baseline models, the estimates for the annual change in deficits are non-significant under coalition governments in any of the year times compared to the post-

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[22] In each model, pre-election years, election years and years between elections were included as three dummy variables, whereas post-election years were omitted as the reference category. Therefore, the estimates measure the average annual fiscal swings in the three year types relative to the annual change in the post-election year.

[23] The political variables for each country-year were coded for governments that occupied office at the start of each calendar year. This coding scheme – as opposed to weighing governments by the number of days in office in any given year – prioritizes the period when budgets are prepared.

[24] To test for the inclusion of country- and time-fixed effects, I first ran a set of F-tests for common intercepts among countries and years. The null hypothesis of no country- and year-specific effects can be strongly rejected in the data ($p<0.001$). Secondly, I ran Hausman tests to investigate whether the country-specific influences captured in the error terms that are unaccounted for by the models are correlated with the regressors, hence biasing random-effects estimates. These tests strongly rejected the null hypothesis ($p<0.001$) that the random-effects models are consistent; therefore I estimated the models with both country- and time-dummies. Test results for all F-tests and Hausman tests are provided in Appendix 3.

[25] To test for the violation of the standard Gauss-Markov assumptions in panel data (Kittel and Winner, 2005) a number of diagnostic tests were carried out (test results available upon request). A modified Wald test and a Pesaran test (Pesaran, 2004) indicate a panel-heteroskedastic, and cross-sectionally correlated error structure, respectively. Following Beck and Katz (1995), I thus ran OLS regressions with panel-corrected standard errors as a superior alternative to the previously popular feasible-GLS method. Since serial correlation, due to the first-difference specification of the dependent variable was not detected in the variance-covariance matrix of the error terms based on a Wooldridge (Lagrange Multiplier) test, neither lagged dependent variables nor a Prais-Winsten transformation was necessary to yield valid OLS test results. Test results for all diagnostic tests are provided in Appendix 3.

election reference category. By contrast, the election-year swing is strongly significant under single-party rule, preceded by a weaker but still marginally significant pre-election swing. The substantive impact is large: on average, the estimated difference between the election-year and the post-election year fiscal swing under single-party governments is around 1.3% of GDP, whereas it is non-distinguishable from 0 under coalition-rule. As expected, the bulk of this electioneering effect shows up on the expenditure side but no conditional effect of single-party settings is found for government revenues. Among the control variables, growth[26] exerts a strong counter-cyclical influence on budgetary outcomes in line with expectations. As the tax base shrinks, higher unemployment exerts a statistically significant negative impact on the government revenues, but not on government expenditures. Among the macroeconomic constraint variables, higher debt in the previous period does seem to pressure governments into cutting expenditures and raising taxes when drafting their budgets. Finally, neither the globalization proxy (Dreher index) nor the cabinet share of left parties show up as significant in the models.

[26] To address potential endogeneity concerns between growth and the dependent variables, I re-ran the models in a two-stage least squares (2SLS) framework where growth was instrumented with estimates for potential growth and growth rates for the euro-area. (OECD economic outlook database no.84). These growth rates are presumably exogenous to fiscal measures in individual countries but are highly correlated with individual countries' growth rates. Because of the data availability, I ran these 2SLS models in a more limited sample but the substantive results of interest of the models did not change.

Table II.3
Political budget cycle models explaining annual changes in fiscal outcomes among government types†

	Δnetlending	Δnetlending	Δexpenditure	Δexpenditure	Δrevenue	Δrevenue
growth	0.143**	0.151**	-0.302**	-0.332**	-0.147**	-0.167**
	(3.44)	(3.87)	(6.61)	(9.39)	(4.64)	(6.47)
election	-0.298	-0.252	-0.064	-0.097	-0.354*	-0.366**
	(1.29)	(1.23)	(0.27)	(0.53)	(2.45)	(2.65)
pre-election	-0.002	0.022	-0.053	-0.059	-0.007	-0.011
	(0.01)	(0.10)	(0.22)	(0.31)	(0.05)	(0.07)
betweenelections	0.094	0.131	-0.123	-0.143	-0.029	-0.039
	(0.39)	(0.60)	(0.51)	(0.74)	(0.19)	(0.26)
singleparty	0.627	0.645	-0.488	-0.562	0.230	0.140
	(1.69)	(1.95)	(1.20)	(1.82)	(0.88)	(0.55)
election*singleparty	-0.884*	-1.156**	0.549	1.053**	-0.318	-0.058
	(2.25)	(3.43)	(1.34)	(3.52)	(1.09)	(0.20)
pre-election*singleparty	-0.550	-0.559	0.235	0.411	-0.333	-0.149
	(1.39)	(1.65)	(0.57)	(1.27)	(1.17)	(0.53)
betweenelections*singleparty	-0.386	-0.363	0.188	0.347	-0.165	0.043
	(0.93)	(0.99)	(0.44)	(1.03)	(0.51)	(0.14)
unemployment		-0.024		-0.029		-0.050
		(0.69)		(1.06)		(1.92)
dreherindex		0.014		-0.020		-0.013
		(0.52)		(0.95)		(0.71)
L.realrates		0.002		-0.007**		-0.005*
		(1.16)		(2.70)		(2.08
L.debt		0.031**		-0.023**		0.009*
		(4.67)		(4.06)		(2.09)
left		-0.001		0.001		0.000
		(0.43)		(0.60)		(0.32)
R^2	0.31	0.35	0.39	0.45	0.21	0.24
N	624	608	624	608	624	608

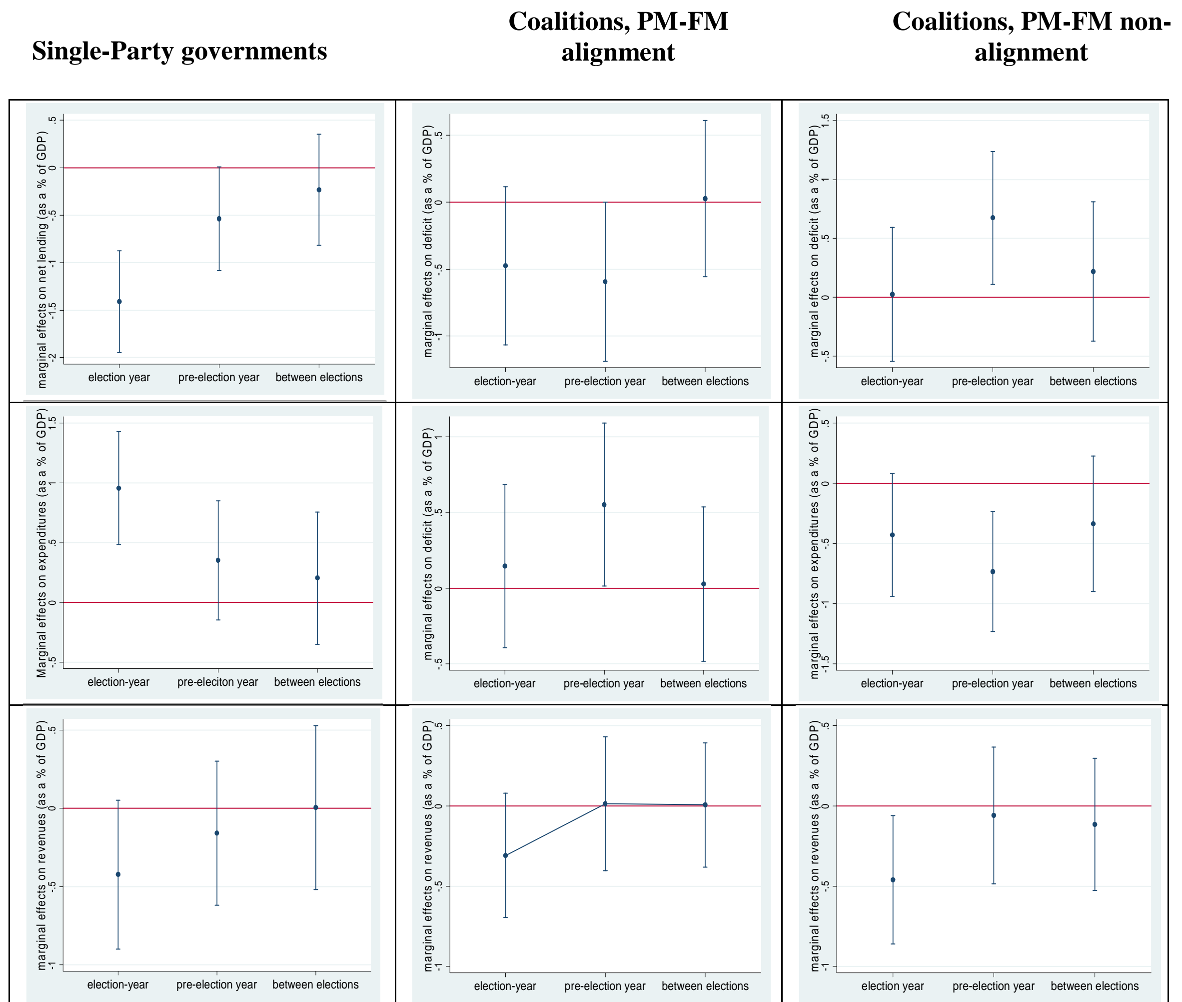
* p<0.05; ** p<0.01

†Fixed-effect estimates with panel-corrected standard errors

Turning to the three-way interaction between the electoral indicators, single-party governments and PM-FM alignment, Figure II.4 illustrates the marginal effect of each year type under different political constellations from the extended models[27]. The top row includes the calculated effects from models using annual changes of deficits as the dependent variable, while the second and third row capture the expenditure and revenue models, respectively.

[27] The regression output for the three-way interaction model is shown in Appendix 3. Since three-way interaction makes reading marginal effects from the coefficient estimates extremely tedious, marginal effects plots provide a more convenient summary of the estimated effects (Brambor et al, 2006).

Figure II.4
Point estimates and 95% intervals for the effect of the electoral cycle under different political constellations*



* Effects are estimated relative to the benchmark, post-election year

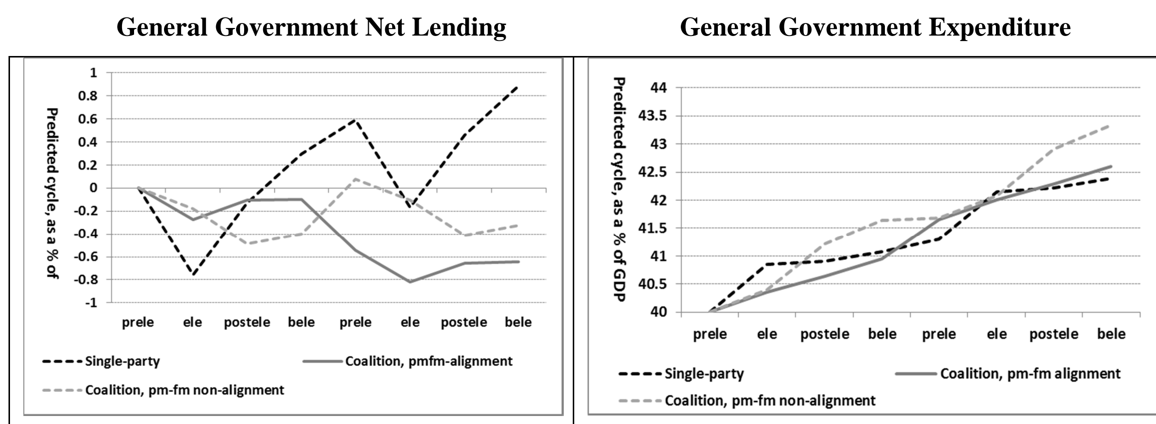
The first row – with the annual change in deficits as the dependent variable – provides evidence for the moderating influence of political fragmentation (PM-FM non-alignment) in coalition settings. As policy-making control is becoming more dispersed from single-party governments to coalition settings with PM-FM non-alignment, election-induced fiscal swings moderate or even reverse. While single-party governments undertake large election-year fiscal expansions, coalitions with PM-FM alignment run higher deficits in both the election year and the pre-election year compared to the post-election period. Interestingly, in contrast to single-party settings, these coalitions focus their electioneering efforts on the pre-election year where the annual change in the deficit compared to post-election years exceeding 0.5% of GDP and is significant at the 5% level. Finally, in the most fragmented setting, coalitions

with PM-FM non-alignment, there is no evidence for election-time fiscal expansions whatsoever. On the contrary, these coalitions tighten fiscal policy in the year before elections compared to post-election years by a sizeable extent: on average the tightening is around 0.8% of GDP and easily achieves statistical significance.

When looking at the composition of these electioneering patterns, the estimated effects conform to our expectations: the patterns we observed on deficit changes almost exclusively results from the expenditure side of budgeting. While the expenditure patterns (second row) across political constellations are almost identical to deficits with an opposite sign, there is hardly any evidence for electioneering effects for revenues (third row). These results are consistent with our expectations that the scope for constituency-specific targeting is greater on the expenditure side.

A visually more convenient way to capture the electoral cycle through these estimates is to calculate predicted values on the evolution of fiscal aggregates at selected levels of the variables included in the model. I thus set all control variables at their sample means and calculated average country- and time-specific affects that resulted from unobserved influences on budget outcomes. Moreover, I chose 0 as starting position for the deficit (ie. a balanced budget) and 40 for general government expenditure as a % of GDP, respectively. Under this hypothetical "average" case, assuming that the levels of control variables in the model remain unchanged, I then calculated the predicted electoral cycle under the three government types. Figure II.5 illustrates the predicted cycle on annual changes in deficits and expenditures.

Figure II.5
The predicted evolution of fiscal aggregates for different government types across two electoral cycles



The differences between the three government types are noteworthy. The predicted evolution of the deficit in single government governments is highly cyclical with a general improvement over time, interspersed with election-year fiscal expansions. Under coalition governments with PM-FM alignment, by contrast, the fiscal balance steadily deteriorates over time, mostly driven by pre-electoral and election-year fiscal expansions. Finally, in coalition governments with PM-FM non-alignment, the fiscal balance is roughly steady over the cycle with large improvements in the pre-electoral period. Turning to general government expenditures, in all three government types expenditure shares of GDP increase on average over time. Major differences are found, however in the timing of these increases: under single-party governments and coalition governments with PM-FM alignment, the increases are largely concentrated on the pre-electoral/election-year periods, while for coalition governments with PM-FM non-alignment, the trend is mostly driven by post-election expenditure increases.

Robustness checks

One potentially important problem with the findings above is the issue of endogenously-timed elections (Reid, 1998). In other words, treating the electoral timetable as exogenous assumes that governments can perfectly plan fiscal policy several years ahead because they know when the next election will occur. However, in countries where election-timing is not fixed (e.g. the United Kingdom) or where no-

confidence motions often terminate parliamentary terms ahead of schedule (e.g. Denmark), this assumption may be heroic. Inconveniently, it is exactly in coalition settings – where the theory predicts and the findings have shown dampened budget cycles – that such early elections are more likely to occur as a result of intra-coalition frictions. To address this possibility, I reran my models with a modified set of electoral indicators such that I distinguished between "regular" elections that occurred in the year of the constitutionally mandated term limit and "early" elections that occurred any year before that. These models thus tested whether moderation under fragmented settings are driven by government collapses making opportunistic budgeting difficult to plan. This new specification thus introduced six dummy variables in the model instead of the original three: regular election years, regular pre-election years, years between regular elections, early election years, early pre-election years and years between early elections.

Reassuringly, the results indicate that the estimated differences between government types are not driven by early elections (marginal effects plot shown in Appendix 3). If anything, many of the significant estimates – such as the large election-year swing under single-party governments as well as the pre-election year fiscal tightening by coalitions with PM-FM non-alignment – actually grow in size when elections are held at the constitutionally mandated term limit. Interestingly, while the cyclical patterns of single-party governments hold up during early elections as well, the electoral path of coalition governments' budgeting is considerably different between early elections and regular elections. It seems therefore, that early elections do hinder coalition governments from strategic budgeting. Most importantly, however, the differences between government types with regards to election-induced budget outcomes are large and significant for both early and regular elections.

A second possible limitation that my robustness checks address is the presence of both new and old democracies in the sample. As Brender and Drazen (2005) and Shi and Svensson (2002) argued, voters' lack of experience in democratic politics increase incumbents' incentives to undertake opportunistic fiscal policy in new democracies. It is therefore possible that the findings are driven by these new democracies. I thus excluded from my sample the post-communist countries that only recently democratized and tested whether the conditional electioneering effects are muted in this

limited sample. Again, the estimated coefficients – results shown in Appendix 3 - are very similar to the full-sample models. Importantly, both the election-year fiscal swing of single-party governments and the pre-electoral fiscal tightening of coalition governments with PM-FM non-alignment are similar in size and significance to our earlier estimates.

Finally, a concern that has been evoked by the fiscal policy literature is the discrepancy between the change in the consolidated debt figures and official deficit numbers highlighting the fact that governments often engage in creative accounting (Von Hagen and Wolff, 2006; Alt et al, 2012). I thus reran my models with the deficits calculated from the change in the debt levels instead of the official figures (see Appendix 3 for marginal effects plot). Under the new measure of this dependent variable, evidence for hypothesis 1 is still strong: single-party governments increase their deficits in election years by a large and significant margin compared to the post-election period. The size of this point estimate is now even larger than in the earlier models. In other words, when looking at the change in debt instead of the official reported deficits, electioneering under single-party governments is even stronger. By contrast, however, no electoral budget cycle has been detected for coalition governments regardless of power fragmentation within them, proxied by the PM-FM dummy. The only noteworthy finding here is that under PM-FM alignment, a large consolidation effort takes place in the middle of the electoral cycle. Under the most divided setting, coalition rule with PM-FM non-alignment, no evidence for political budget cycles has been found whatsoever, consistent with our second hypothesis.

II.5. Conclusions

The fact that elections matter for fiscal outcomes comes as no surprise. What this article sought to demonstrate, however, is that incentives to undertake pre-electoral fiscal expansions largely depend on the political fragmentation of governments. Following the predictions from a simple model on a bargaining-game between coalition partners, I hypothesized that single-party governments display a higher propensity to electioneer.

Furthermore, the power asymmetry in coalitions, proxied by the party-alignment of the prime minister and the finance minister, the two most powerful government players in the allocation of public funds, has been tested as a further conditioning factor on the prevalence and size of political budget cycles. Therefore, my predictions ran counter to the common resource pool paradigm's extension to PBCs, which predicts that incentives to overspend are larger in fragmented coalition settings.

The findings from 25 EU member states provided strong and robust empirical evidence for my theory. Whether one looks at the full sample of EU member states or a limited sample of older democracies where voters are likely to be more familiar with the opportunistic incentives of incumbents, political cohesion has been shown to increase PBCs. Also, the fact some of the elections in our sample were held ahead of schedule did not fundamentally change our main results. Furthermore, whether deficits were measured by officially reported figures or by the change in debt levels which are harder to manipulate gave rise to the same broad patterns across government types over the electoral cycle. In line with expectations, I also found that election-related fiscal swings almost entirely come from the expenditure side.

One obvious limitation of this study was a fairly parsimonious account of political cohesion/fragmentation. Surely, the control of specific ministries beyond the powerful finance portfolio matters for policy-making leverage in budgeting. Furthermore, a number of countries in my sample have a tradition of minority (Denmark, Sweden) or oversized coalition (Finland) governments which provide theoretically ambiguous expectations for propensities to electioneer. While a single-party minority government is surely weaker than a single-party majority one (Edin and Ohlsson, 1991), the fact that it doesn't have to abide by the coalition partners' priorities in budget drafting may easily outweigh its minority status in the legislature in terms of its propensity and capacity to carry out electorally induced fiscal expansions. Similarly, on the one hand, oversized coalitions contain a large number of parties and hence possibly large party-political division in important portfolios. On the other hand, the fact that some coalition partners are disposable without running the risk of calling early elections potentially strengthens these governments. More attention to these nuances in policy-making dispersion in parliamentary democracies with regards to fiscal outcomes would be a most welcome research effort in the future.

Appendix 1

Table II.4
Data Sources

Variables	Source
Fiscal variables (General government net lending, expenditures and revenues	European Commission: ECOFIN economic databases
Electoral year types	Interparliamentary Union: Parline database
Political variables (single-party governments, pm-fm alignment)	European Journal of Political Research yearbook: ParlGov database
Economic control variables (growth, unemployment, debt, interest rates)	OECD economic outlook no.92
Other control variables (Dreher index, partisanship)	http://globalization.kof.ethz.ch/, CPDS comparative database, University of Bern

Appendix 2a

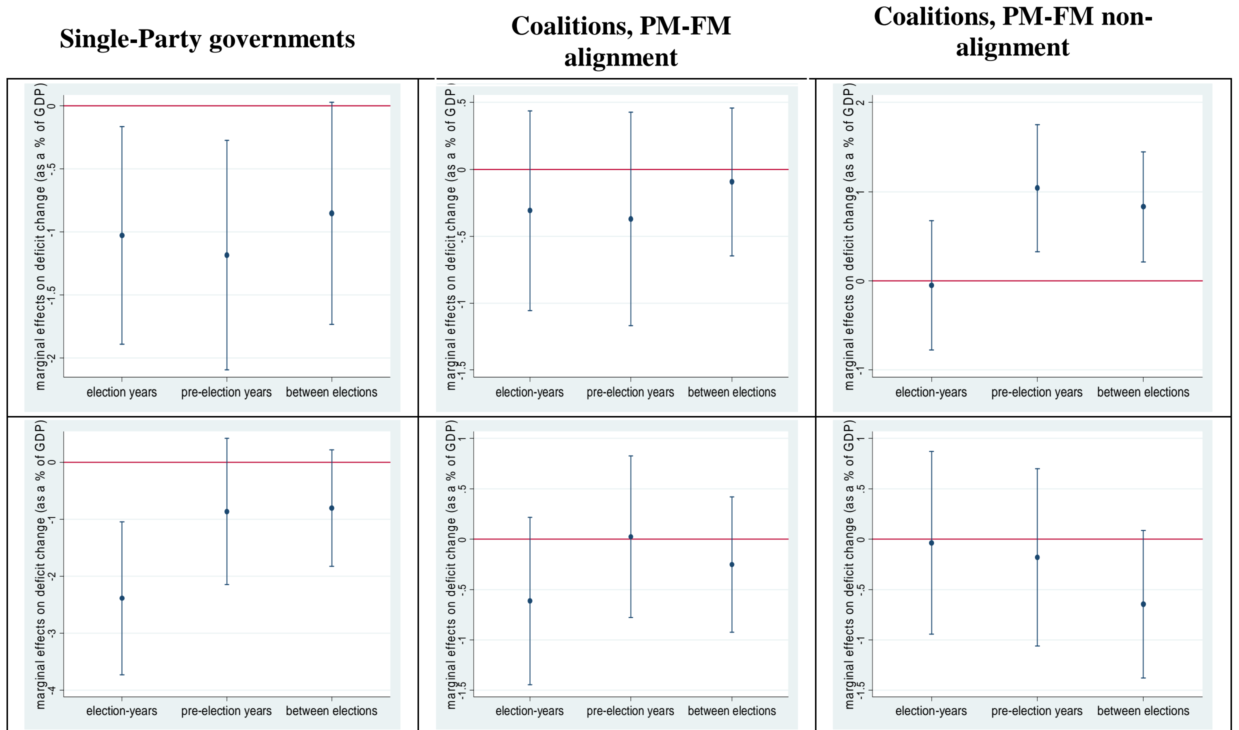
Table II.5
Regression output for the three-way interaction models†

	Δnetlending	Δnetlending	Δexpenditure	Δexpenditure	Δrevenue	Δrevenue
growth	0.137**	0.142**	-0.303**	-0.326**	-0.153**	-0.169**
	(3.69)	(3.77)	(7.44)	(9.40)	(5.11)	(6.63)
election	-0.002	0.019	-0.393	-0.426	-0.436*	-0.460*
	(0.00)	(0.07)	(1.18)	(1.63)	(2.12)	(2.25)
pre-election	0.702*	0.661*	-0.767*	-0.717**	-0.060	-0.053
	(2.16)	(2.29)	(2.22)	(2.74)	(0.26)	(0.24)
betweenelections	0.216	0.152	-0.431	-0.329	-0.206	-0.171
	(0.58)	(0.50)	(1.09)	(1.15)	(0.95)	(0.81)
singleparty	0.252	0.845	-1.165	-1.653	-0.822	-0.663
	(0.19)	(0.94)	(0.68)	(1.78)	(0.84)	(0.76)
pmfm	0.349	0.356	-0.514	-0.514	-0.209	-0.205
	(0.97)	(1.15)	(1.41)	(1.81)	(0.91)	(0.92)
pmfm*singleparty	0.231	-0.394	1.005	1.437	1.260	1.013
	(0.17)	(0.42)	(0.58)	(1.51)	(1.26)	(1.13)
election*singleparty	1.506	-1.395	-0.954	2.710*	0.564	1.306
	(0.94)	(1.18)	(0.47)	(2.56)	(0.48)	(1.30)
election*pmfm	-0.540	-0.547	0.574	0.618	0.128	0.181
	(1.11)	(1.27)	(1.18)	(1.57)	(0.44)	(0.62)
election*singleparty*pmfm	-2.490	0.482	1.537	-2.035	-0.986	-1.567
	(1.53)	(0.38)	(0.75)	(1.82)	(0.79)	(1.47)
pre-election*singleparty	-2.682	-2.965**	2.487	3.220**	-0.255	0.092
	(1.68)	(2.69)	(1.21)	(3.25)	(0.20)	(0.09)
pre-election*pmfm	-1.350**	-1.315**	1.344**	1.323**	0.079	0.103
	(2.79)	(3.16)	(2.78)	(3.50)	(0.26)	(0.35)
pre-election*singleparty*pmfm	2.934	3.220**	-3.036	-3.645**	-0.097	-0.326
	(1.79)	(2.76)	(1.44)	(3.32)	(0.07)	(0.29)
betweenelections*singleparty	-0.849	-1.118	2.197	2.391	1.338	1.250
	(0.38)	(0.64)	(0.97)	(1.77)	(1.01)	(0.96)
betweenelections*pmfm	-0.247	-0.177	0.562	0.410	0.301	0.222
	(0.49)	(0.42)	(1.10)	(1.05)	(1.03)	(0.78)
betweenelections*singleparty*pmfm	0.553	0.918	-2.320	-2.366	-1.716	-1.392
	(0.24)	(0.51)	(1.01)	(1.65)	(1.23)	(1.03)
unemployment		-0.022		-0.036		-0.055*
		(0.64)		(1.34)		(2.13)
dreherindex		0.018		-0.029		-0.022
		(0.73)		(1.52)		(1.21)
L.realrates		0.002		-0.007**		-0.004
		(1.23)		(2.70)		(1.92)
L.debt		0.030**		-0.022**		0.010*
		(4.81)		(4.03)		(2.39)
left		-0.001		0.001		0.000
		(0.50)		(0.51)		(0.13)
R^2	0.34	0.37	0.42	0.46	0.21	0.24
N	625	611	625	611	625	611

