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Austerity from the Left

Explaining the Fiscal Policies of Social Democratic
Parties in Response to the Great Recession

Björn Bremer

Thesis submitted for assessment with a view to
obtaining the degree of Doctor of Political and Social Sciences
of the European University Institute

Florence, 15 March 2019

European University Institute
Department of Political and Social Sciences

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15 February 2019

Austerity from the Left

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March 2019

Abstract

Austerity has come to define the post-crisis European political economy as the predominant policy response to the Great Recession since 2010. After a brief period of “emergency Keynesianism” from 2008 to 2010, even social democratic parties abandoned plans for deficit-spending and accepted austerity as the dogma of the day. Most of the existing literature attempts to explain this outcome either by pressures from financial markets or by the influence of external institutions, for example the European Union or the International Monetary Fund. However, social democratic parties also accepted fiscal orthodoxy in countries where the pressures from financial markets and external institutions were weak or absent, and thus they are not a sufficient explanation to explain austerity from the left. This thesis instead shifts the focus towards the popular coalitions that underlie macroeconomic policy by examining the elite and the popular politics of austerity. It argues that social democratic parties had both *electoral* and *ideational* reasons to support orthodox fiscal policies during the crisis, as they were trapped by the legacy of the Third Way that they had embarked upon prior to the crisis. On the one hand, social democratic parties believed that there was a high public support for fiscal consolidation. Influenced by the differentiation of interests among their traditional constituencies, they attempted to increase their economic credibility in order to appeal to centre-left voters from the expanded middle class. On the other hand, social democratic parties were influenced by mainstream economic ideas. They drew on New Keynesianism, endogenous growth theory, and the social investment paradigm, which had become popular among social democrats at the end of the 20th century, to legitimize their support for the “austerity settlement” during the Great Recession. This combination of electoral and ideational forces created powerful pressures for social democrats to support orthodox economic policies over Keynesian deficit-spending which many failed to resist. To make this argument, this thesis combines qualitative and quantitative methods and draws on a wide range of empirical evidence. Among others, it uses evidence from quantitative content analysis, survey experiments as well as insights from over 40 elite interviews with leading social democratic politicians and policy-makers in Germany and the UK. In this way, the thesis studies both the *popular* and the *elite* politics of austerity in Western Europe and provides a new account of social democratic austerity.

Keywords: Great Recession, macroeconomic policies, austerity, social democratic parties, electoral coalitions, economic ideas.

To my parents

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Contents

Acknowledgements	iv
List of Figures	xii
List of Tables	xiv
1 Introduction	1
Introduction	1
The puzzle and research question	4
Existing explanations for social democratic austerity and their short-comings	7
Outline of the argument	10
The electoral pressures for social democratic austerity	11
The ideational pressures for social democratic austerity	12
Paradigm change, social democrats, and the Great Recession	14
Research design and methods	16
Outline of the dissertation	20
Extended literature review and theoretical chapter	20
An empirical analysis of the response of social democratic parties to	
the Great Recession in 11 countries	21
The popular politics of austerity: Studying the demand-side of politics	21
The elite politics of austerity: Studying the supply-side of politics .	22
Conclusion	23
2 Theoretical Framework	24
Introduction	24
Social democratic parties and macroeconomic policies before the Great	
Recession	25
Existing explanations for social democratic austerity in the context of the	
Great Recession	30

A new explanation for social democratic austerity	39
The electoral foundations of social democratic austerity	40
The ideational foundations of social democratic austerity	48
Social democratic parties, paradigm change, and the Great Recession . .	54
Conclusion	59
3 The Programmatic Response	60
Introduction	60
Party positions, issue salience, and the economy	62
The programmatic response of social democratic parties to the Great Re-	
cession: Some expectations	64
Data and methods	66
Social democratic parties and the crisis: Changes in issue emphasis	69
Social democratic parties and the crisis: Changes in issue positions	72
Conclusion	79
4 Attitudes Towards Austerity	81
Public preferences towards fiscal consolidation	83
Differences in debt aversion across individuals and countries	85
Individual-level determinants	86
Country-level determinants	88
Data and Methods	89
Empirical results	92
Differences in debt aversion across countries	92
Country-level determinants	94
Conclusion	107
5 Public Opinion Towards Fiscal Consolidation in the Face of Trade-Offs	110
Introduction	110
Literature review and motivation	112
Theory: The importance of trade-offs and priorities for attitudes towards	
fiscal consolidation	116
Research Design	119
Part 1: Experiment with split-sample questions	119
Part 2: Conjoint survey experiment	120
Sample	124
Results: Measuring attitudes towards fiscal consolidation with trade-offs .	124
Descriptive results of preferences towards two-dimensional trade-offs	124

Regression analysis of preferences towards two-dimensional trade-offs	127
Preferences towards multidimensional trade-offs	130
Heterogeneous effects: Analysis of conjoint experiment by subgroups	132
Conclusion	135
6 The Fiscal Policies of the British Labour Party in Times of Crisis	138
Introduction	138
Labour's economic policies before the Great Recession	140
The reign of Keynesianism (1945-1979)	140
In the shadow of monetarism (1979-1997)	142
New Labour's symbiosis (1997-2008)	144
Economic crisis and the response of the Labour party	147
Explaining austerity from the left in the UK	151
2008-2010: The crisis years – Labour's response to the financial crisis	152
2010-2015: The austere years – Labour in opposition	160
Discussion: Electoral and ideational pressures for austerity	169
The politics of austerity	169
The economics of austerity	172
Labour trapped and divided	177
Conclusion	179
7 The Fiscal Policies of the German SPD in Times of Crisis	182
Introduction	182
The SPD's fiscal policies before the Great Recession	184
From Marxism to Keynesianism	184
From Schmidt to Schröder	185
Germany's Third Way	186
Economic crisis and the response of the SPD	188
Explaining austerity from the left in Germany	192
2008-2010: The crisis years – The SPD's Response to the Financial	
Crisis	192
The austere years - torn between opposition and government	199
2009-2013: The SPD in opposition	199
Discussion: Electoral and ideational pressures for austerity	209
The politics of austerity	209
The economics of austerity	213
The SPD trapped and divided	217
Conclusion	219

8 Conclusion	221
Introduction	221
Summary of the Argument	222
Electoral foundations of social democratic austerity	222
Ideational foundations of social democratic austerity	224
Social democracy trapped and divided	225
Contributions and limitations of the thesis	226
Limitations	226
Contributions	228
Social democratic austerity and its consequences	230
Social democratic austerity and the economic predicaments of our time	230
Social democratic austerity and the current crisis of the left	233
Social democratic policies for the 21th century	235
Bibliography	239
Appendix A	273
A.1 Data collection	273
A.2 List of issues by category	278
A.3 Methods	279
A.4 List of key variables used in the regression analysis	281
A.5 List of parties by country and party family	283
A.6 Nominal changes of parties in response to the crisis	287
A.6.1 Nominal changes of social democratic parties in salience and left-right position by issue categories	287
A.6.2 Aggregate nominal changes by party families	289
A.7 Observed shifts in salience and left-right position by social democratic parties	290
A.7.1 Observed shifts in salience by issue category	290
A.7.2 Observed shifts in left-right positions by issue category	290
A.8 Additional results (three-way interactions)	293
A.9 Positions of social democratic parties over time	296
Appendix B	297
B.1 List of variables	297
B.2 Summary statistics	303
B.3 Results from fixed effects model	304
B.4 Results from logit regression models with all waves	305

B.5 Results from ordinal logistic regression analysis	308
Appendix C	310
C.1 Summary statistics	310
C.2 List of all questions used in the split-sample experiment	311
C.3 Distribution of responses to the split-sample questions, by country	313
C.4 Mean support for all policies with and without trade-offs, pooled	315
C.5 OLS regression analysis for split-sample experiment including wealth	316
C.6 Instructions for the conjoint survey experiment	318
C.7 Additional tests for heterogeneous effects in the conjoint survey ex- periment	320
C.8 Robustness tests for the conjoint survey experiment	322
Appendix D	324
D.1 List of all British Interviews	324
Appendix E	326
E.1 List of all German Interviews	326

List of Figures

1.1 Average vote share of of left-wing parties in Western Europe, 1945 - 2018	6
2.1 Theoretical framework	41
3.1 Issue salience of all economic issues by party family by country . .	70
3.2 Salience of different economic issues for social democratic parties by country	73
3.3 Average party positions on economic issues by party family by country	74
3.4 Average positions of social democratic parties on different economic issues by country	77
3.5 Average positions of social democratic parties on different economic issues by election type	78
4.1 Share of respondents by debt aversion	93
4.2 Share of respondents by debt aversion in countries with different structural positions	94
4.3 Share of respondents by debt aversion in different regions	95
4.4 Share of fiscal hawks by country	95
4.5 Share of fiscal conservatives by country	96
4.6 Predicted probabilities of debt aversion by home ownership	101
4.7 Predicted probabilities of debt aversion by left-right ideology	101
4.8 Predicted probabilities of debt aversion by financial situation	103
4.9 Interaction effect of the budget balance and an individual's financial situation on the predicted probabilities of debt aversion	106
4.10 Interaction effect of growth and subjective evaluation of the economy on the predicted probabilities of debt aversion	107

5.1	Distribution of support for higher government spending, lower taxes, and lower government debt	115
5.2	Distribution of support for fiscal consolidation by treatment	125
5.3	Average support for six fiscal consolidation by treatment	126
5.4	Average support for six fiscal consolidation by treatment, country, and partisanship	127
5.5	AMCEs from conjoint survey experiment, pooled	131
5.6	AMCEs from conjoint survey experiment by income group	133
5.7	AMCEs from conjoint survey experiment by occupation	134
5.8	AMCEs from conjoint survey experiment by partisanship	134
5.9	AMCEs from conjoint survey experiment by country	135
6.1	UK GDP Growth, 1970-2015	148
6.2	UK Unemployment, 1960-2015	148
6.3	Left-right position of Labour and the Conservatives over time	149
6.4	Left-right position of the Labour party for different economic cate- gories over time	150
6.5	UK government net lending, 1970-2015	155
6.6	UK government spending and revenues, 1970-2015	155
6.7	UK government net financial liabilities, 1970-2015	156
6.8	UK polls, 2005-2015	158
6.9	Attitudes towards government debt in the UK, 2010-2015	163
6.10	UK output gap, 1985-2015	166
6.11	UK interest rates on government bonds, 1960-2015	173
6.12	UK cyclically adjusted government lending, 1980-2015	175
7.1	German real GDP growth, 1991-2015	189
7.2	Left-right position of the SPD and CDU/CSU over time	190
7.3	Left-right position of the SPD for different economic categories over time	191
7.4	German government spending and revenues, 1991-2015	195
7.5	German unemployment, 1991-2015	203
7.6	Attitudes towards government debt in Germany, 2010-2015	205
7.7	German polls, 2005-2015	210
7.8	German output gap, 1985-2015	214
7.9	Interest rates on German government bonds, 1991-2015	216

List of Tables

1.1 Research Design	17
1.2 Logic of case selection	20
2.1 Paradigm change and the interplay of ideas and electoral constraints	55
3.1 List of economic issue categories (adopted from Kriesi et al. 2008) .	65
3.2 OLS Regression - Saliency of Economic Issues by Different Party Families	71
3.3 OLS Regression - Left Right Positions of Different Party Families .	75
4.1 Random effects model: Macro-level support for fiscal consolidation	97
4.2 Logit regression: Individual-level determinants of debt aversion . . .	99
4.3 Debt aversion by ideology	102
4.4 Logistic multi-level regression: Individual- and national-level determinants of debt aversion	105
5.1 Design of the split experiment	120
5.2 Attributes and Levels of the Conjoint Experiment	122
5.3 OLS regression: Preferences towards government debt	129
6.1 List of elections by time period	149
7.1 List of elections by time period	189

Chapter 1

Introduction

‘It is not the consciousness of men that determines their being, but, on the contrary, their social being that determines their consciousness.’

Karl [Marx](#) ([1996](#))

‘The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist.’

John Maynard [Keynes](#) ([1936](#))

Introduction

The Great Recession has been the deepest economic crisis in Europe since the Great Depression. It was triggered by the collapse of the American investment bank Lehman Brothers in September 2008, which sent shock waves through the international financial system and created a deep deflationary spiral. Then German Finance Minister Peer Steinbrück summarised the feeling among the governing elite when he said that ‘we were all looking into the abyss’ ([Der Spiegel](#), [2008](#)). In response to this situation, almost all governments in the advanced economies responded resolutely: they developed large government programmes in order to save tumbling financial institutions and to maintain output (e.g. [Seccareccia](#), [2011](#); [Pontusson and Raess](#), [2012](#); [Hall](#), [2013](#); [Raess and Pontusson](#), [2015](#)). Three decades after the Keynesian consensus had

fallen apart in the economic turmoil of the 1970s, policy-makers used “emergency Keynesianism” (Hall, 2013) to prevent a depression on the scale of the 1930s. The G-20 collectively vowed to ‘use fiscal measures to stimulate demand to rapid effect’ and neo-classical economist Robert Lucas even complained that ‘everyone [was] a Keynesian in a foxhole’ (Fox, 2008).¹ However, only a few months after the beginning of the financial crisis, the economic winds already changed and austerity came back with a vengeance.

The end of the Keynesian era began with the bail-out of Greece in May 2010, which was made conditional on strict austerity measures. Shortly afterwards, world leaders agreed to ‘growth-friendly fiscal consolidation’ at the G-20 meeting in June 2010. According to conventional wisdom, the Greek crisis illustrated the perils of government debt. It undermined arguments for further fiscal stimulus and contributed to a pre-mature rush to austerity, which was particularly strong in Europe. As the “American” financial crisis was re-imagined as a “European” sovereign debt crisis, governments of all stripes and colours implemented austerity by slashing government spending and/or increasing taxes.² This transformation of a financial crisis into a fiscal crisis confused cause with effect (Tooze, 2018), but it was the perfect outcome for financial market actors: it diverted attention from the failures of the financial system, as “excessive” levels of government debt came to be perceived as the biggest danger to the international economic system.

Subsequently, the pressure was on monetary policy to support demand in Europe. Fiscal austerity was combined with quantitative easing, as central banks devised tools for an unprecedented level of monetary expansion. This protected most economies in Europe from a deep depression, but in some countries, output dropped substantially and unemployment reached levels that were previously unthinkable in advanced capitalist economies. Importantly, the entire European continent remained in a perpetual state of crisis as Ireland, Greece, Portugal, and Spain had to ask for bail-outs from the International Monetary Funds (IMF) and the European Union (EU), while other countries, like Italy and France, also continued to fight deflationary pressures. The crisis created a division between the prosperous North and the struggling South, but popular discontent was widespread across both regions: the debtor countries opposed

¹ Five years earlier, Robert (Lucas, 2003) had declared in his presidential address to the American Economic Association that such stimulus programmes were not necessary anymore because the “central problem of depression-prevention has been solved.”

² The crisis is better described as a typical balance of payment crisis as the credit crunch created a “flight to safety” (Copelovitch et al., 2016). This led to a sudden stop of liquidity in the European periphery and lenders found it increasingly difficult to re-finance their debt as investors lost trust in the ability of governments and private actors to repay their debt.

the Northern *Spardiktat*, while the creditors were unwilling to pay for the perceived lavishness of the South. The policies that resulted from these opposing positions created unsatisfactory results: the EU muddled through the crisis and ten years after the fall of Lehman Brothers, the level of economic production in the EU barely has barely surpassed the pre-crisis level. Today the European economy still operates below its full capacity, large parts of the workforce in the Eurozone remain unemployed and inflation is low, contributing to a truly “lost decade” (Chinn and Frieden, 2011) for Europe.

Despite its economic ramifications, Europe’s political mainstream remained committed to austerity for a long time. In 2010, austerity became the only game in town and the “austerity settlement”, i.e. the dominance of austerity across the political spectrum, has seen governments of all stripes across the continent, albeit in different contexts and to varying degrees, implement austerity measures.³ This move to fiscal orthodoxy that began in 2009 was all encompassing. It included countries and governments across the entire European continent, ranging from debtor to creditor countries, from countries with an export-led growth models to countries with an export-led growth model (Baccaro and Pontusson, 2016), and from liberal market economies (LMEs) to coordinated market economies (CMEs) (Hall and Soskice, 2001).

By accepting austerity, however, Europe’s governments shifted the burden of the crisis onto the shoulders of the weakest citizens, and the most surprising element of this austerity settlement is thus the way in which social social democratic parties, both in and out of power, have acquiesced to it.⁴ Originally, the financial crisis presented social democratic parties with a unique opportunity to renew their *raison d’être*. It highlighted the vulnerabilities of unfettered capitalism and undermined the legitimacy of the existing economic order. But social democrats were unable to formulate a coherent response and largely accepted the shift to austerity across Europe, independent of whether they were in government or in opposition. In debtor countries social democratic parties bowed to external pressure and accepted austerity as a necessary evil (e.g. Greece, Spain, and Ireland); in ‘creditor countries’ social democratic parties did not only help to impose austerity on the debtor countries, but they also pursued fiscal consolidation at home. For example, in Germany, the Social Democratic Party (SPD) already supported the introduction of a constitutional debt brake

³The Great Recession is used here as a term that refers to both the 2008 financial crisis and the Eurozone crisis, i.e. it conceptualises both crises as one larger economic crisis.

⁴Following Kitschelt (1994, p. 1), social democracy is employed as a generic concept that covers ‘a cohort of parties that run under socialist, labour and social democratic labels.’ I will use the terms “social democratic”, “centre-left”, and “moderate left” parties interchangeably.

in 2009. Similarly, France adopted austerity policies despite François Hollande's victory in the presidential election of 2012. The Socialist government increased taxes and reduced public spending in 2013 when they adopted the *Pact for Competitiveness*, and after Manuel Valls had replaced Jean-Marc Ayrault as Prime Minister, the government promised even more fiscal consolidation.

The puzzle and research question

The accommodation of social democratic parties with austerity is puzzling for several reasons. First, social democratic parties have historically been associated with policies that are opposed to austerity. Their dominant *modus operandi* in the post-war period was based on Keynesian policies of demand management (Przeworski, 1985; Hall, 1989), which allowed governments to limit the adverse effects of free markets on their citizens. Although social democratic parties moved towards the centre during the Third Way and adopted more liberal economic policies (Lavelle, 2008; Pierson, 2001a; Glyn, 2001; Callaghan, 2000, e.g.), the 'essential and enduring' goals of social democracy, remained to minimise the 'cost of capitalism' for the working classes (Hirst, 1999, p. 87). Despite its numerous historical and geographical incarnations, social democrats always attempted to decrease social inequality by creating the conditions for (full) employment and a strong welfare state. Yet, during the Great Recession austerity challenged both. It contributed to the deflationary spiral in Europe and undermined the fiscal basis of the welfare state that social democratic parties had vigorously fought for in the 20th century.