* p<0.05; ** p<0.01
†Fixed-effect estimates with panel-corrected standard errors

Appendix 2b

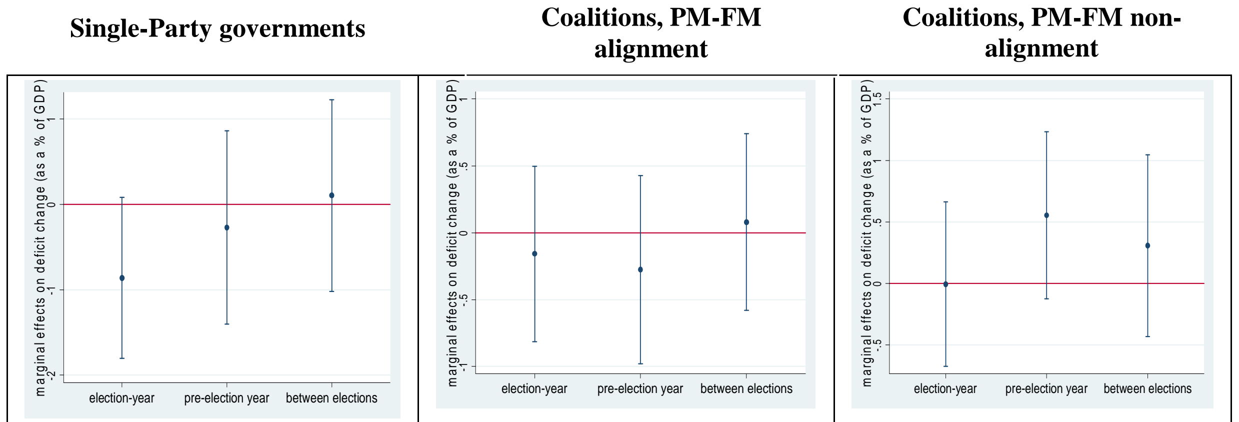
Figure II.6
Point estimates and 95% intervals for the effect of the electoral cycle on annual deficit change under different political constellations by regular (row 1) and early (row 2) elections*



* Effects are estimated relative to the benchmark, post-election year

Appendix 2c

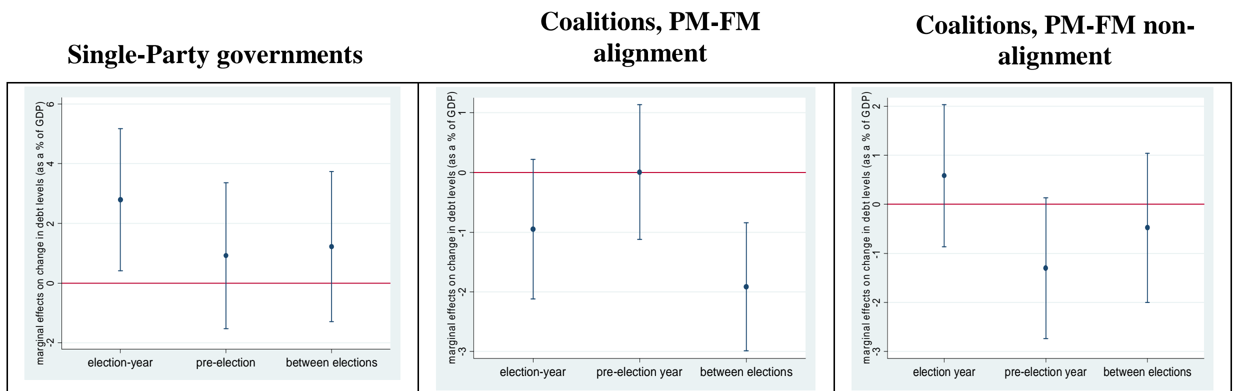
Figure II.7
Point estimates and 95% confidence intervals for the effect of the electoral cycle on annual deficit change under different political constellations in old democracies*



* Effects are estimated relative to the benchmark, post-election year

Appendix 2d

Figure II.8
Point estimates and 95% intervals for the effect of the electoral cycle on annual deficit change, measured by the change in debt levels*



* Effects are estimated relative to the benchmark, post-election year

Appendix 3

TableII.6
Diagnostic test-results*

Test	Dependent Variable	Test-statistic, p-value
Kruskill-Wallis test for differences between group medians	Δdeficits for singleparty governments	Chi-square statistic:11.838 p-value: 0.008
	Δdeficits for coalition governments with pm-fm alignment	Chi-square statistic: 3.696 p-value: 0.296
	Δdeficits for coalition governments with pm-fm non-alignment	Chi-square statistic: 5.926 p-value:0.115
	Δexpenditure for singleparty governments	Chi-square statistic: 5.93 p-value: 0.115
	Δexpenditure for coalition governments with pm-fm alignment	Chi-square statistic:0.663 p-value: 0.882
	Δexpenditure for coalition governments with pm-fm non-alignment	Chi-square statistic:1.95 p-value: 0.58
F-test for country dummies	Δdeficits	F-statistic: 2.21 p-value: 0.0013
	Δexpenditure	F-statistic: 2.88 p-value<0.0001
F-test for year dummies	Δdeficits	F-statistic: 2.55 p-value<0.0001
	Δexpenditure	F-statistic: 2.03 p-value=0.0004
Hausman-test	Δdeficits	Chi-square statistic: 50.65 p-value <0.0001
	Δexpenditure	Chi-square statistic: 46.51 P=value: 0.0001

Modified Wald test for groupwise heteroskedasticity	Δdeficits Δexpenditure	Chi-square: 241.47 P-value<0.0001 Chi-square: 658.6 P-value<0.0001
Pesaran test for cross-sectional dependence	Δdeficits Δexpenditure	CD-statistic: 4.815 P-value <0.0001 3.498 P-value=0.0005
Wooldridge (Langrange Multiplier) test for first-order serial correlation	Δdeficits Δexpenditure	F-statistic:0.091 P-value: 0.7662 F-statistic: 0.291 P-value: 0.5952

*Diagnostic tests were conducted based on the fully specified models

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Essay II

Rational Voters and the Keynesian Electorate?

Evidence from the UK

Abstract:
This article contributes to economic voting research by drawing attention to an overlooked factor in the "clarity of responsibility" thesis. Rational voters' responsibility attribution should be targeted at the macroeconomic policies pursued by incumbents rather than the economic outcomes themselves. Developing this idea in a rational choice framework in the United Kingdom, I demonstrate that business cycle fluctuations condition the electoral response to fiscal decisions taken by incumbents. First, relying on the British Election Studies' post-election surveys on the individual level, I show that the median voter's fiscal preferences realign with different income groups as business cycle conditions change. Second, by using time-series analysis on the aggregate-level, I argue that this re-alignment gives rise to a counter-cyclical voting pattern in response to fiscal decisions taken by incumbent governments. This counter-cyclical voting helps our understanding of why the simple "reward-punishment thesis" in economic voting research has produced mixed and unstable results in past research.

III.1. Introduction

The broad relationship between economic performance and government accountability is one of the most studied research areas in political economy. The highly intuitive and seemingly uncontroversial observation that support for incumbents and re-election prospects depend on economic conditions has triggered a rich literature with different strands from the 1970s onwards: partisan theory, political business cycle research and economic voting. The point of departure of this article is the third strand or the "demand-side" of the economics-incumbency nexus: Is the electoral response adequately captured by the reward-punishment hypothesis?[28] Alternatively, do voters distinguish between macroeconomic outcomes and the policy choices leading up to these outcomes? In other words, are voters fundamentally outcome-oriented or are they able to hold incumbents accountable for the specific policies they pursue? Moreover, to the extent voters do assess economic policy-making when casting their vote, is the electoral response uniform over time or is it conditioned by underlying macroeconomic conditions?

These questions should be understood against the backdrop of more than forty years of research on the "demand-side" of our conceptual equation, generating 500+ articles and books in the field (Lewis-Beck and Stegmaier, 2007). Economic voting, as it came to be known, postulated one of the most robust "iron laws" in political economy: incumbent governments tend to be punished by disappointing economic performance and rewarded by economic prosperity.

However, when the pioneers of economic voting went beyond their turf (mostly the US and the UK) and began to undertake cross-country comparisons, the consistency of prior results seemed to buckle. As my literature review will show, not all electorates seemed to hold incumbents accountable equally and in some cases the relationship simply broke down. As a response to this conundrum, a new paradigm started to emerge: the simple reward-punishment hypothesis gave way to the "clarity of responsibility" thesis (Powell and Whitten, 1993): the domestic institutional context as

[28] For an extensive review of the early versions of the simple reward-punishment hypothesis, see Nannestad and Paldam (1994)

well as changes in the world economy fundamentally alter the extent to which the electorate is able to credit/blame governments for their assumed impact on the macro-economy. More concisely, where clarity of responsibility is high, economic voting remains strong. In contexts where the clarity of responsibility is weaker, economic voting dampens or disappears. The responsibility paradigm, as will be subsequently shown, has been able to account for a large part in the variation of economic voting across countries and elections. As one of the earliest extensive reviews captured the moral of the story in a nutshell, around one third of the change in vote share of governments can be explained by economics when these issues are accounted for (Nannested and Paldam, 1994).

Such a sophisticated electoral assessment of incumbent competence admits a great degree of rationality to the economic voter. As this article will argue, however, this rationality sits uneasily with economic outcomes rather than the policies that lead up to these outcomes as the main object of responsibility attribution. Rational voters should break the broad link between outcomes and electoral reward/punishment and bring accountability closer to where actual decisions are made: fiscal choices. This article will therefore push the responsibility paradigm to its substantive conclusion where the variable of interest for voters is one of means rather than ends. If governments use these means (fiscal policy) in an optimal fashion, they should be rewarded. Otherwise, they should be punished.

To date, the link between fiscal policy and electoral fortunes has been surprisingly tenuous, according to most empirical studies in the field (Alesina et al, 1998, 2012; Brender and Drazen, 2008; Mulas-Granados, 2006). Neither pre-electoral fiscal stances in general nor more extended fiscal adjustment periods in particular have been found to be strong predictors of re-election prospects of incumbent governments. If the link between economic outcomes and electoral fortunes are robust, especially in the contexts of high policy-making responsibility, it is rather puzzling that the very policies that incumbents employ to achieve the desired economic outcome provide so little explanatory power for electoral success or failure. This article offers an explanation for this puzzle in a rational-choice framework. Individuals' cost-benefit calculations on fiscal policy change across the business cycle. In particular, the preference alignment for expansionary/contractionary policies of different income groups depends on varying

labour market conditions along the business cycle. My findings offer evidence on counter-cyclical preference changes and vote intentions on incumbents among the British electorate. It is therefore not the fiscal stance per se that determines incumbents' re-election prospects, but the interaction between the underlying economic conditions and fiscal policy that exerts a sizeable influence on incumbent popularity.

The structure of this article runs as follows. Section II will offer a brief literature review on economic voting starting from the classics to the recent state of the responsibility paradigm. Section III introduces my theory in a rational choice framework leading up to my hypotheses on electoral behaviour in response to fiscal choices. Section IV will introduce my case study and my two-pronged empirical strategy on the individual- and the aggregate-level, respectively. Section V will present my findings. Section VI concludes.

III.2. Literature review: from economic to fiscal voting

Although sometimes credited to the "lost chapter"(Lewis-Beck and Stegmaier, 2009) in Campbell et al's path-breaking work, the American Voter(Campbell et al, 1960). economic voting research usually takes Goodhart and Bhansali's (1970) and Kramer's (1971) seminal contributions as its reference point. These early works were grounded in the neat two-party competition of the US and the UK, where voters had a clear choice between two candidates (parties) and their economic record. Research thus earnestly began on the relationship between macroeconomic aggregates and vote/popularity of incumbents. The so-called VP-function was thus born, wherein incumbent's vote share/popularity was modelled as a function of economic and political determinants. While the choice of the right economic variable on the "right-hand side" triggered some debate, the political determinants were largely left to some variables capturing "events" –such as the Falkland's war during the Thatcher government (Norpoth, 1987) –and some trend variable accounting for the natural effects of the electoral cycle: typically a honeymoon effect followed by gradual popularity erosion only to reverse in the

campaign period was chosen to pick up this near-universal fate of incumbents(Veiga and Veiga, 2004; Bellucci and Lewis-Beck, 2011).

In the early days, economic voting was studied on the aggregate level. After much empirical work on the US (Kramer, 1971) and the UK (Goodhart and Bhansali, 1970; Whiteley, 1980, 1986) European scholars ventured outside these safe two-party domains into multi-party contexts and continue to do so until the present day. This European literature is simply too voluminous to cite for our present purposes; it suffices to say that starting from the largest European countries – France, Germany (Lafay, 1985; Frey and Schneider, 1980) – through the European periphery – Italy, Spain, Portugal, Ireland (Lewis-Beck and Bellucci, 1982; Bravo, 1987; Veiga and Veiga, 2004; Harrison and Marsh, 1998) – VP functions were fit on single country data with largely consistent findings: the three most important economic variables, unemployment, inflation and income growth have had large, albeit varying, explanatory power in accounting for the fate of incumbents at the polls. More recently, pooled studies have also been performed for advanced economies with similar results (Bellucci and Lewis-Beck, 2011). Interestingly, the VP function also held up rather well in new democracies (Lewis-Beck and Stegmaier, 2008).

While the aggregate-level relationship between vote/popularity of incumbents and the macro-economy has been impressive, it says little about individual considerations of the vote. It is tempting to fall in the trap of the ecological fallacy, whereby individual-level conclusions are prematurely drawn from aggregate-level evidence. Only with the advent of regular election surveys (e.g. NES in the US and BES in the UK) did it become possible to look at the individual-level determinants of the vote choice. In an early work, Lewis-Beck provides comprehensive evidence of economic voting occurring at the individual level (Lewis-Beck, 1988). Taking data from various Eurobarometer surveys, the author regularly finds subjective economic evaluations as strong predictors of the vote choice for incumbents. More recently, Nadeau et al (2002) and Duch and Stevenson (2008) followed this approach by pooling electoral surveys across nations to gain insights into the determinants of the vote choice. In both cases, individual-level economic voting received substantial empirical support.

Notwithstanding these successes, individual-level studies have grappled with a number of issues for decades. Just like aggregate-level researchers long-debated the most appropriate macro-variable to use, individual-level studies fought hard to establish some sort of consensus on two particular dilemmas: 1) Do voters care mostly about their personal finances (pocketbook voting) or the broader state of the economy (socio-tropic voting) when casting their votes? 2) Do voters judge the past performance of the economy (retrospective voting) or make their choice based on what they can expect (prospective voting)? While the jury is still largely out, the overall evidence seems to point towards retrospective, socio-tropic voting.

Moreover, much thought has been devoted to the potential endogeneity bias in assessing the overall state of the economy; to the extent that a large number of voters are driven by partisan convictions, they will find it hard to make an ideologically unbiased assessment of the economy. This-so called partisan rationalization argument has often been ignored or trivialized as a nuisance. Promisingly, however, Duch and Stevenson (2008:4) explicitly address this possibility and show that individual-level economic voting still holds up. Moreover, in a subsequent article, the authors documented that subjective economic evaluations tend to track the real economy relatively closely, mitigating the potential bias from partisan rationalization (ibid, 2011).

The substantive and statistical significance for most economic voting coefficients in both aggregate-level and individual-level studies did not divert attention from an inconvenient fact, however. While the overall evidence was clear, when VP-functions or survey-based regressions were fit on the data, the estimated impact varied largely from country to country and across time. What Nannestad and Paldam referred to as the "predicament of instability" of the VP function (1994, p.214) was gradually resolved by the emerging responsibility paradigm. Although noted much earlier before them(Lewis-Beck, 1988) Powell and Whitten's (1993) seminal article offered the first concise theory on institutional and political determinants that condition the economic vote. Looking at factors like coalition governments, coalition cohesion, divided government (or cohabitation in the French case), upper chamber controlled by an opposition party, federalism etc., the authors demonstrated that where the responsibility for policymaking is blurred, economic voting weakens. Nadeau et al (2002) push this point further by

constructing an index of responsibility taking short-run, medium-run and long-run features of the political system into account and arrive at similar conclusions. Specific aspects of the responsibility paradigm were taken up by Pacek and Radcliff (1995) and Hellwig (2001) who demonstrate, respectively, that welfare state generosity, by dampening the effects of the business cycle on society and economic openness, by rendering economic outcomes at the mercy of the global economic conditions weaken economic voting. Most comprehensively, Duch and Stevenson (2008:5) run individual-level regressions from 163 election surveys and use these individual estimates to explore the responsibility paradigm. Their approach rests on the assumption of instrumentally rational voters who are faced with a signal extraction problem from incumbents[29]. Their conclusions, in line with earlier studies, is that when the ratio of electorally accountable decision-makers (mostly government party leaders and ministers) to non-accountable ones (entrenched civil service, wage-bargainers, regulators, foreign decision-makers in the context of small and open economies etc.) grows, economic voting strengthens. Moreover, the signal-extraction also becomes difficult when responsibility is split among the electorally accountable decision-makers, so here again, we observe dampened economic voting.

In sum, there is a lot be said for the responsibility paradigm in accounting for the instability of the VP function. That said, as this article will argue, the most obvious facet of government responsibility has not been adequately addressed thus far. Rational voters before observing economic outcomes (and hence faced with the difficult signal extraction problem from Alesina and Rosenthal's (1995) model) observe economic policy variables under the government's control. In particular, fiscal policy lies at the heart of so many political debates not only because of its impact on the economy but also because of its distributional impact on household income..

Studies recognizing the importance of fiscal policy as potentially important determinant of incumbent popularity, however, have reached inconclusive results. The fiscal adjustment literature, in particular, has largely produced non-findings, ie. no systematic relationships between adjustment efforts and re-election prospects (Alesina et al, 1999, 2012; Mulas Granados, 2006; Ilera and Mulas-Granados, 2001; Von Hagen et al,

[29] See also Alesina and Rosenthal (1995) for the original version of the signal extraction model.

2002). While the potential selection bias in the observed retrenchment episodes has been recognized and partly addressed[30], the overall message remains: voters do not seem to punish contractionary fiscal policies at the polls. If anything, the opposite has been found by other studies that do not restrict their attention to periods of austerity. Brender and Drazen (2008) find statistical evidence in a cross-national analysis that the popularity of incumbents drops after loose fiscal policies. Similar evidence has been provided on sub-national levels in different country-case studies (Peltzman, 1992; Brender, 2003; Drazen and Eslava, 2007). Most recently, Sattler et al (2010) employ a sophisticated VAR-analysis to evaluate the two-way causality between vote intentions and fiscal shocks and reach similar conclusions: fiscal stimuli lead to drops in vote intentions on incumbents. These findings seem to be hard to reconcile with the main story of economic voting: why do voters seem to be indifferent at best and outright hostile at worst to policies that aim to boost economic growth? Are voters inherently fiscally conservative or is there a more nuanced electoral calculus at play?

One inherent difficulty of understanding the electoral logic of fiscal policy is voters' heterogeneity in redistributive interests. A number of individual-level studies have incorporated voter heterogeneity in assessing the impact of economic perceptions on the vote choice (Lewis Beck and Stegmaier, 2011, Lewis-Beck et al, 2012; Palmer and Whitten, 2009). These studies, however, are silent on the dynamic nature of voters' interests: in particular, changing economic conditions in general and labour-market conditions in particular present voters with different considerations when assessing the cost-benefit implications of fiscal stimuli[31]. The following section conceptualizes this idea and offers testable hypotheses on the interaction between economic conditions and the impact of fiscal policy on governments' popularity rating.

[30] The selection bias results from the possibility that strong/popular governments are more likely to undertake fiscal adjustment, confounding the causal effect running from adjustment to re-election prospects (Alesina et al, 2012).

[31] The best-known theory on dynamic preference formation has been postulated by thermostatic theory (Wlezien, 1995). However, thermostatic theory is largely silent on the micro-logic of cost-benefit calculation that my theory builds upon.

III.3. Theory and hypotheses: the cost-benefit calculation of the electoral space

As indicated in the previous section, some of the questions regarding individual-level economic voting are still unresolved. In particular, retrospective vs. prospective and pocketbook vs. socio-tropic considerations have been largely left to empirical modelling by a "let the data speak" approach. Duch and Stevenson's (2008) work is a welcome exception wherein they model voters making instrumentally rational choices by drawing retrospective inference to incumbent's competence in running the economy. Instead of the complicated signal-extraction problem that their model assumes voters are facing, I will put forward a more simple model where voters on the one hand look at past fiscal decisions (retrospective motivations) and form expectations on the likely consequences of these decisions (debt and/or taxes). The cost-benefit calculations are primarily based on self-interested (pocketbook) motivations, as it is customary in rational-choice approaches.

Moreover, my stylized model rests on a long tradition in political economy that views redistributive conflicts as an outcome of class-coalitions between different groups of voters. Instead of viewing redistributive pressures on governments as a function of inequality (Meltzer and Richards; 1981), the type of electoral systems (Iversen and Soskice, 2006) or a broad coalition between employers and workers (Hall and Soskice, 2001; Mares, 2003) in a long-term, static perspective, however, I argue that short-term swings in the business cycle present a dynamically changing preference alignment for more/less redistribution between different income groups. In particular, business cycle conditions affect the share of recipients of different public services and the distribution of costs to finance them. Also, a given fiscal decision may generate different kind of expectations on its economic effects when taking into account different business cycle conditions. I will therefore first take a status-quo situation, approximated by full employment (or some NAIRU-level[32] unemployment) and compare the cost-benefit calculation of different voters to that after a positive unemployment shock.

[32] The NAIRU level of unemployment is one that is consistent with stable prices in an economy that is growing at or close to its potential rate.

Unemployment is chosen as my conditioning variable for three reasons. First, as the previous literature review indicated, it appeared as one of the most likely candidates in economic voting research for capturing the electoral effects of business cycle fluctuations. Secondly, unemployment generally receives privileged media focus and therefore is the one information cue – along with inflation – that most voters, presumably, can acquire at relatively little transaction costs. Thirdly, unemployment, as opposed to GDP growth for instance, is something that those affected (or are threatened by) can directly feel.

More specifically, my theory takes a number of additional assumptions with the following rationales.

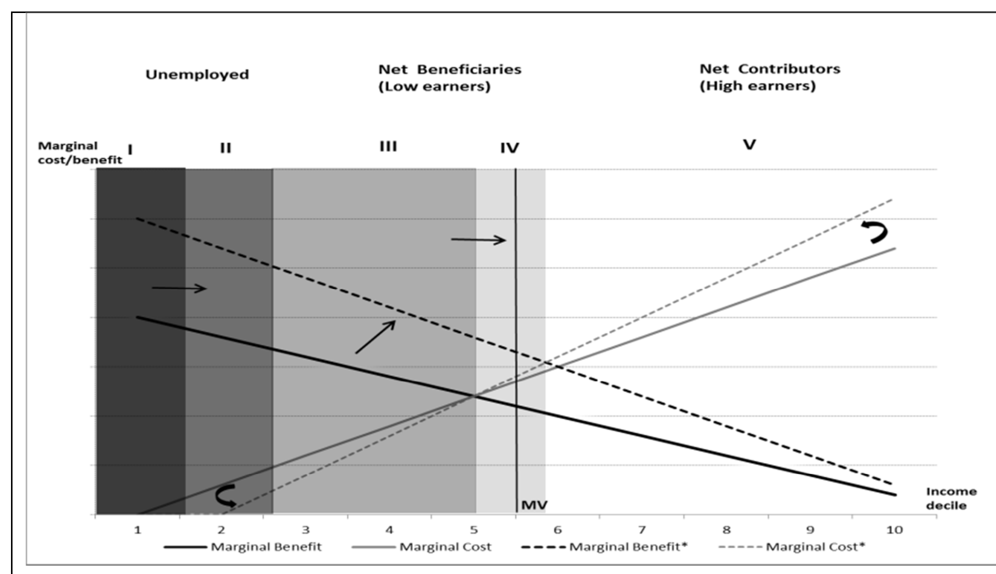
1) Two major parties (The Conservatives and Labour in the British context) compete for votes in a median voter framework. One can think of the electoral space as the set of undecided, or swing voters that either haven't decided whether to vote or abstain, or which major parties they would cast their vote for. More specifically, when the (expected) Marginal Benefit (MB) of a fiscal policy choice exceeds its (expected) Marginal Cost (MC) for a given voter, she will support the incumbent and abstain/vote for the opposition otherwise. While the two-party system assumption admittedly limits the model's generalizability, its advantage is that it presents a strong test against the simple reward-punishment hypothesis because it is exactly in such high clarity of responsibility contexts where one would expect macroeconomic outcomes to exert the strongest influence on the vote choice.
2) Alternative voting motives, such as class loyalty (Evans 2000; Evans and Tilly; 2012), issue-, valence-(Green and Hobolt, 2008) or value-based voting (Walczak et al, 2010) have been found to be important determinants of the vote choice. However, to the extent that certain segments of the electorate are swayed by these, rather than redistributive considerations, I will assume that these influences do not systematically co-vary with the electoral impact of redistributive policies.
3) Voters can be ordered on an income scale by income deciles.

4) The government delivers public services in the political economy. While some of these services are universal (e.g. NHS), others are means-tested (such as housing benefits) and mainly benefit low-income voters. Moreover, to the extent that the monetary value of these services takes up a larger share of low-income voters' budgets, any additional unit of service delivery entails higher marginal benefits for them. From these considerations it follows that the MB curve is downward sloping with income.
5) The tax system is progressive with expected future taxes rising steadily with income.
6) High-income voters are relatively debt- and hence inflation-sensitive because of higher savings (following from partisan theory (Hibbs, 1977))
7) From 5) and 6) it follows that the MC curve of public services is upward sloping with income. High-income voters are relatively averse to extra spending because their future tax burden will rise (Assumption 5) and/or the real value of their debt holding becomes riskier (through rising risk premia or inflation) hence lose in value (Assumption 6).

Our conceptual electoral space is depicted on Figure III.1

Figure III.1

Changing cost-benefit calculation of the electoral space after a positive unemployment shock



The solid lines represent the cost-benefit calculation at a status-quo level of equilibrium-employment. Area I on the left includes the originally unemployed, approximated by the first income decile. Area II and III comprise the original set of net beneficiaries of the tax-benefit system who can be thought of as low-wage earners. Because of tax progressivity, low debt holdings and targeted/means-tested benefits, their marginal benefit from a given increase in spending exceeds the marginal cost. The MB curve is downward sloping as the relatively wealthy gain less from additional spending but never quite reaches 0 because they also benefit from some of the public services that the government delivers. However, since additional spending will have to be financed by taxes or debt, these high-income deciles (Area IV and V) will expect to be net contributors to government finances. A higher share of future taxes will fall onto them (assumption 5) and the real value of their debt holding will lose in value if the additional spending is inflationary or higher risk premia depress the value of outstanding bonds (assumption 6). Overall, therefore, those in area IV and V are spending-averse and get negative utility – the difference between MB and MC – from extra spending at the status quo.

A positive unemployment shock, indicated by the arrows and the dashed lines shifts, increases the pool of unemployed on the one hand and raises the risk of unemployment across all income groups on the other. The larger pool of unemployed now captures area II in addition to area I. At the same time, the net beneficiaries of government finances now comprise area IV as voters towards the middle of the income scale are now threatened by unemployment and/or forced to accept lower-paying jobs. What this means for their cost-benefit assessment is that any additional spending stimulus delivers higher marginal benefit to them for two reasons. First, their lower income may qualify them for spending programmes that they had been excluded from before and universal programmes now serve as a more important complement to their lower income. Second, the additional aggregate demand brought about by the stimulus improves the job prospects of voters affected by the unemployment shock. Towards higher up on the income scale, the shifted MB curve delivers less and less additional marginal benefit (assumption 4) so it converges back towards the original curve.

Turning to the MC schedule, the counter-clockwise rotation depicted on the graph results from the following considerations. First, the tax-base shrinks as the new pool of unemployed pay no direct taxes. To close the gap brought about by the recession, the government can choose to tax this lower base, or issue more debt with the possible implication of sustainability concerns, higher risk premia and fall in bond prices. In either case, voters higher up on the income scale will be faced with higher marginal costs.

On the balance, the following observation can be made. Originally, the median voter – whose position is indicated by the black vertical line – lies to the right of area III hence a net contributor to government finances. After the positive unemployment shock, however, the pool of net beneficiaries of extra spending shifts to the right and the median voter finds herself among them. To the extent that the location of the median voter drives aggregate-level support for incumbents, we can formulate two hypotheses to test the propositions above, one referring to the individual and one to the aggregate-level, respectively.

H1 (Individual-level hypothesis): The median voter's relative spending preference will change along the business cycle. At times of low unemployment, it will be aligned with wealthier voters. In economic downturns, it will realign with the poor.

H2 (Aggregate-level hypothesis): The electoral response to fiscal choices will follow a counter-cyclical pattern. At times of low unemployment, government support drops in response to extra spending. In economic downturns, however, it rises.

III.4. Case selection and methodology: the United Kingdom, the "Downsian laboratory"

Case Selection

It is important to point out here from the outset that in my case selection, I departed from the standard most-likely/least-likely case paradigm to disconfirm/confirm a running theme in the literature (for more detailed discussions, see George and Bennett, 2005; Gerring, 2007). Instead, my proposed theory being of an exploratory nature, I sought a case that fully satisfies the scope conditions of the theory and hence maximizes the empirical plausibility of the argument. Although this potentially limits the generalizability of the findings to other cases, it is still a useful first step in casting a new light on the interaction between economic conditions and economic policies in the electorate's voting calculus.

Turning to the aforementioned scope conditions for my proposed theory, they require a number of contextual features for the appropriate case study to satisfy. Most importantly, my point of departure is the responsibility paradigm which posits that electoral accountability is stronger in instances of clear institutional/political responsibility. The following considerations suggest that the United Kingdom is an appropriate case to test my hypotheses.

First, in terms of institutional responsibility, the British party scene with its first-past-the-post electoral system is among the closest ones to the neat Downsian world of a median voter framework, with two major parties in constant competition for office: The Conservative Party and the Labour Party. Moreover, the majority party in Westminster has an unparalleled control over public finances[33], avoiding complications in responsibility attribution that federalism (Germany, US, Spain), divided executives (US, France), strong bicameralism (US) can entail. Moreover, the number of non-electorally accountable decision-makers (Duch and Stevenson, 2008:7) is

[33] Recent devolution measures to Scotland and Wales did not fundamentally change the centralized nature of the British fiscal system

comparatively low: on both regulatory and corporatist grounds, the UK is remarkably thin; the general level of regulation is lower than in most Western European contexts and wage coordination is one of the lowest in the EU.

Secondly, in terms of non-institutional factors that may condition responsibility attribution the UK likewise scores relatively well for our purposes. While economic openness, measured in terms of exports plus imports/GDP puts the UK in the middle ranks of the EU, its welfare state relies to a large extent on means-tested programmes (Esping-Andersen, 1990:1), exposing large segments of the electorate to the vagaries of the business cycle. These considerations suggest that little will shelter British governments from the electorate's responsibility attribution to the consequences of fiscal decisions.

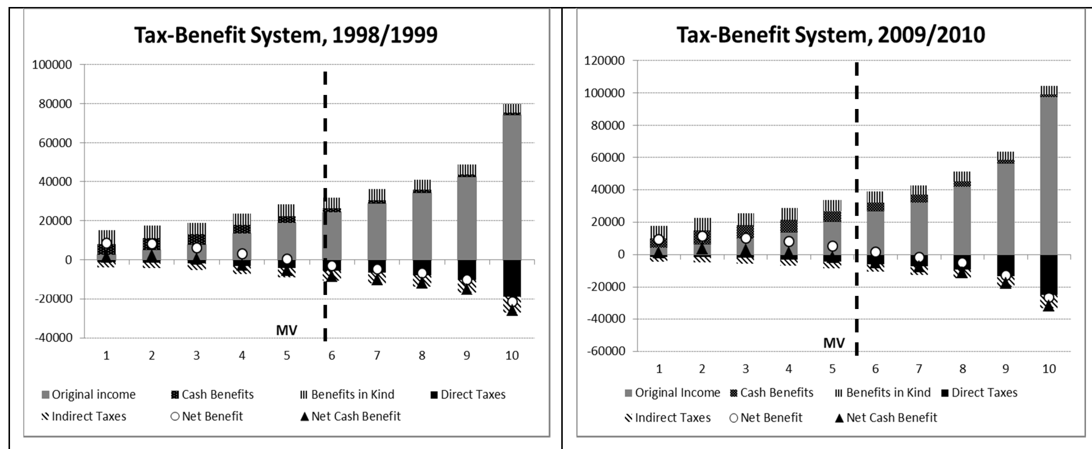
Thirdly, British public finances are among the most transparent to the public, bringing the cost of information acquiring down. Either through the media or their own efforts, British voters have all the means at their disposal to become informed about the government's budgetary decisions. Not least, this transparency also goes hand in hand with reliable data, reducing measurement error and increasing the validity of findings.

Fourthly, British governments, as if realizing that they must deliver if they are to get re-elected, employed the budgetary firepower at great regularity before elections. In fact, it is among those EU member states where political budget cycles have been the most prominent (Schultz, 1995). Perhaps not coincidentally, this went hand in hand with high saliency of fiscal decisions in British election campaigns. Partisan alignment, as will be shown later, is a strong predictor of fiscal preferences among the British public. This makes it likely that the policy position that incumbents are choosing on this issue domain is likely to affect the vote choice.

Lastly, British data allow a unique opportunity to look into the tax-benefit structure of public finances. As Figure III.2 shows, our conceptual model closely approximates the reality on the ground.

Figure III.2

The impact of the tax-benefit system of the UK among income groups



Source: Office of National Statistics (UK)

The columns, for each income decile, illustrate the estimated impact of the tax-benefit system. The components above the 0 line (original income, cash benefits and benefits in kind) add to, while those below (direct and indirect taxes) subtract from an individual's disposable income. The bubbles and triangles indicate the net position of individuals in given income deciles, ie. whether they are net beneficiaries from, or net contributors to the system. Admittedly, this does not take into account the effects of inflation and risk premia on outstanding bold holdings but still gives a reassuring first stab at the empirical task ahead: voters above the median voter appear to be net contributors to and those below net beneficiaries of the system.

Empirical strategy

The empirical sections that follow will test my two hypotheses on two different levels of analysis. In the first stage of my empirical strategy, the analysis will start from the individual level where the British Election Studies surveys helped me identify the spending preferences for different income groups. In the surveys, respondents were asked to report their household income on an annual basis. Using these responses, I constructed three categories – roughly equal in number of respondents – for lower income, higher income and middle income voters with the latter serving as my proxy group for the median voter. The dependent variable capturing spending preferences was based on a survey question asking the respondents to locate their preferences on a scale

ranging from "taxes and public services should be raised" to "taxes and public services should be cut". The advantage of this survey question is to address potential problems arising from fiscal illusion by drawing respondents' attention to the connection between taxes and spending. The disadvantage is that it doesn't allow for the possibility of debt finance, a potentially important consideration in voters' calculus. All in all, however, this survey question comes as close as one can get to obtain information on voters' fiscal preferences.

Ideally, one would like to track the change in each income group's absolute level of fiscal preference over time across different unemployment contexts. However, changes in the scaling[34] of the survey question across electoral surveys make the direct comparison of absolute preferences tricky. Therefore, my analysis was restricted to changes in the relative preference of the middle-income group compared to low-income and high-income voters, consistent with the re-alignment hypothesis (H1). Measuring changes in relative preferences is unproblematic as the scale of the response variable in any given survey is the same across individuals.

Furthermore, standard control variables were used that individual-level economic voting research generally relies on (Duch and Stevenson, 2008). Specifically, I controlled for age, gender, union membership, social class and partisanship. This latter control is especially important because it is both highly correlated with income and has a large and significant impact on tax-spending preferences. The exact wording for survey questions for the individual-level analysis is found in Appendix 1.

The individual-level analysis will be conducted by running OLS regressions in a number of cross-section studies taken after elections by the British Election Studies. The general formula will take the form of:

[34] Both the range of possible response categories and the ordering of the variable from more to less taxes/services as well as the minimum and maximum values for the variable changed from survey to survey, complicating direct comparison of mean responses over time.

$FP_i = \beta_0 + \beta_1 * LI_i + \beta_2 * HI_i + \sum_3^k \beta_k * C_{ki} + \varepsilon_i$, where

FP=Fiscal Preference

LI=Dummy variable for lower income voters

HI=Dummy variable for higher income voters

C= Vector of control variables

With middle income voters omitted as the reference category, the estimated coefficients for β_1 and β_2 will tell us where the median voter's fiscal preferences lie in relation to the lower and higher income segments of the electorate. If my hypothesis holds, one would expect a negatively signed significant coefficient on β_1 and an insignificant coefficient for β_2 in times of low unemployment. In times of high unemployment, one would expect the opposite: β_2 should be positively signed and significant, whereas β_1 should show up as non-significant in the results. To test the conditioning effect of unemployment, one would ideally like to pool the BES surveys and test cross-level interactions between level 1 (income group) and level-2 (unemployment) variables. However, an issue that has been long noted by multi-level researchers is the low statistical power of sample designs where the number of level-2 units (electoral surveys for our purposes) is not sufficiently large. In our case, the number of available electoral surveys in the British context – see a more detailed discussion later – is nowhere near the recommended minimum of 20 level-2 units that is often used as a rule of thumb in the literature units (Kreft and de Leeuw, 1998). For this reason, I opted to conduct the analysis in repeated cross-sectional designs across the various electoral contexts.

In the second stage of the analysis, the aggregate-level hypothesis on counter-cyclical voting will shift to the aggregate level in a time-series framework under the following reduced-form equation[35]:

[35] The often demanding assumption of contemporaneous exogeneity in reduced-form time-series models is relatively unproblematic for our purposes. While it is true that fiscal choices can be endogenous to government popularity, there are important lags (decision, implementation etc.) before the government can change track when faced with declining popularity. Moreover, the main explanatory variables are included with lags, further mitigating endogeneity concerns.

$$VI_t = \beta_0 + \beta_1 * VI_{t-1} + \beta_2 * E_t + \beta_3 * E_t2 + \beta_4 * U_{t-1} + \beta_5 * G_{t-1} + \beta_6 * (U_{t-1} * G_{t-1}) + \beta_7 * C_{t-1}$$

where,

VI_t = vote intentions at time t (on a quarterly average basis), as a % of respondents intending to vote for the incumbent party[36]

VI_{t-1} = is the autoregressive term for the AR(1) model. Test statistics from an Augmented Dickey Fuller test allowed me to reject the presence of unit-roots in the dependent variable at the 5% level. Having stationary series, running the model on levels was thus appropriate. Of the various forms of ARMA specifications tried, a simple (AR1) model provided the best fit based on the Bayesian and Akaike information criteria (Enders, 2004:2, p. 97)[37].

E_t and E_t^2 = a linear and a quadratic term to capture the effects of the electoral cycle on government popularity, measured by the number of quarters that have passed since the last election,

U_{t-1} = the unemployment rate at time t-1 (on a quarterly average basis)

G_{t-1} = government spending on goods and services at time t-1 (on a quarterly basis as a % of GDP),

$U_{t-1}*G_{t-1}$ = an interactive term capturing the conditioning effect of unemployment on the effect of spending on vote intentions,

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[36] The choice of vote-intention rather than other popularity measures – such as government approval – is a conservative test for my argument because it is less likely to respond to economic and political developments (Pickup, 2010).

[37] Having fitted the model, diagnostics were applied for the residuals to test for remaining autocorrelation and conditional heteroskedasticity. These tests showed that residuals were “white noise” hence the OLS estimates for the coefficients and their standard errors are valid. Results for the ADF test and diagnostics are available in Appendix 3

C_{t-1} = control terms for economic growth (since the spending variable is expressed as a % of GDP) and partisanship because of its potentially confounding effect on popularity.

While the net impact of fiscal policy results from the combination of tax and spending changes, this analysis focuses on the spending side of budgetary decisions for two main reasons. First, many items on the expenditure side of the budget have clearer redistributive consequences across income groups than broad-based tax measures do. Second, as the unit of analysis is quarters, we require a measure that is amenable to swift within year discretionary changes[38]. This condition is more likely to be satisfied by spending categories that fall under the Departmental Expenditure Limits[39] as opposed to broad-based transfer programmes or effective tax rates that automatically respond to business cycle fluctuations and require prior legislation to change their parameters.

Regarding the specific type of the spending variable used, two further considerations are important. First, it is necessary to use comparable data for the two levels of analysis; if respondents in the survey (see Appendix 1) have a different understanding of the variable of interest than what we measure on the aggregate-level, our aggregate-level findings will find little external validity. Since respondents are asked about the trade-off between taxes and services, I made sure to specify those expenditures where these services (health, education, housing etc.) mostly fall: government consumption of goods and services. Second, when governments undertake fiscal stimuli in the face of high unemployment, this is presumably where most of their efforts are concentrated as they represent a direct component of aggregate demand. Note that some items, most importantly cash transfers, are excluded from this measure due to their non-discretionary nature. To mitigate this potential problem, I reran my time-series models for general government current expenditures where most government spending items (cash transfers, production subsidies, etc.) are included.

[38] The discretionary nature of the fiscal variable is also important because responsibility attribution requires voters to link budgetary outcomes to government action.
[39] www.hm-treasury.gov.uk, last accessed on: 27/04/2013.

The lagged form of the main independent variables reflects the lag of information processing and preference change among the electorate. For sake of illustration, suppose that unemployment rises at time t. Two processes need to occur before an individual changes her vote choice: first, the information on unemployment has to become public. Second, a cognitive process requires the individual to attribute responsibility to the government which may go against her own partisan convictions. These two lags, information lag and cognitive lag, are captured by introducing the main independent variables in a lagged form.

The main coefficient of interest for our analysis is $\beta 6$, the one that stands for the interactive term. A statistically significant positive estimate on this coefficient would provide corroborative evidence on the counter-cyclical hypothesis: as unemployment increases the marginal effect of spending on popularity increases as well. Robustness check was applied by introducing a control variable for partisanship (a dummy term taking the value 1 when the incumbent is a Labour government and 0 otherwise) both in a linear and in an interactive form with spending. To the extent that partisanship is highly correlated with unemployment, the estimates for $\beta 5$ and $\beta 6$ could suffer from omitted variable bias. While we have no clear theoretical expectations on which partisan governments would be more (less) rewarded (penalized) by extra spending, it is nevertheless a potentially important factor to control for.

In the following section, I will discuss the findings on both levels of analysis.

III.5. Empirical results: re-alignment of the median voter and counter-cyclical voting

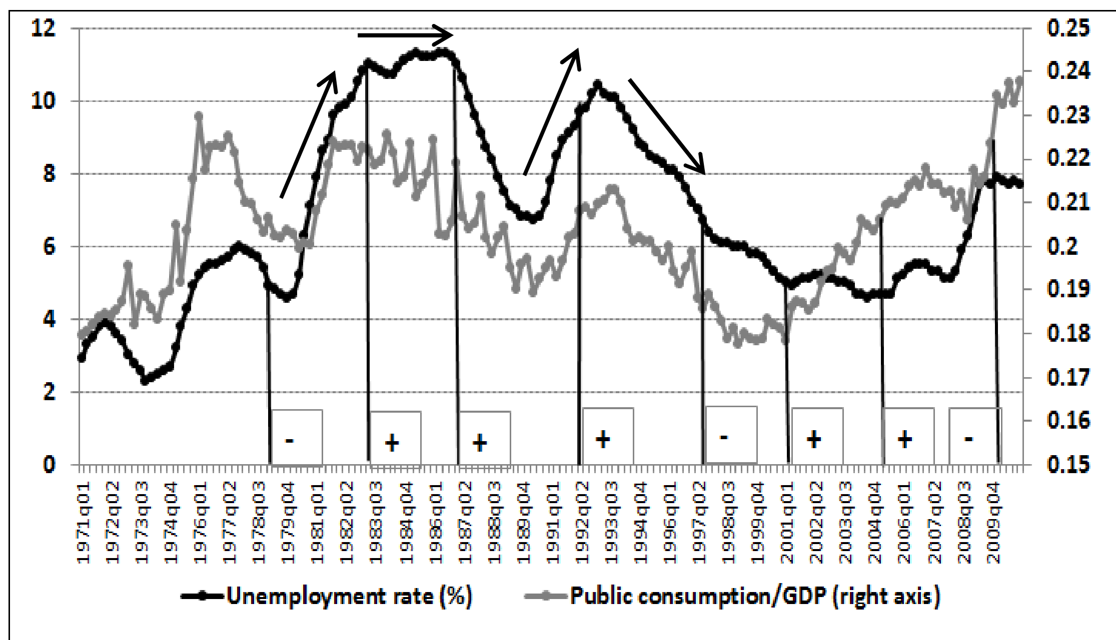
Overview

Before turning to the discussion of the empirical results, an overview of economic and fiscal developments throughout the sample period is in order. Figure III.3 shows the evolution of unemployment, public consumption as a share of GDP as well as the

elections marked by the solid black vertical lines (with the boxes at the bottom showing whether re-election was successful (+) or failed (-).

Figure III.3

Overview of economic and fiscal developments over the sample period



Source: OECD i.library; Office of National Statistics (UK)

The first observation that is clear from the graph is that unemployment, by itself, seems a very poor indicator of re-election prospects. Of the eight elections in our sample period, only four conform well to pure economic voting theory. The last three elections during New Labour were well predicted by low unemployment levels in 2001 and 2005 and economic distress in the wake of the recent credit crunch (2010). Similarly, the 1979 election heralding the Thatcher-era saw the end of the post-war Keynesian consensus when virtually full employment (unemployment rates still hovered between 2 and 4% in the early 1970s) had been the norm. However, the remaining four elections are problematic for our analysis. While Norpoth (1987) convincingly demonstrated that unemployment hurt the first Thatcher government's popularity and her re-election in 1983 was largely due to her management of the Falkland conflict, the remaining three elections (1987, 1992 and 1997) are genuinely problematic for pure unemployment-based economic voting. In 1987, unemployment had been trapped on a high plateau of 11-12% for four years as a consequence of the determination of the Conservative

government to put a lid on the wage-price spiral (Grant, 2002). Yet, the Thatcher government was resoundingly re-elected. The contexts for the 1992 and the 1997 elections show equally surprising patterns: rising unemployment preceded the successful re-election bid of the Tories in 1992 and improving labour-market conditions did not save them from the New Labour landslide in 1997. Whether this was due to fiscal policy choices under different business cycle conditions is the subject of the analysis below.

Individual-level analysis

Testing the first hypothesis requires looking at several election-surveys, since unemployment, for any given point in time when surveys are taken, is constant across individuals. The comparison across different surveys, however, presents a number of difficulties. Most importantly, the availability of the relevant survey question confined my analysis to seven electoral contexts: 1983, 1987, 1992, 1997, 2001, 2005 and 2010. However, while most surveys inquired about weakly/annual income of households in nominal (absolute) terms allowing me to construct income categories, the 1983 survey asked respondents to place themselves relative to others in society. This introduces measurement errors at all sorts of dimensions with unpredictable consequences. I thus opted to exclude 1983 from my analysis. My analysis thus covers the last six elections in the United Kingdom, three under Conservative (1987, 1992, 1997) and three under Labour (2001, 2005, 2010) incumbency.

Secondly, as indicated above, the ordering of the dependent variable (more vs. less services and taxes) changed from 2001, so I multiplied the dependent variable by -1 for the most recent elections to make the coefficient estimates directly comparable. In the analysis below, the dependent variable is thus measured on a 10-unit scale – with the exception of 1997 where the scale consisted of only 7 units - of respondents' preferences between lower taxes and services vs. higher taxes and service provision. Higher values in the dependent variable indicate preferences for more service provision and taxes to finance them.

Thirdly, comparing models requires consistency in specification and model selection by using similar control variables. As listed in the previous section, I used a narrow set of controls that were deemed important by the economic voting literature. The standard ideological control of self-placement on a left-right axis proved problematic because it was not included uniformly across the surveys. I thus chose a party identification variable instead as a proxy for ideology and derived a dummy variable from it taking on value 1 if the respondent is a conservative identifier and 0 otherwise. Furthermore, both working-class identification and union membership were not included in one of the surveys (2001 and 1987, respectively) so I had to omit them from the respective surveys. The estimated coefficients from OLS regressions40 for each of the six post-election surveys are given below in table III.1 in a chronologically descending order.

Table III.1

Individual-level predictions of tax-spending preferences for six elections (level of unemployment in brackets below the years) †

Year	2010	2005	2001	1997	1992	1987
Unemployment	(7.9%)	(4.7%)	(5%)	(7.2%)	(9.3%)	(11%)
low-income	0.262	0.271	0.372	0.366	0.307	0.141
	(1.78)*	(2.76)***	(3.25)***	(3.30)***	(1.72)*	(1.28)
high-income	0.110	-0.004	0.034	0.057	-0.179	0.104
	(0.83)	(0.05)	(0.30)	(0.56)	(1.14)	(1.03)
male	-0.446	-0.177	-0.250	0.090	-0.343	-0.284
	(4.06)***	(2.31)**	(2.81)***	(0.94)	(2.61)***	(3.36)***
age	-0.015	0.087	0.085	0.065	0.052	0.034
	(0.90)	(6.56)***	(5.61)***	(4.67)***	(2.30)**	(2.48)**
age2	0.000	-0.001	-0.001	-0.000	-0.001	-0.000
	(2.00)**	(4.93)***	(4.58)***	(3.13)***	(2.31)**	(1.99)**
workingclass	0.046	0.054		0.115	0.541	0.419
	(0.35)	(0.50)		(1.30)	(3.76)***	(4.34)***
unionmember	0.283	0.278	0.288	0.144	0.308	
	(2.15)**	(2.84)***	(2.74)***	(1.48)	(2.02)**	
conservative	-0.884	-0.670	-0.534	-1.071	0.643	-1.176
	(6.37)***	(5.23)***	(4.92)***	(11.11)***	(0.38)	(12.90)***
_cons	6.148	3.774	4.202	-5.565	-5.298	-4.962
	(14.41)***	(11.78)***	(11.17)***	(16.59)***	(10.15)***	(15.84)***
R^2	0.05	0.06	0.05	0.08	0.03	0.07
N	1,935	2,914	2,216	2,996	1,483	3,238

*p<0.1 **p<0.05 ***p<0.01

† OLS estimates with robust standard errors, t-statistics in parentheses

[40] Since the dependent variable has a fairly wide range, I opted for a linear model instead of ordinal logic/probit estimation to facilitate the interpretation of the coefficients. Both a White test and a Breusch-Pagan test indicated severe heteroskedasticity in the models (the H0 of homoscedastic errors were rejected at the 1% level in both tests) so I estimated robust standard errors to correct for it. The corresponding t-statistics are shown in parentheses below the coefficient estimates.

The levels of unemployment at the time of the different surveys (elections) should be put in the context of the range of unemployment levels in the UK over the sample period: 4.6% to 11.3%. Accordingly, the 2001 and the 2005 elections can be clearly regarded as low-unemployment contexts and the 1987 election as a high-unemployment context. Regarding the three remaining elections, in 1997 the job-market had been on an improving path with unemployment dropping for almost 20 consecutive quarters. In 2010, the reverse was the case; while the level of unemployment was not dramatically high, it had been on a rising trend with no economic recovery in sight. Finally, in 1992, again the trend had been one of increasing unemployment for several quarters.

Starting with the low-unemployment contexts, the preference alignment between the middle-income group and the high-income group is clearly borne out by the data. In both cases, the low-income dummy is highly significant ($p<0.01$) and positive whereas no statistically significant difference is found for the high-income group compared to the middle-income group. It seems, therefore that in solid economic conditions (low unemployment) the fiscal preference alignment between high earners and the middle-income group against the expansionary preferences of the low-income group is supported by the data.

Turning to the ambiguous (intermediate) settings, 1992, 1997 and 2010 – when unemployment stood at 9.2, 7.2% and 7.9%, respectively, the expectations for alliance formation are more nuanced. Findings from these surveys broadly conform to our expectations, however: first, in 1997, when the job-market trends pointed towards improving conditions the preference-alignment between the middle-income group and high-earners remains; the low-income dummy is still positively signed and strongly significant at the 1% level. By contrast, under less promising job-market conditions and prospects, in 1992 and 2010, the relationship disappears as neither low-earners nor high-earners appear to form significantly different fiscal preferences from the middle-income group ($p>0.05$ in both cases).

Finally, 1987 was an election year uniquely accompanied by double-digit unemployment rate (11%) in our sample. Here, the expectations are clear based on the theoretical model: the middle-income group should “switch sides” and form a

preference-coalition with the low-income group. Only partial support for this prediction is found in the 1987 sample, however: the dummy for the high-income group is statistically insignificant and it is signed opposite to expectations (positive). That said, we also obtain the smallest (non-significant) point estimate for the low-income dummy among all the samples, indicating that this high-unemployment context did blur the difference in fiscal preferences between the low-income group and the median voter as the theory predicted.

While the individual level-analysis does not allow us a rigorous control for partisan incumbency, there are reasons to be optimistic about the findings not being driven by which party occupied government at the time. Among the low unemployment contexts, two took place under Labour (2001 and 2005) and one under Conservative (1997) incumbency. Similarly, among the intermediate contexts, one election occurred under Labour (2010) and one under Conservative (1992) incumbency. It seems therefore, that the relative fiscal preference alignment across income groups was not driven by partisan considerations.

In sum, the evidence offered on the individual-level hypothesis is quite robust. While 1987 is a (partially) problematic case for our purposes, the remaining five elections fit nicely with the theory. On the balance, it seems that under different business cycle conditions, fiscal preferences undergo important changes; in particular and most importantly, to the extent that the median-voter's preference-alignment drives the electoral response to fiscal policy, the individual-level findings suggest a counter-cyclical electoral response on the aggregate level. This hypothesis (H2) is tested in the next empirical section.