Second, the Great Recession presented a unique opportunity for social democracy to push for paradigm change after thirty years of economic liberalisation. Some voters had already punished social democratic parties for their Third Way policies before 2008 and the crisis would have been an opportune moment for the left to push for a counter-movement in the spirit of Karl Polanyi (2001). In the past, social democrats were able to do this: in response to economic crises, they did not only conceive new ideas, but they were also able to implement them (e.g. Blyth, 2002; Berman, 2006). The Great Recession provided a similar opportunity for the centre-left to experiment with new policies and to reform the dominant economic order.⁵ Seeking new alliances with actors in politics, social movements, and academia, social

⁵In the beginning of the crisis, social democrats were seemingly able to do this. In countries like the UK, Germany, and Spain, social democrats played a key role in the initial response to the financial crisis, while the election of Barack Obama in November 2008 invigorated hope among progressives forces across the world. They developed a range of demands for new financial regulation and future-

democrats could have used austerity to rally the left and oppose the dominance of the market.⁶

Third, this counter-movement has become even more likely over time because austerity has, arguably, not worked. From a Keynesian view, austerity made little sense in the post-crisis context (e.g. Blyth and Matthijs, 2017; Sandbu, 2015) and there is growing evidence that they made the crisis worse by contributing to a deflationary spiral (e.g. Blanchard and Leigh, 2013; Heimberger, 2017). It overburdened monetary policy as the main instrument to stabilise demand in Europe and pushed the Eurozone towards the brink of disintegration. This low growth environment again aggravated the fiscal crisis in Europe and consequently austerity did not even achieve its primary goal. Instead, it created a large amount of social and economic unrest and undermined Europe's social contract.

Finally, austerity also contributed to significant electoral tumult among the left (Roberts, 2017). While the economic crisis pushed voters into the arms of radical right- and left-wing parties, social democratic parties were unable to capitalise on the economic turmoil whatsoever. Instead, radical left- and right-wing parties led the charge against austerity and rose to new heights. In some European countries like Greece, France, and the Netherlands, social democratic parties experienced electoral annihilation, whereas they have been thrown into a deep electoral crisis in countries as diverse as Germany, Italy, or Finland. Overall, the vote share of social democratic parties in Western Europe dropped dramatically since the beginning of the crisis, as shown in Figure 1.1. This situation is remarkably similar to that of the 1930s, when social democratic parties also implemented austerity in response to the Great Depression with disastrous consequences.⁷ By prolonging the recession and creating record levels of unemployment, it divided the labour movement and pushed voters into the arms of fascist movements. In light of this historical experience and the current electoral slump of the centre-left, it is particularly surprising that social democratic parties have bought into the austerity settlement.

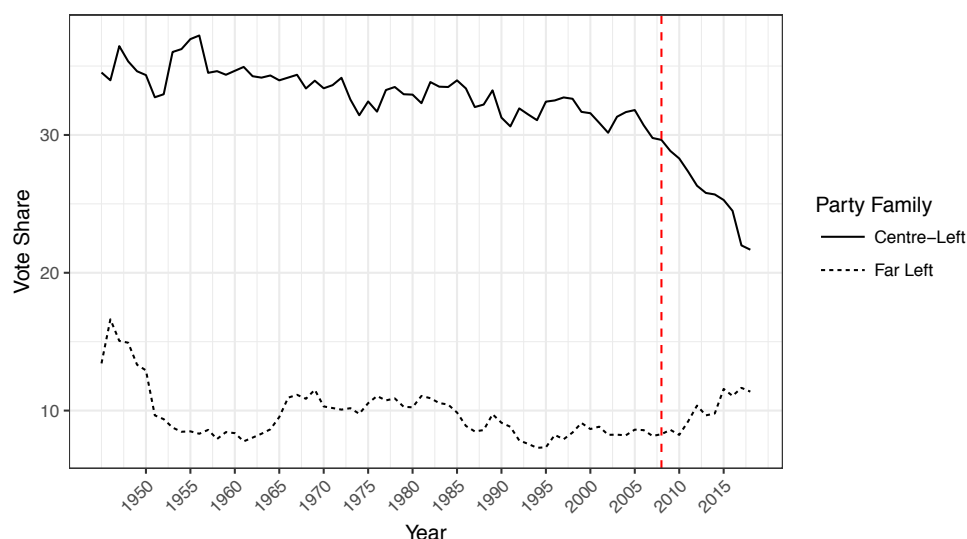
My dissertation addresses this puzzle, i.e. it attempts to answer the question why social democratic parties accepted austerity as a macroeconomic policy in response

oriented investment programmes and were concerned with protecting citizens from the effects of the financial crisis.

⁶Colin Crouch (Crouch, 2011) most famously discussed this “strange non-death of neoliberalism” previously.

⁷For example, the Labour Prime Minister Ramsay MacDonald formed a National Coalition government to implement austerity in the UK (Skidelsky, 1970), while the German SPD rejected Keynesian-style policies and supported the austerity policies implemented by the government under Heinrich Brüning (Berman, 1998).

Figure 1.1: Average vote share of of left-wing parties in Western Europe, 1945 - 2018



Note: The figure shows the average vote share that moderate and far left parties have received in 20 Western European countries. For any given year it is calculated by taking the average of the vote share that a given party has received in the last election prior to that particular year.

to the Great Recession. For this purpose, I define macroeconomic policies narrowly as government policies that are designed to influence aggregate economic variables including growth, unemployment, and the general price level.⁸ Austerity is a specific macroeconomic policy, which I define as fiscal consolidation (i.e. the reduction in the government's budget deficit) during hard economic times. In other words, in using the term "austerity" I am referring to fiscal consolidation during economic crises when a given economy is operating below its potential. In theory, such a programme can be achieved in very different ways and, for example, it might be useful to distinguish between expenditure- as opposed to revenue-based consolidations. In practice, however, austerity packages often include 'some combination of measures to reduce public expenditure and to increase tax revenues and other government receipts (such as the selling off of non-financial assets)' (Konzelmann, 2014, p. 703). Therefore, I do not make such a distinction; rather I focus on the broad outlines of the economic positions that social democratic parties adopted in the wake of the Great Recession. Put differently, the dependent variable in this dissertation is the extent to which social democratic parties supported fiscal consolidation during the economic crisis as a

⁸Many social and regulatory policies have a macroeconomic impact. According to my definition, these policies are classified as macroeconomic policies if and only if they are aimed at aggregate economic variables.

partisan strategy. Rather than focusing on the implementation of austerity measures in government, I attempt to determine a broadly “social democratic” element of how centre-left parties approached and have come to adopt austerity as a partisan strategy during the Great Recession.

Existing explanations for social democratic austerity and their short-comings

There are a number of existing approaches in the literature that could be used to explain “austerity from the left” or “social democratic austerity”, i.e. the broad acceptance of austerity by social democratic parties in post-crisis Europe. The most prominent explanation comes from a materialist literature focused on the structural imperatives of the global economy. Some contend, for instance, that the collapse of the Bretton Woods system and end of the post-War economic boom that accompanied the subsequent oil crises has effectively killed off social democracy by ruling out traditional Keynesian policy tools (Panitch and Leys, 2001, p. 107; Bailey, 2009, p. 606; Rogers, 2013, p. 8-9; Lavelle, 2008). Others point to the rise of globalised capital markets in the 1980s – which were seen to empower footloose capital to punish inflationary economic policies – to explain the ‘death’ of social democracy. Most prominently, Scharpf (1991, p. 24) already argued in the late 1980s that ‘there is now no economically plausible Keynesian strategy that would permit the full realisation of social democratic goals within the national context without violating the functional imperatives of a capitalist economy.’

Wolfgang Streeck (2014) has more recently updated this thesis, arguing that the secular trends of stagnating economic growth, shrinking tax revenues, and rising public debt have made sovereign governments increasingly vulnerable to the whim of financial market actors, who can impose strict austerity via the threat of capital flight. Relatedly, critical perspectives on European integration have explored the role of the European Union in institutionalising a ‘disciplinary neoliberalism’ (Gill, 2003, p. 65-67; Bailey, 2009; Strange and Worth, 2012, p. 34), including through post-crisis developments such as the Fiscal Compact, which is seen to necessitate austerity (Bailey, 2014, p. 245; Escalona and Vieira, 2014, p. 26).

These accounts point to significant challenges for social democratic parties, but they contain a number of limitations which must be recognised. First, we should be careful with statements concerning the death of domestic policy autonomy at the hands of

global capital. For instance, the economic globalisation thesis of the 1990s and 2000s ignored ongoing differences in national economies (Garrett, 1998a) and the way in which different economies could mediate the pressures associated with globalisation in order to pursue Keynesian policies (Clift and Tomlinson, 2007). This reflects the way in which governments, such as the British Labour government of 1974-79, were able to pragmatically adjust to the monetarily constrained environment of post-Bretton Woods without sacrificing all elements of their Keynesian programme (see Hay, 1999, p. 209-12; Crook, 2018). Moreover, the period of internationally coordinated Keynesianism in the immediate post-crisis period revealed the way in which expansionary macroeconomic policies, long regarded as ineffective or dangerous, were still very much an integral part of policy-makers' toolkits (Clift and Woll, 2012, p. 307).

Second, it is not evident that financial markets have 'bit the hand that fed them' and imposed austerity since 2008. In an otherwise toxic environment, post-crisis interest rates on government bonds have plummeted in many of Europe's major economies as capital moved to these relative safe havens despite their high debt levels. As a result, governments in countries such as Germany, France, or the UK have been able to borrow relatively cheaply. Moreover, in 2010, market actors came to perceive the fiscal position of some European governments as fragile only because the ECB's role as lender of last resort was not guaranteed (De Grauwe, 2013; De Grauwe and Ji, 2013). They did not demand austerity per se, but rather a credible backstop that would safeguard their assets. When ECB President Mario Draghi provided this backstop in 2012, promising to do 'whatever it takes' to save the Euro, the financial pressure on Europe's periphery ceded but austerity continued. Austerity policies pursued thereafter have thus been more a political choice than an economic necessity.

Finally, EU integration is not sufficient to explain the austerity settlement, either. Even if the conditions of bailout agreements necessitated austerity in countries such as Greece, the same argument cannot be made in many other countries. For example, in 2010 the UK government committed itself to fiscal austerity programme on par with those of Portugal and Spain, despite not being institutionally constrained to do so. The UK has its own currency and central bank and it is not subject to Eurozone rules in the same way as other EU members are. Instead, the extent of the austerity measures in the UK can only be explained by the ideological disposition and political strategy of the Conservative-led Coalition government (Gamble, 2015).

However, even the literature attuned to the importance of ideas cannot fully explain social democratic austerity. This constructivist literature views austerity as the result

of the dominance of neoliberal or ordoliberal ideas (e.g. Blyth, 2013; Dellepiane-Avellaneda, 2015; Baker, 2015; Matthijs and McNamara, 2015; Ban, 2016; Carstensen and Matthijs, 2018; Blyth and Matthijs, 2017). Many of these authors have demonstrated that the concept of austerity is underpinned by a range of normative and economic ideas about the appropriate role of the state vis-à-vis markets and household. On the one hand, some argue that neoliberal economic ideas, including the “crowding out” effect of government borrowing (Barro, 1974) and the alleged “expansionary” effect of fiscal consolidations (Giavazzi and Pagano, 1990; Alesina and Ardagna, 1998), have shaped contemporary austerity. On the other hand, others have argued that ordoliberal ideas, including a rule-based approach to economics and the ‘moral hazard’ associated with government debt, have contributed to the dominance of austerity in Europe. In perhaps the best-known account of post-crisis austerity, Blyth (2013) artfully traces a range of ideational developments prior to the crisis and shows that, in fact, a symbiosis or a cocktail of these ideas underpins the way that actors engaged with austerity.

These approaches are useful because they highlight how economic ideas have fed into the post-crisis politics of austerity. However, to date the existing literature cannot effectively explain why contemporary austerity has not been challenged by other economic ideas. In countries outside of Europe, governments have, indeed, pursued alternative economic policies, and it remains unclear why these ideas had so little influence in Europe after 2010. In particular, the constructivist literature has under-theorised social democratic austerity. In focusing on neo- and/or ordo-liberal ideas, the existing literature potentially delimits our current understanding of why social democratic parties embraced fiscal consolidation. Historically, social democratic parties were neither associated with neo- or ordoliberalism, but they also supported fiscal consolidation prior (Armingeon et al., 2016; Kraft, 2017) and during the crisis (see Chapter 3).

Overall, the existing literature thus provides several starting points to explain the austerity settlement in Europe, which are more fully reviewed in Chapter 2. I do not contest that these approaches provide valuable insights, but I would argue that none of them provides a sufficient explanation for austerity from the left. Unless our conception of social democratic austerity boils down to either suggesting social democratic parties had little choice but to accept social democratic austerity or that such actors have merely accepted a neo- or ordo-liberal economic outlook entirely, it is clear that social democratic austerity has hitherto been under-theorised. There remains little understanding of the way in which social democratic actors have come

to engage with, understand, and ultimately embrace austerity policies and my thesis attempts to address this short-coming of the existing literature.

Outline of the argument

My explanation for social democratic austerity is based on the premise that austerity was a political choice and that political actors, including parties, matter for the macroeconomic governance of advanced economies. In other words, fiscal policies are not only a matter of economic necessities, but they are at the heart of politics themselves. In the words of Peter (Gourevitch, 1986, p. 19), ‘to understand policy choices...we must understand the politics that produces them.’ This is especially true in the context of the economic crises, including the Great Recession. Such crises are often “critical junctures” (Capoccia and Kelemen, 2007; Collier and Collier, 1991) that open up the political space. They shake the foundations of the political system and lead to a lot of uncertainty, which allows policy entrepreneurs to engineer change. By creating heightened uncertainty and compressing time horizons, crises provoke actors to shed previous commitments and force them to seek new solutions (Kahler and Lake, 2013, p. 10). They pit interests and coalitions against each other, and as actors are forced to make decisions that lie outside the normal pattern of politics, agency and contingency comes to the fore (Capoccia and Kelemen, 2007). Therefore, we need to understand the political conflicts behind austerity.

To this end, my theoretical framework integrates two distinct perspectives, which are represented by the two quotes from the very beginning of this chapter. It combines an approach based on ‘the political sociology of political economy’ (Gourevitch, 1986) with an approach that takes the role of ideas seriously. Put differently, my thesis explores both the *electoral* and the *ideational* foundations of social democratic austerity. Following Beramendi et al. (2015), it highlights that parties respond to voters’ preferences. They use economic policies as the bedrock of electoral strategies and to build electoral coalitions. However, parties are not just transmission belts for electoral interests, but they are also rooted in distinct ideological traditions. My framework therefore stresses that economic policies are also influenced by the ideas that parties hold about how the economy works (e.g. Hall, 1989; Blyth, 2002). This is particularly true during economic crises, when uncertainty opens up windows of opportunity, during which ideas serve as explanations of what went wrong and how to fix it (e.g. Blyth, 2002; Widmaier et al., 2007; Matthijs, 2011).

The electoral pressures for social democratic austerity

Taking politics seriously, my theoretical framework attempts to bring the “electoral turn” (Beramendi et al., 2015) to the literature on macroeconomic policies. Traditionally, political economy focuses on the interests and ideas of elites and largely ignores public opinion. However, during economic crises this approach is not tenable because ‘mass politics trumps interest group politics when both come into play’ (Hooghe and Marks, 2009). Supply-side explanations might explain politics on non-salient issues, which are in the realm of quiet (Culpepper, 2011) or “technocratic politics”. Yet, the demand-side becomes important for salient issues, which are in the zone of loud or “electoral politics”. In this case, policies are chosen by politicians and ‘when politicians make choices... their choices are constrained by the need to mobilize or retain support’ (Gourevitch, 1986, p. 19). This is particularly true for fiscal policies, which are less insulated from party politics than other economic policies, including monetary policy or financial regulation. They have large distributive consequences, they are very visible, and they receive a lot media attention. Thus, the supply of fiscal policies is not independent of the demand for them: while politicians have the ability to shape and influence public opinion in the medium- to long-run, they are also servant to it in the short-run. In other words, ‘the freedom of politicians is circumscribed by their need to construct support coalitions’ (Gourevitch, 1986, p. 239).

To explain social democratic austerity it is therefore necessary to focus on the strategic choices that party leaders faced in the context of the Great Recession. We have to explore the interdependence between political economy and electoral politics (Kitschelt, 1999, p. 318), analysing how party leaders cope with the changing demands from voters. Party leaders are political animals and their actions are first and foremost guided by their short-term electoral instincts. As they compete in elections, they carefully craft their programmes with reference to electoral considerations. They stay closely tuned to the dominant policy mood (Erikson et al., 2002) or the eb and flow of public opinion (Soroka and Wlezien, 2010) and in recent decades this has been especially true for social democratic parties. During the Third Way era, social democratic parties accepted the dominance of markets and adopted a technocratic and managerial approach to politics, valuing office as a means to reform free market capitalism.

In the context of the Great Recession, this “instrumental” approach to politics best explains the programmatic response of the centre-left to the Great Recession. On the one hand, low-income households, which social democratic parties aim to represent, were particularly at risk during the crisis and, hence, expanding the welfare

state during crises benefits them. On the other hand, the economic crisis was widely narrated as a crisis that resulted from excessive liberalisation of the financial system. This presented centre-left parties with a window of opportunity to oppose economic liberalism and distance themselves from the causes of the Great Recession. They shifted to the left during the crisis on issues relating to both welfare and economic liberalism, thereby retracting large parts of the Third Way policies.

However, social democratic parties treated fiscal policies differently in response to the crisis. When the financial crisis was turned into a fiscal crisis of the state, leading European policy-makers began to demand austerity. The case of Greece set the tone of the debate, as the crisis was quickly narrated as one that was caused by excessive levels of government debt and “irresponsible” behaviour by debtor countries. In this context, social democratic parties perceived the median voter to be fiscally conservative. Based on the voters’ personal experience of balancing their private budget, fiscal consolidation resonates more with the public than Keynesian deficit spending. Many voters falsely equate the public household with the private household and buy into false logic of “folk economics” (Rubin, 2003) that governments should not run deficits. Therefore, social democrats supported austerity in order to appear electable and fit to govern. Especially, in countries where social democratic parties governed when Lehman Brothers collapsed in 2008, the crisis destroyed the economic competence of social democratic parties in the eye of the voters. Based on the firm belief that the path towards power leads through the centre, they adopted austerity policies to (re-)gain economic competence and “fiscal credibility” (Kraft, 2017). In other words, fiscal orthodox policies became part of their electoral strategy.

The ideational pressures for social democratic austerity

The electoral pressures for austerity created a difficult situation for social democrats: while they perceived voters to be fiscally conservative, austerity policies hurt their traditional constituencies and undermined the welfare state. Yet, parties are not only rational office-seeking actors, but they can also influence the preferences of voters. Their economic policies respond to public opinion and the interests of their main constituency, but – at least in the medium- to long-run – this demand is not independent from the supply. Observing that the electoral pressures for austerity were pervasive, in other words, begs the question why social democrats did not attempt to change public opinion in their favour. Politicians can craft party programmes in different ways in order to combine heterogeneous demands into a single political platform and the importance of different electoral pressures is mediated by the ideas that politi-

cians hold. These ideas give legitimacy to policies (e.g. Finnemore and Sikkink, 1998; Haas, 1992), they help to construct coalitions by providing a framework for collective action (e.g. Blyth, 2002), and they allow different actors to articulate their demands.

To explain the reluctance of social democratic parties to challenge the austerity settlement, it is thus also necessary to understand the *ideational pressures* for austerity. As argued above, there has been a growing interest in the idea of neo- or ordoliberalism as a way to understand the economic forces of our times. Even during the height of monetarism, most European social democrats did not really buy into this paradigm, but it is true that they came to accept the dominance of the market as the fundamental mechanism of economic allocation after the end of the Cold War. There was a widespread belief among social democrats that they could neither spend their way to growth nor to equality, abandoning traditional Keynesian demand-management. Instead, they drew on an alternative set of normative and economic ideas, based on New Keynesian theory, supply-side economics, and the social investment paradigm that underpins the way in which social democratic actors have engaged with austerity.