Aggregate-level analysis

To motivate the findings and the interpretation from the interactive specifications between the fiscal variable (government consumption) and economic conditions (unemployment) I start out by including these terms separately to investigate for average additive effects over time. As the first column in Table III.2 shows below, neither the lagged unemployment variable nor the lagged public consumption variable

achieve significance at conventional levels. In line with the prior expectations following from Figure 3, unemployment, by itself is a poor predictor of voting intentions for the incumbent party among the British electorate.

I continue my estimation with setting up a baseline interactive model where only the main variables of interest (unemployment and government spending as well as their interaction) were included[41]. The results are displayed in the regression output table (Table II.2) below. The estimated coefficients point to the expected direction with the interaction term having an opposite (positive) sign to the main spending term and is significant at the 1% level. When fitting the extended model (with year-on-year GDP growth and the partisanship dummy and its interaction with the spending variable added as a control), the main coefficients of interest remain stable. If anything, the estimated impact of the interaction term becomes larger and remains significant at the 1% level. Also, the estimates for partisanship do not suggest different partisan evaluations in terms of reward and punishment. Although the sign of the partisanship-spending interaction is positive (which would imply more favourable assessment of extra spending under Conservative governments relative to Labour), the standard errors are very large, rendering the coefficient statistically indistinguishable from 0. Controls for the electoral cycle behave in line with what the literature suggests: the negative sign of the linear term and the positive sign of quadratic term (both significant at the 1% level) suggests that first popularity gradually erodes over the cycle but recovers some lost ground towards the end of the term (possibly due to campaign and mobilization effects).

To interpret the substantive impact of our variables, it must be noted that spending is expressed as a fraction of GDP and popularity in % points. So interpreting the impact of the spending variables requires dividing the coefficient by 100 to get the marginal impact of 1% extra spending as a % of GDP on popularity levels. Moreover, because we specified an interactive model, the marginal effect of spending can only be interpreted for different values of unemployment. Figure III.4 illustrates the estimated coefficients for spending as a function of unemployment with 95% confidence intervals. The estimated impacts fit very nicely with my first hypothesis. At low levels of unemployment (between 4 and 7%) extra spending is punished by the electorate.

[41] I also included the standard controls for popularity patterns around the electoral cycle (counter) in a linear and a squared term to capture the cyclical evolution of popularity along electoral cycles.

However, when unemployment rises above 9-10%, the electoral verdict reverses. Note that these thresholds are broadly in line with findings from the individual-level analysis.

Table III.2

Models explaining the evolution of British vote intention †

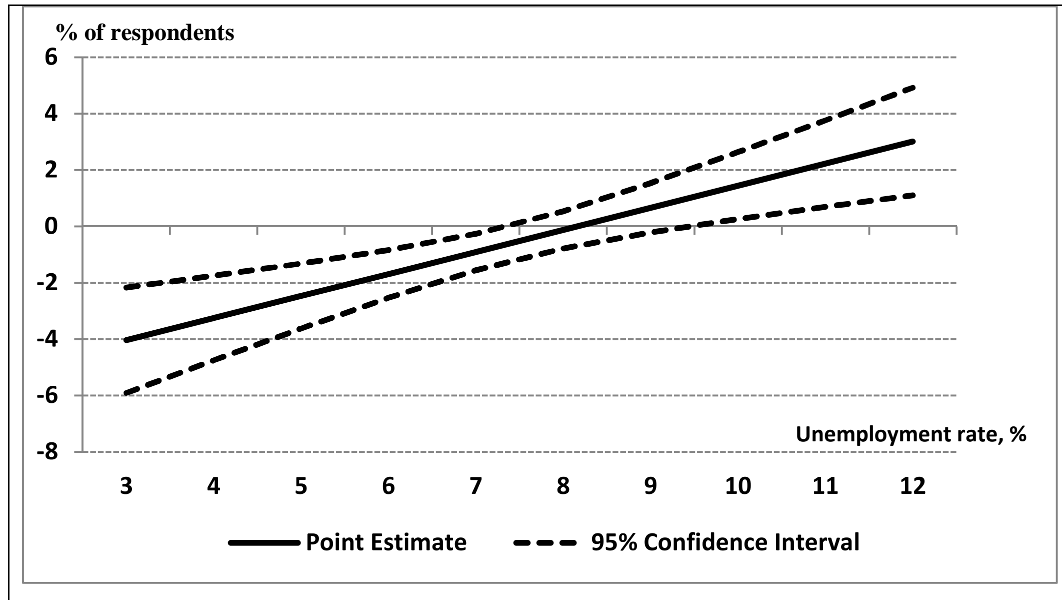
Variables	Additive model	Interactive Baseline Model	Interactive Extended Model
L.voteintion	0.817	0.660	0.652
	(16.54)***	(11.16)***	(9.73)***
counter	-0.764	-0.839	-0.855
	(2.98)***	(3.51)***	(3.32)***
counter2	0.036	0.035	0.037
	(2.82)***	(3.03)***	(2.83)***
L.publicconsumption	-0.061	-636.954	-672.198
	(0.23)	(4.16)***	(3.23)***
L.unemployment	-0.118	-15.572	-16.835
	(0.67)	(3.72)***	(3.27)***
L.publicconsumption*L.unemployment		74.602	80.673
		(3.73)***	(3.29)***
L.growth			0.265
			(1.37)
L.partisanship			-4.278
			(0.25)
L.publicconsumption*L.partisanship			22.601
			(0.28)
Constant	10.232	148.904	155.756
	(3.54)***	(4.44)***	(3.57)***
R2_Adjusted	0.79	0.81	0.80
N	130	130	130

*p<0.1 **p<0.05 ***p<0.01

† ARMA(1;0) model with quarterly data

Figure III.4

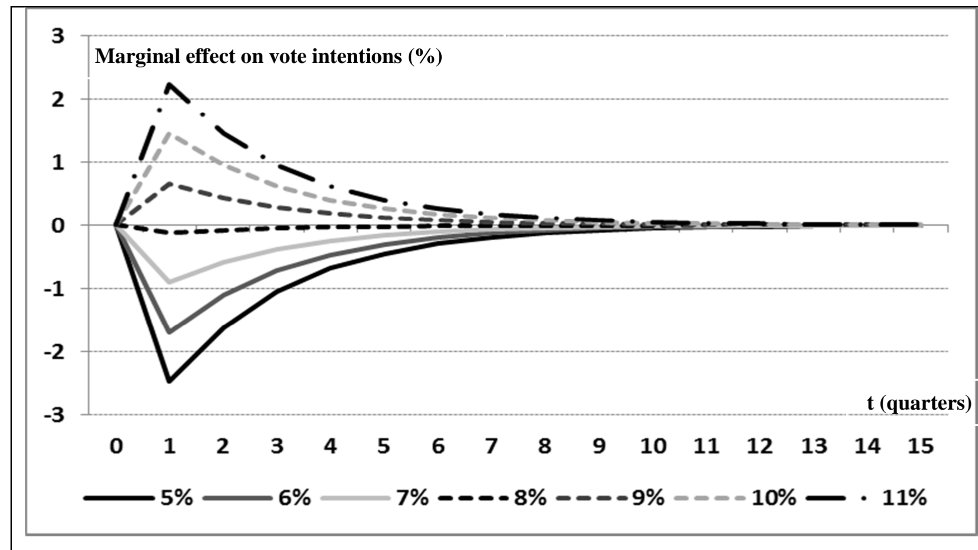
Point estimates and 95% confidence intervals for the estimated impact of public consumption expenditure at different levels of unemployment



It is important to note, however, that the estimated impact only provides the instantaneous effect on government popularity. It is highly plausible that fiscal shocks impact popularity in the long-run as voters' assessment of incumbents responds dynamically to policy choices. The estimated autoregressive coefficient allows us to calculate the long-run effect through the impact of our main variable of interest (public consumption) on the partial adjustment process in the dependent variable (vote intentions) (Kittel and Winner, 2005, p.289). Figure II.5 captures this effect over time through the impulse response function at various levels of unemployment. In each case, following a sudden leap in the impact at t_1 – at t_0 the effect is 0 because of the lagged form of the independent variables in the models – the estimated impact gradually erodes over time and converges back very close to 0 after eight quarters. The long-run cumulative effect can be calculated by $\frac{\beta_f}{1-\beta_a}$ (Enders, 2004:1), where β_f stands for the estimated coefficient for the fiscal variable – at different levels of unemployment – and β_a is the autoregressive coefficient in the model. Accordingly, at very low levels of unemployment (5%), the long-run impact of a 1% fiscal stimulus measured in % of GDP amounts to a 7.1 percentage point loss in vote intentions. Conversely, at very high levels of unemployment (11%) the estimated long-run cumulative effect of the same stimulus is a 6.4 percentage point gain.

Figure III.5

Impulse Response Function to a 1% fiscal stimulus (in % of GDP) at various levels of unemployment

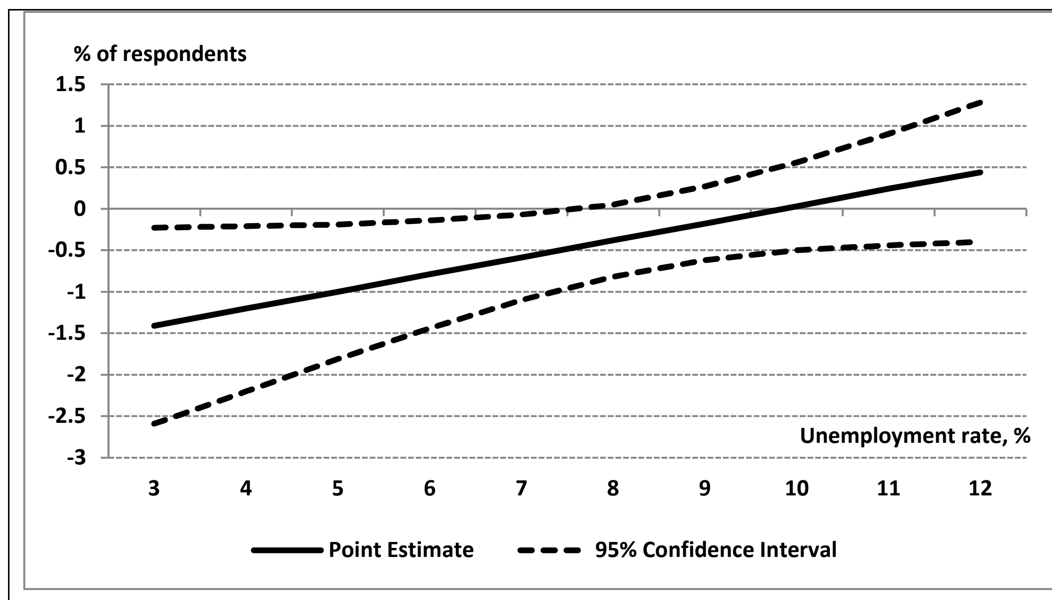


As noted earlier, our chosen indicator for spending omits important items from the general government budget. Transfers, while non-discretionary in nature, may still have high political salience so I return to my time-series with an alternative spending indicator which is more inclusive: general government expenditures. Unfortunately, consolidated general government expenditures are available only from 1990 onwards on a quarterly basis so an important episode of British economic history, the Thatcher period, would be excluded. Therefore, I chose total current expenditures instead where longer-time series are available and include net cash transfers. The exclusion of capital expenditure is probably a minor issue since it represents a relatively small part of the overall budget (typically less than 5%). Our alternative dependent variable is thus total current expenditure of general government. The point estimates with the 95% interval, using the same set of controls as in our previous extended model are shown below on Figure III.6[42].

[42] Regression output as well as the impulse response function for the long-run effects of this alternative dependent variable are available upon request.

Figure III.6

Point estimates and 95% confidence intervals for the estimated impact of total current expenditure at different levels of unemployment



With the alternative dependent variable as our fiscal indicator, the pattern is similar to the previous findings. However, here the punishment effect clearly dominates with the reward end of the curve never reaching statistical significance at the 5% level. When transfers are also considered, therefore, the electorate at large seems "spending-averse". A tentative explanation would be that most cash-transfers in the UK have a relatively narrow group of targeted (means-tested) beneficiaries from which most voters do not directly benefit but they have to finance them in terms of higher taxes in the future or debt. Importantly, however, the interactive pattern still holds with the punishment effect getting larger as unemployment drops. In line with the aggregate-level hypothesis, therefore, for both specifications of our dependent variable under the appropriate controls, counter-cyclical voting does seem to occur.

III.6. Conclusions

The main motivation of this article lies in two separate considerations. On the one hand, as I argued, the responsibility paradigm of economic voting has failed to reach its substantive conclusion of looking at the link between economic policy and electoral behaviour; the primary focus remained instead on economic outcomes. While these outcomes surely rank high on voters' agenda, the ability of government to steer the economy towards full-employment has been much questioned since the 1980s, as exogenous economic shocks, structural changes in the global economy and the inevitable consequences of the business cycle have become enduring facts of British economic reality. Rational voters, therefore, are likely to have a more nuanced understanding of the government's responsibility for macroeconomic outcomes and credit/blame governments for the redistributive impact of economic policy in general and fiscal policy in particular instead. On the other hand, I also argued that the generally inconclusive findings on the effects of fiscal policy on re-election prospects are puzzling in the light of the generally robust results of economic voting research. This article offered a dynamic explanation on the interaction between fiscal policy and economic conditions. It is not the fiscal stance per se that matters, but the economic conditions under which incumbents undertake fiscal stimuli/adjustment that exert a sizeable influence on government's popularity ratings.

The theory I put forward to investigate the relationship between fiscal decisions and incumbent popularity rested on the assumption of rational voters making cost-benefit calculation on the expected impact of these decisions on their finances. As changing labour-market conditions alter these calculations for different income groups, my theory predicted that the median voter (middle-income voters) will change their preferences over the business cycle, giving rise to a counter-cyclical electoral response to fiscal policy on the aggregate level.

In line with these expectations, this article has first demonstrated that the preference-alignment of middle-income voters does indeed change at different levels of unemployment. Secondly, on the aggregate level, I showed that when conditioning on

business cycle conditions – again, measured by the level of unemployment in our framework – fiscal policy variables do indeed explain a great deal of variation in incumbent popularity. In particular, in times of economic hardship (high unemployment), the electorate at large seems supportive of expansionary fiscal policy. In times of prosperity, however, they seem to prefer the Treasury taking a more contractionary policy stance. Widespread perceptions of the popular "Iron-Chancellor" may as well result from these preferences in boom years.

That said, this new angle of looking at economic voting from a policy-based perspective raises a number of questions. Importantly, future research should take more seriously some of the electoral contexts that sit uneasily with the data. For our purposes, a closer look at the 1987 elections would be a most welcome research effort. While it is easy tell stories about why some incumbents failed or won despite what economic voting would predict, further refining existing theories may also have the potential for systematically explaining these "odd cases". One particular idea that could be used to bridge the gap between idiosyncratic considerations (e.g. the transformation of Old Labour) and these "odd elections" is to take the credibility of the challenger into account. When considered against the expected alternatives (e.g. a non-credible policy alternative), rational voters may not have any incentives to "throw the rascals out" even when they go against their fiscal preferences. To return to our previous example, despite stubbornly high unemployment and a tight policy stance, Margaret Thatcher handily won the 1987 elections. Also, individual-level data suggest that the middle-class did not form a clear-cut electoral coalition with the poor to protest against the spending cuts. Perhaps then, taking into account the credibility of the opposition Labour Party at the time would point to a promising direction.

Moreover, the fact that partisanship did not seem to influence the counter-cyclical voting pattern may strike many as surprising. After all, partisan theory has long predicted that different partisan governments run on different policy platforms and therefore should be affected by a given policy stance (e.g. spending cuts) differently. Margaret Thatcher always ran as an inflation-hawk and never promised "garden roses" to those looking for them. Reconciling this theoretical ambiguity between different policy platforms and similar electoral judgement on partisan incumbents is therefore another important question to address.

Finally, my findings give rise to a degree of optimism. Many have lamented democratic accountability for the increasing "technocratization" of economic management, first in the monetary and more recently in the fiscal domain. The main rationale given for these technocratic institutions or governments was their insulation from electoral pressure when painful policies need to be implemented. To the extent that economic-voting research has contributed to this view of the economic voter as a relatively unsophisticated agent of reward or punishment, evidence from this article suggests that this is largely a myth. Voters, the British ones at least, do seem to get it right. Out of individual considerations, a sufficient part of them seem to prefer spending increases when the times call for them. Whether fiscal policy-making responds to the logic of this counter-cyclical preference formation of the electorate is a whole new story.

Appendix 1

British Election Studies survey questions for the individual-level analysis

Dependent variable (tax-spending preferences):

Using the 0 to 10 scale on this card, where the end marked 0 means that government should cut taxes and spend much less on health and social services, and the end marked 10 means that government should raise taxes a lot and spend much more on health and social services, where would you place yourself?

Independent variable (household income):

Which of the letters on this card represents the total income of your household from all sources before tax - including benefits, saving and so on? Please just tell me the letter (with each letter standing for an income category in increasing/decreasing order).

Control variables:

Union membership:
Are you now a member of a trade union or staff association?

Gender:
(observed by interviewer)

Age：
Now, a few questions about yourself and your background. What was your age last birthday?

Class:
Do you ever think of yourself as belonging to any particular class?

Party support:

Generally speaking, do you think of yourself as Labour, Conservative, Liberal Democrat, (Scottish National/Plaid Cymru)1 or what?

Appendix 2

Table III.3
Data Sources for the aggregate-level analysis

Vote intention	*Ipsos-Mori*
Public consumption as a % of GDP *Unemployment* *GDP growth*	*OECD i. Library* *Office of National Statistics*
Total current expenditures of general government	*Office of National Statistics*
Partisanship, election dates	*European Journal of Economic Research data yearbook, ParlGov database*

Appendix 3

Table III.4

Diagnostics test-results for individual-level analysis

White-test for heteroskedasticity	1987 Chi-square statistic: 77.18 P-value<0.0001 1992 Chi-square statistic: 47.65 P-value=0.0215 1997 Chi-square statistic: 47.13 P-value=0.1015 2001 Chi-square statistic: 60.57 P-value<0.0001 2005 Chi-square statistic: 72 P-value<0.0001 2010 Chi-square statistic: 67.72 P-value=0.0011
Breusch-Pagan test for heteroskedasticity	1987 Chi-square statistic: 77.14 P-value<0.0001 1992 Chi-square statistic: 23.71 P-value=0.0026 1997 Chi-square statistic: 26.28 P-value<0.0001 2001 Chi-square statistic: 47.18 P-value<0.0001 2005 Chi-square statistic: 42.22 P-value<0.0001 2010 Chi-square statistic: 19.69 P-value=0.0116

Table III.5

Diagnostics test-results for aggregate-level analysis

Augmented Dickey-Fuller test	Lag (5): p-value=0.0228 Lag (4): p-value=0.041 Lag (3): p-value=0.042 Lag (2): p-value=0.086 Lag (1): p-value=0.04
Akaike and Bayesian Information criteria	ARIMA (1,0,0): AIC: 736.55 BIC: 745.18 ARIMA (0,0,1): AIC: 818.77 BIC: 827.4 ARIMA (1,0,1): AIC: 738.54 BIC: 750.04 ARIMA (2,0,0): AIC: 738.54 BIC: 750.04 ARIMA (2,0,1):AIC: 734 BIC: 748.36
Diagnostic autoregressive tests for remaining autocorrelation and conditional heteroskedasticity	p-values on autoregressive coefficients: (0.36;0.68)

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Essay III

Biting the Hand that Feeds

Reconsidering Partisanship in an Age of Permanent Austerity

Abstract:

The New Politics of the welfare state suggests that periods of welfare retrenchment present policy-makers with a qualitatively different set of challenges and electoral incentives compared to periods of welfare expansion. An unresolved puzzle for this literature is the relative electoral success of retrenching governments in recent decades, as evidenced by various studies on fiscal consolidations. This article points to the importance of partisan biases as the main explanatory factor. I argue that partisan biases of certain constituencies can create incentives for incumbent governments to depart from their representative function and push the burden of retrenchment on the very constituencies that they owe their electoral mandate to (”Nixon-goes-to-China”). After offering a simple model on the logic of partisan biases, the article proceeds by testing the unexpected partisan hypotheses that the model generates. My findings from a cross-section-time-series analysis in a set of 25 OECD countries provide corrobarative evidence for this Nixon-goes-to-China logic of welfare retrenchment: governments systematically inflict pain on their core constituencies. Some of the losses that the core constituencies suffer during austerity, however, are recouped during fiscal expansions when traditional partisan patterns take hold.

IV.1. Introduction

In the wake of the financial crisis and the Great Recession, governments across the industrialized world have accumulated unprecedented peace-time debt levels. The size of their debt liabilities as well as the fact that many governments have already undertaken ambitious consolidation programmes in a sluggish growth environment (IMF Fiscal Monitor, 2012) indicate that sizeable cuts have to be made in some of the most politically sensitive items in their public budgets. It is highly unlikely that the most mature economies in the world can find an easy cure to their fiscal problems by shifting on a high-growth and/or high-inflation path overnight to grow out of or inflate away their debt burden. The more realistic scenario appears to be an arduous road towards fiscal sustainability through austerity and retrenchment. Welfare budgets, across the board, are coming under intense pressure, creating a politically treacherous terrain for any government to tread. We may thus enter another era of "permanent austerity", where scholarly consensus (Pierson, 1994, 1996, 1998, 2001) suggests a qualitatively different electoral logic of welfare policy from the era of welfare expansion. However, the vast empirical arsenal of electorally successful retrenchment episodes presents us with an empirical puzzle which has been largely unexplored by the welfare state literature. This article seeks to account for the relative electoral viability of welfare retrenchment by reconceptualising our understanding of partisanship in hard times.

The notion of "permanent austerity", according to the logic of the New Politics literature (ibid), is a qualitatively different political game from the prior era of welfare-state building because of entrenched constituencies, organized interests and the general popularity of welfare programmes. Outright assaults on the welfare state, even under ideologically highly committed conservative opponents – the Reagan-Thatcher era in the 1980s is an important reference point here – are thus unlikely. What one can expect, at best, is hidden adjustment whereby policy-makers attempt to introduce cost-saving measures in less visible welfare items – such as tax expenditures, indexation rules, etc. – to obfuscate the true impact of their policies (Howard, 1997; Hacker 2002, 2004).

Open retrenchment, on the other hand, is likely to trigger electoral backlash and will thus be widely perceived to be a politically suicidal strategy.

While the New Politics literature provided valuable insights on the apparent timidity of many conservative governments, a central piece in the electoral logic behind retrenchment has been largely overlooked. The number of electorally succesful overt retrenchment episodes is simply too high to ignore as idiosyncracies of the political context of the time and place (Alesina et al, 1998, 2012; Mulas-Granados, 2006). This article seeks to revive the New Politics literature by building a bridge between the qualitatively different nature and the apparent electoral viability of retrenchment. Specifically, a crucial factor that has been underemphasized, if not ignored, in welfare retrenchment debates is partisan loyalties. By incorporating the idea of loyalties intothis debate, I point towards an important blame-avoidance strategy that re-election seeking incumbents can employ.I will argue that even highly visible adjustment is feasible when incumbent governments have a high level of electoral loyalty among certain constituencies. Relying on what I will call partisan bias, these governments will have an incentive to shift a large part of retrenchment efforts onto their core constituencies in an effort to broaden their electoral appeal by sheltering tradtionally more hostile constituencies. The notion of partisan bias, in times of austerity, can thus create a Nixon-goes-to-China environment where the axe falls on those welfare programmes where one would least expect.

I will proceed with my argument in the following structure. After reviewing the current state of the partisanship-welfare state nexus, section II will offer a more formal conceptualization of partisan bias in times of austerity leading up to my hypotheses to test. I will operationalize my data and measurement in section III. Section IV will offer an empirical analysis in a time-series-cross-section framework in an (unbalanced) set of 25 OECD countries over three decades. Section V concludes.

IV.2. The partisanship-welfare state nexus in an era of "permanent austerity"

Literature Review

The role of partisanship in shaping the post-war consensus in economic and social policymaking has been long recognized. Left-wing governments have been widely acknowledged as chiefly responsible for ensuring full employment in face of adverse economic shocks, providing decommodification to workers, or expanding social programmes to the socially weak in an attempt to protect against various sources of social risks along the life-cycle (Hibbs, 1977; Cusack, 2001 ; Esping-Andersen, 1990; Korpi, 1983). As slowing growth, structural unemployment, deindustrialization (Iversen and Cusack, 2000), increased pace of globalization(Swank and Steinmo, 2002; Jahn, 2006)[43], population aging and other concomitant social processes put an end to a period of welfare expansion in the 1970s, the importance of partisanship came under closer scrutiny(Huber and Stephens, 2001).

In his seminal work on welfare-state resilience in the face of an international surge in conservative power[44], Pierson (1994) provides a comprehensive analysis of how welfare-recipients managed to block retrenchment efforts by this ideological wave. The channels of this logic were twofold. On the one hand, mature welfare states created their own constituencies with vast organizational capacity (e.g. the Association of American Pensioners in the US) that survived the much diminished power of trade unions. These groups managed to garner sufficient popular support to block reform efforts. Secondly, as Pierson's subsequent works emphasize, governments also recognized the "tremendous electoral risks" of retrenchment policies (Pierson, 1996, p. 178). Even though their electoral mandate pointed towards welfare cuts, conservatives simply could not disregard such mobilization capacity of interest groups and the ensuing electoral verdict if they launched a radical assault on welfare programmes. The

[43] The so-called efficiency, or "race-to-the bottom" hypothesis, however, has been challenged from different angles (Rodrik 1997; Garrett 1998).
[44] During the time of Pierson's analysis, conservative governments reigned supreme in the US (Reagan administration), the UK (Thatcher-Major premierships), Germany (coalition governments led by Helmut Kohl) and a number of other countries.

New Politics literature thus generated two important research agendas to pursue for political economists. First, would permanent austerity really render partisanship irrelevant on the economic policy-making domain? Second, when governments occasionally do engage in retrenchment politics, are they doomed to suffer electoral punishment?

In the decade following Pierson's theorizing, the answer to the first question was a qualified no. Soon after the publication of the New Politics of the Welfare State (Pierson, 2001) some of the "Old Politics" factors have staged a spectacular revival. Kwon and Pontusson (2005), Bradley et al (2003) , Korpi and Palme (2003), Allan and Scruggs (2004), Swank (2005) have all provided evidence that partisanship continues to operate in the conventional way. Although a few critiques pointed to the instability of the effect of partisanship over time (Kittel and Obinger, 2003; Huber and Stephens, 2001), the bias induced by neglecting the influential role of agrarian parties in Scandinavia (Manow, 2009), the pressure on social-democratic governments in corporatist settings to rely on regressive consumption taxation (Beramendi and Rueda, 2007), the main thrust of the partisanship debate can be largely summarized as "partisanship still matters". The welfare-state may have survived its conservative assault, but on the margin, left-wing governments have appeared its more reliable defendant nevertheless.

There are doubts, however, about the validity of these "politics as usual" conclusions of welfare research. Political sociology has long recognized the rather dated conceptualization of what right-wing and left-wing constituencies are. Since Hibb's (1977) influential theory on partisan cycles changing partisan constituencies have cast doubt on the neat alignment of partisan governments with issue-priorities. More specifically, the "decline of class voting" thesis is of paramount importance for partisanship debates. In Hobolt's (2012) summary of "bottom-up" versus "top-down" accounts of changing class-voting in industrial democracies, the consensus that emerges is that due to different sources, class-voting has indeed declined in most countries over time. Whether due to ideological convergence by parties (Evans, 2000; Evans and Tilly, 2011), or to changes in underlying policy preferences across the electoral space(Clark and Lipset, 1991; Kitschelt, 1994), the implication for contemporary party politics is one of discontinuity. If traditional party systems structured by historical cleavages

(Lipset and Rokkan, 1967) give way to growing partisan fluidity, the politics as usual view of the "Old Politics" accounts on the welfare state is on a rather weak theoretical footing. Why should one expect the same partisan determinants to matter as they used to when the nature of constituencies underlying "Old Politics" accounts has undergone such dramatic changes?

Regarding the expected electoral punishment, the fiscal adjustment literature has produced surprisingly inconclusive findings. Electoral constraints, as mentioned above, have been widely posited to act as an ultimate brake on governments to engage in welfare retrenchment. In line with the political budget cycle theories[45], these expectations implicitly assume a fundamentally spending and/or deficit-prone median voter with a de-facto veto power over retrenchment policies. Yet, Alesina et al (1998; 2012) convincingly show that fiscal adjustments episodes had little, if any, predictive power on the re-election prospects and within-cycle popularity of incumbent governments. In a similar vein, Brender and Drazen (2008) find no direct evidence for deficits – partly induced by social spending – helping incumbent popularity. Moreover, as subsequent contributions to this debate have confirmed (Ilera and Mulas-Granados, 2001; Mulas-Granados, 2006; Von Hagen et al, 2002), the composition of adjustments has been a strong predictor of the duration and hence the political viability of adjustment efforts: cuts in transfer programmes and public wages, in contrast to public investment cuts and tax hikes, have led to more permanent debt stabilization programmes. While these contributions are largely silent on partisan dynamics driving the adjustment efforts, a related study by Alesina et al (2006) shows that when faced with fiscal crises, left-party governments tend to undertake adjustment earlier than their conservative counterparts. Not only do these findings suggest that elections may not necessarily spell the death knell of retrenching governments, but they also potentially shed light on an unexpected partisan dynamics at play.

In fact, when one takes a closer look at these retrenchment periods, the frequency of consolidation efforts initiated by the left is striking. While a detailed analysis of retrenchment periods lies beyond the scope of this paper, a few well-known cases bring the point home. The Swedish Social Democrats long-tenure in power under the

[45] This literature is too voluminous to cite here at detail but see Drazen (2008) for a relatively recent review

premiership of Goran Persson following its banking and fiscal crisis in the early 1990s, New Zealand's Labour governments under Helen Clark in the years preceding the Great Recession, Britain's New Labour's first term in office between 1997 and 2002, Denmark's Social Democrat-led coalition governments in the second half of the 1990s all saw a significant reduction of social expenditure as a % of GDP even when the cyclical position of the economy is accounted for(OECD economic outlook database 92, 2012). Not only were these and other episodes successful in stabilizing public finances but they also resonated well with the electorate who returned these governments to power in a number of consecutive occasions.

In accounting for unexpected partisan policy-making in a rational-choice framework, a number of scholars pointed to the role of expectations and credibility deficits for parties of the left. Cukierman and Tomassi (1998) set up a formal model relying on imperfect information and credibility deficit to explain a number of empirical examples provided by the authors on different policy domains[46]. Adams (2001) explicitly invokes the idea of partisan biases to account for the highly volatile nature of policy stances by different political parties[47]. The underlying idea that governments want to appear distinguishable from their rivals because of voters' partisan biases is again, rooted in the expectation that the same policies will trigger different electoral responses when implemented by different partisan governments. Kitschelt (2001) brings in the credibility of opposition parties as guardians of the welfare state to predict whether and how the left can deal with welfare pressures. Perhaps closest to the main thrust of this paper, Ross (2000, p. 164) argues that the left has a credibility advantage in welfare reform because of its issue-association with welfare programmes that has been accumulated over more than half a century:

[46] The examples include stabilization and pro-market policies conducted by Latin American presidents elected on a populist platform as well as land for peace policies undertaken by hawkish Israeli leaders.
[47]The author, however, does not predict "policy leapfrogging", ie the left adopting more right-wing stances than the right, or vice versa.

"According to this logic, rightist parties should be more vulnerable in their retrenchment efforts than parties of the left—and especially so on explosive issues like welfare reform. The principal psychological mechanism conditioning voters' response to issue-associations appears to be trust—specifically the opportunities trust provides for framing retrenchment initiatives in a manner that voters find acceptable if not compelling"

As these insights suggest, credibility, partisan biases and trust seem to be crucial factors in welfare retrenchment debates. It also resonates well with the qualitatively different nature of welfare retrenchment, as Pierson (1998) himself recognized at the time that the first signs of Nixon-goes-to-China type of policy-action by social democrats began to materialize. The theory in the following section builds on this insight by allowing partisan biases to impact upon how far partisan governments can go in selling retrenchment policies to the electorate.

Theory: preference polarization under partisan - biased constituencies

Before incorporating the idea of partisan biases in parties' strategic positions on a policy space, a basic conceptualization of permanent austerity with regards to welfare preferences of the electorate is in order. Importantly, I assume endogenous preferences by the electorate whereby their preferred welfare provision takes into account the possibility frontier defined by permanent austerity. Specifically, I make the assumption that in times of "normal" or "old" politics, electoral preferences will point toward an expansion of multiple welfare programmes. In times of retrenchment politics, however, recognizing the trade-off nature of welfare provision, electoral preferences will reflect the defence of one's favoured program at the expense of the other(s).This assumption chimes in well with the seminal piece by Alesina and Drazen (1991) who elegantly model a war of attrition game where two constituencies attempt to shift the burden of adjustment onto the other side. Furthermore, this rather "selfish" characterization of voters stuck in a redistributive battle for scarce resources have been borne out by a number of different scholars in the social policy literature (see Busemeyer, 2012 and

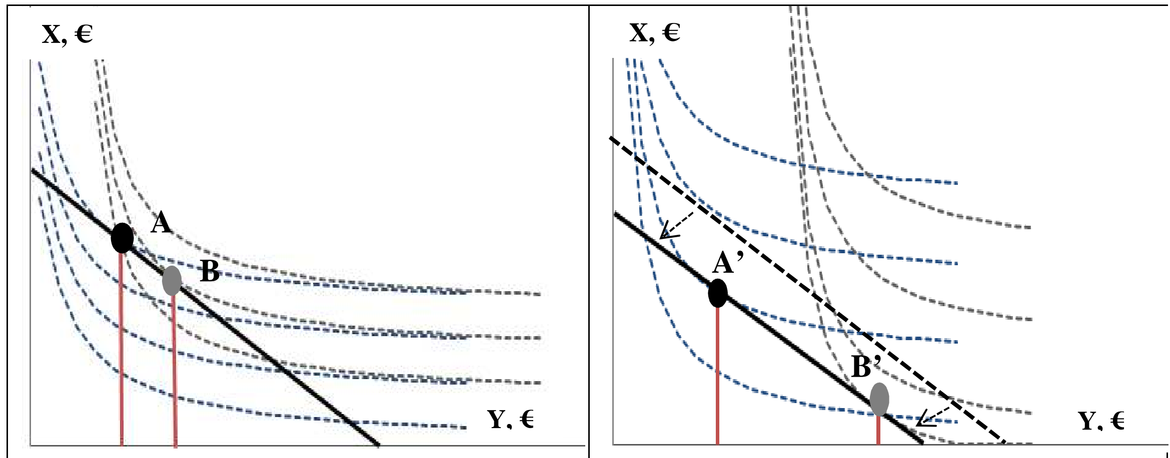
Tepe and Vanhuysse, 2009 with regards to education policy and public pensions, respectively)[48].

More specifically, assume government provides two public services (or two welfare programmes) in the political economy: X and Y[49] with two distinct constituencies (group 1 and group 2) benefiting from them. Figure IV.1 is a stylized illustration of the pre-retrenchment period (left panel) compared to "permanent austerity" (right panel). In the first period, as high growth and low debt levels allowed the expansion of the welfare state without running into financial constraints, the two groups are expected to forge an alliance for the parallel expansion of the programmes: their preferences are relatively proximate. One can conceptualize this idea by regular (circular) indifference curves for two groups of voters: group 1 preferring higher provision in good X and group 2 preferring higher level of provision in Y. Both groups, however, are willing to trade-off X for Y at similar rates at any given combination of X and Y. As a result, given the budget constraint of the welfare state, ideal points A and B are relatively close to each other.

Once permanent austerity hits, the mutual expansion of spending programmes gives way to a distributional conflict between the two groups under a tighter budget constraint. Translating this into visual representation on the right-hand panel, indifference curves for the two groups are now very different. The most intuitive way to understand the new scenario is that for group 1 (2), a higher level of Y (X) is required to leave it at the same level of utility compared to the pre-retrenchment scenario. Alternatively, at any given combination of X and Y, the terms of trading off X for Y for the two groups will be sharply different. As a result, given the new budget constraint of the welfare state, the ideal points A' and B' will be further apart compared to the pre-

[48] That said, some contending views argue that programme-specific support for welfare policies is far from automatic (Lynch and Myrskala, 2009)
[49] For illustration's sake, the two goods can be thought of as unemployment programmes for the working age and pension programmes for the retired population.

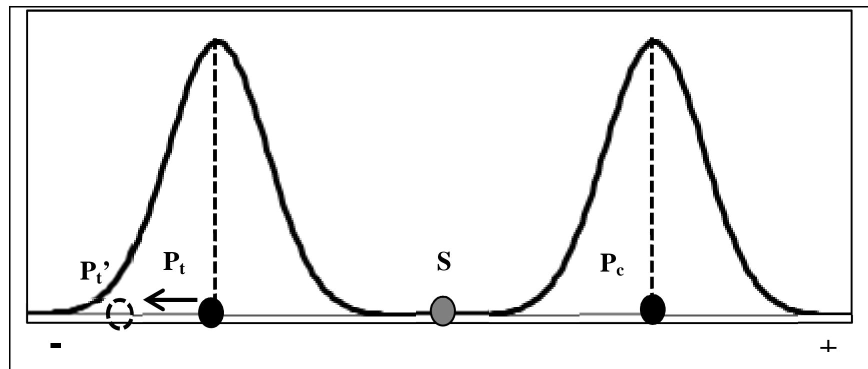
Figure IV.1
Indifference curves and ideal points for two groups of voters during welfare-state building (left) and retrenchment (right)



The next step in the analysis is translating this distributional conflict to a single-issue space for good X. The incumbent party – labelled S for social-democratic – tries to optimize its vote share among two groups, its traditional core constituency and a target group that it tries to sway over. The groups are caught in a conflict on the provision of good X, as the core is interested in the good's maintenance/expansion while the target is interested in its reduction in order to free up resources for its own preferred program. I assume the distribution of the two groups along the single-issue space is approximating a bimodal distribution with the two peaks located at the two groups' "ideal points" of provision level[50]. Therefore, in Figure IV.2, the core constituency for party S has an ideal preference point $P_{c.}$ The target constituency[51] of party S has an ideal preference point P_t. The core constituency is the one with preferences towards the bottom-right corner of Figures IV.1 and IV.2 (point B, B*), in other words who benefit more from the provision of good Y. The target constituency is the one with preferences towards the upper-left corner in Figures IV.1 and IV.2 (point A, A*), in other words who prefer less provision of good Y to allow for increased provision in good X.

[50] The assumption of bimodal distribution follows from a stylized restriction of the electoral space to the two groups under analysis; since each group has a favoured program to defend, their preference distribution, following from Graph IV.1, will be polarized around the two ideal points.
[51] I use the notion of target constituency to emphasize the idea that in order to increase its electoral support, the incumbent must make policy concessions to traditionally antagonistic groups.

Figure IV.2
The preference distribution of two groups of voters on a single-issue space



The incumbent government party's vote-maximizing strategy is to find an ideal location along the issue space (ranging from less to more provision of good X). The farther it locates from the ideal preference point of its core (target) constituency the more votes it will lose among the respective constituencies. Specifically, I adopt a quadratic loss function for the vote share the government faces with a minor, but crucial modification. Building on the logic of partisan bias, I assume that party S, the natural guardian of good X, enjoys positive (negative) partisan bias among the core (target) constituency because of its historical commitment (or ideology) to the core group and its preferred program, X. In political terms, this idea can be expressed by an asymmetric evaluation of a policy shift by the core and the target group: if the government reduces the provision of good X, the core can expect that due to party S's ties to the core, this shift doesn't fully reflect S's true preferences and it will thus revert back to more provision in the future. In a similar vein, being distrustful of S's true preferences, the target group will reward S's shift by a smaller vote gain compared to a similar shift undertaken by a traditionally less hostile party. The vote loss function of S can thus be expressed as follows:

$$F(V) = -(P_c - S)^2\alpha - (S - P_t)^2\beta$$

where $0<\alpha<1$ and $2>\beta>1$ are two partisan bias parameters to reflect the idea above[52]. The constraints of these parameters reflect the idea that the vote loss function can be either amplified (by β) or dampened (by α) as a function of the relative partisan biases of the ruling party among the two constituencies. By minimizing the loss function with respect to S, the first-order condition gives

$$\frac{dV}{dS} = 2\,(P_c\alpha + P_t\beta) - 2(S\alpha + S\beta) = 0$$

Which solves to:

1) $S = \frac{Pc\alpha + Pt\,\beta}{\alpha + \beta}$

Comparing this result to a party with no partisan bias among the electorate (ie. $\alpha = 1$;, $\beta = 1$) the vote loss function simplifies to:

$$F(V) = -(P_c - S)^2 - (S - P_t)^2$$

Which results in the solution of:

2) $S = \frac{Pc + Pt}{2}$

Which leads party S to locate exactly half-way between the two groups' ideal points.

To the extent permanent austerity sharpens the trade-off between the provision of two public goods, one can expect that austerity shocks trigger into redistributive preferences by moving P_t to the left towards P_t* on Figure IV.3, reflecting the target group's attempt to safeguard its own preferred programme, Y. What happens to S's vote

[52] The range of parameters α and β are constrained between 0 and 1 and 1 and 2, respectively as a matter of convenience to allow for a symmetric range around 1, a scenario with no partisan bias among either of the constituencies.

maximization location in response to a one-unit leftward shift of P_t? Under a government with no partisan bias among either of the constituencies, the result is straightforward from 2): S follows P_t by half a unit. However, once partisan bias is introduced, the impact on S's new location is given by taking the first derivative of 1) with respect to P_t, resulting in: $\frac{\beta}{\alpha+\beta}$. It is easy to see that given the constraints of the partisan bias parameters, this fraction is strictly $> \frac{1}{2}$ and asymptotically converges to 1 with β going to 2 and α going to 0. In other words, the austerity shock is expected to result in the greatest move against the core constituency when the incumbent government has high partisan bias (low α) among them.

The result of this simple model suggests two hypotheses to test in the empirical section of this paper. The two hypotheses offer two different conceptualizations of permanent austerity. According to the first (baseline) hypothesis, austerity implies a permanent preference shift for voters (from Figure IV.1 to Figure IV.2) as they recognize the inevitable trade-off between the goods that the government delivers – in the present and the future. Put differently, voters will permanently abandon their prior expectation of welfare consensus on the mutual expansion of welfare programmes and will sharpen their defence of their preferred programmes. Alternatively, according to the second (conditional) hypothesis, voters' preference change will follow the short-term exigencies of austerity politics. In other words, periods of retrenchment will reflect the preference alignment of Figure IV.2, but in times of relative prosperity, regular preferences will dictate no polarization between the two groups' ideal points (Figure I) and hence no Nixon-goes-to-China effect. Stated more concisely, therefore:

Hb: Since the mid-1970s, welfare retrenchment is guided by a Nixon-goes-to-China logic. Parties enjoying high degree of partisan bias among certain social groups are more likely to inflict pain on these groups when structuring their welfare budgets.

Hc: Since the mid-1970s, governments occasionally had to surrender their commitments to welfare programmes in their effort to stabilize debt levels. Only in times of retrenchment do we observe a Nixon-goes-to-China logic, but when budgetary exigencies are absent traditional partisan effects dominate.

Operationalizing the partisan bias parameter and different fiscal periods as well as introducing our data and measurement will be the subject of the next section.

IV.3. Partisan bias in times of "permanent austerity": data and measurement

As our literature review and theoretical propositions indicated, partisan biases could be crucial modifying factors in providing room for manoeuvre for certain political parties to engage in austerity politics when in government. The problem of course is that partisan biases are hard to observe. The simplest approach would be to rely on traditional party policy labels as the bulk of partisanship debate in welfare state research has done (Huber and Stephens, 2001, Alan and Scruggs, 2004). The obvious limitation of this approach is that as changing partisan constituencies have become of paramount concern in electoral research, so should our understanding of party families. It is not all that clear, for instance, that today's social democratic parties still represent the same social interests as partisan models assumed (Hibbs, 1977; Alesina, 1987). An alternative solution would be to look at policy stances of political parties based on electoral manifestos as a number of welfare scholars have done so(Kim and Fording, 2002; Haupt 2010;Ward et al;2011; Finseraas and Vernby, 2011 etc.). However, it is a highly dubious assumption whether occasional (written) emphases on certain issue priorities automatically translate into partisan loyalties that my argument requires for empirical testing.

I therefore opt for yet another approach which relies on revealed preferences of voters. I argue that partisan biases should be reflected by the relative appeal of given parties to social groups. This relative appeal is measured by the vote share parties can expect to obtain among members of a given social group relative to the overall vote share in the population, based on annual opinion data from Eurobarometer and ISSP (details in Appendix 1).

More specifically, I constructed a group-specific relative support measure[53] (RSP from here on), which is defined as follows:

$$RSP_{gp} = \frac{Vgp - Vtp}{Vtp}$$

Where V_{gp} and V_{tp} are the vote (intention) share of party P among social group G and and its total vote (intention) share, respectively. The logic behind this measure is that the deviation of group-specific support from overall support (numerator) is divided (standardized) by the overall strength of the party (denominator). A 5% vote share deviation from its overall support share is surely more important for a fringe party in a multiparty system than for a catch-all party in a two-party system. Standardizing by party strength thus ensures that group-specific deviation from overall support is measured relatively to the party's overall strength. Accordingly, the obtained measure takes on the value 0 when the group-specific support share equals the overall support for the party. It takes on the value -1 when no member of the given group votes for the party. If the group-specific support is double that of the overall support, RSP will equal 1[54]. Therefore, an alternative reading of partisan bias is the extent to which parties are beholden to certain constituencies measured by the relative electoral support among them.

With RSP thus defined, the next task is to pin down the social groups of interest. One concern was finding groups with clearly identifiable interest towards welfare programmes. Another was size: overly small groups' (less than 5% of the electorate) electoral support is notoriously hard to reliably measure in electoral surveys. Moreover, including small groups in the analysis is also problematic for their likely limited electoral influence. My choice thus fell on three important voting constituencies that are comparable in size (each comprising around 20% of the voting population): pensioners,

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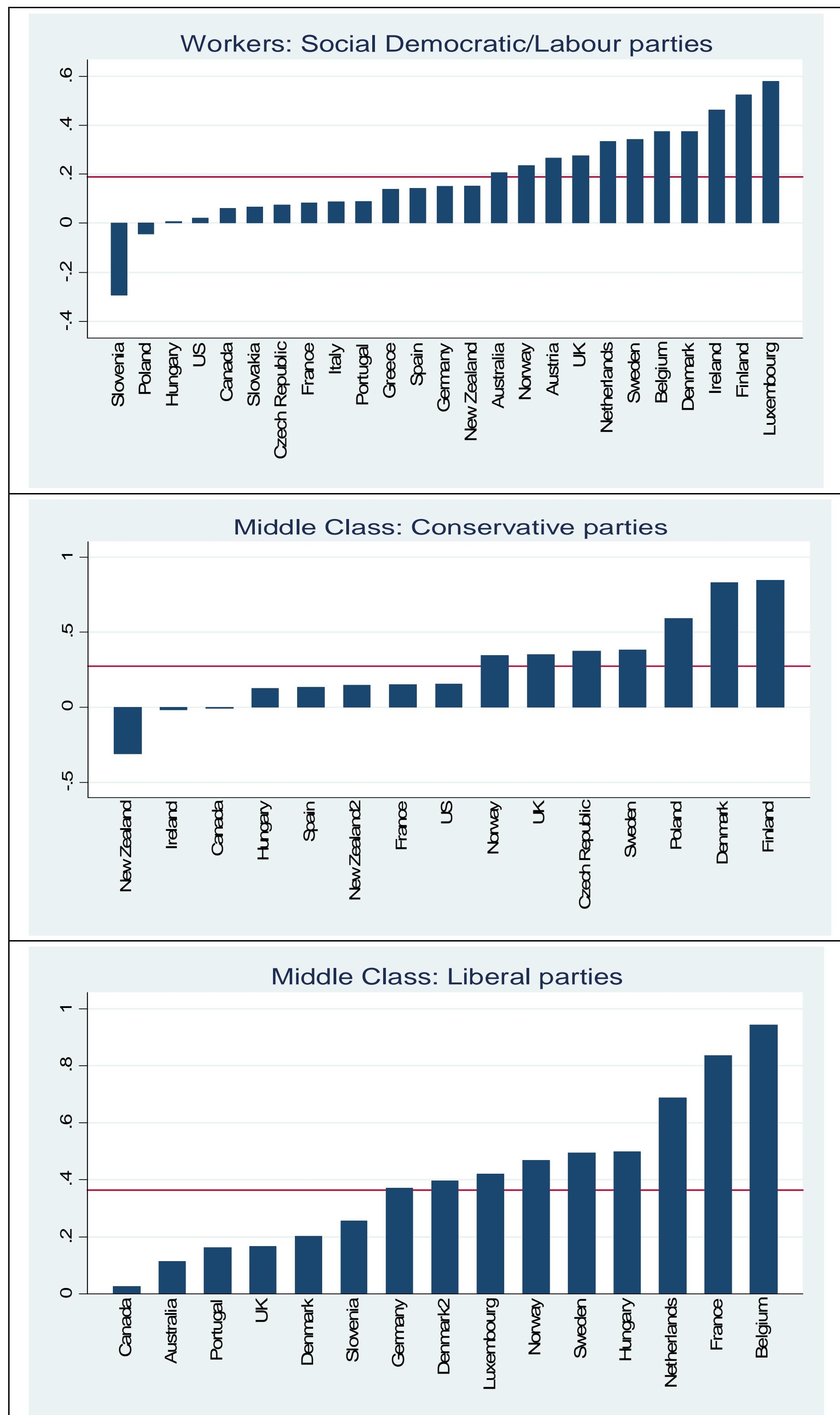
[53] This is a modification of a popular measure in the class voting literature called the Alford Index, defined by the % of manual occupations voting left minus the % of non-manual occupations voting left (Alford, 1963). While the Alfold Index could be modified to allow for more meaningful post-industrial occupational categories than the crude "manual" vs. "non-manual" distinction, I argue that there are two other advantages of this new measure: first, it is party-specific, which is crucial for multiparty systems with more than one left parties. Second, it is standardized, ie. it takes into account the size of party in question.

[54] While in theory RSP can exceed 1 (when the group-specific support is more than twice of the overall support) in the empirical distribution of the cases it is very seldom above 1. Therefore, it is practical and convenient to think of -1 and 1 as the lower and upper bounds of RSP.

low-/semi-skilled workers and the working-age middle and upper classes. The identification of pensioners was unproblematic as both survey series ask respondents about their current job status. Identifying the latter two groups was based on occupation categorizations in the two survey series (see Appendix 1 for details).

According to traditional partisan approaches, the second and third of these groups should display more or less homogenous party preferences. More specifically the second group should be affiliated with social democratic parties while the third group should overwhelmingly support the conservatives and liberals. Figure IV.4 depicts the average RSP for workers and the middle-class for these three party-types over the time-span of our analysis.

Figure IV.4
Average RSP for workers (top row) and the middle classes (middle and bottom rows) across their traditional party families*



*Horizontal red lines indicate averages over the sample period
Source: Eurobarometer, ISSP [55], author's calculation

[55] Accessed through Zacat-Gesis Online Study Catalogue (http://zacat.gesis.org/webview/), last accessed: 03/09/2013.

While the general pattern confirms partisan theory, the variation among parties in different countries is far from trivial. Average social-democratic/labour RSP for workers ranges from 0.58 in Luxemburg to -0.3 in Slovenia. Regarding the middle class's alignment with conservative parties, their RSP ranges from 0.84 in Finland to -0.31 in New Zealand's smaller conservative party. Liberal parties' middle class RSP is in the positive territory with no exception, but the range is still remarkable: from 0.94 in Belgium to 0.03 for the Canadian liberals. This wide variation calls into doubt the analytical value of party family labels and suggests that even historically similar party types owe their mandate to a fundamentally different composition of electoral blocs today.

Turning to the main dependent variable of our study, welfare retrenchment, a lively debate has emerged in empirical scholarship on how to best measure it. Allan and Scruggs (2004) cogently argue that looking at the policy parameters of welfare programmes (replacement rates, eligibility criteria etc.) is a superior measure of welfare retrenchment to conventional expenditure data, because as Esping-Andersen famously remarked, "it is hard to imagine that anyone struggled for spending per se" (1990, p.21). Green-Pedersen (2004), by contrast argues that what has become known as the "dependent variable problem" should be resolved by conceptualization rather than rules of thumb. Moreover, critics of spending measures (see Starke's (2006) excellent review in this regard) often make the valid point that spending is driven by a number of structural developments in welfare states, such as aging, structural unemployment and deindustrialization (Huber and Stephens, 2001; Iversen and Cusack, 2000).