Based on a synthesis of new classical and Keynesian arguments, New Keynesianism suggests that macroeconomic policies should maintain output in response to economic crises, but it accepted that this role was much more limited and could only work in the short-run. On top of this, it also stipulates that demand management was best achieved by monetary policy, and not fiscal policy policies. Social democrats bought into these ideas and became more sceptical of using fiscal policies to fine-tune the economy. Rather, they used insights from supply-side economics to argue for an active role of the state in governing the economy. Based on endogenous growth theory (Romer, 1994) and the social investment paradigm (see e.g. Morel et al., 2012; Hemerijck, 2017), the centre-left argued that the state has a fundamental role in the creation of wealth. However, for the state to play this role, it needs to retain the capacity to act in the long-run. Fiscal policies thus need to be concerned with the sustainability of public finances, which leads to what Haffert and Mehrtens (2015) call the “progressive consolidation thesis.” According to this view, public debt undermines the sustainability of the welfare state and constrains the politicians’ ability to invest and to deliver services that are essential to generate growth. Accumulating government debt foreshadows painful spending cuts and exposure to pressures from financial markets. To avoid both, consolidation is an important element to ensure the

viability of the state; in other words, ‘consolidation is not an end in itself but a means to regain fiscal capacity’ (Haffert and Mehrtens, 2015, p. 120-21).

My theoretical framework stresses that these ideas influenced social democratic parties in the context of the Great Recession. Contrary to the existing literature, however, this account stresses that the ideational foundations of social democratic austerity are distinct from neo- and ordoliberal austerity. It shows that policy issues such as austerity can mean different things to different actors, who draw upon and use different ideas to understand and justify their policy programmes (Ban, 2016). Ideas can be differently absorbed in different contexts (Matthijs, 2011; Blyth, 2002; Berman, 1998) and establishing that a distinct set of ideas provides the intellectual framework social democratic austerity is more than an exercise in typology or ideational hair-splitting. Rather, I suggest that one can only fully understand social democratic austerity in the context of the Great Recession by acknowledging these ideational foundations, i.e. the ideas and economic theories on which social democratic austerity is built and legitimised.

Paradigm change, social democrats, and the Great Recession

Acknowledging the *ideational pressures* for austerity still begs the question why social democratic parties were not able to move beyond them, though. Following a Kuhnian logic, Peter Hall (1993) suggests that paradigm change occurs when anomalies accumulate that the dominant theory cannot explain. Given that austerity policies have not worked and that they have hurt traditional social democratic constituencies, the literature on social democracy is rightfully puzzled by the social democratic response to the Great Recession (e.g. Coates, 2017; Bailey et al., 2014; Keating and McCrone, 2013). It can neither explain the lack of a paradigm change nor the fact that social democratic parties hardly attempted to push for such a paradigm change.

To explain why this happened, my thesis attempts to re-think when paradigm change is likely. It brings back politics and re-evaluates the conditions that lead to economic policy output. In the short-run, my framework stresses that paradigm change is constrained by public opinion and the prevailing political discourse. In most circumstances, vote- and office-seeking politicians are thus not the right people to push for paradigm change. They have to work with preferences from the electorate that are fixed in the short-run and that are shaped by the legacies of previous policies and programmes. In this context, paradigm change cannot happen if voters do not want it to happen. Politicians can only strategically move their position in the existing issue

space, positioning themselves vis-a-vis other parties. Nevertheless, in the medium- to long-term politicians and other elites can change public opinion. They are able to create coalitions against the existing paradigm by pointing out its short-comings and proposing an alternative prism through which to interpret the economy. This process takes time, but it relies on leaders that play with new ideas, that rally against the previous paradigm, and that shore up support for the new paradigm.

I argue that social democratic parties were unable to take up this role in the context of the Great Recession because they faced a twin problem: they were trapped and divided, which undermined their ability to push for ideational renewal. In the absence of a clear new economic paradigm, they combined short-term electoral opportunism with technocratic policy initiatives and convinced themselves that austerity was necessary.

First, social democratic parties faced an *electoral trap* (resulting from path dependency) because their electoral constituency had changed as the result of the policies that they implemented prior to the crisis. In general, previous policies have distributive consequence, including the potential to fragment and divide the electorate (Esping-Andersen, 1985, p. 322). Prior to the Great Recession, this is what happened as a result of the Third Way. Disappointed with the Third Way, many working class voters had abandoned social democratic parties and, in the shadow of the crisis, the complexity of building electoral coalitions become more difficult. Social democrats were squeezed by an (anti-austerity) far left and a (pro-austerity) centre-right and faced a dilemma that was not unique in the history of social democracy: either they promised austerity policies that appeal to the median voter but contribute to their long-term decline, or they adopt policies that oppose austerity but keep them outside of government.⁹

Second, social democrats also faced an *ideational trap* because the implementation of ideas and policies prior to the crisis destroyed alternatives (Galbraith, 1958). In the beginning of the crisis, observers expected the financial crash to undermine the dominant intellectual edifice. Yet, in hindsight, the crisis only led to a narrow debate about the merits of finance but the dominant macroeconomic paradigm largely remained in tact. Policy-makers were able to prevent the Great Recession from turning into another Great Depression and the perceived success of the immediate response to the crisis undermined the intellectual renewal that some expected at the beginning of the crisis. For social democratic parties, this ideational trap was compounded by

⁹For a similar argument for different time periods, see Kitschelt (1994, p. 93-94) as well as Luebert (1991, p. 227-32).

the experience of the Eurozone crisis. While the economic pain for the crisis-ridden debtor countries only really started in 2010, other countries like Germany bounced back relatively quickly. Conventional wisdom attributed this success to Germany's Agenda 2010, which was a set of supply-side reforms that the centre-left government had implemented in the early 2000s. Eventually, the crisis was thus seen as a crisis of debt and competitiveness rather than a crisis of demand. This made it difficult for social democrats to disavow supply-side Keynesianism as they remained trapped by their previous economic ideas and discourse.

The problem for social democratic parties was compounded because they were deeply divided during the Great Recession. Left-wing factions within social democrats opposed austerity, while pragmatic Third Way social democrats held onto supply-side Keynesianism and the progressive consolidation thesis. However, actors on the left had been marginalised in the 1990s and early 2000s within their parties and they lacked the necessary leadership to turn these parties against the austerity settlement. Rather, Third Way social democrats leveraged strategic considerations (focused on public opinion) to win the intra-party conflict. They argued that social democratic parties had to play sensibly to voters' concerns about government deficits and debt. They presented austerity as a policy that is "good" in economic terms (because it safeguards the "fiscal capacity" of the state) *as well as* in political terms (because it signals "fiscal credibility"). As a result, in most countries, opposition to austerity was bundled by forces outside the traditional social democratic parties, for example by Syriza in Greece, Podemos in Spain, or even Melonchon's movement in France. There were only very few countries where left-wing factions within social democratic parties were able to win the inter-party conflict, like Portugal or the UK. In these countries actors from the left-wing of social democracy were able to push for an anti-austerity platform and eventually moved from the outskirts of their party to the leadership.¹⁰

Research design and methods

To test my theoretical framework, this dissertation uses a mixed-method research design. It draws on wide variety of data and it is divided into three parts, as summarised in Table 1.1. The first part asks whether and how the programmatic claims of the centre-left with regards to the economy have changed during the crisis. It uses the economic policies of social democratic parties as the dependent variable and aims to

¹⁰See Chapter 6 for an analysis of the British case.

provide a comprehensive description of the social democratic response to the Great Recession. In particular, it analyses the programmes of social democratic parties in three different issue areas (welfare, economic liberalism, and budgetary rigour) and focuses on both the salience that these parties attribute to economic issues as well as the positions that they adopt towards these issues. For this purpose, it uses on quantitative content analysis, relying on a large dataset that records the positions of parties in election campaigns through core sentence analysis. The data comes from the manual coding of newspapers in eleven Western European countries (Austria, France, Germany, Greece, Ireland, Italy, Netherlands, Portugal, Spain, Switzerland, UK), following the approach used by Kleinnijenhuis and Pennings (2001) and Kriesi et al. (2008, 2012). Descriptive analysis and time-series-cross-section (TSCS) regression analysis are then used to explore the data.

Table 1.1: Research Design

Analytical Steps	Questions	Method	Data
Puzzle	1) What economic policies did SD parties adopt? 2) How did their positions change in response to the crisis?	Quantitative content analysis	Media data from election campaigns
Demand-side	1) What is public opinion on fiscal consolidation? 2) What makes people more likely to be fiscal conservative?	Quantitative survey analysis	Eurobarometer surveys; online survey experiments
Supply-side	1) What did SD politicians and policy-makers think? 2) How important were electoral and ideational concerns for them?	Qualitative process-tracing	Elite interviews

The second part of the thesis studies the demand-side or the “electoral politics” of fiscal policies in Western Europe. It analyses public preferences towards fiscal consolidation as the dependent variable in order to evaluate how strong the electoral pressures for austerity were during the crisis. To this end, I first use data from existing surveys to study preferences for fiscal consolidation across Europe. In particular, I pool responses from 12 waves of the Eurobarometer and use regression analysis to examine country- and individual-level determinants of fiscal preferences. On the aggregate level the chapter again uses TSCS analysis, while it employs logistic regressions analysis on the individual-level. Testing the importance of variables like

income, occupation, asset-position, and partisanship, this allows me to assess support for austerity among (social democratic) voters.

Yet, existing surveys that include questions about preferences towards fiscal consolidation are problematic. They do not acknowledge that austerity is potentially costly, i.e. that it will result in the cutting of welfare state spending or the increase of taxes. While many respondents might in principle agree that balanced budgets are desirable, it is not clear whether they are also willing to accept the trade-offs associated with it. Consequently, the second part also uses data from two online survey experiments (a split-sample experiment and a conjoint survey experiment) conducted in Germany, Italy, Spain, and the UK in which respondents were asked to evaluate different fiscal policy packages. It analyses these experiments in multiple ways and draws on several methods, including linear regression models and regularization (Ridge regression). This will help me to better explore preferences for fiscal policies at the micro-level and evaluate how constrained social democratic parties were in the context of the economic crisis.

Finally, part 3 studies the supply-side or the “elite politics” of fiscal policies. It uses case studies to explain the fiscal policies that the British Labour party and the German SPD in response to the Great Recession adopted. The focus in these case studies is not on the actual implementation of austerity measures in government; rather, the case studies attempt to explain party strategies in the wake of the Great Recession. As mentioned above, they attempt to determine a broadly “social democratic” element of how these parties approached and have come to internally legitimise austerity to themselves.

Importantly, the British Labour party and the German SPD are used as “crucial case studies” because in both countries the external constraints that political parties faced during the Great Recession were weaker than in most other European countries. The UK is not part of the Eurozone and subject to less control from Brussels, while Germany emerged as the dominant country during the Euro crisis. Moreover, interest rates on government bonds remained extremely low in both countries as investors looked for safe investments in the wake of the financial crisis. This allowed both countries to finance government debt very cheaply and, hence, market pressures for austerity were very low in both countries. In theory, this should have given politicians in both countries more freedom to develop the fiscal policies of their own choice, at least compared to the crisis-ridden debtor countries. And they would have had good reason to do so: both countries experienced a sharp decline in economic output in the wake of the financial crisis. Although unemployment never reached the heights seen

in some Southern European countries, their economies only recovered slowly from the economic crisis. Arguably, both economies were still running below potential in 2010 when Europe's governments turned towards fiscal consolidation, which should have given social democrats reason to oppose it.

Still, in both countries social democratic parties largely accepted conservative fiscal policies and supported voluntary fiscal consolidation. In Germany, the SPD was instrumental in the introduction of the German constitutional debt brake in 2009, which was an early sign of the fiscal consolidation that would haunt Europe in the following years. Afterwards, the SPD supported this path of fiscal consolidation, even when it was in opposition from autumn 2009 to 2013. In the *Bundestag* the party supported almost all the bail-out packages and measures, which the government introduced in response to the Eurozone crisis and which enforced austerity across Europe. After the 2013 election the SPD again formed a coalition with the CDU/CSU. As the junior partner, it continued to support the government's Eurozone policy and did not strongly object to the *Schwarze Null* (balanced budget) that finance minister Wolfgang Schäuble implemented. In the UK, Labour lost the general elections in 2010 and it was in opposition when David Cameron implemented austerity. However, prior to the general election, the Labour party had already endorsed the so-called "Darling Plan" that called for substantial fiscal consolidation. In opposition under Ed Miliband, the party struggled to define its own fiscal policy, but eventually it continued to support fiscal consolidation, advocating for deficit reduction and "iron discipline on spending."

This support for austerity among the centre-left cannot be explained by structural forces given that Germany and the UK are different on many different dimension, as summarised in table 1.2: they have different economic systems; they operate in different political systems; and they had different positions in government. This leads to a "most different systems design" (Przeworski and Teune, 1970), allowing me to test whether my theoretical framework can explain the policies that the German SPD and the British Labour party adopted. To this end, I will use process-tracing primarily based on evidence from more than 40 interviews (conducted between August 2016 and March 2018) with leading policy makers in both Germany and the UK. Interviewees were selected by combining "purposive" sampling method with a "chain" or "snowballing" sampling method. They included former cabinet members, budgetary spokespeople, and a range of high-level economic and political advisers.

Table 1.2: Logic of case selection

	Germany	UK
Strategic Position	Core of Eurozone (creditor)	Outside of Eurozone
Fiscal Position	No fiscal problems	Some fiscal problems
Market Pressure	No market pressure	Some market pressure
Variety of Capitalism*	CME	LME
Growth model**	Export-led growth	Consumption-led growth
Electoral system	Mixed member proportional representation	First-past-the-post
Govt. Responsibility***	$G \Rightarrow O \Rightarrow G$	$G \Rightarrow O$
Expl. Variables	Electoral constraints & economic ideas	Electoral constraints & economic ideas
Dependent Variable	No challenge to austerity	No challenge to austerity

* Adopted from Hall and Soskice (2001)

** Adopted from Baccaro and Pontusson, 2016

*** Govt. responsibility of SD parties from 2008 to 2015 (G = govt.; O = opposition; \Rightarrow = change)

Outline of the dissertation

Extended literature review and theoretical chapter

Concretely, my dissertation is divided into eight chapters. Chapter 2 situates the dissertation in the context of the existing literature on political economy and party politics and outlines the analytical framework. The chapter begins by reviewing the policies that the centre-left pursued before the Great Recession. Afterwards, it reviews the existing approaches that can be used to explain austerity from the left in the context of crisis. It provides a more comprehensive assessment of these explanations and argues that they are not sufficient to explain austerity from the left. Therefore, the chapters provides a new explanatory framework that combines two different approaches. The framework attempts to bring the “electoral turn” (Beramendi et al., 2015) to the study of fiscal policy, but it also takes the role of ideas seriously. By analysing the electoral and ideational foundations of social democratic austerity, it attempts to explain partisan choices for macroeconomic policies and focuses on public opinion and its interaction with ideas and the dominant political discourse, as summarised above. This model will be developed in order to explain the response of

social democratic parties to the recession, but theoretically it should equally apply to other party families.

An empirical analysis of the response of social democratic parties to the Great Recession in 11 countries

The third chapter analyses how social democratic parties changed their electoral strategies in the context of the crisis. It tests whether parties are strategic actors that change their programmes in response to economic crises, i.e. it tests whether we can expect crises to have an influence on party positions in the first place. The results suggest that this is the case given that social democrats moved to the left in response to the crisis. However, this shift towards the left by social democratic parties did not extend to all economic issues. On the one hand, social democratic parties defended the welfare state and opposed economic liberalism after the 2008 financial crisis, which partly reverted their own Third Way. On the other hand, many parties also supported the reduction of government deficits and taxes during the crisis, i.e. they joined the chorus of austerity that became the dominant tune during the Euro crisis. This confirms that the positions of social democratic parties towards fiscal policies did not align with their positions on other socio-economic policies in the shadow of the economic crisis. The remaining part of the dissertation will attempt to explain this incoherent platform by focusing on the puzzling support for austerity among the centre-left. It will focus less on the variation among social democratic parties in the extent to which they accepted austerity, but it attempts to focus more on explaining the broad acceptance of the austerity by the centre-left across Europe.

The popular politics of austerity: Studying the demand-side of politics

For this purpose, the fourth chapter studies the popular politics of austerity, i.e. the demand-side. It uses existing data from Eurobarometer surveys that ask respondents about their attitudes towards fiscal policy. In particular, the chapter shows that a large amount of voters felt uneasy about their country's government debt and the chapter seeks to understand why this was the case. At the beginning of the crisis, on average, 72 percent of respondents in the European Union agreed that "measures to reduce the public deficit and debt cannot be delayed" in their country. Even in 2015, a large majority of individuals still agreed with this statement, indicating that support for fiscal consolidation remained high throughout the crisis. Chapter 4 attempts to explain this staggering support for fiscal consolidation, and – to my knowledge – it is the first

study to systematically investigate the public's "debt aversion" across a large amount of countries. It uses regression analysis to examine the country- and individual-level determinants of preferences towards fiscal policy. The results show that people that are less well-off are generally less concerned about government debt, generating a positive relationship between income (or wealth) and debt aversion. Moreover, on the aggregate level, voters respond to changes in the economy in an anti-Keynesian fashion: they are more likely to support fiscal consolidation during the bust than during the boom. Voters seem to equate the public deficit with that of a private household and consequently the individual experience of the economy also mediates the influence of the macroeconomic conditions on support for fiscal consolidation.

The fifth chapter digs deeper to understand the preferences for fiscal policies better. It uses data from two survey experiments conducted in Germany, Italy, Spain and Greece to re-evaluate how strong the electoral pressures for austerity really are. First, it uses a split-survey experiment to analyse to what extent and whether individuals support fiscal consolidation when this comes at the cost of lower government spending and/or higher taxes. Second, the chapter uses a novel conjoint survey experiment to evaluate fiscal policy packages. Following existing approaches that use conjoint analysis (e.g. [Bechtel et al., 2014](#); [Hainmueller et al., 2014](#); [Hainmueller and Hopkins, 2015](#)), respondents need to evaluate different combinations of fiscal policies, including fiscal consolidation. In other words, in a pair-wise comparison, participants chose between two simplified fiscal policy packages and indicate how much they support each of the proposals. Through randomization this analysis allows me to identify the causal effect that consolidation has on the support for a given fiscal package. The results from both experiments show that fiscal consolidation is less popular than commonly assumed. Although most citizens support fiscal consolidation in principle, it is not a priority for them; rather, they are more concerned about the level of government spending and taxation. This suggests that the centre-left had some scope to interpret and influence public opinion, despite the consensus for fiscal consolidation that chapter 4 identified. The case studies will take up this finding, analysing to what extent social democratic perceived this as a possibility.

The elite politics of austerity: Studying the supply-side of politics

In the last two empirical chapters, I analyse the elite politics of austerity, i.e. the supply-side of politics. The chapters primarily use "explaining-outcome process tracing", as outlined by [Beach and Pedersen \(2013\)](#), to study the fiscal policies of the German SPD and the British Labour in response to the Great Recession. While Chapter 6

explores the electoral and ideational pressures for austerity within the British Labour party, Chapter 7 analyses the same pressures within the German SPD. They situate the fiscal policies of each party in a historic context and use quantitative content analysis to fully explore the programmatic response of these parties to the economic crisis (based on the data used in 3). Then the chapters draw on over 20 elite interviews to draw out the causal mechanisms that contributed to social democratic austerity. Both chapters argue that social democratic politicians are not neoliberal or ordoliberal ideologues that have accepted the dominance of the market. Instead, both parties are portrayed as strategic actors that are confronted with a common problem: the need to establish economic competence and credibility in the eye of the voter. They faced a large amount of distrust among voters towards higher deficits, and convinced that the path to power leads through the centre, they tried to appeal to fiscally conservative voters. They did not believe that they could change public opinion, accepting evidence from conventional surveys as well as focus group research. Internally, however, these positions were also legitimised by a set of economic ideas that social democratic parties already adopted prior to the Great Recession and that were part and parcel of their Third Way. This ideological framework based on New Keynesianism, supply-side economics, and the social investment paradigm is distinct from neo- or ordoliberalism, but it contributed to social democratic austerity, and helped to mainstream austerity in Europe.

Conclusion

Finally, chapter 8 summarises the main argument and the empirical findings from the previous chapters. It argues that the field of comparative political economy has paid too little attention towards fiscal policies and the role of party politics for these policies. Given that the way that public revenue is generated and the way that this revenue is spent have enormous consequences for the development of our economies and societies more broadly, this should be changed. To this end, chapter 8 outlines the broader contributions of the dissertation, but also expands on the limitations of my framework. It raises open questions that my thesis cannot answer and suggests possible avenues for future research. Finally, the thesis ends by re-evaluating the fate of social democracy in Europe in the 21st century. It considers whether and how social democratic parties can move beyond the austerity settlement after the Great Recession. It argues that social democratic parties need to push for ideational renewal to regain their rightful place in the heart of European politics, developing bold responses to some of the biggest challenges of our time.

Chapter 2

Social Democratic Austerity: A Theoretical Framework

Introduction

This chapter reviews the existing literature and sets out the theoretical framework. My framework is based on the premise that austerity was a political choice and that actors, including parties, matter for the macroeconomic governance of advanced economies. Although capitalism is a system, there are actors within that system whose choices matter. Especially during economic crises, a focus on agents and their choices is important because crises often are ‘critical junctures’ (Capoccia and Kelemen, 2007; Collier and Collier, 1991) that open up the political space. In the words of Gourevitch (1986), during economic crises, ‘patterns unravel, economic models come into conflict, and policy prescriptions diverge.’ They shake the foundations of the political system and lead to a significant amount of uncertainty, allowing policy entrepreneurs to engineer change. In the past, economic shocks led to important political upheavals, including swings in partisan politics, institutional innovation, and changes in the dominant economic paradigm (Gourevitch, 1986).

To explain the economic policies of social democratic parties in response to the Great Recession, my theoretical framework integrates two distinct perspectives. It combines an approach based on ‘the political sociology of political economy’ (Gourevitch, 1986) with an approach that takes the role of ideas seriously. In other words, the framework analyses both the *electoral* and the *ideational* foundations of social democratic austerity. Following Beramendi et al. (2015), my framework highlights

that parties respond to voters' preferences. They use economic policies to build electoral coalitions and address the concerns of particular electoral constituencies. However, parties are not just transmission belts for electoral interests, but they are also rooted in distinct ideological traditions. My framework, therefore, stresses that economic policies are also influenced by the ideas that parties hold about how the economy works (e.g. [Hall, 1989](#); [Blyth, 2002](#)). This is particularly true during economic crises when uncertainty opens up windows of opportunity, during which ideas serve as explanations of what went wrong and how to fix it (e.g. [Blyth, 2002](#); [Widmaier et al., 2007](#); [Matthijs, 2011](#)).

To develop this framework, the chapter considers the policies that social democratic parties pursued before the Great Recession. Then it reviews the existing explanations for social democratic austerity and their short-comings. I argue that many of these explanations may contain some truths but that none can fully explain social democratic austerity. Consequently, I set out my own theoretical framework, focusing on both the electoral and ideational pressures that social democrats faced during the recent economic crisis. Finally, I re-visit the economic and political dilemma that social democratic parties faced in the context of the crisis, arguing that social democratic austerity was largely reflexive. Social democratic parties found themselves in electoral and ideological traps, which prevented them from leading the charge against austerity.

Social democratic parties and macroeconomic policies before the Great Recession

The existing literature is inconclusive about the importance of political parties for economic policy-making, but according to a large amount of research from the 20th century, different parties implement different economic and social policies.¹ Focusing on macroeconomic policy, [Hibbs \(1977\)](#) p.1467) argued that 'governments pursue macroeconomic policies broadly in accordance with the objective economic interests and subjective preferences for their class-defined core political constituencies.' Accepting the trade-off between unemployment and inflation that existed according to the Philips curve, he showed that the centre-left adopts policies that reduce unemployment and increase inflation, whereas the centre-right adopts policies with the opposite effect. Studies from [Tufte \(1978\)](#), [Alesina and Rosenthal \(1995\)](#), and [Boix](#)

¹For example, the power resource school views socio-economic policies as the outcome of the democratic class struggle ([Stephens, 1979](#); [Korpi, 1983, 1989](#); [Esping-Andersen, 1990](#); [Hicks, 1999](#)).

(2000) supported this conclusion showing that social democratic parties implement Keynesian policies of demand management more than other parties.

Although there has never been a single social democratic model (Keman, 2017; Bartolini, 2000), the marriage between social democracy and Keynesianism goes back to the Great Depression.² A few decades before this historic economic shock, European social democratic parties were born from the labour movement. Closely allied with trade unions, political parties emerged to fight for the interests of the working class. In the wake of the Bolshevik revolution in Russia in the beginning of the 20th century, however, the labour movement split (Lindemann, 1983): revolutionary socialists who wanted to emulate the revolution in Russia opposed moderate socialist who sought to reform capitalism.³ In most countries, the latter became known as social democratic or labour parties, which began to participate in the democratic process.

In 1929, when the Great Depression struck, some of these parties were even in government, and in this context, most social democrats advocated and implemented deflationary policies with disastrous consequences (Temin, 1989; Berman, 1998). In the UK, Labour prime minister Ramsay McDoland opted for austerity against the support of large parts of the Labour party (Skidelsky, 1970). His decision to form a National Government split the Labour movement, leaving deep scars for decades to come. Similarly, in Germany the SPD supported Heinrich Brüning's government, which implemented harsh spending cuts that worsened the deflationary spiral.⁴ Only in Scandinavia social democrats implemented a bold economic program in response to the Great Depression, which involved a social compromise between labour and capital and a shared commitment to full employment (Paterson and Thomas, 1986; Berman, 1998).

After the Second World War, the thinking of John Maynard Keynes (1936) gave social democratic parties an ideological roadmap to abandon austerity. Keynes believed that the economy does not follow natural laws and argued that market orthodoxy insufficiently paid attention to the problem of demand. According to his key insight, private investment was volatile, following pro-cyclical tendencies and leading to-

²Keynesianism here is defined as a macroeconomic theory to explain and influence the business cycle. It proposes to use a variety of monetary and fiscal policies to smooth the amplitude of the business cycle. During economic crises, Keynesians suggest that governments should use loose monetary policies and a combination of deficit-spending and tax cuts to stimulate the economy. See below for a further discussion of Keynesianism.

³The ideological fathers of social democracy, including Eduard Bernstein, emphasised the primacy of politics, which allowed them to reject Marxist historical materialism. They believed that political action could significantly improve the conditions of the working class.

⁴Although largely forgotten in contemporary Germany, these cuts contributed to the rise of the Hitler and the Nazi, paving the way for the Second World War (Galofré-Vilà et al., 2017).

wards booms and busts. Assuming that demand fluctuates while supply is stable, he argued that output gaps could emerge, leading to a dramatic under-utilization of economic resources. To address this, Keynes suggested that governments should manage demand to ensure full employment. Macroeconomic policies were not just supposed to stabilise demand when private investment was low, but they were also supposed to influence the ‘animal spirits’, creating positive economic expectations that would facilitate private investment. This provided the intellectual foundation for state intervention in the economy and supplied social democratic parties with its new dominant *modus operandi*: it allowed them to abandon the goal of nationalising the means of production, which was electorally infeasible (Przeworski, 1985), while pursuing distinctive macroeconomic policies that were in line with the economic interests and preferences of ‘their class-defined core political constituencies’ (Hibbs, 1977, p. 1467).

Therefore, Keynesianism supplied the basis for a European class compromise of capital and labour (Hall, 1989; Offe, 1983, 1985; Fourcade, 2009) and became closely associated with social democracy in most European countries (Przeworski, 1985; Hall, 1989).⁵ Avoiding the levels of unemployment that Western Europe previously experienced, it allowed social democratic parties to make peace with capitalism. They established themselves as a mainstream political force across Europe, while the radical communists moved to the fringe of the party system in most Western European countries.⁶ And as governments were actually successful in using the tools of the state to generate growth, Keynesianism even became the dominant economic paradigm in advanced economies during the post-war era (Shonfield, 1965). In the context of this Keynesian settlement, the centre-left was able to use the resources of the working class movement (Stephens, 1979; Korpi, 1983, 1989) to build a generous welfare state (Esping-Andersen, 1990; Hicks, 1999) and to introduce corporate wage bargaining across most of Europe (Korpi, 1983; Cameron, 1984).⁷

This golden age of social democracy, or *les trente glorieuses*, came to an end in the midst of the economic crises of the 1970s. Repeated economic crises and the

⁵In some countries, social democratic parties did not explicitly use Keynesian demand management. For example, in Sweden social democrats espoused the Rehn-Meidner model, including restrictive fiscal policies (Pontusson, 1992). However, the Rehn-Meidner model also solved the problem of demand that Keynes had identified by creating the pre-conditions for full employment and reducing wage inequality.

⁶The communist party in Finland was the exception, which participated in several governments during the Cold War period.

⁷The welfare state has also fulfilled a Keynesian function in many European economies. By providing for automatic stabilisers like unemployment benefits, it lowered economic volatility and thereby reduced the need for discretionary monetary and fiscal policies.

occurrence of stagflation challenged the Keynesian settlement. In the absence of broad-based economic growth that could sustain higher rates of profit for capital as well as higher living standards for labour, the grand compromise was undermined. The economic disruptions of the 1970s, including the collapse of the Bretton Woods system and the oil shocks, rather led to a wide range of policy experimentation. In this context party politics became increasingly relevant for the management of the economy again. After Keynesianism had been the dominant doctrine in the post-war era, clear differences emerged between the ways that different parties governed the economy (Hibbs, 1977; Tuft, 1978; Alesina and Rosenthal, 1995). Over time, however, the predictions of the partisan model were challenged as the centre-left abandoned the Keynesian demand management in the 1980s.

The most common explanation for this development refers to globalisation and the growing economic interdependence of countries (Scharpf, 1987, 1991; Keohane and Milner, 1996; Simmons et al., 1999): increasing capital mobility and free-floating exchange rates changed the basic parameters of economic policy management and undermined the ability of governments to use Keynesian macroeconomic policies to address the economic problems of the 1970s and 1980s (Garrett and Lange, 1991; Boix, 2000). In particular, the failure of Keynesianism to fight stagflation handed the victory to neoliberalism, which became the dominant doctrine after the election of Margaret Thatcher and Ronald Reagan (e.g. Hall, 1993; Blyth, 2002).⁸ Subsequently, right-wing governments liberalised Western Europe's economies, while most social democratic parties were stuck in opposition. In the few countries where the centre-left was still in government, its leaders also felt compelled to change their economic policies. For example, Mitterand, the first socialist president in France, made a dramatic u-turn in economic policy in 1982, when he adopted 'austerity with a human face' (Hobsbawm, 1994, p. 411). Similarly, the social democrats in Sweden implemented austerity policies to fight the recession in 1989 and 1990, but they subsequently lost the election in 1991 (Pontusson, 1995). The 1980s thus ended the symbiosis between Keynesianism and social democratic parties (Scharpf, 1987, 1991).

Instead, the failure of traditional leftist policies led to a lot of soul-searching among social democratic parties. Facilitated by the collapse of the Soviet Union and the end of the Cold War, they moderated their economic positions and shifted towards the centre (Glyn, 2001; Callaghan, 2000). They stepped away from their Keynesian

⁸Neoliberalism is often used as a catch-all phrase that is primarily used by its opponents. I define neoliberalism here more narrowly by following Harvey (2005, p.2) who defined neoliberalism a 'theory of political economic practices that proposes that human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets and free trade.'

economic programmes and embraced deflationary policies. Arguing that globalisation and technological changes put pressure on the social democratic model, many social democrats adopted pro-market positions and distanced themselves from trade unions (Moschonas, 2002, p.253). Social democrats still pursued distinctive supply-side policies to further their traditional goals (Garrett and Lange, 1991; Boix, 2000), but they accepted that the basic parameters of economic policy-making had changed. This turn towards the centre was most pronounced in the UK and Germany under Tony Blair and Gerhard Schröder, respectively. Beginning in the mid-1990s, both adopted the so-called “Third Way” that abandoned traditional positions of the left and espoused liberal reforms to deregulate the economy (e.g. Lavelle, 2008; Pierson, 2001a). Consequently, a large literature found that there was a convergence of positions on economic policies, and thus, party politics mattered less for socio-economic policy-making (e.g. Mishra, 1999; Pierson, 1994, 2001a; Ross, 2000).

The official argument for the social democratic accommodation with economic liberalism referred to structural factors: accepting the deterministic character of globalisation, Blair and Schröder argued that supply-side reforms were necessary (Blair and Schröder, 1999; Giddens, 1998). However, the logic of electoral competition also pushed the left towards the centre in the 1990s because its traditional constituency, the working class, was shrinking. In fact, the working class had never been a numerical majority in any of the advanced capitalist economies and centre-left parties always had to build coalitions with other groups in society in order to win elections (Przeworski and Sprague, 1986; Esping-Andersen, 1985). Over time, this ‘dilemma of electoral socialism’ (Przeworski and Sprague, 1986, p. 55) only became more acute as structural changes reduced the size of the working class. The moderate left increasingly competed for the support of the middle classes (Kitschelt, 1994), and to this end, the centre-left responded in two ways: it adopted liberal positions on the ‘cultural’ dimension of political competition (largely in response to the rise of the New Left, which had raised the salience of ‘cultural’ issues like gay rights, gender equality, and immigration) and it struck a ‘Faustian bargain’ with economic liberalism, by embarking on the Third Way.

This Faustian bargain was successful in the 1990s and early 2000s when the stability of the Great Moderation allowed governments to pursue policies that were favourable to capital owners, while protecting the most vulnerable in society through the welfare state (Merkel et al., 2008).⁹ Volatility in the business cycles of advanced economies had become extremely low, as independent central banks used monetary policy to

⁹The Great Moderation refers to a period of remarkable economic stability in most advanced economies from the mid-1890s to 2007. At the time the reduction in the volatility of business cy-

steer their economies.¹⁰ Most (social democratic) governments in Europe relished in this situation. The relative economic prosperity guaranteed high revenues and easy access to financial markets, allowing them to finance high levels of government spending. Effectively, they were able to have their cake and eat it too: introducing liberal economic reforms, they simultaneously increased public spending in areas like health and education. Helped by the reluctance of the European Union (EU) to enforce the Excessive Deficit Procedure of the Stability and Growth Pact (SGP), government expenditures rose in many countries in the early 2000s.¹¹

In this context, social democratic parties experienced their second spring (as seen in Figure 1.1 from Chapter 1). At one point in the early 2000s, centre-left parties were in government in twelve out of fifteen countries of the EU. Still, the turn towards the centre alienated the traditional constituency of social democratic party: many blue-collar and lower white-collar employees abandoned social democratic parties (Arndt, 2013; Schwander and Manow, 2017). In particular, the dualisation of the work-force created a large group of outsiders (Rueda, 2005, 2007), who were unemployed or could only find employment in an increasing low-wage sector with little job security. At the same time, the alliance between labour unions and social democratic parties began to crumble (Piazza, 2001), and parties on the far left gained in popularity again. For example, in Germany disgruntled politicians and voters abandoned the SPD, boosting support for the successor of the East German communist party and facilitating the rise of a nation-wide ‘social populist party’ (March and Mudde, 2005; March, 2011). The bargain that the centre-left had struck with neo-liberalism at the beginning of the 21st century, therefore, also left it exposed when the economic crisis hit in 2008.

Existing explanations for social democratic austerity in the context of the Great Recession

In the beginning of the crisis, social democratic parties were still in government in some of the largest European economies, including Germany, Spain, or the UK. Like most economists, commentators, and political parties, they initially called for deci-

cles across the advanced economies was thought to be permanent but the 2008 financial crisis shattered this illusion.

¹⁰Gordon Brown (1999b) famously even declared that under the New Labour government Britain would ‘never return to the days of Tory boom [and] bust.’

¹¹The EU even relaxed the SGP in 2005, after Germany and France had been the first countries to breach the Maastricht criteria due to excessive deficits.

sive action to dampen the effects of the economic shock. Led by British prime minister Gordon Brown, there was concerted government action to avert another Great Depression (Drezner, 2014): governments across the world bailed out banks and resorted to emergency Keynesianism to fight the deflationary pressures in the global economy (e.g. Pontusson and Raess, 2012; Hall, 2013). Yet, when the financial crisis turned into a sovereign debt crisis in 2010, even social democratic parties accepted austerity as the only game in town, as outlined in chapter 1. Although there was some variation in the extent to which social democratic parties bought into the austerity settlement, most of them accepted the need to reduce public deficit and debt across Europe. This happened in 2010, when the economic crisis was far from over. Some countries returned to meagre growth in 2010, but the recovery was slow and output remained below its potential in most European economies. From a Keynesian perspective, therefore, it was far too early to engage in fiscal consolidation. Subsequently, all the pressure was on monetary policy to support demand in Europe and it was only due to massive interventions by Central Banks that aggregate demand did not fall even further in Europe.

To understand why social democratic parties still participated in this roller-coaster ride from emergency Keynesianism to austerity, the existing literature provides several starting point. These approaches focus on a range of different variables, including external constraints (stemming from globalised markets), institutional constraints (stemming from the EU and different growth models), economic ideas, and electoral strategies. However, as I argue below, none of the existing approaches is sufficient to explain why social democratic parties embraced austerity in response to the Great Recession.

First, some authors question the explanatory power of political parties for economic policy-making; rather, they focus on external constraints and the structural imperatives of the global economy. According to Katz and Mair (1995, 2009), parties have formed a political “cartel”, which is detached from voters. Their positions have converged because parties with an aspiration to govern are increasingly more “responsible” to external constraints and less “responsive” to their constituencies, which also leads to a ‘hollowing out of democracy’ (Mair, 2013).¹² Some authors, for instance, contend that the collapse of the Bretton Woods system and end of the post-War economic boom that accompanied the subsequent 1973 oil crisis effectively killed off social democracy by ruling out traditional Keynesian policy tools (Scharpf,

¹²The cartel party thesis takes the argument from the de-alignment thesis further. Dalton et al. (1984) already claimed that the durable linkages between voters and parties broke up during the 20th century and that issue-specific competition replaced partisan competition.