An appropriate choice of our dependent variable and the estimation strategy must take these considerations seriously. For our purposes, however, a number of other considerations weigh against these arguments. First, as the welfare regime literature (Esping-Andersen, 1990, Iversen and Wren, 1998) has long emphasized, welfare services constitute a significant part of "welfare effort" in a number of welfare states, especially among the Nordic/Social-democratic types. Since spending data on cash and in-kind captures these services (elderly care facilities for instance) which the welfare entitlement measures relying on replace rates do not, the former constitutes a more encompassing and thus more appropriate measurement to use. Secondly, much of the

welfare retrenchment debate revolves around the goal of cost-containment (Pierson, 2001; Starke, 2006) which, in contrast to Esping-Andersen's famous remark above, is primarily a spending-related issue and hence not *epiphenomenal* to the study of interest as he argued (1990, p.19). In other words, if our primary object of interest is welfare retrenchment in the context of (permanent) austerity, expenditure outcomes *per se* are of high conceptual relevance for this study. On a related note, a lot of retrenchment reforms do not directly impact on the welfare of current beneficiaries (a rise in the retirement age would be a typical example) and hence do not show in current expenditure outcomes. However, since my constituency-based partisanship measure (see the foregoing discussion) relies on current beneficiaries of welfare programmes, it is important to prioritize those reforms in my empirical measures that actually affect these groups (e.g. changed pension indexation formula). Expenditure measures go a long way in taking this consideration into account. Thirdly, in response to the valid concern on demand- as opposed to policy-driven spending outcomes, careful control variables (see a more detailed discussion below) on these structural drivers (the population share of the elderly group with regards to pension spending for instance) are easily available and applicable for quantitative analysis, allowing the researcher to clean the estimate of theoretical interest of the confounding effect of these structural driving forces. Last but not least, expenditure data is widely available, expanding the empirical horizon to countries and time periods that are not covered by the commonly used entitlement datasets.

Accordingly, I chose programme-specific expenditure data as the dependent variable of interest. As previously mentioned, one of the main considerations in defining social groups was to clearly align them with welfare programmes where they have a vested interest. For the first group, the pensioner population, old age pension expenditure is an obvious program that satisfies this criterion. Workers face a number of risks along the life-cycle so it less obvious which program they are most prepared to defend. I argue that given the occupation categories that constitute this group in this study, unemployment is probably the most prominent of these risks: a shrinking manufacturing base in advanced economies, global competition, structural employment, dualized labour markets (Rueda, 2005) etc. all expose this low-skilled group to the risk of job loss (Rehm, 2011). I thus chose unemployment benefits as the core program of workers. The middle and upper classes' welfare interests is by itself a problematic

notion, because being located at the upper end of the income echelon, they are predominantly net contributors to redistributive programmes[56]. The main reason for their inclusion in the study is to see whether the theoretical expectations can be extended to the financing side of the welfare state. Hence I included total tax revenues as the middle class's main redistributive interest.

In addition to these core measures, I also adopt a broader measure for the first two groups that take into account other welfare programmes that are potentially relevant for their interest. For pensioners, the broader measure includes health expenditure and survivor benefits. The elderly are frequent users of healthcare facilities, regular consumers of subsidized drugs as well as the main beneficiaries of survivor programmes. For workers, these complementary programmes largely address what the welfare state literature identifies as "new social risks" in the post-industrial economy (Hauserman, 2010; Bonoli, 2005): measures to fight structural unemployment by activation policies, family policies to ease women's entry and re-entry in the labour force after child-bearing and so on. I thus included active labour market policies, incapacity and family benefits because these policies primarily target working age individuals. Given their relatively low-income status, family and incapacity benefits are probably important complements to workers' income especially when faced with temporary income loss due to sickness, maternity/paternity leave, etc. Active labour market policies in turn can increase reemployment opportunities for workers faced with a high risk of job loss and a generally higher risk profile in their sector of employment (Cusack et al, 2006).

To summarize, the core dependent variables of interest are old age pensions, unemployment benefits and tax revenues for pensioners, workers and the middle-class, respectively. The broader measure for the first two groups will additionally include health care expenditure and survivor benefits for pensioners and incapacity, family benefits and active labour market policies for workers.

[56] Some authors, however, drew attention to the insurance rather than the redistributive functions of welfare programmes to highlight the fact that the two functions offer different expectations on the distribution of welfare interests (Moene and Wallterstein, 2001; Kenworthy and McCall, 2008)

The final variable of main interest to discuss is the fiscal consolidation variable. The second hypothesis addresses the possibility that the era of "permanent austerity" should not be taken as a coherent whole but rather as extended efforts to stabilize/bring down debt levels interspersed with times with less pressure on public budgets. There is, of course, considerable cross-national variation as well in the extent to which characterizing the last three to four decades as permanent austerity is appropriate. Recognizing this heterogeneity I followed Alesina and Ardagna's (2009) approach who identify large fiscal efforts by changes in the cyclically adjusted primary balance of the general government (capb). Specifically, they separate their empirical sample into three periods: 1) consolidation periods, where the capb increases by more than 1.5% of potential GDP; 2) expansion periods, where the capb drops by at least 1.5% of potential GDP 3) "neutral" periods in between. While the 1.5% threshold, as any other, is admittedly arbitrary, the advantage of this relatively high threshold is to rule out idiosyncratic and one-off changes in the fiscal stance. Setting the threshold high allows the researcher to pin down periods where changes in the fiscal stance most probably result from well-designed and adequately prepared policy actions of the government. In addition to measuring adjustment periods through these consolidation and expansion dummies, I also introduce the capb variable in a continuous form to test my second hypothesis in a linear form.

In addition to the main variables of theoretical interests, a number of control variables will be essential for the analysis. Most importantly, structural developments driving program-specific expenditure outcomes have to be correctly specified. First, as expenditure data is expressed as a % of GDP, GDP growth has to be accounted for to take into account the denominator effect. Moreover, growth has an indirect effect on expenditure data as the cyclical position of the economy affects the pool of beneficiaries of welfare claimants. For the financing side, it is well known that much of the tax intake (both direct and indirect taxes) is highly sensitive to cyclical swings in economic growth. Secondly, unemployment will be taken into account for the worker-related specifications because it increases the pool of unemployed, directly impacting unemployment benefits and indirectly other welfare expenditure for the working age. Unemployment can also exert a detrimental effect on public revenues, in addition to the effects of growth, by shrinking the direct tax base. Hence I also included the unemployment variable for the tax specifications. For pensioners-related expenditure, in

turn, aging will be controlled for in the form of the % of elderly (people aged above 60) in the population. In addition to these structural developments, a political party family control will be used to disentangle the effects of partisan biases (RSP) from the traditional effects of ideology (party families). Although the descriptive analysis above has shown that RSP is by no means just an equivalent measure for party family labels, I nevertheless control for party families to purge the estimates from the possibly confounding effects of ideology.

In addition to these controls, a number of further variables could be of potential theoretical interest. One a common theme in the welfare retrenchment literature is the varying degree of leeway different incumbent governments have in enacting policy change (Obinger, 2002; Tsebelis, 2002, Bonoli, 2001). A large number of veto players – coalition partners, second chambers, presidential veto etc. – can create policy deadlock even when the government's partisan leaning (ie. its constituency composition) is otherwise favourable towards welfare retrenchment. Hence I included a political constraint index (POLCON III) index (Henisz, 2006), a popular composite index ranging between 0 and 1 to capture the political constraint that a government faces at any point in time. Furthermore, another important theme in the welfare retrenchment literature is the impact economic integration and globalization have on welfare state stability. To adjudicate between two competing claims on the directional effect of globalization in the empirical literature[57], I included a sub-component of the popularly used Dreher index that captures economics flows and restrictions on movements of goods, services and capital (Dreher, 2006). Finally, I included an EMU dummy to pick up the potentially constraining effect of the currency union on public budgets and hence on welfare programmes. However, none of these additional control variables were remotely close to achieving statistical significance in any of the models so I discarded them from the final analysis.

Before proceeding to the empirical analysis of this article, a final note on the partisan variables is in order. The welfare state literature, as a rule, measured incumbency by incorporating all parties holding cabinet portfolios. This is warranted on the grounds that government portfolios offer the primary tools for parties to affect policy. It is not

[57] See Meinhard and Potrafke (2012) for an excellent summary, literature review and empirical re-examination of the so-called "efficiency" and "compensation" hypotheses.

all that clear, however, that a numerical (%) measure of junior coalition parties is appropriate to determine their influence on welfare decisions: a small coalition partner controlling the environmental and the transport ministry, for instance may have considerably less policy-making power than one controlling welfare-related portfolios. Focusing on the leading government party is thus arguably a safer choice because the control over the premiership and the finance ministry[58] (typically the case for large senior coalition members) gives the leading party considerable, if not predominant leverage in acting according to its own welfare preferences. Moreover, the clarity-of-responsibility thesis in electoral research (Powell and Whitten, 1993; Duch and Stevenson, 2008) has consistently shown that senior parties are held more responsible for electoral outcomes, hence their strategic incentives for Nixon-goes-to-China policy-making should be also sharper. Finally, reliably measuring group-specific RSP from electoral surveys is extremely difficult for small parties due to the limited (sub)sample size. Although the omission of coalition partners should be kept in mind as a possible limitation, these considerations suggest that focusing on leading parties is a reasonable choice.

IV.4. Empirical analysis: Nixon-goes-to-China in times of welfare retrenchment

To begin the discussion on specification issues for the empirical analysis, I lay out the general time series-cross section model to be estimated, taking the general form of:

$$Y_{it} = \beta_0 + \sum_1^k \beta_k * X_k + \alpha_i + \mu_t + e_{it}$$

[58] Although traditional models on portfolio allocation (Laver and Shepsle, 1990) assumed a great degree of ministerial autonomy, a large number of countries have taken radical steps towards strengthening the role of finance ministers in the allocation of public funds (Hallerberg et al, 2009)

Where Y_{it} is the endogenous (dependent) variable of the model, $\sum_1^k \beta k * Xk$ is a vector of k regressors (may or may not including lagged dependent variable(s) to account for dynamics), α_i, μ_t are unit- and time-specific intercepts and e_{it} is an observation-specific error term. The observations are taken from a sample of 25 OECD countries – including 5 new member states of the European Union – over more than 3 decades (1975-2007)[59] that largely covers the period of "permanent austerity".

The first concern that immediately arises is to what extent the main variable of our interest, RSP can be regarded as exogenous so that the weak exogeneity assumption – $E(X_{it}e_{it}) = 0$ – holds. If that assumption is violated, the estimated parameters of interest will be biased. Theoretically, we have strong expectation to assume that the contemporaneous RSP and expenditure data are mutually endogenous, as the relative party support among different constituencies may very well depend on welfare spending decisions. To circumvent this possibly severe endogeneity bias, I "fixed" my RSP measure to the year that a new government comes to power. For the entire term of the incoming government, the group-specific RSP will reflect the preceding four years' average of the RSP measure at the beginning of the term[60]. This static RSP measure along the government term can thus be understood to reflect the constellation of relative support levels by groups that the government owes its mandate to. It may still be questionable whether the prior RSP observations are exogenous (if a party's rhetoric in opposition, for instance, turns against a spending program, the beneficiaries may turn against the party even before coming to power), but measuring RSP from the pre-incumbency period is a theoretically informed way to capture the notion of a government's "electoral mandate" and goes a long way in addressing endogeneity concerns[61].

[59] In practice, program-specific expenditure data is available from 1980 only, so that serves the starting point for all panels. Moreover, for some of the countries in the sample have different availabilities for expenditure data and electoral surveys, resulting in an unbalanced panel for the analysis.
[60] Taking a four-year average as opposed to just the annual observation when the government comes to power helps to reduce sampling error which would pose serious problems if RSP was measured based on a single electoral survey. The four-year moving average RSP series are thus considerably smoother than the very noisy "base" series. The window of four rather than some other moving average window was chosen to reflect the length of a typical electoral cycle.
[61]Moreover, to the extent that a positive endogeneity bias may still be present in the estimates (expectations of program-specific cuts resulting in lower relative group-specific RSP), the estimated negative coefficients will understate the true effect, rather than inflate it.

A second important theoretical consideration is the functional form of the dependent variables. While level specifications are usually interpreted as models predicting "long-run" effects, first-difference specifications are better suited to capture "short-run" dynamics. For our purposes, it is the latter aspect that we mostly care about: to what extent do incumbent governments adopt retrenchment policies – often in the face of financial pressures to take urgent decisions – as a function of their electoral constituencies. Moreover, as Kittel and Winner (2005) discussed in their re-analysis of Garrett and Mitchell's (2001) public expenditure data, the level form of these series can be often non-stationary with a coefficient of the autoregressive term being very close to unity. First differencing the dependent variable thus also has a technical advantage wherein the risk of running spurious regressions is minimized. As for the structural predictors (old age ratio, unemployment and growth) the first two of these entered with a first-differenced format in the specifications, but I left growth – which is theoretically speaking a "change variable" itself – in its level form to control for the denominator effect. The political variables (RSP and party types) were introduced in levels[62].

The first step of my estimation strategy was to investigate unit (and time) heterogeneity by testing for inclusion of fixed effects (α_i and μ_t) in the models. If unobserved unit-/time-specific characteristics – and hence the error terms – are correlated with our regressors, the estimated coefficients will suffer from omitted variable bias. However, in the absence of this source of bias, a random-effects model is preferable as it allows for more precise (more efficient) estimates. First, I began with the inclusion of time-dummies because of well-known periods of time-specific shocks (e.g. Maastricht process) that simultaneously affected many countries in the sample. Predictably, an F-test on the joint significance of these time dummies ($p<0.001$ in all cases) allows us to convincingly reject the null hypothesis of no time-specific effects. As for unit-heterogeneity, F tests for different dependent variables and models provided mixed results: for unemployment benefit programmes, for instance, there is no evidence for unit-specific effects; for tax revenues, the joint effect of country dummies is marginally significant; for old age spending, the effect is highly significant. I thus proceeded to a set of Hausman tests to check whether the more efficient random effects estimator is

[62] Unlike with the structural variables where it is theoretically justified to expect that "changes drive changes", political variables have a different logic: government continuity – hence non-changing RSP and party family variables – is very well compatible with changing expenditure outcomes.

also consistent[63] (the H0 of the test). These tests unambiguously indicated that where unit-specific effects are present (e.g. for old-age spending), these effects are not correlated with the regressors, hence the omission of fixed effects to gain a more efficient random effects estimator is warranted. That said, I will provide fixed effects specifications as robustness check in section 5 to examine the stability of the findings.

With these random effects specifications – with time dummies – as our benchmark, I proceeded to test for violations of the standard Gauss-Markov conditions(Beck, 2001) under which regular standard errors of individual coefficients may be severely inflated, yielding invalid test results. The first possible source of these violations is panel heteroskedasticity whereby residuals from different panels have unequal variances. This is a highly plausible scenario because countries with higher levels of program-specific spending are expected to display higher fluctuations (annual changes) around the mean. These expectations were confirmed both by a visual inspection of residuals (large differences across units) and a modified Wald-test which strongly rejected the null hypothesis of homoskedastic errors across units ($p<0.001$). Proceeding to the covariances of the residuals, valid standard error estimates require independence across the rows in the variance-covariance matrix of the errors (no contemporaneous correlation) as well as in the columns (no autocorrelation in panels). Based on a Pesaran test, most of the models appear to be contaminated by contemporaneous correlation (test results are provided in Appendix 4). First order serial correlation[64], on the other hand was detected only in the unemployment benefit series, indicating that changes in unemployment benefit programmes have a high degree of "stickiness". In other words, a given change in unemployment benefit schemes is likely to entail a similar change in the next period. To model this feature of the unemployment benefit data, I included a lagged dependent variable in the specifications. Regressing residuals on past residuals after this LDV specification showed no remaining serial correlation in the data.

[63] The more technical null hypothesis that the Hausman specification test tests against is whether the unit-(country-) specific effects are correlated with the regressors, which would render the random effects or fully pooled OLS estimates biased (Bartels, 2008).
[64] A Wooldridge (Lagrange Multiplier) test was used to test against the null hypothesis of no first order serial correlation in the data.

Equipped with these diagnostic results[65], I estimated the random effects models correcting for panel-heteroskedasticity and cross-sectional correlation, using panel-corrected standard errors as suggested by Beck and Katz (1995) as a superior alternative to the FGLS-based Parks method.

Table IV.1
Models explaining old-age spending in OECD countries†

	Baseline	Extended	Interactive I	Interactive II
RSP_pensioners	-0.215	-0.249	-0.343	-0.204
	(2.79)***	(4.37)***	(4.71)***	(5.23)***
growth	-0.042	-0.038	-0.045	-0.043
	(3.32)***	(3.39)***	(3.82)***	(3.67)***
Δoldage	39.712	39.261	36.847	37.266
	(5.57)***	(4.19)***	(4.21)***	(4.79)***
conservative		-0.061	-0.046	-0.048
		(1.49)	(1.10)	(1.27)
christdem		0.044	0.049	0.041
		(1.44)	(1.50)	(1.27)
liberal		-0.002	-0.001	-0.003
		(0.04)	(0.02)	(0.06)
other		-0.100	-0.083	-0.077
		(2.34)**	(2.15)**	(1.91)*
Consolidation			-0.072	
			(1.68)*	
Expansion			-0.011	
			(0.25)	
RSP_pensioners*Consolidation			0.238	
			(2.19)**	
RSP_pensioners*Expansion			0.854	
			(4.50)***	
Δcapb				-0.020
				(2.45)**
RSP_pensioners* Δcapb				-0.091
				(2.54)**
R^2	0.19	0.21	0.25	0.25
N	489	415	392	392

p<0.01* *p*<0.05; ** *p*<0.01***

†The coefficients are random -effects estimates with a set of time dummies (panel-corrected standard errors in parentheses).

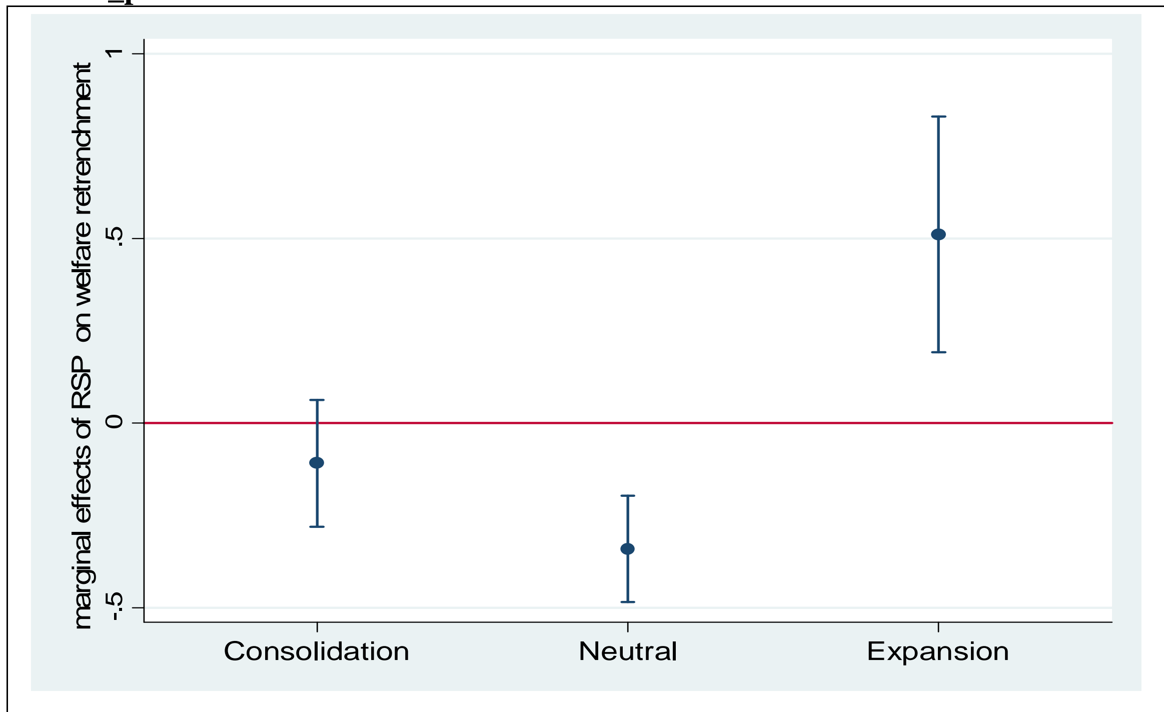
Table IV.1 summarizes the main findings on old-age spending (time dummies suppressed from this and all subsequent outputs). The baseline model shows that structural variables are important determinants of spending outcomes: higher growth and a larger increase in the ratio of the elderly decreases and increases the share of output devoted to old age expenditure, respectively. By contrast, the Henisz index, our

[65] All diagnostic test results are provided in Appendix 4

proxy for veto players in the political systems, did not achieve statistical significance in any of the models hence I omitted it from the final analysis.

The main variable of interest, pensioner-specific RSP is highly significant in the expected (negative) direction. Looking at the extended model with party family controls, the only noteworthy finding is the non-significance of most party family variables[66]. Only the "other" category (comprising very few cases where the leading party did not belong to any of the four major party families) displays significant differences compared to the benchmark, social-democratic category. Introducing the interactive models, the estimates largely lend support to the second hypothesis. Regarding Alesina and Ardagna's (2009) approach, the RSP variable's marginal effect in different time periods are depicted on Figure IV.5. The point estimates of the RSP variable are negative in both neutral and consolidation periods, consistent with the conditional hypothesis, but turn positive in times of fiscal expansion. In other words, only in times of relative prosperity do incumbents reward their own constituencies while in more austere periods, the Nixon-goes-to-China effect holds.

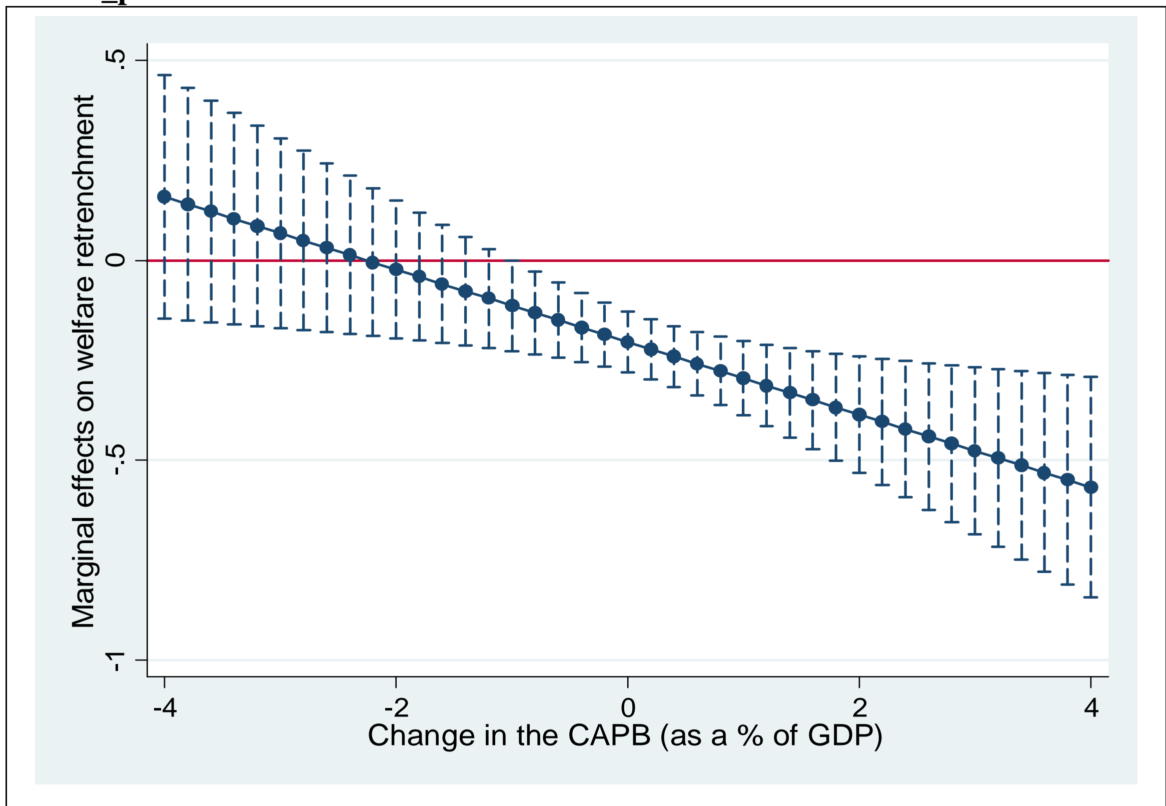
Figure IV.5
Marginal effects with point estimates and 95% confidence interval for the RSP_pensioner variable under different fiscal stances from Interactive model I



[66] Social democratic parties were omitted as the reference category in all models.

The same pattern emerges from the second interactive model where the capb variable is interacted with the RSP measure in a continuous form. Point estimates and confidence intervals for different annual changes in the capb are shown on Figure IV.6. Once the annual change in the capb is greater than -1 of potential GDP, incumbents with higher relative support among pensioners cut old-age spending more (expand it less) than incumbents with lower relative support among pensioners.

Figure IV.6
Marginal effects with point estimates and 95 % confidence interval for the RSP_pensioner variable under different fiscal stances from Interactive model II



Proceeding to unemployment benefits programmes, Table IV.2 presents the main findings. Since we are including the lagged dependent variable among the set of regressors to take into account autocorrelation and dynamics, the coefficient estimates now have a slightly different reading. The estimates for the exogenous variables only provide the instantaneous effect; to understand the long-run effect, one has to take into account the effect of the regressors on the partial adjustment process in the dependent variable via the autoregressive term (Kittel and Winner, 2005). The long-run relationship between X and Y will be given by: $\frac{\beta 2}{1-\beta 1}$where β_2 and β_1 are the estimated

coefficients on the exogenous and the autoregressive term, respectively (Beck and Katz, 2011).