1991; Panitch and Leys, 2001, p. 107; Bailey, 2009, p. 606; Rogers, 2013, p. 8-9; Lavelle, 2008). Others point to the rise of globalised capital markets in the 1980s — which were seen to empower footloose capital and to punish inflationary economic policies — to explain the “death” of social democracy. Wolfgang Streeck (2014) has more recently updated this thesis, arguing that the secular trends of stagnating economic growth, shrinking tax revenues, and rising public debt have made sovereign governments increasingly vulnerable to the whim of financial market actors, who can impose strict austerity via the threat of capital flight.

The pessimistic conclusions of these authors, however, rest on the assumption that international (financial) markets are what Thomas Friedman (1999) has called a “golden straitjacket”. According to this view, the increasing mobility of capital made it more difficult for the state to regulate markets, while international competition undermined the welfare state. In line with the first wave of studies on the impact of globalization (McKenzie and Lee, 1991; Strange, 1996; Ohmae, 1995), the options for centre-left parties to implement their traditional policy programmes have become smaller over time. Yet, successive studies have shown that globalisation constrains states less than it is often assumed. National states are anything but irrelevant (Ruggie, 1993; Hirst and Thompson, 1996) and substantial differences in economic policies remain across countries (Huber and Powell, 1994). Arguably, with regards to macroeconomic policy the evidence is debatable: Garrett (1998a,b) and (Boix, 1998) show that domestic institutions have an important effect on macroeconomic policy, while Mosley (2000, 2003) argues that the impact of international capital markets holds with respect to fiscal and monetary policy. However, it is important to remember that ‘states are in fact agents of globalization’ (Barkawi, 2006, p. 168). In other words, globalization is contingent on the state system and states actively shape its process (Krasner, 1999; Gilpin, 2001). Consequently, policy-makers often use globalization as an excuse (Hay and Jo-Anne Smith, 2010), but its supposedly deterministic impact needs to be questioned.¹³

This is also true with regard to contemporary austerity in Europe. On the one hand, market pressures are not sufficient as an explanation for social democratic austerity. The centre-left did not only embrace austerity in countries that were embroiled in deep financial and economic crises; rather, the move to fiscal orthodoxy was much broader, encompassing countries and governments across the entire European continent. Even if social democrats in countries like Greece, Portugal, or Spain had little choice but to adopt “involuntary” austerity, other social democratic parties chose to

¹³Undoubtedly, this is also true for European integration, which Milward (1992) even views as an attempt to rescue the nation state.

adopt what can be called “voluntary austerity”.¹⁴ For example, social democratic parties in countries like the UK, the Netherlands, or Germany also supported fiscal consolidation, even though the pressures for austerity from markets were relatively weak or absent (see Chapter 3). Many of these countries were perceived as safe havens during the crisis and, as a result, interest rates on government debt in Europe’s major economies have plummeted. In these countries, governments were thus able to borrow cheaply, making austerity less and not more likely.

On the other hand, it is not even clear whether and why markets demand austerity in the first place. In the immediate aftermath of the financial crisis, governments across the advanced economies successfully used expansionary macroeconomic policies, thereby preventing a crisis on the scale of the Great Depression (Eichengreen, 2015b; Drezner, 2014). These policies were supported by market actors, demonstrating that globalisation had not made Keynesianism an implausible economic strategy.¹⁵ Moreover, in 2010, when the financial crisis became a fiscal crisis, market actors came to perceive the fiscal position of some European governments as fragile because the ECB’s role as lender of last resort was not guaranteed (De Grauwe, 2013; De Grauwe and Ji, 2013). They did not demand austerity as their policy of choice, but instead, they demanded a credible backstop that would safeguard their assets and investments in crisis-ridden countries.¹⁶ When ECB President Mario Draghi provided this backstop in 2012, promising to do “whatever it takes” to save the Euro, the financial pressure on Europe’s periphery ceded but austerity continued. Austerity was, therefore, more a political choice than an economic necessity, which begs the question how we can explain the austerity settlement politically.

A second explanation for social democratic austerity focuses on institutional constraints. These arguments are closely related to the previous approach, but they go beyond the imperatives of globalised markets as an explanation for economic policies. Generally, these explanations take two forms. First, some authors point to the institutional bias in European integration, which has reduced the policy instruments available to member states (Scharpf, 2011) and favoured fiscal consolidation (e.g. Hallerberg et al., 2007; Schmidt and Thatcher, 2013). Building on a large empirical

¹⁴Some social democratic parties even adopted austerity as their policy of choice, despite being in opposition. For example, in Italy the PD supported the technocratic government of Monti, which implemented harsh austerity measurements.

¹⁵In many countries, market actors even explicitly called on the government to adopt Keynesian strategies. For examples, see the case studies on the British Labour party and the Germany SPD in chapter 6 and 7, respectively.

¹⁶In a research note Rommerskirchen (2015, p. 845) also reviews the literature and finds that ‘the alleged preference of financial market participants for stricter fiscal rules is based on a handful of articles whose generalisability and validity can be questioned.’

and theoretical literature (e.g. von Hagen, 1992; von Hagen and Harden, 1996; von Hagen and Poterba, 1999; Debrun et al., 2008), this approach suggests that ‘the institutions governing the budget process are important determinants of a country’s fiscal performance’ (Hallerberg et al., 2007, p. 340). In the EU, these institutions were centralised in the early 1990s when member states signed the Stability and Growth Pact (Heipertz and Verdun, 2010). The pact enshrined rules for the national deficits and debt levels and specified sanctioning procedures, thereby reducing the ability of governments to pursue expansionary fiscal policies in bad times when GDP shrinks and the government’s revenues fall. Moreover, monetary integration in the Eurozone limits the government’s ability to use deficit-spending during economic crises. The ECB is beyond the control of national governments, who issue bonds in a currency that they do not control. As De Grauwe (2013, p. 520) argues, ‘they cannot guarantee to the bondholders that they will always have the necessary liquidity to pay out the bond at maturity.’ Instead, national governments have to rely on the ECB as a lender of last resort to prevent self-fulfilling fears of liquidity crises. In the absence of an explicit guarantee that the ECB will play this role, governments in a monetary union had to limit their the government deficits.

Second, other authors have argued that different countries have different “varieties of capitalism” (VoC) (Hall and Soskice, 2001) or “growth models” (Baccaro and Pontusson, 2016), which limits the macroeconomic policies that countries can pursue. Initially, the VoC literature paid little attention to macroeconomic policies, but Soskice (2007) argued that liberal market economies (LMEs) manage aggregate demand more flexibly than coordinated market economies (CMEs) due to powerful complementarities in different economic systems (also see Carlin and Soskice, 2009; Amable and Azizi, 2014). For example, CMEs rely less on discretionary macroeconomic policies than LMEs because stronger welfare states and employment protection (as well as other institutional characteristics) act as automatic stabilisers. Instead, for CMEs rule-based macroeconomic policies facilitate wage bargaining between social partners, signalling to trade unions that demands for excessive wage hikes would not be accommodated. Similarly, the growth-model perspective assumes that there are strong imperatives for distinct economic policies in different countries. According to Baccaro and Pontusson (2016), several distinct growth-models developed in the post-Fordist area, in which different components of aggregate demand are the drivers of growth. Following the imperatives of these growth-models, there is little room for partisan politics when there is a clear driver of growth: when growth is consumption-led (e.g. in the UK) governments stimulate domestic consumption, whereas they pur-

sue restrictive macroeconomic policies to boost their competitiveness when growth is export-led (e.g. in Germany).

However, these approaches are again not sufficient to explain the dominance of austerity among the centre-left in Europe's post-crisis political economy. Austerity became the dominant policy in countries where the constraints from European integration were relatively weak or absent. Even if the conditions of bailout agreements necessitated austerity in countries such as Greece, the same cannot be said about countries like the UK, France, or Germany. For example, the UK has its own currency and central bank and is not subject to the rules of the Eurozone in the same way that other members are. Still, the British Labour party embraced fiscal orthodoxy in the wake of the economic crisis (see Chapter 6). Although the British government committed itself to fiscal austerity programme similar to that of some debtor countries in 2010, the Labour party did not openly describe itself as anti-austerity until the election of Jeremy Corbyn as the leader of the Labour party in 2015. Moreover, even in large countries inside the Eurozone, which should be less susceptible to pressures from Brussels, social democratic parties accepted austerity, including the SPD in Germany (see Chapter 7) or the *Parti Socialiste* (PS) in France. As mentioned above, these countries had already broken the Maastricht criteria in the mid-2000s without serious consequences, and it remains unclear why constraints from European integration should have been more binding during the recent economic crisis (when expansionary fiscal policies could have been more easily justified). Moreover, austerity was also implemented in countries with different growth models and varieties of capitalism, ranging from consumption-oriented to export-oriented countries or LMEs to CMEs. Importantly, in many of these countries the social partners – which are assumed to be the main actors in both accounts – did not rally behind austerity as the dominant economic policy. Instead, trade unions were often more strongly opposed to austerity policies than social democratic parties, and in some instances even businesses protested against fiscal consolidation as the dogma of the day (see Chapter 7 on Germany). This cannot be explained by accounts that exclusively focus on institutional constraints.

Third, a large number of scholars turned towards the importance of ideas to explain the dominance of austerity in the context of the Great Recession.¹⁷ These approaches are especially important because the constructivist literature already demonstrated the salience of how crises themselves come to be understood for the nature of the political struggle thereafter (see Blyth, 2002; Widmaier et al., 2007; Gamble, 2009;

¹⁷The next few paragraphs largely draw on a paper jointly written with Sean McDaniel entitled 'The Ideational Foundations of Social Democratic Austerity' published in the *Socio-Economic Review*.

Hay, 2016). The subjective and inter-subjective ideas held by actors about their environment are integral to the process of how these actors make sense of the world around them and the nature of the crisis environment that confronts them (Hay, 2016, p. 525). They create windows of opportunity, during which ideas can trump vested interests and existing institutions, and act as ‘switch-men of history’ according to in Max Weber (1946, p. 280) words. In other words, crises create the perfect pre-conditions for paradigm change, as outlined by Hall (1993). During these favourable moments ideas serve as explanations of ‘what went wrong, and how to fix it’ (Blyth, 2002, p. 32) and, hence, they decisively shape the response to any crisis (Hall, 1993; Berman, 1998; Matthijs, 2011).

Attendant to this, the role that ideas play in shaping particular policy outcomes has already been well established in relation to austerity policies since 2010 (e.g. Blyth, 2013; Dellepiane-Avellaneda, 2015; Baker, 2015; Ban, 2016; Carstensen and Matthijs, 2018; Blyth and Matthijs, 2017). Many of these authors have demonstrated that the concept of austerity is underpinned by a range of normative and economic ideas about the appropriate role of the state vis-à-vis markets and households (Blyth, 2013; Gamble, 2013a). The choices that governments make when conducting fiscal adjustment (e.g. to cut funding for public libraries or increase income taxes) are the product of ideational legacies which shape our understandings of what is both appropriate and necessary (Schmidt, 2002; Finseraas and Vernby, 2011, p. 210). Consequently, this perspective provides another possible explanation for austerity from the left. In perhaps the best-known account of post-crisis austerity, Blyth (2013, see ch. 5) artfully traces a range of ideational developments on both sides of the Atlantic. For Blyth, German ordoliberalism has acted as the ‘basic design template’ for contemporary austerity, with these ideas flourishing upon their interaction with the neoliberal tenets of monetarism and public choice theory and, in the post-crisis period, the “expansionary fiscal consolidation” thesis, which gained enormous traction within key governance institutions from 2010. Importantly, Blyth’s account demonstrates the way in which various political economic ideas come to be co-opted and re-purposed over time and space. However, whilst Blyth (2013, p. 133) makes us fully aware of different historical “variants” of austerity, his account leads us toward a singular conception of post-crisis austerity as a “cocktail” of ideas and (quite understandably) devotes less space to an interrogation of the way in which various political actors have utilised different ideas to legitimise their programmes since 2010.

The wider literature tends to present the contemporary austerity settlement in Europe as either “neat” neoliberalism or ordoliberalism. Those who argue that aus-

terity is rooted in neoliberalism demonstrate the importance of neoliberal economic ideas, including the ‘crowding out’ effect of government borrowing on both business and household spending (Barro, 1974) and the ‘expansionary’ effect of fiscal consolidation (see Giavazzi and Pagano, 1990; Alesina and Ardagna, 1998), in shaping contemporary austerity (Peters, 2012; Mirowski, 2013; Schmidt and Thatcher, 2013; Dellepiane-Avellaneda, 2015; Helgadóttir, 2016; Carstensen and Matthijs, 2018). Similarly, other accounts uncover the powerful role played by ordoliberal liberal ideas in shaping contemporary austerity.¹⁸ Ordoliberal notions of “sound money”, a rule-based approach to economics and the “moral hazard” associated with debt are often used to explain the austerity settlement in Europe’s post-crisis political economy (Berghahn and Young, 2013; Young, 2014; Matthijs and McNamara, 2015; Nedergaard and Snaith, 2015; Matthijs, 2016; Woodruff, 2016). For instance, an ordoliberal rule-based approach to economics was an essential part of the construction of the German debt brake in 2009 (Woodruff, 2016, p. 98) and the European Fiscal Compact (Nedergaard and Snaith, 2015, p. 1102).

I do not contest that such ideas have fed into the post-crisis politics of austerity (for an overview, see Konzelmann, 2014), but there are three key and overlapping limitations with this literature. First, post-crisis austerity is almost always discussed in the singular form, with its intellectual roots in either neoliberal or ordoliberal ideas, or a fusion of the two. This creates a confusion within the literature; like the proverbial blind men and the elephant, each component of the literature produces a distinct account of austerity whilst seeking to describe the same phenomenon. Second, the constructivist perspective is problematic because it cannot effectively explain why austerity has not been challenged by alternative ideas in Western Europe. Constructivists implicitly invoke a Gramscian notion of ‘cultural hegemony’ (Gramsci, 1992) in order to explain this outcome. Yet, in the 21st century ideas cannot easily be domesticated by national borders and, given that alternative ideas exist outside of Europe, it is not very clear why austerity remained such a powerful idea in Europe. For example, Japan has pursued an alternative economic policy under Prime Minister Abe and in the United States, Keynesian macroeconomic ideas also remain popular. Even the IMF began to question austerity as a doctrine during the crisis (see Clift, 2018). For example, then IMF Chief Economist Olivier (Blanchard, 2012) admitted that fiscal consolidation ‘is clearly a drag on demand, it is a drag on growth’. In 2013, Blanchard went further and conceded that forecasters had significantly underestimated the

¹⁸Little discussed in the pre-crisis period, ordoliberalism can be defined as a variant of liberalism, which ‘asserts the authority of the state as the political master of the free economy’ (Bonefeld, 2012, p. 641). In other words, contrary to neoliberalism, it argues that ‘full competition requires strong state authority to assure the orderly conduct of self-interested entrepreneurs’ (Bonefeld, 2012, p. 638).

multiplier effect and, therefore, ‘underestimated the increase in unemployment and the decline in private consumption and investment associated with fiscal consolidation’ (Blanchard and Leigh, 2013, p. 5). Why have had these ideas so little influence in Europe? Third, in focusing on neo- and/or ordoliberal ideas, the existing literature potentially delimits our current understanding of why social democratic parties embraced austerity. Historically, social democratic parties were neither associated with neo- nor ordoliberalism, yet as noted already, parties and governments of the left also supported fiscal consolidation policies prior (Armingeon et al., 2016; Kraft, 2017) and during the crisis (see Chapter 3). Unless our conception of social democratic austerity boils down to suggesting that such actors have merely accepted a neo- or ordoliberal economic outlook entirely, it is clear that social democratic austerity has hitherto been under-theorised. In other words, the literature fails to recognise the potentially differential internal legitimisation of post-crisis austerity policies among social democrats, and in doing so, misses out on understanding how and why austerity has become part of the mainstream policy settlement¹⁹

Finally, a possible explanation for the failure of social democratic parties to challenge austerity focuses on the demand-side and invokes a bottom-up conceptualisation of politics. This conceptualisation is valuable because parties are accountable to the electorate and their support for policies depends on how they project the effect of these policies on their electoral success. Therefore, Beramendi et al. (2015) have called for an “electoral turn” in political economy, which takes voters’ preferences and public opinion seriously. A growing literature on the welfare state has already done this and shows that the constituency of social democratic parties has become more heterogeneous in the last few decades. In particular, the literature puts forward two explanations for the changing behaviour of parties (see Häusermann et al., 2013): either parties mobilize different social groups or, if parties mobilize the same social groups, the preferences of these groups have changed.²⁰ For example, Kitschelt (1994) and Gingrich and Häusermann (2015) point out that social democratic parties increasingly represent middle-class voters instead of the working class, whereas Rueda (2005, 2007) argues that the dualisation of the working class into insiders and outsiders has changed the preferences of the working class.²¹

¹⁹A large literature, however, makes exactly this assumption by arguing that there was a neoliberal convergence among mainstream parties, which only had marginally differentiated policy positions (e.g. Mishra, 1999; Glyn, 2001).

²⁰This is caused, for example, by large-scale structural transformations like tertiarisation, educational expansion, and female employment growth.

²¹The distinction between insiders and outsiders refers to the employment vulnerability of different workers. Please see Rueda (2007 ch.2) for a detailed explanation.

A new ‘integration-demarcation’ cleavage that emerged as a consequence of globalisation further complicates the aggregation of preferences that political parties need to represent (Kitschelt, 1994; Kriesi et al., 2008, 2012). In the last few decades, radical right-wing parties have increasingly mobilized the losers of globalization, which led to a resurgence of nationalism and transformed established party systems in Western Europe. Parties, therefore, do not only respond to the material interests of their voters, but they also respond to their cultural values (Häusermann and Kriesi, 2015). Social democratic parties are especially struggling to position themselves in response to this process of realignment because their constituency consists of an alliance between the socio-cultural professionals and the traditional working class (Beramendi et al., 2015): while the former are liberal and embrace universalistic values, the latter often have particularistic or authoritarian values (Lipset, 1959).

Unfortunately, the strength of the demand-side literature is also its greatest weakness: it offers a clearer picture of the micro-foundations of party policies, but mostly ignores macroeconomics and lacks an awareness for economic context. For example, it is striking that in the recent volume by Beramendi et al. (2015) there is neither much discussion about macroeconomic policies nor about the Great Recession. Thus, it still remains unclear whether macroeconomic policies are also determined bottom-up by the preferences of voters, and in the wake of the deepest economic crisis since the Great Depression this should be changed. The macroeconomic policies prior to the crisis did not only contribute to its outbreak (Adam and Vines, 2009; Bean, 2010; Blanchard et al., 2010), but the responses to the crisis have also had a dramatic impact. Given that economic crises heighten economic grievances, they also intensify the political competition about macroeconomic policies. Consequently, it is necessary to consider whether and how demand-side explanations apply to macroeconomic policies.

A new explanation for social democratic austerity

My explanation of social democratic austerity is based on the premise that we need to take politics seriously. As the English Prime Minister William E. Gladstone allegedly said, ‘budgets are not merely a matter of arithmetic, but in a thousand ways go to the root of prosperity of individuals and relations of classes, and the strength of kingdoms.’ In other words, fiscal policies are not only a matter of economic necessities, but they are at the heart of politics themselves. In the words of (Gourevitch, 1986,

p. 19), ‘to understand policy choices... we must understand the politics that produces them.’