Table IV.2
Models explaining unemployment-benefit spending in OECD countries†

	Baseline	Extended	Interactive I	Interactive II
L.Δunemploymentbenefits	0.303	0.337	0.292	0.295
	(7.43)***	(11.09)***	(9.79)***	(9.59)***
RSP_workers	-0.046	-0.062	-0.127	-0.063
	(1.79)*	(6.02)***	(8.03)***	(4.41)***
growth	-0.008	-0.002	-0.005	-0.005
	(2.07)**	(0.60)	(1.11)	(0.99)
Δunemployment	0.055	0.054	0.057	0.058
	(6.41)***	(9.91)***	(9.41)***	(9.32)***
conservative		0.037	0.032	0.033
		(3.73)***	(3.32)***	(3.21)***
christdem		0.029	0.033	0.031
		(2.82)***	(3.45)***	(3.01)***
liberal		0.064	0.065	0.064
		(4.66)***	(4.64)***	(4.56)***
other		-0.044	0.037	0.032
		(1.46)	(1.14)	(0.88)
Consolidation			-0.011	
			(0.80)	
Expansion			0.041	
			(2.26)**	
RSP_workers*Consolidation			0.124	
			(2.66)***	
RSP_workers*Expansion			0.281	
			(3.05)***	
Δcapb				-0.003
				(0.68)
RSP_workers* Δcapb				-0.007
				(0.44)
R^2	0.47	0.48	0.54	0.53
N	472	397	375	375

p<0.01* *p*<0.05; ** *p*<0.01***

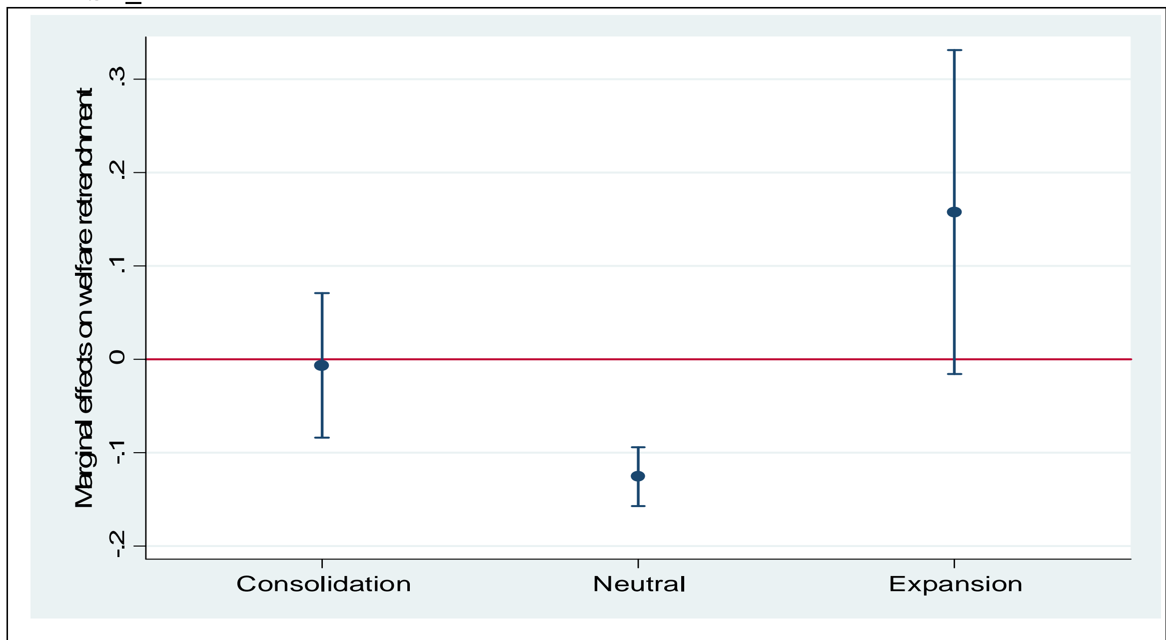
† The coefficients are random -effects estimates with a set of time dummies (panel-corrected standard errors in parentheses).

As it can be seen from table IV.2, in all three models the effect of worker-specific RSP is statistically significant in the expected direction (albeit only marginally so in the baseline model). The long-run relationship between RSP and the dependent variable, however is considerably greater than the point estimates. Calculating from the extended model, for instance, $\frac{\beta 2}{1-\beta 1}$ implies a long-run effect of -0.09% of GDP, augmenting the short-run (instant) effect by a factor of 1/3. In other words, while moving from an incumbent with -0.5 RSP among workers to one with 0.5 among them implies an instantaneous cut in unemployment benefits amounting to 0.06% GDP, the full effect

felt over the years (assuming unchanged incumbency and values of other variables in the model) increases to 0.09%. In contrast to the pension models, the party family variables are significant at the 1% level with the surprising finding that christian-democrats, liberals and conservatives all cut the program less (or expand it more) than their social-democratic rivals. That said, the Nixon-goes-to-China phenomenon holds even after controlling for these party families: the RSP coefficient, if anything, increases in size and significance when party families are taken into account. Similar to the pensioner models, while structural variables – growth and the change in unemployment rates – are highly significant in the expected direction, the political constraints index as a proxy for the political opportunity space to enact retrenchment is non-significant and therefore I omitted it from the final specifications.

Turning to the interactive models, a qualitatively similar pattern emerges to the pensioner models. Figure IV.7 shows the point estimates and 95% confidence interval for the RSP_worker variable under different fiscal stances. Again, the point estimates suggest that only during times of fiscal expansion do incumbents reward their low-skilled working age constituency when they enjoy high relative support among them. That said, the estimate marginally falls short of significance at the 5% level. The point estimate is slightly below 0 during times of consolidation and is both substantially and statistically highly significant in neutral times. On the other hand, no interactive effect is found in the second interactive specification: while the interaction between the capb and the RSP variable is signed in the expected (negative) direction, the point estimate is very close to 0 and non-significant.

Figure IV.7
Marginal effects with point estimates and 95 % confidence interval for the RSP_worker variable under different fiscal stances from Interactive model I



Turning to the financing side of the welfare state, the third set of models tests the middle class's affiliation with the leading incumbent party as a possible determinant of tax changes. Here we are reverting back to a static specification as no autocorrelation was detected with the diagnostic tests. Table IV.3 shows the model estimates.

Table IV.3
Models explaining tax revenues in OECD countries†

	Baseline	Extended	Interactive I	Interactive II
RSP_middleclass	0.075	0.049	-0.105	0.030
	(0.79)	(0.37)	(1.12)	(0.45)
growth	-0.133	-0.148	-0.080	-0.091
	(5.12)***	(5.73)***	(3.61)***	(4.17)***
Δunemployment	-0.276	-0.292	-0.235	-0.239
	(7.07)***	(9.40)***	(9.03)***	(8.42)***
conservative		-0.083	-0.122	-0.132
		(1.14)	(1.65)*	(1.84)*
christdem		-0.086	-0.112	-0.130
		(1.06)	(1.60)	(2.07)**
liberal		-0.164	-0.169	-0.185
		(1.76)*	(2.03)**	(2.34)**
other		-0.227	-0.271	-0.301
		(1.32)	(2.69)***	(3.09)***
Consolidation			0.772	
			(8.78)***	
Expansion			-0.806	
			(8.90)***	
RSP_middleclass*Consolidation			-0.109	
			(0.50)	
RSP_middleclass*Expansion			1.051	
			(3.82)***	
Δcapb				0.212
				(13.67)***
RSP_middleclass*Δcapb				-0.151
				(2.89)***
R^2	0.21	0.23	0.35	0.32
N	601	514	474	475

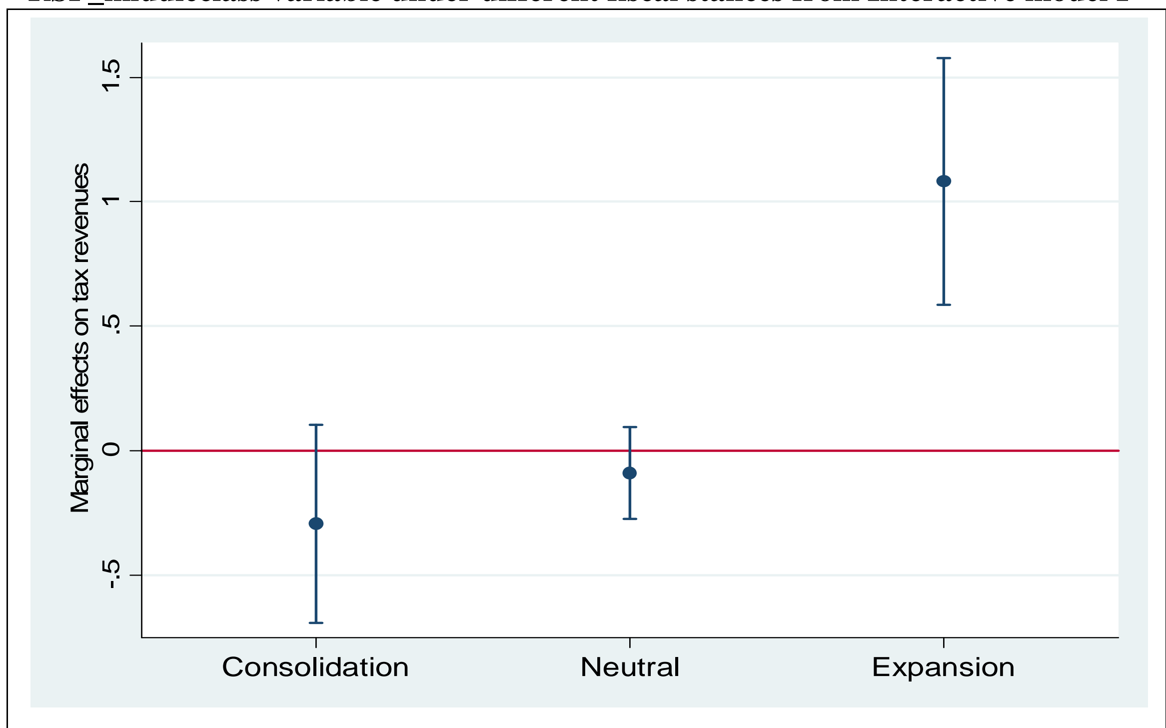
p<0.01* *p*<0.05; ** *p*<0.01***

†The coefficients are random -effects estimates with a set of time dummies (panel-corrected standard errors in parentheses).

Compared to the two welfare programmes, the Nixon-goes-to-China hypothesis receives much weaker support on the revenue side. The estimated sign of the middle class-specific RSP is positive (larger increases in the tax burden under middle-class parties) as predicted but the effect is substantively small and non-significant. The structural variables, as in the previous models, behave according to expectations: higher growth and lower unemployment increase tax revenues. The coefficients for the party family variables from the extended model do not achieve significance with the exception of liberal parties that seem to cut taxes more (raise them less) compared to social-democrats. Even this coefficient, however, is just marginally significant at the 10% level. Turning to the interactive model, we receive opposite patterns to what we have estimated for core welfare state recipients (pensioners and workers). From both interactive models, it seems that middle class parties shelter their constituency from tax hikes compared to other parties in times of consolidation, albeit the point estimate is not

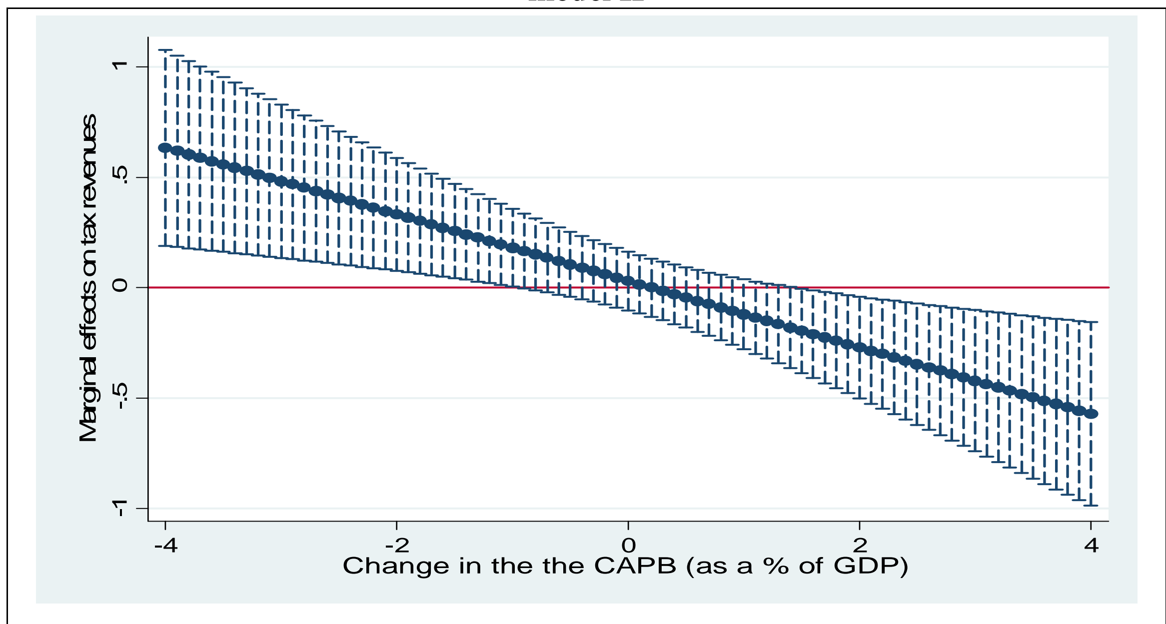
significant. Moreover, in times of fiscal expansion, incumbents with high relative support among the middle classes increase the tax burden more (cut it less) than incumbents with less support among this group (Figure IV.8). In other words, in contrast to our conditional hypothesis, it is times of fiscal expansions, rather than austerity, when middle-class parties seem to enact policies that are less favourable to their core constituencies. The same conclusion results from the second interactive model when the capb variable is introduced in a continuous form (Figure IV.9).

Figure IV.8
Marginal effects with point estimates and 95 % confidence interval for the RSP_middleclass variable under different fiscal stances from Interactive model I*



*Point estimates and 95% confidence intervals are depicted for the three episodes separately

Figure IV.9
Marginal effects (in % of GDP) with point estimates and 95 % confidence interval for the RSP_middleclass variable under different fiscal stances from Interactive model II



To sum up our findings thus far, plenty of evidence for the baseline Nixon-goes-to-China hypothesis (H_b) has been found. Most importantly, in all our models on the two core welfare programmes, high relative support among the main beneficiaries is associated with deeper cuts (smaller expansions) in the respective programmes. For the financing side of the welfare state, however, while the estimated signs do point in the right direction, the statistical evidence has been weak. As far as the conditional version of the Nixon-goes-to-China hypothesis (H_c) is concerned, the evidence holds, albeit in varying degrees, for the core welfare clienteles: pensioners and workers. By contrast, the middle-classes seem to fare worse during incumbents that are popular among them in times of relative prosperity (fiscal expansions) only, contrary to what the conditional hypothesis predicted.

Do these findings extend to a broader understanding of group-specific interests? As a first robustness check of our prior results, the same models have been re-estimated for the broader welfare categories for pensioners and workers, respectively. For welfare programmes representing a broader set of pensioners' interest – including health and

survivor benefits – the results (shown in Appendix 2)[67] are not qualitatively different from the core models[68]. The size of the estimated coefficients is larger (probably reflecting the larger size of this broader set of programmes) and they are significant at the 5% level in all the models. Moreover, both interactive models indicate an almost identical pattern on the conditioning impact of the fiscal stance to the core models. Turning to workers-related programmes, the baseline model provides similarly strong evidence for the first hypothesis as the core models did. In the extended model, when party family labels are included, the estimated coefficient for workers' RSP now falls short of significance at the 5% level (however it is still significant at the 10% level). The interactive models, on the other hand lend little support to the conditional hypothesis: the point estimates are below 0 in all three types of fiscal episodes. Similarly, in the second interactive model, while the point estimate of the interaction turn is in the expected (negative) direction, it fails to achieve statistical significance.

Returning to our core models, a further round of robustness check examined the stability of the estimated coefficients after fixed-effect estimations. As the tables in Appendix 2show, the substantive results hold after restricting the analysis to within-country variation under the fixed-effect estimates. The estimated size of the RSP coefficient is halved in the pension models but still achieves significance at the 5% level in the extended model. The worker-specific RSP is practically the same in size and significance terms compared to the random-effects estimates for unemployment benefits. Finally, the tax models' RSP coefficient for the middle class even increases compared to the random-effects specifications but still falls short of statistical significance with the partial exception of the baseline model where the middle class's RSP is marginally significant at the 10% level. As far as the interactive specifications are concerned, the general patterns and the strength of the statistical evidence are broadly similar to the random effects models. It seems, therefore, that our main results obtained earlier are unlikely to be driven by omitted country-specific characteristics that the random-effects models failed to capture.

[67] Marginal effects plot for models on the broader spending items are available upon request

[68] Contrary to the core models, I was now unable to reject no first-order serial correlation with this new dependent variable ($p<0.05$). I thus included a lagged dependent variable which, however, did not substantively change the coefficients of interest.

IV.5. Conclusions

How partisanship shapes welfare preferences of different incumbent governments has long been one of the primary interests of welfare state scholars. Electoral considerations in most of these accounts have been implicit at best with highly pessimistic expectations: welfare state retrenchment should be inherently unpopular so even conservative governments with a clear electoral mandate often shy away from it. My paper has offered an alternative view which attempts to bridge the gap between these expectations and contrary findings of the fiscal adjustment literature. Building on the qualitatively different nature of retrenchment politics inspired by the New Politics literature, I argued that once partisan biases behind different governments are taken into account, one can make sense of high re-election probabilities of retrenching governments. Specifically, I set out to test the hypothesis that high relative support propensity among certain social groups leads to deeper cuts (more limited expansions) of welfare programmes that primarily serve the interests of these groups. My analysis extended the same logic to the financing side of the welfare state as well to test whether middle-class parties are better positioned to raise taxes in times of "permanent austerity".

Our findings from a set of 25 OECD countries provided strong support for the baseline hypothesis (H_b). Over recent decades, high relative support among pensioners have, on average, been associated with deeper cuts (more limited expansions) in public pension programmes on the one hand and in a broader set of welfare entitlements – health care and survivor benefits – on the other. A similar pattern has been found for welfare programmes that primarily benefit low-status working age individuals. A high relative support propensity among them has been associated, on average, with deeper cuts (more limited expansions) in unemployment programmes on the one hand, and in a broader set of welfare programmes – family benefits, incapacity benefits and active labour market policies – on the other. Much weaker evidence has been found on the financing side of the welfare state: although high relative support among the middle classes is, on average, associated with larger increases in tax revenue in our sample, the statistical evidence for it has been too weak to infer anything conclusive about it.

A second hypothesis (H_c) investigated whether this effect is uniform over time or whether it holds only in periods when retrenchment pressure is perceived particularly acute. On the balance, the evidence have been mixed in this regard: for our core welfare measures – unemployment benefits, and old age pension expenditure - during fiscal expansions incumbents appear to compensate their core constituencies for painful policies they inflict on them in hard times. If anything, however, the opposite pattern seems to hold for the financing side of the welfare state, which presents new and intriguing research agendas ahead.

In addition to these main findings, one important contribution to the welfare state debate that this paper had to offer was a reconsideration of partisanship. In the models that controlled for party family labels, the estimated impact of group-specific support propensity has been at least as strong as in the baseline models. Taken together with the descriptive patterns offered in an earlier section of this paper, we can confidently state that traditional party family labels lump together a highly diverse set of parties as far as their underlying electoral constituencies are concerned. It would be thus fruitful for future empirical investigations of partisanship to take into account this electoral heterogeneity both across and within party families.

A second conclusion – in the footsteps of Schelkle (2012), among others - that follows from this is the need for a more disaggregated view of the welfare state than has been often the case in many empirical works. Highly aggregate variables, such as social spending or general government expenditures give us little guidance for times of severe budgetary trade-offs when the expansion/maintenance of a given social program may inevitably entail cuts in another one. The evolution of program-specific spending (or the institutional parameters – eligibility criteria, replacement rates etc. – that define the functioning of the program) is therefore more conducive to gaining a fine-grained understanding of welfare state politics.

Finally, the obvious next step that my argument calls for is the investigation of the micro-level dynamics of welfare programmes. Specifically, the individual-level determinants of vote-switching between elections during retrenchment would offer valuable insights into the understanding of partisan biases among the electorate.

Appendix 1

Construction of RSP series

As indicated in the text, RSP for the three social groups for a given party for a given year was defined by $RSP_{gp}= \frac{Vgp\text{-}Vtp}{Vtp}$. The categorization of respondents into the three social groups of interest were based on the survey questions on respondents' occupation/and or job status. From the Eurobarometer series I classified respondents into pensioners (answering "retired" to the survey questions), workers (answering "manual skilled worker", "manual unskilled worker" and "other unskilled worker") and middle-class (answering "employed professionals", "professional", "general or middle manager", "business owner" and "shop owner"). The ISSP series allowed a more systematic classification of respondents relying on ILO-ISCO (4 digit) categories where higher categories indicate lower "status". This was cross-validated by comparing self-reported family income across the major occupational groups.

Accordingly, workers comprised the last 3 of the 9 main categories.

7) Craft and related trades workers,
8) Plant and machine operators,
9) Elementary occupations.

I classified the first 3 of the main categories into middle class respondents:

1) Legislators, senior officials and managers
2) Professionals
3) Technicians and associate professionals

Finally, pensioners were classified by another survey question on occupation status.

The general rule I followed to ensure as much consistency as possible is to use the Eurobarometer trend file from its beginning until its end in 2002 (vote intention questions were interrupted in that year and subsequent Eurobarometer surveys did not include that question). Following 2002 I switched to the ISSP files. For countries that had little or no Eurobarometer coverage I extended the ISSP series further back in time until the earliest observation (generally in the early 90s).

Appendix 2
Output of robustness checks

Table IV.4
Models explaining a broader measure of spending representing pensioners' interest in OECD countries†

	Extended	Interactive I	Interactive II
L.Δ.pensionerrisk	0.114	0.115	0.103
	(1.31)	(1.27)	(1.21)
RSP_pensioners	-0.299	-0.482	-0.242
	(2.28)**	(3.15)***	(2.48)**
growth	-0.054	-0.064	-0.060
	(3.32)***	(3.77)***	(3.51)***
Δoldageratio	17.989	17.876	17.554
	(0.88)	(0.89)	(0.94)
liberal	0.020	0.009	0.010
	(0.30)	(0.15)	(0.20)
christdem	0.083	0.089	0.073
	(1.77)*	(1.75)*	(1.45)
conservative	-0.013	-0.031	-0.033
	(0.20)	(0.45)	(0.54)
other	-0.250	-0.222	-0.197
	(1.77)*	(1.62)	(1.36)
Consolidation		-0.192	
		(2.50)**	
RSP_pensioners*Consolidation		0.423	
		(1.98)**	
Expansion		-0.118	
		(1.24)	
RSP_pensioners*Expansion		1.437	
		(3.08)***	
Δcapb			-0.028
			(1.49)
RSP_pensioners* Δcapb			-0.158
			(1.83)*
R^2	0.26	0.30	0.30
N	403	382	382

p<0.01* *p*<0.05; ** *p*<0.01***

†The coefficients are random-effects estimates with a set of time dummies (panel-corrected standard errors in parentheses).

Table IV.5
Models explaining a broader measure of spending representing workers' interest in OECD countries†

	Extended	Interactive I	Interactive II
L.Δworkerrisk	0.216	0.245	0.235
	(2.02)**	(2.00)**	(2.04)**
RSP_workers	-0.215	-0.223	-0.171
	(1.73)*	(1.69)*	(1.58)
growth	-0.014	-0.026	-0.025
	(0.90)	(1.53)	(1.51)
Δunemployment	0.042	0.011	0.012
	(0.69)	(0.17)	(0.17)
liberal	0.086	0.077	0.071
	(1.10)	(0.92)	(0.84)
christdem	0.049	0.025	0.025
	(0.75)	(0.36)	(0.37)
conservative	0.087	0.057	0.062
	(1.47)	(0.89)	(1.00)
other	-0.153	-0.163	-0.150
	(1.13)	(1.10)	(1.03)
Consolidation		-0.063	
		(1.22)	
Expansion		0.139	
		(1.80)*	
RSP_workers*Consolidation		0.086	
		(0.51)	
RSP_workers*Expansion		0.152	
		(0.64)	
Δcapb			-0.040
			(3.68)***
RSP_workers* Δcapb			-0.025
			(0.69)
R^2	0.39	0.43	0.43
N	360	343	343

p<0.01* *p*<0.05; ** *p*<0.01***

†The coefficients are random -effects estimates with a set of time dummies (panel-corrected standard errors in parentheses).

Table IV.6
Models explaining old-age spending in OECD countries under fixed-effects estimation†

	Baseline	Extended	Interactive I	Interactive II
RSP_pensioners	-0.100	-0.116	-0.173	-0.042
	(1.36)	(2.24)**	(2.79)***	(0.78)
growth	-0.053	-0.052	-0.055	-0.051
	(3.78)***	(7.25)***	(7.12)***	(6.39)***
Δoldageratio	42.272	44.959	35.027	34.168
	(4.29)***	(3.11)***	(2.55)**	(2.84)***
liberals		-0.014	-0.008	-0.012
		(0.26)	(0.19)	(0.33)
conservatives		-0.063	-0.041	-0.040
		(1.57)	(1.02)	(1.11)
christiandemocrats		0.052	0.066	0.058
		(1.84)*	(2.14)**	(1.99)**
others		-0.107	-0.083	-0.083
		(2.19)**	(2.07)**	(1.96)**
Consolidation			-0.074	
			(2.22)**	
Expansion			-0.046	
			(1.34)	
RSP_pensioners*Consolidation			0.264	
			(2.97)***	
RSP_pensioners*Expansion			1.011	
			(6.90)***	
Δcapb				-0.017
				(2.13)**
RSP_pensioners* Δcapb				-0.100
				(2.77)***
R^2	0.25	0.28	0.33	0.32
N	489	415	392	392

p<0.01* *p*<0.05; ** *p*<0.01***

†The coefficients are fixed-effects estimates with a set of time dummies (panel-corrected standard errors in parentheses).

Table IV.7
Models explaining unemployment-benefit spending in OECD countries under fixed-effects estimation†

	Baseline	Extended	Interactive I	Interactive II
L.Δunemploymentbenefits	0.281	0.324	0.283	0.283
	(6.78)***	(10.94)***	(9.24)***	(8.88)***
RSP_workers	-0.019	-0.043	-0.101	-0.043
	(0.78)	(2.57)**	(5.57)***	(2.68)***
growth	-0.012	-0.007	-0.012	-0.012
	(2.54)**	(1.51)	(2.00)**	(1.86)*
Δunemployment	0.051	0.050	0.052	0.052
	(5.81)***	(9.95)***	(7.15)***	(7.76)***
liberals		0.068	0.061	0.062
		(5.11)***	(4.39)***	(4.28)***
conservatives		0.030	0.025	0.025
		(2.84)***	(2.36)**	(2.22)**
christiandemocrats		0.029	0.034	0.031
		(2.71)***	(3.22)***	(2.75)***
others		-0.037	0.035	0.031
		(1.10)	(1.04)	(0.80)
Expansion			0.038	
			(2.02)**	
Consolidation			-0.011	
			(0.86)	
RSP_workers*Expansion			0.300	
			(3.40)***	
RSP_workers*Consolidation			0.123	
			(2.65)***	
Δcapb				-0.003
				(0.66)
RSP_workers* Δcapb				-0.008
				(0.51)
R^2	0.49	0.51	0.56	0.55
N	472	397	375	375

p<0.01* *p*<0.05; ** *p*<0.01***

†The coefficients are fixed -effects estimates with a set of time dummies (panel-corrected standard errors in parentheses).