This is especially true in the context of the Great Recession, which was the deepest economic crisis since the Great Depression. It was triggered by a crisis in the sub-prime mortgage market in the US, but it quickly spread across the globe to become a major economic recession. It presented policy-makers with enormous challenges on multiple fronts. They were scrambling to hold the financial system together as some of the largest international banks were pushed towards the brink of bankruptcy, while also trying to prevent an economic crisis on the scale of the Great Depression. In the face of paramount uncertainty, policy-makers were expecting the worst and, at least in Europe, this feeling persisted well beyond 2008. As the Eurozone crisis pushed entire countries to the brink of bankruptcy, Europe remained in a perpetual state of upheaval, and many observers questioned the viability of the common European currency.

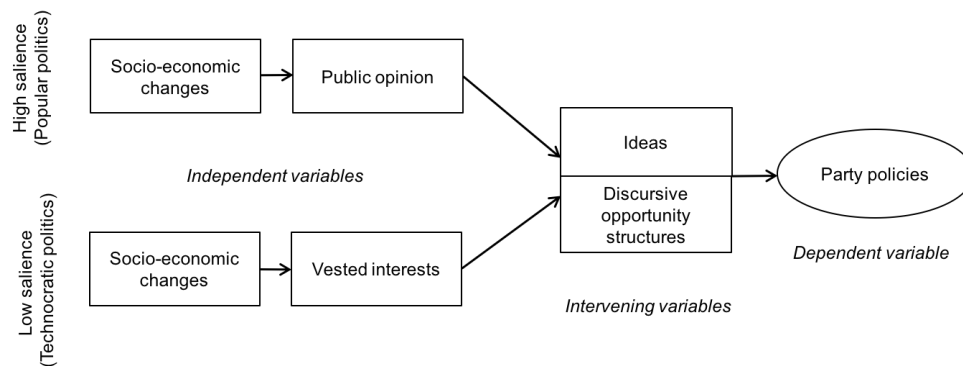
In the context of such monumental crises, politics is extremely important to explain policy (Gourevitch, 1986). They are moments of flux, providing freedom to policy-makers. By creating heightened uncertainty and compressing time horizons, crises provoke actors to shed previous commitments and seek new solutions (Kahler and Lake, 2013, p. 10). They pit interests and coalitions against each other and as actors are forced to make decisions that lie outside the normal pattern of politics, agency and contingency comes to the fore (Capoccia and Kelemen, 2007). Therefore, we need to understand the political conflicts behind austerity.

The electoral foundations of social democratic austerity

Taking politics seriously, my theoretical framework attempts to bring the ‘electoral turn’ to the literature on macroeconomic policies. Traditionally, political economy focuses on the interests and ideas of elites and largely ignores public opinion. However, during economic crises this approach is not tenable because ‘mass politics trumps interest group politics when both come into play’ (Hooghe and Marks, 2009). Supply-side explanations might explain politics on non-salient issues, which are in the realm of quiet (Culpepper, 2011) or technocratic politics. Yet, the demand-side becomes important for salient issues, which are in the zone of loud or electoral politics. In this case, policy choices are made by politicians and ‘when politicians make choices,... their choices are constrained by the need to mobilize or retain support’ (Gourevitch, 1986, p. 19). This is particularly true for fiscal policies, which are

less insulated from party politics than other economic policies, including monetary policy or financial regulation;²² they have large distributional consequences, they are very visible, and they receive a lot media attention. Especially during economic crises, fiscal policies are highly salient and firmly lie in the realm of popular politics, as shown in Figure 2.1. Therefore, the supply of fiscal policies is not independent of the demand: while politicians have the ability to shape and influence public opinion, they are also servant to it. In other words, ‘the freedom of politicians is circumscribed by their need to construct support coalitions’ (Gourevitch, 1986, p. 239).

Figure 2.1: Theoretical framework



Still, in recent decades political economists paid little attention to the role of electoral politics for explaining both macroeconomic policies and social democratic policy preferences. With regard to the latter, Kitschelt (1999, p. 318) already criticised this fact eloquently when he argued that

political economists typically assume that social democratic policy preferences are exogenous and stable so that economic policy variance among social democratic governments depends entirely on the political web of interest intermediation and state capabilities in conjunction with economic conditions. Political economists rarely, however, consider varying social democratic policy objectives in the context of changing conditions of electoral competition that derive from new voter demands and strategic stances of their competitors and are mediated by intra-party coalitions.

²²As Culpepper (2011) shows, we can expect interest groups as well as other elites to have a greater influence in these realms.

This observation largely remains true today as there is still an absence of electoral considerations in the analysis of macroeconomic policies. This absence is striking because, as Vlandas (2018, p. 515) points out, it ‘is at odds with the prominent role attributed in other political economy literature.’ For example, a large amount of research on labour market policies (e.g. Boix, 1998; Rueda, 2007) and the welfare state (e.g. Pierson, 1996; Häusermann, 2010; Rehm, 2016) show that individual preferences matter for policy choices. In general, this literature has suggested two different models that consider how parties connect with the electorate.

First, some research suggests that parties represent the economic interests of their constituencies. From this perspective, parties are embedded in a broader, social context: they developed out of social divisions and remain linked to organised interests such as unions. In this model, parties have commitments to specific constituencies that they aim to represent. For example, Hibbs (1977) already argued that political parties implement different macroeconomic policies because their respective constituencies have different economic interests: while left-wing parties represent people with insecure jobs and low savings, right-wing parties represent parties with more secure jobs and higher saving. Therefore, left-wing parties support and implement policies that lead to lower unemployment at the cost of higher inflation than right-wing parties. Similarly, according to Boix (1998, p. 203), ‘economic policies respond to the material interests of each party’s main electoral constituencies.’ He argued that the possibilities for Keynesian demand-management had been tightly constrained by globalisation, but he found that political parties implement different supply-side policies according to the interests of their electorate: ‘in the first place, all political parties prefer policies that maximize growth... in the second place, parties adopt distinctive economic strategies depending on their redistributive consequences’ (Boix, 1997, p. 816).

Second, other research suggests that parties compete for the median voter and strategically adjust their positions in response to shifts in public opinion. According to the theory articulated by Anthony Downs (1957), the party closest to the median voter will win a majority in single-member districts. This creates incentives for parties to compete for the median voter, i.e. to adopt and implement policies that are in line with the preferences of the median voter (Huber and Powell, 1994; Cox, 1997, ch. 12). In electoral systems with proportional representation (PR), the party closest to the median voter will not automatically win a majority, but the so-called median legislative party, i.e. the party closest to the position of the median voter, is expected to be pivotal in the process of government formation. It is usually included in the

governing coalition and thus office-seeking parties also have an interest to compete for the median voter in PR systems.

Independently, whether parties respond to their constituents or the median voter, there is an increasing literature which shows that parties respond to public opinion (Soroka and Wlezien, 2010; Brooks and Manza, 2007). As Robert Dahl (1989, p. 95) put it, in democratic systems ‘a majority of citizens can induce the government to do what they most want it to do and to avoid doing what they most want it not to do.’ Parties are accountable to the electorate, and therefore, they ‘stay closed attuned to the eb and flow of public opinion’ (Wlezien and Soroka, 2007, p. 805). This is especially important when one tries to explain the positions that parties take, as opposed to the policies that they actually implement once they are in office: as parties compete in elections, they either adopt vote or office-seeking strategies, carefully crafting their programmes with reference to electoral considerations (Erikson et al., 2002; Page and Shapiro, 1983). Especially in the last few decades as polling techniques have become cheaper and more sophisticated, parties and politicians have increasingly relied on them to get a sense of public opinion.

This is also true for social democratic parties. They were born from the reformist aspirations of the working class. In other words, social democrats attempted to win office to reform capitalism in the interest of the working class (Przeworski and Sprague, 1986; Esping-Andersen, 1985, p. 26), and contemporary social democratic parties still act very much in line with this tradition. After the end of the cold war, many social democrats accepted capitalism as hegemonic and bought into the argument by Fukuyama (1992) who proclaimed the ‘End of History’. During the Third Way era, they did not challenge the underlying faith in free markets and bought into the assumption that markets would be the primary instrument for achieving their own objectives. In the absence of a debate about the role that markets should play in society, Third Way social democrats adopted a technocratic and managerial approach to politics, valuing office as a means to reform free market capitalism. Put differently, there was a deep underlying commitment to “instrumental politics” among most social democratic parties, i.e. the idea that elections are a means to win power.

I assume that most contemporary social democrats are still influenced by this tradition, i.e. that they behave as office-seekers. And to win office, social democrats have to win votes, which requires them to closely follow public opinion. To explain social democratic austerity it is, therefore, necessary to focus on the strategic choices that party leaders faced in the context of the Great Recession. In other words, we have to explore the interdependence between political economy and electoral poli-

tics (Kitschelt, 1999, p. 318), analysing how party leaders cope with the changing demands from voters. However, this begs the question how the voters' demands can explain austerity? Based on the two dominant approaches in the literature there are two possible explanations.²³

First, there is evidence that the median voter is fiscally conservative (see Chapter 4). Many voters falsely equate the public household to the private household and thus buy into the law of "folk economics" (Rubin, 2003) that governments should not run budget deficits. Adam Smith (1776, Book IV, Chapter II, pp. 456-7) already expressed this idea, when he argued that 'what is prudence in the conduct of every private family can scarce be folly in that of a great kingdom.' Based on the voters' experience of balancing their private budget, orthodox fiscal ideas thus resonate more with the public than Keynesianism. The latter is very difficult to explain to voters because it relies on complex economic ideas like the 'paradox of thrift' or fiscal multipliers. Moreover, Keynesianism relies on a faith in the legitimacy and the efficacy of the state, which has been increasingly undermined in recent decades. Therefore, a large amount of voters are fiscal conservatives independent of their material interests.

Arguably, this was especially the case in recent years. After governments implemented large bank bailouts and stimulus packages that emptied the states' coffers in the wake of the financial crisis, the Greek sovereign debt crisis demonstrated the danger of too much government debt. In this context, voters became increasingly concerned about their country's public debt. The public budget developed a symbolic importance, as voters lacked the competence to make a comprehensive assessment of the economic consequences associated with different fiscal policies. As Skidelsky (1970) already observed with reference to the Great Depression, 'we must not neglect the special symbolic importance of the balanced budget as a sign of "sound" financial policy. There must always be some criteria by which to judge whether a policy is likely to be acceptable or not, and the balanced budget was just such a "rule of thumb".'

This was also true during the Great Recession and social democratic parties, therefore, had an interest to support austerity in order to appear electable and fit to govern. The Third Way was based on the fundamental belief that the electoral road to power leads through the centre, a strategy that many social democrats had internalised prior to the Great Recession. In the context of the European sovereign debt crisis, this

²³To a certain extent these hypotheses are competing, but they can also be incorporated into a joint framework.

came to the fore as the centre-left adopted fiscal consolidation as a office-seeking strategy: to appear electable and increase their economic credibility, they supported austerity (Kraft, 2017). They attempted to extend their electoral coalition by moving closer to the pivotal voter and thus bought into popular discursive elements based on the household analogy.

Such strategic concerns were particularly important true in countries where social democratic parties had been in government when the financial crisis hit in 2008. In these countries, the recession shattered the economic credibility of social democrats, and when the financial crisis turned into a fiscal crisis of the state, they attempted to regain this credibility by supporting fiscal consolidation.²⁴ Failure to balance the public budget and to reduce the level of government debt was seen as a matter of incompetence and thus the government's budget became a valence issue (Stokes, 1963).²⁵ This is the first electoral explanation for social democratic austerity.

A second possible explanation goes beyond the median voter and considers the interests of social democratic constituents more specifically. This explanation emphasises that social democratic parties did not simply chase the median voter to gain fiscal credibility, but that they faced significant pressures to support fiscal consolidation even from their own constituency. Originally, social democratic parties emerged from the working class movement but in the last few decades social democrats had to manage a variety of electoral constituencies (Kitschelt, 1994, p. 33). Contrary to the expectations of Marx, the industrial working class never became a majority in advanced economies. Hobsbawm (1979, p. 279) already became wrote in the 1970s that 'the forward march of labour and the labour movement, which Marx predicted, appears to have come to a halt.' This problem confronted social democratic parties with the need to build electoral alliances; 'with the support of workers alone or of the people in general, electoral majorities turned out to be an elusive goal' (Przeworski and Sprague, 1986, p. 4).

The imperative of cross-class cooperation, which was already recognised by the ideological founding fathers of social democracy like Eduard Bernstein, had important consequences consequences for the programmatic choices of social democratic parties. As Przeworski and Sprague (1986, p. 3) argued, 'given the minority status of workers, leaders of class-based parties must choose between a party homogeneous in

²⁴As the economic voting literature predicts (e.g. Duch and Stevenson, 2008; Lewis-Beck and Stegmaier, 2000), social democrats were punished for the state of the economy in many countries following the 2008 financial crisis.

²⁵This was very much in line with Labour's fiscal discipline during the Third Way, which can also be seen as an attempt to increase Labour's fiscal credibility (Clift and Tomlinson, 2007).

its class appeal but sentenced to perpetual electoral defeats or a party that struggles for electoral success at the cost of diluting its class orientation.’ Office-seeking social democrats followed the latter strategy: they attempted to maximize the interest of their core clientèle within a system of competitive elections. To this end, social democratic parties cobbled together an alliance between working and middle class voters in the post-war era.

The alliance between the working and the middle classes, however, has been crumbling for decades. Not only have these groups different attitudes towards questions that fall on the second-dimension of political conflict in Europe (Kitschelt, 1994), but their socio-economic experiences have also diverged: while many middle class voters have benefited from large-scale transformative processes like globalisation, de-industrialisation, and digitalisation, the working class has suffered from them. Moreover, these large-scale structural transformations created more heterogeneity in the electorate. It reduced the size of the working class and divided the remaining (working) classes into sections with diverging interests (e.g. Rueda, 2005, 2007).

These changes had a dramatic impact on most social democratic parties. Esping-Andersen (1985, p. xiv) already argued in the mid-1980s that ‘the new salaried white-collar strata hold the key to any viable social democratic alliance’ (Esping-Andersen, 1985, p. xiv), while Kitschelt (1994, p. 6) argued a decade later that ‘social democrats are no longer primarily the political agents of blue collar worker, but forge socio-economic coalitions that include different segments of the labour market.’ These predictions have largely been confirmed over time. Social democratic parties increasingly shifted their electoral platform and have primarily sought support from the expanded middle-classes (Gingrich and Häusermann, 2015; Amable et al., 2012; Piketty, 2018).²⁶

The shifts in the electoral constituency of social democratic parties also have important consequences for the strategic choices that social democratic parties face. Working class voters and the expanded middle classes may have similar attitudes towards redistribution (Häusermann and Kriesi, 2015), but they have diverging interests with regards to macroeconomic policies. Lowering inflation and increasing unemployment hurts groups in vulnerable labour market positions but, as Kalecki (1943, 1971) already argued, there is a strong political opposition against full employment poli-

²⁶Different authors have used slightly different terminology to make this argument: Gingrich and Häusermann (2015) found that social-cultural professionals have become the core clientèle of social democratic parties; Amable et al. (2012) argue that social social democratic parties are now supported by a ‘bourgeois bloc’ (also see Amable and Palombarini, 2014) and (Piketty, 2018) showed that highly educated voters are now the key constituency for social democratic parties.

cies. Importantly, the preferences of social-cultural professionals as well as the upper part of the working class have become influenced by their increasing ownership of capital in the last few decades. In the past few decades, the notion of increasing one's income and wealth by investing has been tempting not only for the upper classes in recent years (Mau, 2015). Considering all assets and pension entitlements as a source of lifetime income, these groups tend to be creditors who have a stake in the financial system (if their wealth is privately invested) or in the public social security system (if their wealth depends on public pension schemes).

This is important because it can be shown that capital owners have different preferences towards range of different economic policies (Ansell, 2014; Bremer and Winkler, 2016; Pagliari et al., 2018). The life-time income of these individuals partly depends on their investments, which face different income risks than those traditionally associated with labour market income. Given that the value of assets is strongly influenced by monetary and fiscal policies, assets owners also have different preferences towards these policies. Creditors may support government intervention in response to a financial crisis in the short-term, but they should also support fiscal consolidation in the long-term. They fear that their life income is at risk when governments implement expansionary fiscal policies that create inflation and decrease the real value of their investments. Therefore, asset ownership moves the middle-class voter towards support for fiscal consolidation, which also influences social democratic parties: as they have increasingly become middle-class parties, they are also 'creditor parties'. They act in the interest of creditors and become more supportive of austerity even if that comes at the cost of their traditional constituency.

Finally, the interests of the sub-constituencies of social democratic parties have further diverged due to different interests with regards to nature of government expenditure. Welfare states have increasingly become complex entities and a dichotomous choice about more versus less welfare spending does not exist anymore. Instead, the key choice for governments to make is between social investment and social consumption: whether to 'empower people to earn a living in the labour market' or whether to 'help individuals to cope with the loss of income' (Beramendi et al., 2015, p.8). The working class is generally in favour of the latter, including social benefits and pensions. In contrast, the expanded middle class is in favour of social investment policies that include education, active-labour market policy, or family policies.²⁷ The problem for social democratic parties is that the benefits of supply-side investment

²⁷The logic of these policies is closely tied to the Third Way: accepting the commodification of labour, they are supposed to invest in the capacities of individuals to compete in the market (Beramendi et al., 2015; Morel et al., 2012).

policies occur in the long-run, but the working class voters need consumption in the short-run. Middle class voters, however, do not want to pay for both and thus they are less attached to the traditional welfare states that social democratic parties helped to build in the 20th century.

In sum, there are two different mechanisms through which electoral forces can explain social democratic austerity. Given that social democratic parties, however, have increasingly appealed to the extended middle-classes in the last few decades, these two explanations are not mutually exclusive. Although left and centre-left voters are still less likely to have fiscally conservative views than supporters of conservative or liberal parties, their preferences are closer to the median voter. Independently of whether social democratic parties follow the preferences of their constituency or the median voter, they therefore faced strong *electoral pressures* to support austerity.

The ideational foundations of social democratic austerity

The electoral pressures for social democrats to pursue an orthodox budgetary policy were pervasive during the Great Recession, which created a difficult situation for them: although a majority of voters demanded fiscal consolidation, accepting this position threatened to undermine social democracy's historic support for the welfare state. However, parties and politicians are not only rational vote and office-seeking actors, but they can also influence the preferences of voters. In other words, the political demands of voters cannot be conceived separately from the supply-side of politics. Parties give 'coherence and organized political expression to what otherwise are inchoate and fragmentary beliefs, values and experiences among members of social groups' (Kriesi, 1998, p. 167). This begs the question, why social democratic parties did not attempt to change public opinion in their favour?

To explain the reluctance of social democratic parties to oppose public opinion, it is also necessary to understand the *ideational pressures* for social democratic austerity.²⁸ To cite Gourevitch (1986, p. 233) again, 'economic reality is rarely so clear that objective circumstances impose themselves on behaviour with no mediation from ideas.' Ideas are marshalled to interpret the world and they provide a framework for political action. And for macroeconomic policy-makers, the ideas of economists are particularly important. As Farrell and Quiggin (2017, p. 270) observe, 'policy ac-

²⁸This section largely draws on the theoretical section from a paper jointly written with Sean McDaniel entitled 'The Ideational Foundations of Social Democratic Austerity'.

tors care about the advice of professional economists because it helps them deal with specific policy problems, and because expert approval casts luster on their own efforts, providing them with an important resource in battles with other policy-makers.’ They give legitimacy to policies (e.g. Finnemore and Sikkink, 1998; Haas, 1992), facilitate coalition-building (e.g. Blyth, 2002), and allow political groups to articulate their demands.

For social democratic parties, these ideas were a combination of New Keynesianism, supply-side economics, and the social investment paradigm, which I collectively call “supply-side Keynesianism”. In combination with normative ideas relating to the state and inequality, these economic ideas shaped the way in which social democratic parties engaged with austerity and helped them to internally legitimise these policies. To recognise this, one has to go back to the 1970s. As argued above, following the Second World War, Keynesianism provided a strong intellectual basis for social democratic parties. It demonstrated how the interest of the working classes could be accommodated in a free market economy by showing that private ownership of the means of production could be reconciled with the democratic management of the economy (Przeworski, 1985; Hall, 1989, p. 207). Social democratic parties prospered as managed capitalism generated the economic growth and prosperity used to build the welfare state (Korpi, 1983; Stephens, 1979). Yet, repeated economic crises and the occurrence of stagflation in the 1970s challenged the economic paradigm that combined Keynesian demand management and welfare state expansion with capitalism. This environment provided space for monetarism and new classical economics, embraced by the conservative governments of Margaret Thatcher and Ronald Reagan, to become dominant, ushering in a new economic era that presented a major challenge to the centre-left (Hall, 1989; Blyth, 2002; Matthijs, 2011).²⁹

Beginning in the 1980s, however, economists such as Olivier Blanchard, Ben Bernanke, Greg Mankiw, and Paul Romer began to integrate Keynesian macroeconomic theory with the microeconomic models used by the neo-classical economists. Although they accepted the core of the influential Lucas critique (Lucas, 1976) – conceding that economic agents are rational – they introduced nominal rigidities in their models, i.e. the idea that prices are staggered or sticky and only adjust slowly or periodically (e.g. Taylor, 1979; Calvo, 1983). This fusion of the major macroeconomic schools of thoughts allowed New Keynesians to show that output gaps can exist in the short-run even when assuming that all economic agents are rational. Although output was

²⁹In this environment, European social democratic governments, including the Labour government under Callaghan in the UK and Mitterand’s Socialist administration in France, also stepped away from their Keynesian economic programmes and embraced deflationary policies.

efficient in the long-run, this provided a much-needed justification for policy-makers to stabilise the economy in the short-run. Yet, given that the long-run equilibrium is unaffected by demand forces in the New Keynesian framework, it was necessary to turn to supply-side arguments which emphasise that growth is determined by supply-factors such as labour productivity and labour and product market institutions. While conservative supply-side economists in the US had originally used this idea to argue for lower taxes and less state intervention, left-leaning economists now argued that state investment in human and physical capital was crucial to determine long-run growth and increase productivity. This claim was formalised through the work of Paul Romer (1994) on endogenous or ‘new growth theory’.

In combination, New Keynesianism and new growth theory – which I collectively call ‘supply-side Keynesianism’ – provided social democrats with a novel but powerful rationale for state intervention in order to improve market outcomes.³⁰ Scharpf (1991, p. 270) had originally argued that ‘the hour of supply-side policies has always been the hour of employers and conservative parties,’ but social democrats also began to champion supply-side policies in the late 1980s and 1990s (Boix, 1998; Garrett and Lange, 1991). Accepting the dominance of the market as the fundamental mechanism of economic allocation, there was an increasing belief among social democrats that they could neither spend their way to growth nor to equality. Social democrats, therefore, began to ‘search search for a “virtuous circle” in which higher productivity continued to attract private capital but allows for higher wages and for higher taxes, which are then employed to sustain and increase domestic productivity’ (Boix, 1998, p. 30).

Social democrats across the world latched onto this search because it allowed them to redefine the purpose of state intervention. In the face of recurring economic crises in the 1970s and the 1980s, many had come to believe that the left could not just discern itself with redistributing the proceeds from economic growth any longer. Instead, supply-side Keynesianism promised something better: it presented an argument for why the state had to involve itself in the process of wealth creation (Miliband, 1994). In this way, the centre-left tried to overcome one of its biggest weaknesses: the perception that it was good at distributing growth, but that it lacked a theory of production. Third Way social democrats, therefore, enthusiastically embraced the no-

³⁰These ideas resonated with contemporary social democrats because their formative life and career experience was also the economic crises of the 1970s, including stagflation.

tion the state could deliver such growth, developing a technocratic approach to politics.³¹

This approach to politics became extraordinarily successful in the late 1990s and 2000s. As argued above and shown in Figure 1.1 (Chapter 1), it contributed to an astounding electoral comeback, but it also coincided with an era of remarkable economic stability. In the 1990s and the early 2000s, it seemed like governments in the advanced economies had successfully fended off the risks of severe financial and economic crises, which reinforced the dominance of supply-side Keynesianism among the left.

However, the marriage between social democracy and supply-side Keynesianism became more difficult in the context of the Great Recession. After an initial period of emergency Keynesianism (Hall, 2013; Pontusson and Raess, 2012; Raess and Pontusson, 2015), they followed the centre-right and turned to austerity. Why, then, did supply-side Keynesianism help to legitimise austerity among social democratic actors (i.e. among social democratic parties and politicians)? In the short-term, New Keynesians believe that during crisis periods government spending is necessary to sustain demand due to nominal rigidities, which prevent the economy from operating close to its potential. Yet, there are three caveats when it comes to demand stimulus that are grounded in central tenets of supply-side Keynesianism.

First, New Keynesianism reduced the importance of the output gap compared to Keynes' theory. Originally, Keynes argued that supply is stable while demand fluctuates, which leads to output gaps. He argued against classical economists, who believed that swings in output were caused by external shocks to the economy based on Say's famous dictum that supply creates its own demand. The synthesis on which New Keynesianism was based combined both arguments: output gaps still exist in the short-run, but the potential or efficient output varies in response to shocks. It can move upward and downward and does not grow continuously. Importantly, New Keynesianism accepted that there was a non-accelerating inflation rate of unemployment (NAIRU), as introduced by Tobin (1980). This concept refers to the unemployment rate that is consistent with maintaining stable inflation.³² In response to an economic shock, governments should use macroeconomic policy to close the output gap, but only up to the point at which the economy is reaching the NAIRU and is operating at its potential. This potential might be lower than the potential prior to the economic

³¹Paraphrasing Jim Scott, Gingrich (2018) argued that social democrats began "seeing like technocrats", referring to his book "Seeing like a State" (Scott, 1998).

³²The concept is closely related to the natural rate of unemployment, which is a concept coined by Milton Friedman (1968).

shock and, hence, the macroeconomic response prescribed by New Keynesians is generally smaller than by traditional Keynesians.

Second, according to New Keynesianism the government's role in the stabilisation of the economy is limited (Iversen and Soskice, 2006, p. 437). Monetary policy governs demand management because an independent central bank can avoid the time-inconsistency problem, which Kydland and Prescott (1977) identified. Moreover, monetary policy is more effective than fiscal policy in the New Keynesian model because the output gap in the short-run is usually the result of an inter-temporal mismatch between demand and supply. Assuming that the interest rate is effectively the relevant price that affects the inter-temporal allocation of demand, monetary policy can quickly and directly affect demand in response to an economic crisis. In contrast, fiscal policy affects demand more slowly and less directly. There is usually a lag in the implementation and effectiveness of fiscal policy and, as long as the economy is not in a liquidity trap, it is less effective than monetary policy in stabilising the economy. As a result, there was a shift to monetary dominance in advanced economies (McNamara, 2002; Johnson, 2016) and demand management became depoliticised (Iversen and Soskice, 2006). There was a policy consensus that fiscal policy should be used to achieve medium- and the long-term goals, while monetary policy would be used to manage demand in the economy in the short-run. This view was reinforced by the Great Moderation when monetary policy conducted by an independent central bank seemed well equipped to steer the economy single-handedly. Robert (Lucas, 2003, p. 1) thus famously said in his Nobel prize speech that the 'central problem of depression prevention [had] been solved.'

Third, supply-side Keynesians believe that the state has a fundamental role in generating long-run growth in an economy, by investing in human and physical capital and by providing public goods that markets do not deliver. This argument was most forcefully made by proponents of the social investment paradigm (e.g. Morel et al., 2012; Hemerijck, 2017), who strongly influenced the centre-left parties in the early 2000s during the Third Way era. For some social democratic parties, including New Labour, the social investment paradigm promoted a shift away from the traditional social democratic goal of equality of outcomes towards a focus on ensuring equality of opportunity (Blair, 1998, p. 3). Based on a supply-side perspective, the social investment paradigm emphasized that against the background of large structural transformations, including globalization, de-industrialisation, and technological change, there were 'new social risks' (Bonoli, 2007) that traditional welfare states did not address. The view that the left cannot spend its way towards equality spread

among social democrats and thus the social investment paradigm became more popular.

Aimed at creating human capital, for example through active labour market policies, public childcare provision, or education, social investment was supposed to both modernise the welfare state and contribute to economic growth (Morel et al., 2012). Yet, for the state to play this role it needs to retain the capacity to act in the long-run. This presents policy-makers with an important inter-temporal trade-off: as the government stimulates the economy and incurs more debt in the short run, the cost of servicing this debt in the long-run also increases. This is problematic for two reasons: first, it places a higher burden on future tax-payers and raises concerns of inter-generational equity; second, it has the potential to limit the capacity of the state to act in the long-run as governments have to use a large share of their budget to pay for interest rate payments and, increasingly, become dependent on financial markets to re-finance their debt. Fiscal policies thus need to be concerned with the sustainability of public finances, which leads to what Haffert and Mehrtens (2015) call the “progressive consolidation thesis.” According to this view ‘consolidation is not an end in itself but a means to regain fiscal capacity’ (Haffert and Mehrtens, 2015, p. 120-21).

Based on these ideas, social democratic parties and progressive leaders already opted for fiscal consolidation at the end of the 20th century in very different contexts. Following Mitterand’s *tournant de la rigueur* (or austerity turn), for example the centre-left in the United States or in Sweden pursued fiscal consolidation. Both Bill Clinton and the Swedish Social Democratic Party (SAP) shared the progressive consolidation thesis and attempted to rebalance the budget in order to retain the capacity of the state to act in the long-run. In response to an economic shock like the Great Recession, then, these tenets of supply-side Keynesianism also had the potential to play a central role in legitimising austerity on the left and, by extension, contributing to the broad acceptance of austerity in Europe since 2010. That is not to suggest that social democrats have never previously employed austerity policies. However, the core tenets of supply-side Keynesianism outlined above were significant to social democrats in the post-crisis period, in particular.

Moreover, it is important to note that these ideas significantly differ from neo- and ordoliberalism, even though there is arguably some overlap. Neoliberalism implies that state intervention in the economy is costly and should not be concerned with correcting for inequalities, while social democrats argue that the state needs to intervene in the economy. They share this support for state intervention with ordoliberals, but

these two schools of thought are set apart by the type of state intervention that they prescribe. Social democrats have a more positive vision of the state, which, in their view, has a fundamental role to play in generating long-run growth. This also allows social democrats to combine supply-side Keynesianism with an ideational framework that champions equality and the welfare-state, as long as it contributes to innovation and the long-run accumulation of human capital – an innovation of ‘new growth theory’ that was not present in earlier instances of deflationary social democratic policies in the 1970s and early 1980s. Although social democratic parties may have had difficulty reconciling redistribution with austerity in reality, the framework of supply-side Keynesianism sketched out above provides the ideational foundation for doing so.

Social democratic parties, paradigm change, and the Great Recession

Acknowledging these *ideational pressures* for austerity still begs the question why social democratic parties were not able to move beyond them. Following Thomas Kuhn (1962), Peter Hall (1993) suggests that paradigm change occurs when anomalies accumulate that the existing theory cannot explain. He defines policy paradigms ‘a framework of ideas and standards that specifies not only the goals of policy and the kind of instruments that can be used to attain them, but also the very nature of the problems that they are meant to be addressing’ (Hall, 1993, p. 279). Given that austerity policies have not worked and that they have hurt traditional social democratic constituencies, the existing literature on social democracy in the context of the crisis is puzzled by the social democratic response to the crisis. It can neither explain the lack of a paradigm change nor the fact that social democratic parties hardly attempted to push for such a paradigm change in the first place (e.g. Coates, 2017; Bailey et al., 2014; Keating and McCrone, 2013).

To explain why this happened, my thesis attempts to re-think when paradigm change is likely. It brings back politics and re-evaluates the conditions that lead to economic policy output. It stresses that we need to think about how ideas align with the electoral interests of the elites. My framework stresses that in the short-run paradigm change is constrained by public opinion and the prevailing political discourse (reflecting public opinion in interaction with previous political legacies). In most circumstances, vote- and office-seeking politicians are thus not the right people to push for paradigm change: they have to work with preferences from the electorate that are fixed in the

Table 2.1: Paradigm change and the interplay of ideas and electoral constraints

	Electoral constraints	
	High	Low
Parties open to new ideas	Ideational conflict within existing parties	Paradigm change pushed by existing parties
Parties closed to new ideas	Status quo	Emergence of new parties

short-run and that are shaped by the legacies of previous policies and programmes. In this context, paradigm change cannot happen if voters do not want it to happen. Politicians can only strategically move in the existing issue space, positioning themselves vis-à-vis other parties.

In other words, ideas do not exist in a vacuum and, instead, it is the interaction of ideas and electoral forces that explains paradigm change. As shown in Table 2.1, paradigm change becomes possible when parties support ideas that question the dominant paradigm and when there is the electoral space to mobilise these ideas. In other words, ideas matter most if they are aligned to the material (or electoral) interest of politicians. However, paradigm change cannot happen if the voters do not believe that it should happen, i.e. when the electoral constraints are high that prevent politicians from articulating new ideas. Instead, one can expect this situation to lead to ideational conflict within the political party as its leaders struggle to reconcile their ideology and the prevalent public opinion. During the Great Recession, some social democratic parties in creditor countries found themselves in this situation: as their voters supported budget consolidation, the economic ideologies and their electoral interests pulled into two different direction. However, social democrats are not economists but political animals and their actions are, first and foremost, guided by their short-term electoral instincts. They prioritise the preferences of the voters and social democratic parties thus accepted austerity even in countries where there was little institutional pressure to do.

However, in the medium- to long-term politicians and other elites can change public opinion. They can create coalitions against the existing paradigm, which point out the anomalies and propose an alternative prism through which to interpret the economy. This process takes time, but it relies on leaders that play with new ideas, that rally against the previous paradigm, and that shore up support for the new paradigm. Social democratic actors were unable to take up this role in the wake of the Great Recession because they faced a twin problem: they were trapped and divided, which

undermined their ability to push for ideational renewal. In the absence of a clear new economic paradigm, they combined short-term electoral opportunism with technocratic policy initiatives and convinced themselves that austerity was necessary.

First, social democratic parties faced an *electoral trap*: their electoral constituency had already changed significantly as the result of the policies that they implemented prior to the crisis. As Esping-Andersen (1985, p. 322) stresses, economic policies have distributional consequence, including the potential to fragment and divide the electorate. Exactly, this is what happened to social democracy in the late 1990s and early 2000s. The realignment of voters was partly the result of policies that social democratic parties had pursued prior to the economic crisis, including the Agenda 2010 in Germany or the Third Way in the UK (Karreth et al., 2013). Working class voters had abandoned social democratic parties in favour of populist parties on the left and the right of the political spectrum, while social democratic policies increasingly appealed to middle-class voters. In the context of the economic crisis, the latter had become the social democratic core constituency and, therefore, they had to adjust their economic policies with reference to them.

Moreover, as a result of the legacies from the Third Way, the complexity of building an electoral coalition between the expanded middle class and the working class had become more difficult. This left social democratic parties electorally exposed when the crisis hit, facing a dilemma that was not unique in the history of social democracy. As Kitschelt (1994, p. 93) already observed with reference to the 1980s and 1990s, social democrats ‘faced a catch-22 between outright electoral decline and ephemeral, transitory electoral success: either they promised austerity policies that initially boosted their support but contributed to their latter gradual electoral decline when enacted; or they remained true to their run-of-the-mill Keynesian economic prescriptions and were kept on the opposition benches.’ This was even similar to the problems that socialist governments experienced in liberal democracies in the 1920s: ‘they obtained government office only when they abandoned their more ambitious programs, but precisely the compliance with the liberal economic order also precipitated their political decline’ (Kitschelt 1994, p. 93; Luebbert 1991, p. 227-32). In the wake of the 2008 financial crisis, this dilemma was acute again but – trapped by the electoral consequences of their previous policies – social democracy chose austerity over demand stimulus.

Second, social democrats also faced an *ideational trap*. The implementation of some ideas and policies prior to the economic crisis destroyed alternatives. Galbraith (1958, p. 20) already argued that ‘ideas are inherently conservative. They yield

not to the attack of other ideas but... to the massive onslaught of circumstances with which they cannot contend.' In 2008, many observers expected the financial crisis to present such circumstances. For example, in 2009 the former Chairman of the FED Alan Greenspan famously said that 'the whole intellectual edifice collapsed in the summer of last year' (Andrews, 2008). Yet, over time the conventional interpretation of the Great Recession became a different one: economics may have been wrong with regards to finance, but it provided for a coherent macroeconomic response, as the 'fire-fighting phase' from 2008 to 2010 was relatively successful.³³ Massive interventions by national governments and central banks saved most countries from a disaster on the scale of the Great Depression.

The success of the immediate response to the crisis undermined the intellectual renewal that some expected at the beginning of the crisis. Although many macroeconomists recognised that some of their economic models were fundamentally flawed, policy-makers did not. For social democratic parties, this ideational trap was compounded by the experience of the Eurozone crisis. While the economic pain for the crisis-ridden debtor countries only really began in 2010, other economies emerged relatively well from the financial crisis. Especially Germany bounced back strongly. Unemployment remained relatively low and continuously declined after 2010, as Germany's export-oriented economy returned to growth. This facilitated a one-sided economic interpretation of the crisis (see Chapter 7). Conventional wisdom attributed Germany's success to the Agenda 2010, referring to a set of supply-side reforms that the centre-left government implemented in the early 2000s. The crisis therefore became increasingly seen as a morality tale of saints and sinners (Matthijs and McNamara, 2015), which also influenced social democrats. It prevented them from disavowing supply-side Keynesianism, as the German SPD and other European social democratic parties remained trapped by their previous discourse.

The problem for social democratic parties was compounded because they were internally deeply divided. Social democratic parties, just as the voters that they represent, are not homogeneous entities. As Sartori (2005, p. 23) stressed, parties instead consist of different 'factions' and 'currents'. This is especially true for the centre-left today: they are a collection of interests rather than an coherent ideology group.³⁴ As emphasised above, social democratic parties were founded on a reformist platform, but many of them also bundled together a heterogeneous and complex set of groups

³³This conventional interpretation is, for example, as captured by many memoirs from policy leaders of the time (e.g. Brown, 2017; Bernanke, 2015; Geithner, 2014; Darling, 2011; Steinbrück, 2010).

³⁴This is similar for many other progressive parties in the world. For example, Grossmann and Hopkins (2016) make this argument for the Democratic party in the US.

opposed to unfettered capitalism. More than other party families, social democratic parties thus faced a significant amount of heterogeneity in the interests that they represent. This heterogeneity has important implications for the positions that social democratic parties adopt. Schattschneider (1960) suggested that parties always need to integrate a plurality of different interests by developing a shared normative perspective, allowing them to mould them into an overarching programme. However, during the Great Recession social democratic parties struggled to live up to this task. Left-wing factions within social democrats were radically opposed to austerity, while the pragmatic Third Way social democrats were clinging on to the progressive consolidation thesis and supply-side Keynesianism in general.