Table IV.8
Models explaining tax revenues in OECD countries under fixed-effects estimation†

	Baseline	Extended	Interactive I	Interactive II
RSP_middleclass	0.171	0.108	-0.058	0.109
	(1.76)*	(0.74)	(0.46)	(1.17)
growth	-0.132	-0.154	-0.082	-0.100
	(4.32)***	(5.27)***	(3.80)***	(4.61)***
Δunemployment	-0.281	-0.302	-0.245	-0.253
	(6.77)***	(8.77)***	(9.19)***	(8.83)***
liberals		-0.171	-0.158	-0.173
		(1.71)*	(1.73)*	(1.97)**
conservatives		-0.089	-0.140	-0.154
		(1.15)	(1.95)*	(2.12)**
christiandemocrats		-0.075	-0.105	-0.123
		(0.95)	(1.40)	(1.89)*
others		-0.277	-0.286	-0.312
		(1.38)	(2.02)**	(2.10)**
Expansion			-0.792	
			(9.07)***	
Consolidation			0.840	
			(8.98)***	
RSP_middleclass*Expansion			1.268	
			(4.43)***	
RSP_middleclass*Consolidation			-0.098	
			(0.37)	
Δcapb				0.221
				(13.35)***
RSP_middleclass* Δcapb				-0.165
				(2.66)***
R^2	0.24	0.26	0.39	0.36
N	601	514	474	475

p<0.01* *p*<0.05; ** *p*<0.01***

†The coefficients are fixed -effects estimates with a set of time dummies (panel-corrected standard errors in parentheses).

Appendix 3

Table IV.9
Data Sources

Variables	Source
Programme-Specific Spending	OECD Social Expenditure Database
Tax Revenues	OECD i.library
RSP	Eurobarometer Trend-File, ISSP
Cyclically Adjusted Primary Balance of General Government	OECD Economic Outlook database no. 84, no. 92
Economic and Structural Control variables (growth, unemployment, old-age ratio)	OECD i.library, Eurostat
Party Family Labels	Comparative Political Dataset, University of Bern

Appendix 4

Table III.10

Diagnostic test-results*

Test	Dependent Variable	Test-statistic, p-value
F-test for unit-specific effects	Unemployment benefits	F-statistic=0.97 P-value= 0.5084
	Old-age spending	F-statistic=1.46 P-value=0.0767
	Tax revenues	F-statistic=0.97 P-value=0.5052
F-test for time-specific effects	Unemployment benefits	F-statistic: 2.91 P-value<0.0001
	Old-age spending	F-statistic: 1.79 P-value=0.0109
	Tax revenues	F-statistic: 3.66 P-value<0.0001
Hausman-test	Unemployment benefits	F-statistic=8.05 P-value=0.3279
	Old-age spending	Chi-square statistic=4.8 P-value=0.6841
	Tax revenues	Chi-square statistic=7.66 P-value=0.3631
Modified Wald-test for group-wise heteroskedasticity	Unemployment benefits	Chi-square statistic=21435.48 P-value<0.0001
	Old-age spending	Chi-square statistic=1700.08 P-value<0.0001
	Tax revenues	Chi-square statistic=851.25 P-value<0.0001
Pesaran-test for cross-sectional dependence	Unemployment benefits	CD-statistic=2.671 P-value=0.0076
	Old-age spending	CD-statistic=1.199 P-value=0.2307
	Tax revenues	CD-statistic=6.752 P-value<0.0001

Wooldridge (Lagrange Multiplier) test for first-order serial correlation	Unemployment benefits	F-statistic=27.572 P-value<0.0001
	Old-age spending	F-statistic=0.656 P-value=0.426
	Tax revenues	F-statistic=0.007 P-value=0.9350

*Diagnostic tests were conducted based on the extended models

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Conclusion

The main theme of this thesis has been the complex interaction between the electorate and fiscal policy-making in the post-Golden Age era. I have argued that a number of strongly held views should be nuanced at best and discarded at worst to refine our understanding of this interaction. Moreover, all three essays in this thesis have built on the notion of context-conditionalities (Franzese 2007; Franzese and Jusko, 2005), whereby propensities to electioneer before elections, electoral assessment of fiscal policy choices and partisan patterns behind welfare retrenchment were conditioned by political structures, underlying economic conditions and the degree of fiscal strain, respectively. In particular, this conclusion will first recap the three main arguments of this thesis along with their contributions to wider debates in political economy. In addition, I will address a few considerations based on what we have learnt and what we can accordingly expect in the current, post-crisis environment.

First, in essay I, I have shown that policy-making fragmentation can moderate election-induced manipulation of public budgets despite the common pool nature of fiscal resources of the state. The logic behind this moderation lies in the (partly) opposing electoral interests between coalition members. To the extent that the electoral race for votes has a zero-sum nature because the number of voters to sway over by pre-electoral benefits is limited, coalition partners can find themselves caught in a conflict of interest in whom to target with spending plans. When the junior party in a coalition can exercise – or threatens to exercise – its veto-power over the aggregate budget, pre-electoral spending expansions will be more limited compared to single-party settings. Empirically, the essay has confirmed that coalition governments have in fact displayed smaller political budget cycles, especially so when the two key political figures – the prime minister and the finance minister – are delegated by separate parties in the coalition.

These findings should be understood against the backdrop of highly influential research contributions on the harmful influence of policy-making fragmentation in governments (Roubini and Sachs, 1989; Alesina and Drazen, 1991). The implicit consensus in these accounts is the notion that overly fragmented settings impose large burdens on society by hindering/delaying necessary reforms or stabilization programmes that governments must undertake. Veto points have thus been conceptualized as a price that democracy pays for representing multiple preferences and constituencies in the decision-making

process. What I have shown in this essay is that this pessimistic assessment is not necessarily warranted. To the extent that veto points – coalition partners in my account – exert influence by moderating opportunistic incentives of leading incumbent parties, they can actually improve the economic record of the democratic process.

Secondly, essay II shifted the focus of inquiry on the "demand-side" of the budgeting-electoral dynamics nexus in a clear "clarity-of-responsibility" context, such as the United Kingdom. I have argued that the electoral response to fiscal decisions does not follow from the simple reward-punishment mechanism postulated by the pioneers of economic voting research in a straightforward manner. More specifically, I have posited that different income groups have different redistributive interests along the business cycle giving rise to a counter-cyclical voting pattern on the aggregate level: in business cycle downturns, the electorate at large favors fiscal expansions; in booms, it opposes them. These aggregate level dynamics have been shown to be driven by the changing preferences of middle-income groups when labour-market conditions change.

Similar to the previous essay, essay II also challenges a wide-spread conceptualization of how democracy works: voters who suffer from fiscal illusion and/or myopia (Alesina and Perotti, 1994) may be easily fooled by loose fiscal policies as they deliver instantaneous benefits in the form of increased spending or lower taxes. Admittedly, the idea of the "fiscally conservative" voter (Eslava, 2006; Brender and Drazen, 2008) has recently gained ground as an alternative understanding of this electoral calculus. What my essay sought to achieve is to bridge the gap between these opposing accounts by arguing that the electoral reaction to fiscal changes is more dynamic than these accounts suggest. In particular, voters were shown to change their relative preference alignment as business cycle conditions change, giving rise to a counter-cyclical electoral response; while economic policy-making in the post-Golden Age era may have done away with activist demand-management, the much less understood electoral consequences of budgeting decisions remained "Keynesian" in nature.

Finally, essay III has narrowed down on arguably the most salient aspect of fiscal decisions: welfare state reform/retrenchment. Building on the New Politics literature, I argued that the partisan patterns shaping welfare retrenchment are in fact qualitatively different from the Golden-Age era of welfare expansion. Departing from various

findings on the surprising resilience of the welfare state even in the face of conservative governments, I have argued that it is exactly the most likely defenders of welfare programmes that are electorally the best positioned to inflict pain on their natural (core) constituencies. The logic behind welfare retrenchment is thus guided by a "Nixon-goes-to-China" mechanism whereby governments that enjoy a high degree of partisan attachment (partisan bias) among certain groups can impose a large part of the burdens of fiscal adjustment on them. These patterns, however, are observed only in hard times when the fiscal space does not allow for mutual expansions of welfare programs. In times of fiscal expansions, traditional partisan patterns dominate.

The main contribution of this essay lies in the reconsideration of conventional understandings of partisanship. Since the seminal contribution of Douglas Hibbs (1977), different partisan governments' preferences have been widely assumed to follow the representative function of democracy: as different partisan governments alternate in power, they will attempt to maximize the welfare of the constituencies, albeit subject to various constraints, that they primarily represent. Building on earlier insights that challenged such views – most prominently Fiona Ross's Nixon-goes-to-China logic (2000) – I have shown that re-election seeking incumbents may have a very different set of incentives in hard times. Partisan alternations give rise to unexpected programmatic changes in the welfare budget as incumbents attempt to broaden the scope of their support coalitions by sheltering traditionally hostile constituencies from the pains of fiscal adjustments.

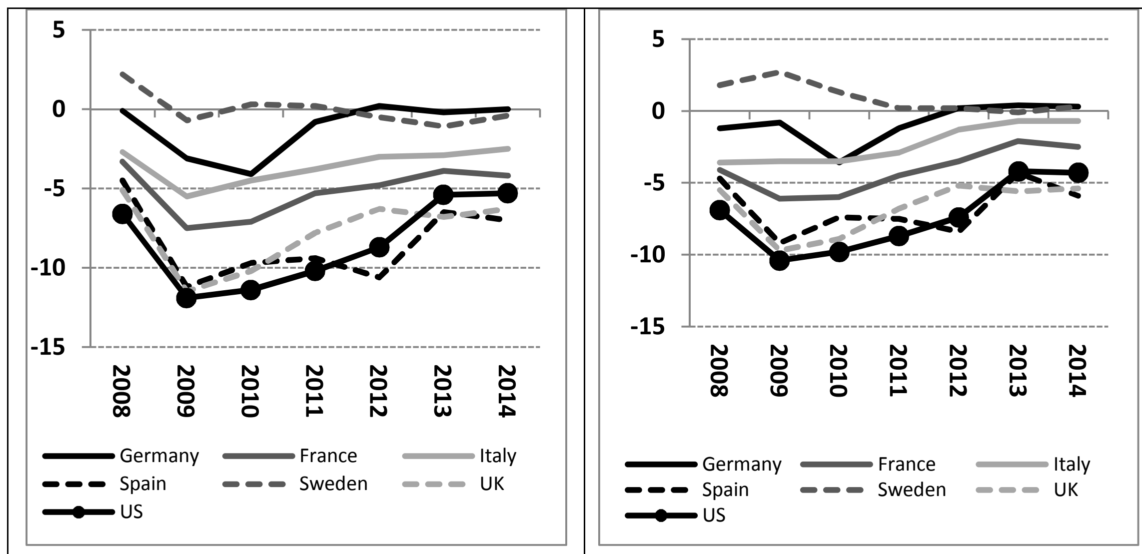
The analyses spanned the time-frame that is conventionally referred to as the "neoliberal era", beginning from the slowdown in economic growth in the early 1970s, ending with the recent financial crisis followed by the Great Recession. While it is clearly too early to tell whether these dramatic events that lie outside the empirical scope of this thesis will mark a watershed in the evolution of economic thought and policy-making akin to the neoliberal turn of the 1980s/1990s, there are reasons to suspect that a new era has dawned with potentially important implications for the findings in my essays. The rest of this concluding chapter will thus offer a number of tentative remarks on the future of the incumbency-electoral dynamics nexus in the post-crisis world characterized by extremely tight budget constraints. I will start by

observations that more or less directly follow from the empirical findings of this thesis and proceed with more general considerations in the post-crisis environment.

First and foremost, since the fiscal stimuli that governments undertook in response to the Great Recession, simultaneous debt reduction efforts, albeit in varying degrees, have been initiated regardless of the sub-potential growth and/or protracted recessions in the European periphery. Figure V.1 illustrates the annual evolution of the general government balance (left-hand side) and the cyclically adjusted primary balance (right-hand side) since 2008, the year of the financial crisis, for the seven economies that I selected in the introduction of this thesis. The latest forecasts available at the time of writing (August, 2013) by the European Commission/OECD for 2013 and 2014 were also included to provide a snapshot for the near-future.

Figure V. I

The post-crisis evolution of the general government balance (left-panel) and the cyclically adjusted primary balance (right-panel) in seven selected economies (as a % of GDP)



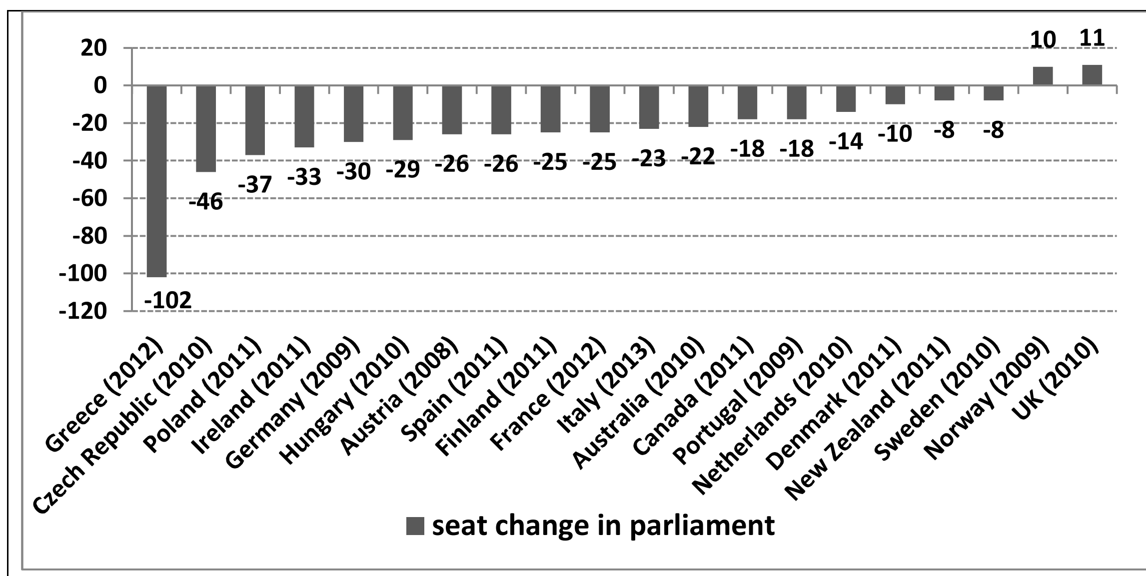
Source: ECOFIN-General Government Database, OECD-Economic Outlook Database no.93

The general pattern, with the notable exception of Sweden, is a continuous fiscal tightening which has been carried out despite intervening elections during this seven year window (Germany: 2009, 2013, France: 2012, Spain: 2011, Italy: 2013, Sweden: 2010, UK: 2010, US: 2012). To the extent that the main aggregate-level finding from Essay II can be extended to cases beyond the United Kingdom, electoral punishments

for these adjustment efforts are likely to be a major theme in political developments across the developed world. It is no coincidence that austerity riots and protests have made headlines across democracies ever since the simultaneous debt stabilization programmes started to bite. Moreover, when one looks at the electoral fate of mainstream parties at the first post-crisis elections, such punishment was manifest in a number of places. Not only were ruling parties severely punished, but many voters also deserted large centrist parties altogether and voiced their discontent by voting for small, protest parties that had comparatively little responsibility over the economic management of these economies in the run-up to the crisis. To illustrate these developments, Figure V.2 shows the aggregate seat change in national parliaments for the largest parties following the first post-crisis elections[69].

Figure V. 2

Aggregate seat change for the major parties[70] following the first post-crisis parliamentary elections among OECD countries



Source: Inter-Parliamentary Union, Parline database

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[69] The aggregate seat changes indicate the gains/losses of the two – or three in such multi-party contexts as Denmark, Finland and the Netherlands – major parties that led governments either by themselves or as senior parties in coalitions during the focus period of this thesis.

[70] These major parties, grouped by country in order of seat losses in line with the graph, are: Greece – New Democracy, PASOK; Czech Republic – ODS, CSSD; Poland – PO, PIS; Ireland – Fianna Fail, Fine Gael; Germany – SDP, CDU/CSU; Hungary – MSZP, FIDESZ; Austria – SPO; OVP; Spain – PP, PSOE; Finland – SDP, KOK, KESK; France – UMP, PS; Italy – PD, PDL; Australia – Labour, Liberal Party; Canada – CPC, LP; Portugal – PS, PSD; Netherlands – Labour, VVD, CDA; Denmark – SD, Venstre, KrF; New Zealand – National, Labour; Sweden – SD, Moderate Party; Norway – Labour, Hoyre; UK – Labour, Conservatives

The electoral fortunes of these “mainstream” parties following the first post-crisis elections were clearly on the wane. Most dramatically, the two perennial ruling parties in Greece, PASOK and New Democracy lost more than 100 parliamentary seats among their ranks, largely due to the collapse of the Greek mainstream-left. In other contexts the losses were less dramatic but with the exception of the UK and Norway[71] mainstream parties lost between 8 and 46 parliamentary seats.

One direct consequence of the weakening of the party-political core is increasing difficulties to form parliamentary majorities. Illustratively, for the first time since the 1970s, British politics is now run by coalition rule. Similarly, single-party cabinets that had been the default form of government in Greek politics since democratization now gave way to coalition politics. Other instances abound where coalition formation has become increasingly difficult as a result of parliamentary losses of traditional government parties. To the extent that such fragmentation of the party scene will increasingly necessitate coalition governments, this has clear implications with regards to the findings from Essay I. Specifically, very few political parties will be able to form governments by themselves, forcing them to give concessions to coalition partners when it comes to pre-electoral budgeting. While it is unlikely that political budget cycles will be completely eliminated in the post-crisis environment, their frequency and size may decrease compared to the past.

Moreover, to the extent that cuts in public programmes are deeper than in previous consolidation periods, it is highly unlikely that governments will be able to shelter the most politically salient aspects of the welfare state. In fact, since the crisis, a number of countries have already designed and implemented a number of significant welfare reforms that will negatively affect current and future beneficiaries alike. Most significantly, public pension programmes have come under the greatest scrutiny, as they make up by far the largest part of the welfare budget. Table V.1 provides a summary of post-crisis welfare reforms with all OECD countries included that implemented significant reforms in the post-crisis environment with clearly negative effects for programme-beneficiaries.

[71] While the major British parties were sheltered by the first-past-the-post electoral system, Norwegian politics was arguably less affected by the relatively moderate impact of the crisis. That said, the recent rise in UKIP may very well challenge the two/three-party domination of the British party-political landscape.

Table V.I

Summary of post-crisis welfare reforms among OECD countries

Country	Year	Area	Summary of reform elements
Austria	2012	Old-age pensions	Encouraging employees to participate in funded pensions to relieve burden on pay-as-you-go scheme
Belgium	2010	Early retirement	Discouraging early retirement by increasing contribution rates on employers
Canada	2012	Old-age pensions	Increasing retirement age, encouraging workers to delay claiming benefits in exchange for higher benefits in the future
Czech Republic	2013	Old-age pensions	Changing indexation rules
	2011	Old-age pensions	Partial pension-privatization by creating individual accounts
	2010	Old-age pensions	Raising retirement age, lengthening contribution periods, raising contribution ceilings
Denmark	2012	Early-retirement	Early retirement scaled down by encouraging older workers to remain in labour force
	2012	Administration	Centralizing control over benefit disbursements to cut costs
France	2010	Old-age pensions	Gradual increase in retirement age, only to be partly reversed by the new government
Germany	2011	Health care	Raising contributions on all actors to close the health insurance deficit
Greece	2013	Old-age pensions	Increasing retirement age, capping/cutting pension payments
	2011	Old-age pensions	Freezing pension payments
		Incapacity	More rigorous checks on abuses
	2010	Old-age pensions	Raising retirement ages, increasing contribution periods, cutting benefits
Hungary	2012	Incapacity	Disability benefits restructured, encouraging return to work, stricter monitoring
		Early-retirement	Stricter eligibility criteria for early retirement
Italy	2012	Old-age pensions	Increasing retirement age, postponing payouts to public sector pensioners
Netherlands	2013	Old-age pensions	Increasing retirement age
New Zealand	2011	Old-age pensions	Reduction of government subsidies to KiwiSaver plans
Norway	2012	Incapacity benefits	Stricter monitoring and stricter eligibility criteria for sick pay
	2011	Old-age pensions	Lower benefits for high earners, more flexible retirement age, modified indexation rules
Poland	2012	Old-age pensions	Retirement age raised
	2009	Early-retirement	A number of early-retirement schemes abolished
Portugal	2012	Unemployment insurance	Replacement rates cut, eligibility period reduced
		Early-retirement	Early retirement temporarily suspended for employees covered by public pension insurance
		Old-age pensions	Freezing pensions, eliminating 13th and 14th month benefits for high earners
Slovenia	2013	Old-age pensions	Raising retirement-ages, changing benefit-calculation rules
Spain	2013	Early-retirement	Discouraging early retirement
		Old-age pensions	Raising retirement ages and contribution periods
UK	2013	Incapacity benefits	Reform of existing disability benefits with stricter monitoring and qualifying criteria
		Family benefits	Introducing means-testing for child benefits
	2011	Old-age pensions	Raising retirement ages for the state pension, changing indexation and revaluation rules for occupational pensions

Source: International Social Security Association

The resilience of the welfare state that the New Politics literature had suggested has clearly given way to austerity pressure and welfare cuts in the post-crisis environment. Partisanship is also a weak predictor of these retrenchment efforts as governing parties across the political spectrum have implemented welfare cuts in tandem: while the British, Spanish, Portuguese, French and Canadian reforms were implemented by conservative governments, the Norwegian, Danish and some of the Greek reforms were undertaken by social democrats, the Dutch pension reforms were carried out by the liberals and the German health-care measures were implemented by a Christian-democratic-liberal coalition. Most importantly, to relate these developments to the findings from essay III, it is unlikely that all these listed reforms were helped by welfare credibility that the respective parties had built up in recent decades. In fact, what will likely distinguish the post-crisis era from previous episodes of welfare retrenchment is

vanishing credibility of any political party with regards to their commitment to the welfare state. To the extent that partisan biases do arise from programmatic credibility for political parties – with regards to welfare programmes for our purposes – even traditionally pro-welfarist parties will struggle to maintain that image after a series of welfare reforms they had to implement. Voters with interest- or value-based attachment to the welfare state will find it increasingly hard to find a political home among traditional political parties that presided over austerity policies over the previous decades and the current debt-crisis. In this regard, welfare retrenchment will become a politically even more difficult task to undertake, if it has ever been easy in the first place.

Beyond these likely consequences of the crisis that affected most developed economies, a number of more general observations can be tentatively made in the post-crisis environment. First and perhaps most importantly, contrary to the passive role of fiscal policy with regards to business cycle fluctuations that characterized the neoliberal era, governments across the board have undertaken aggressive counter-cyclical measures in 2008/2009 to counter what turned out to be the most severe economic crisis since the Great Depression in the interwar period. These fiscal stimuli, although varying in scope and length, have been widely acknowledged to push developed economies towards a tepid recovery, which central banks hitting the 0-bound interest rate level were unable to ensure by themselves even with unconventional monetary stimuli (quantitative easing). However, as mentioned above, after debt levels sky-rocketed to unprecedented peace-time levels as a result (IMF, 2012 - see graph I.1 from the Introduction), indebted governments – US, UK, Spain, Portugal, Italy, Ireland, Greece etc. – laid out long-term plans to stabilize their debt ratios, largely relying on severe austerity measures to cut expenditures and raise revenues. Again, while the scope and composition of austerity efforts vary across contexts, the imperative of debt reduction is likely to set an anchor for fiscal policy in the foreseeable future.

Both the counter-cyclical stimuli in response to the Great Recession and the subsequent stabilization efforts indicate that the politicization of fiscal policy which lies at the conceptual core of this thesis will be constrained at best. This is not to say that fiscal policy will become politically less relevant in the post-crisis environment; what it merely implies is that the paradoxical implication of the neoliberal paradigm that freed

fiscal policy from managing aggregate demand and allowed governments to deploy it for political/redistributive purposes has arguably come to an end; governments, in the near future at least, will have to surrender it to the imperative of debt stabilization even if it entails significant political costs on the streets or in the ballot box. In addition to increasing difficulties in forming single-party majorities in legislatures, these constraints cast further doubts on the future of political budget cycles.

Second, to the extent that public debt reduction coincides with the deleveraging of the private sector in many countries, the very concept of debt may take on new meanings and connotations in the political struggles between competing political parties. Under one plausible scenario, if incumbent governments succeed to frame their debt-reduction efforts as a "war on debt"[72] , it may resonate well with many indebted voters who can draw a link between their household's fortunes and those of their governments. Alternatively, a new cleavage may emerge between voters whose purchasing power and living standards have been severely impaired by deleveraging – and hence welcome government efforts to ease their burden – and non-indebted taxpayers who oppose their governments bailing out banks and households responsible for the pre-crisis credit binge. Either way, whether these developments reinforce previous findings on the "fiscally conservative voter" or structure fiscal preferences along new cleavage lines[73], it is likely that current developments in public finances will mark a turning point in the electoral assessment of debt-financed electioneering efforts. In fact, in recent waves of Eurobaromater surveys, around 20% of the European electorate identified public debt as the most pressing concern for their country; this issue had been hardly mentioned in the spring wave of 2008, just a couple of years before the sovereign-debt-crisis struck with full force[74].

Third, electoral dynamics are also likely to change as new cohorts replace older ones among the electorate. Much has been said about the retirement of the baby-boom generation for their sheer size and the consequent burden on pay-as-you-go pension systems in the developed world. Also, a number of political studies have examined the

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[72] Such crisis-rhetoric was particularly common by the right-wing governments of Hungary and the UK that came to power at the onset of the debt-crisis in 2010.

[73] The impact of different socioeconomic positions on the electoral evaluation of economic conditions and policies has been documented in a wide range of contexts (see Weatherford, 1978, Palmer and Whitten, 2011 and Lindvall, 2013 for relevant examples)

[74] http://ec.europa.eu/public_opinion/archives/eb_arch_en.htm, last accessed: 15/08/2013

impact of generational replacement on turnout patterns and partisan choices (Lyons and Alexander, 2000; Leigh, 2005; Wass, 2007). In this regard, the fact that the generation that came of voting age in the 1970s, the beginning of the neoliberal era, is nearing retirement may have potentially important consequences. To the extent that political socialization during the post-Golden Age era implied a greater awareness of rising deficits and indebtedness, the zero-sum nature of redistributive politics in a low growth environment may become more and more the norm rather than the occasional exigency of fiscal strain. In other words, as older cohorts with direct memories from the Golden Age era of welfare consensus are outnumbered among the electorates, the collective perception of public budgeting may undergo a profound transformation, sharpening the competition for the limited fiscal resources of the state, as tentatively illustrated by Essay III. Whether this will manifest itself in more modest electoral demands on funding for social programmes, or a more hostile political battle between constituencies – between working-age taxpayers or typically non-taxpaying pensioners for instance – may turn out to be one of the most interesting questions for the generations to come.

To wrap up these tentative remarks on the future of the public budgeting-electoral dynamics nexus, one final conclusion seems fairly clear. Adding to the context-conditionalities that formed the backbone of this thesis, a new one may be emerging on the research horizon. For future generations, the experience with the recent financial crisis and the Great Recession and sovereign debt-crisis that followed will be an important reference point to governments, opposition parties and voters alike. How public budgeting and electorates will interact in the future will certainly depend, among other factors, on the extent to which the country in question has been exposed to, suffered from or managed to deal with the crisis. Future comparativists working in the field of the political economy of public budgeting would greatly benefit from integrating this particular source of path dependence in their research.

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