The conflict between these two faction was decided top-down in most parties by reference to electoral considerations. As Przeworski and Sprague (1986, p. 184) already observed ‘elections are just not a vehicle for radical transformations. They are inherently conservative precisely because they are representative, representatives of interests and values in a heterogeneous society.’ Third Way social democrats, therefore, could always appeal to the need to win elections as an argument. They used strategic considerations as a weapon to win intra-party conflicts by presenting austerity as a good policy in both political and economic terms: good in political terms because it signals fiscal credibility and good in economic terms because it ensures the capacity of the state to act in the long-term.

The left-wing factions within most social democratic parties were not able to counter these arguments. As Berman (1998, p. 204) notes, ‘ideologies do not achieve resonance or political power on their own; instead, they must be “carried” by political actors capable of implementing political projects and changing the way that people think and act.’ The anti-austerity forces within social democratic parties lacked these kind of actors, who were able to carry their ideas. They were disorganised, lacked effective leadership, and had been weakened by the dominance of the Third Way before the Great Recession. As a result, there were only very few countries where the left-wing factions were able to overcome the austerity settlement. In most countries, opposition to austerity was bundled by forces outside the traditional social democratic parties, for example by Syriza in Greece, Podemos in Spain, or Melonchon’s movement in France. There were only very few countries where left-wing factions were able to win the inter-party conflict and push for an anti-austerity platform including Portugal and the UK.³⁵

³⁵In the latter case, Jeremy Corbyn was able to move from the outskirts of the party to its leadership in 2015 (see Chapter 6).

Conclusion

In conclusion, my explanation of social democratic austerity is based on the premise that austerity was a political choice and that actors, including parties, matter for the macroeconomic governance of advanced economies. It stresses that we need to take into account both the *electoral* and *ideational* pressures for austerity in order to explain the response of social democratic party to the crisis.

During economic crises, when macroeconomic policies are highly salient, parties first and foremost respond to public opinion and the material interests of their potential constituencies. In the short-term, they can hardly change public opinion and only navigate the existing issue space in relation to their competitors. Ideas and the existing discursive opportunity structures in a given country still mediate how electoral interests are turned into party programmes, but vote- and office-seeking parties cannot fundamentally ignore the given public opinion. Social democratic parties were therefore severely constrained in the context of the European sovereign debt crisis. They perceived voters to be fiscally conservative, as there was a strong scepticism among voters against government debt after the financial crisis had been turned into a fiscal crisis. In combination with a distinct set of economic ideas – which I call supply-side Keynesianism – this prevented social democratic parties from opposing austerity.

However, in the medium- to long-run political actors have more flexibility to influence the public opinion and adopt new ideas that are less dependent on previous ideational legacies. In the wake of the financial crisis social democratic parties were unable to do this because they remained trapped and divided. They were trapped by the legacy of the Third Way, which had also created deep internal divisions with social democratic parties. It had undermined the left-wing factions of social democratic parties, which were disorganised and intellectually weak. They had no access to the levers of influence and lacked the necessary leadership to lead the charge against austerity. In the absence of such a push for intellectual renewal, social democratic parties instead combined electoral opportunism with technocratic policy initiatives. In their search for economic credibility, they adopted austerity to appeal to a dominant public opinion that is sceptical of government debt.

Chapter 3

The Programmatic Response of Social Democratic Parties to the Great Recession¹

Introduction

The Great Recession was the deepest economic crisis in advanced capitalist countries since the Great Depression. In Europe, this economic crisis also led to a crisis of social democratic parties, which struggled to respond to the economic malaise. Prior to 2008, they had mostly shifted towards the centre and embraced Third Way policies. However, the Great Recession that begun in 2008 raised new doubts about the merits of this shift. The break-down of the international financial system exposed the vulnerability of the existing economic order and created high unemployment and inequality. Moreover, in response to the European sovereign debt crisis governments across the continent implemented austerity policies, undermining the European welfare state that social democratic parties had built in the post-war era (Korpi, 1983; Stephens, 1979). How have social democratic parties responded to this crisis in programmatic terms?

To answer this question, the chapter examines empirically whether and to what extent social democratic parties changed their economic positions during the Great Recession. Although it is too early to tell what the long-term political consequences of the

¹This chapter is a slightly modified version of the paper with the same name published in *Party Politics* in January 2018.

crisis will be, the purpose of studying this response is to understand how economic crises influence party competition in the short- and medium-term (also see Clements et al., 2017). The starting point for this analysis are two conflicting findings in the literature. First, some authors argue that parties hardly change their positions over time (e.g. Budge, 1994; Budge et al., 2001). In particular, social democratic parties are portrayed as parties with a strong ideology and close ties to social movements that constrain them in responding to changes in the economy (Adams et al., 2009). Other authors, in contrast, argue that social democratic parties have radically changed their positions in the last few decades. In response to globalisation, they shifted to the right resulting in a “neoliberal convergence” of centre-left and centre-right parties (e.g. Mishra, 1999; Glyn, 2001).

In this chapter, I test which of these expectations holds with evidence from the Great Recession. I use an original dataset based on media analysis in 11 countries that allows me to compare the salience that parties attribute to different issues and the positions that they adopt with regards to these issues during electoral campaigns before and after 2008. Analysing this data, I present evidence that social democratic parties shifted their positions towards the left during the crisis, which is contrary to common perceptions in the media (Münchau, 2015; The Economist, 2016) and emerging research (English et al., 2016; Dalton, 2016). However, their positions diverged with respect to different issue categories. On the one hand, social democratic parties defended the welfare state and opposed economic liberalism after the 2008 financial crisis, which partly reverted their own Third Way. On the other hand, many parties also supported the reduction of government deficits and taxes during the crisis – that is, they joined the chorus of austerity that became the dominant tune during the Euro crisis. Hence, social democratic parties adopted positions with regards to the three different issue categories (welfare, economic liberalism, and budgetary rigour), which do not neatly align on a single left-right line of conflict. This suggests that party competition during the Great Recession was complex and cannot be represented on a single dimension (Otjes, 2016).

To make these arguments, the chapter proceeds in six steps. First, I briefly review the existing literature. Second, I set out my expectations about the response of social democratic parties to the Great Recession. Afterwards, I introduce my dataset and explain the methods that I use to analyse party competition. In section 5 and 6, I proceed to present my empirical results. Combining descriptive analysis with regression analysis, I first examine the salience that social democratic parties attributed to eco-

conomic issues during the crisis. Then, I analyse the position that these parties adopted with regard to economic issues. Finally, section 7 concludes.

Party positions, issue salience, and the economy

There is a large literature that studies the platforms on which political parties compete. Influenced by the median-voter theorem of Downs (1957), many scholars view parties as vote-seeking (e.g. Huber and Powell, 1994; McDonald and Budge, 2005). They argue that there is a close link between the positions that parties take and the preferences of the electorate. Consequently, party elites systematically respond to variations in the distribution of voters' preferences, which is a process that (Stimson et al., 1995) called "dynamic representation."² However, given that large shifts in the distribution of voters' preferences are rare, the programmes of parties remain relatively stable over time. As a result, many scholars shifted their attention towards studying salience (Budge et al., 2001; McDonald and Budge, 2005; Bélanger and Meguid, 2008). They focused on "issue emphasis" (Budge and Farlie, 1983) because '[v]arying emphases on issues are by and large the only way that parties express their policy differences' (Budge et al., 2001, p.82). Based on the notion of "issue ownership" (Petrocik, 1996), parties are attributed different levels of competence in different policy areas and they have an interest to selectively emphasise those areas in which they outshine their competitors. However, the voters' prioritisation of different issues can change between elections (Petrocik, 1996; Petrocik et al., 2003; Bélanger and Meguid, 2008). Thus, parties are expected to change the salience that they attribute to different issues, even if they hardly change their positions over time.

The conclusion that party positions are relatively stable is shared by two other strands of the literature. On the one hand, the classical work by Lipset and Rokkan (1967) argues that parties are rooted in cleavages. These cleavages are relatively stable over time and given that parties have distinct cleavage locations, they limit the positional manoeuvrability of existing parties in response to external shocks (Hooghe and Marks, 2018). On the other hand, other authors viewing parties as policy-seeking also consider the positions of parties relatively stable (Strøm, 1990; Müller and Strøm, 1999; Dalton and McAllister, 2015). From this perspective, the positions of parties reflect the beliefs of their elites, which, in turn, are shaped by the parties' core ideologies. Ideologies provide actors with a general frame of reference, which allow them to

²There is some evidence for the plausible alternative hypothesis that parties respond to fluctuations in the preferences or priorities of their constituencies and not the entire electorate (e.g. Ezrow et al., 2011)

understand and interpret events. Assuming that these ideologies are sticky, parties are not expected to radically change their positions, either. In particular, left-wing parties are resistant to change their position for two reasons (Adams et al., 2009). First, left-wing parties are historically more ideological than other parties. They were born from the labour movement in the 19th century and remained committed to engineering social change even after they had abandoned their revolutionary ambitions (Przeworski and Sprague, 1986). Second, social democratic parties have close ties to trade unions and social movements that restrict their ideological flexibility even if these ties have weakened in the last few decades (Kitschelt, 1994; Piazza, 2001).

However, the problem with many of these studies is that they examine party competition in a vacuum and ignore the role of contextual factors. Only recently authors have begun to explicitly study the importance of economic conditions for party competition (Ward et al., 2015, 2011; Haupt, 2010; Adams et al., 2009). Much of this research studies the effect of globalisation on political parties and it is closely related to research in political economy, which has argued that globalisation constrains state intervention in the economy (Berger, 2000; Strange, 1996). Paradoxically, this literature has also singled out social democratic parties to make their case (Scharpf, 1987; Garrett and Lange, 1991; Ward et al., 2011). Assuming that globalisation makes it increasingly difficult for social democratic parties to correct undesirable market outcomes, they abandoned their core ideologies and increasingly embraced orthodox policies. Thus, globalisation diminished the policy differences between the left and paved the way for a “neoliberal convergence” of mainstream parties (Mishra, 1999; Ross, 2000; Callaghan, 2000; Glyn, 2001; Pierson, 2001a). Although some authors dispute this “neoliberal convergence” hypothesis (Allan and Scruggs, 2004; Burgoon, 2001; Boix, 1998), they often agree that globalisation forces parties to adapt their political programmes, albeit in a complex and variegated way. Political parties are seen as strategic actors that use different political programmes to respond to domestic and international economic changes. In principle, this approach is not necessarily contradictory to research, which finds that party positions are relatively stable: while many authors emphasising stability study the basic dimensional position of parties, those predicting change focus on individual issues. Still, the literature provides two different expectations about how social democratic parties respond to economic changes: some authors argue that party positions are stable and that parties only selectively emphasize and de-emphasize certain issues, whereas others argue that parties actually adapt their programmes in response to the domestic and international economic context. Which of these conclusions holds up when we consider the response of social democratic parties to the Great Recession?

The programmatic response of social democratic parties to the Great Recession: Some expectations

The Great Recession has been a structural break for the development of the advanced economies. It was triggered by the mortgage crisis in the United States and became a full blown financial crisis in September 2008, when the investment bank Lehman Brothers collapsed. This bankruptcy sent shock waves through the international financial system and created a deep economic recession across almost all advanced capitalist countries. Europe was hit especially hard because in 2010 the ‘American’ financial crisis turned into a ‘European’ sovereign debt crisis. The political repercussions of this crisis are still uncertain, but it is already becoming clear that the Great Recession was a critical juncture that has changed long-term trends of political conflict in Europe (Hernández and Kriesi, 2016).

One important trend prior to the Great Recession was the increasing importance of non-economic or cultural issues for party competition (Franklin et al., 1992; Kitschelt, 1994; Kriesi et al., 2008; Hooghe and Marks, 2009). Yet, the crisis increased economic grievances throughout Europe and presented all political actors with an acute set of economic problems. Given that materialist concerns become more important for the electorate during times of economic hardship (e.g. Margalit, 2013; Singer, 2011; Traber et al., 2017), I expect that all political parties attempted to capture the public mood and increased the salience of economic issues after 2008. Still, it is likely that the crisis did not effect all parties equally because parties ‘own’ different political issues (e.g. Petrocik, 1996; Green and Hobolt, 2008; Wagner and Meyer, 2014). Although the economy is usually addressed by all parties, social democratic parties are historically associated with issues relating to social solidarity. Therefore, I also expect that social democratic parties increased the salience of economic issues more than other parties, which are less concerned with social justice (e.g. Conservative parties) or more associated with non-economic issues (e.g. the Greens or the radical populist right).

However, the impact of the crisis was not uniform across all economic issues. Importantly, in the wake of the crisis one has to distinguish between three issue categories: (1) issues that relate to the welfare state and redistribution; (2) issues that relate to economic liberalism; and (3) issues that relate to the budget of the government (see table 3.1). This distinction is necessary because in order to capture the complex political impact of the crisis. First, the crisis was widely narrated as a crisis that resulted from excessive liberalisation of the financial system (e.g. Blanchard et al.,

2010; Bean, 2010). This presented centre-left parties with a window of opportunity to oppose economic liberalism and distance themselves from the causes of the Great Recession. Similarly, low-income households, which social democratic parties claim to represent, were particularly at risk during the Great Recession due to the increase in unemployment and economic uncertainty. Thus, the Great Recession also provided social democratic parties with an opportunity to renew their support for the welfare state. Yet, with regards to macroeconomic policies, social democratic parties had less leeway to change their policies. Most governments stimulated the economy immediately after the financial crash in 2008 (Kahler and Lake, 2013; Pontusson and Raess, 2012), but leading policy makers soon began to demand austerity when the financial crisis turned into a sovereign debt crisis. As Matthijs and McNamara (2015) critically point out, conventional wisdom held that this crisis was caused by excessive government debt and ‘irresponsible’ behaviour by the debtor countries. Social democratic parties in these countries were, thus, forced to accept austerity measures in return for bail-out packages from the European Union and the International Monetary Fund (e.g. PASOK in Greece, PS in Portugal, and PSOE in Spain).

Table 3.1: List of economic issue categories (adopted from Kriesi et al. 2008)

Categories	Description of left-wing positions
Welfare	Support for the welfare state and redistribution through taxes and benefits
Economic Liberalism	Opposition to competition, deregulation, and privatization
Budgetary Rigour	Opposition to a rigid budgetary policy and the reduction of taxes (without an explicit redistributive character)

Parties in creditor countries or outside the Eurozone also largely accepted this shift to austerity. For example, the German SPD already supported the introduction of a constitutional debt brake in 2009 and promised to reduce government debt as one of the key pillars of its economic programme in 2013 (Social Democratic Party of Germany, 2013). Similarly, the Labour party in the UK accepted the need for fiscal consolidation. The party opposed the spending cuts by the Conservative government, but it also adopted a fiscal commitment prior to the 2015 election promising to ‘balance the books and deliver a surplus on the current budget and falling national debt in the next Parliament’ (Balls, 2014c). Consequently, we need to disentangle issues that relate to the government’s budget from other economic issues. In particular, I expect that left-wing parties did not shift to the left with regards to budgetary issues during the crisis but that they addressed these issues more often in order to signal eco-

conomic competence (Kraft, 2017) and to appeal to fiscally conservative voters, who favour balanced budgets. Facing attacks from other political parties, they attempted to present themselves as economically competent and responsible in this way.

Still, there are reasons to believe that the expected shifts by social democratic parties as stated above did not happen in all countries equally. In particular, the depth and length of the crisis should have influenced the response of left-wing parties to the Great Recession. In countries that escaped the crisis relatively unscathed, left-wing parties had less reason to increase the salience of economic issues and change their position with regards to issues like welfare and economic liberalism. Importantly, while they might have also shifted to the left in the immediate aftermath of financial crisis, I expect that they moderated their positions again as the impact of the recession waned in their country. Therefore, in countries that were hit especially hard by the economic crisis, we can expect that parties altered their positions on the economy more fundamentally.

Data and methods

In order to analyse the programmatic response of social democratic parties to the Great Recession, I study the platforms on which parties compete before elections. Electoral campaigns provide a good indicator of party positions because parties have to develop a coherent programme prior to elections and, thus, their positions crystallise. In this article I use a new and original dataset that is an update to the dataset used by Kriesi et al. (2008, 2012). The data was collected by the POLCON project to study the political consequences of the Great Recession. It measures party positions by analysing how they are represented by the mass media during electoral campaigns. This type of data is appropriate for studying the response of parties to the crisis for three reasons. First, the data allows me to analyse both the salience that parties attribute to economic issues and the positions that they take towards these issues, which are important aspects of party competition in the 21st century. Second, the data shows the positions that parties adopt in public discourse and, thus, reflects the positions of parties with regards to the most important issues of the day. This should make any changes induced by the crisis more visible than in other sources. Finally, the data enables me to disentangle economic issues into different issue categories, which is necessary in order to understand party competition in the context of the economic crisis.

Unfortunately, the data also has some short-comings. Most importantly, media biases might misrepresent some actors and provide limited information about small parties and non-salient issues. Alternative data sources avoid such biases. In particular, the Manifesto Project (MARPOR) (Volkens et al., 2017) has created a large database that is commonly used to study party positions. However, this data cannot be used in this chapter because the coding scheme does not capture positive and negative stances for all issues that are relevant for my analysis, which would directly allow for the calculation of positions (Gemenis, 2013; Dolezal et al., 2014). Most importantly, the data from MARPOR does not allow me to disentangle economic issues as described above. Therefore, as suggested by Helbling and Tresch (2011), I use media analysis in order to study parties' positions on sub-issues instead.

Specifically, the following analysis is based on the detailed coding of newspapers during thirty-one election campaigns in eleven different Western European countries. These countries include seven Northern European countries (Austria, France, Germany, Ireland, Netherlands, Switzerland, and the United Kingdom) and four Southern European countries (Greece, Italy, Portugal, and Spain). In each country, I use the last election prior the beginning of the crisis in 2008, against which I compare all electoral campaigns that have occurred from 2009 to 2015.³ The newspapers that were used for this analysis and the detailed list of the electoral campaigns and their classification is included in Appendix A.1. From each newspaper, a representative sample of relevant articles is coded by means of core sentence analysis (Kleinnijenhuis et al., 1997; Kleinnijenhuis and Pennings, 2001), which records the relationship between a subject (an actor) and an object (another actor or an issue) on a scale from -1 to $+1$. In total, the resulting dataset contains 81,159 core sentences and for each election I have, on average, 2136 core sentences. The actors mentioned in the newspapers are coded based on their party affiliation, while the issues were coded inductively and classified into more than 200 categories. From these categories, I created three meta-categories about the economy, as shown in Appendix A.2: welfare, economic liberalism, and budgetary rigour. Following (Kriesi et al., 2008), I assume that all other issues are either embedded in a second, cultural dimension of political conflict or in none of the two dimensions.⁴

³Elections that occurred in 2008 are excluded from the analysis due to their proximity to the breakdown of Lehman Brothers in September 2008.

⁴This approach excludes economic issues that have a European dimension from the analysis (e.g. Eurobonds or support for the European Stability Mechanism). These issues became more important during the crisis, but they were not politicised in the same way across all countries included in this study. Importantly, in some countries European integration is still more associated with cultural issues than with economic issues (Otjes and Katsanidou, 2017), which makes an analysis of European issues more difficult.

In order to test my expectations, I use the data to compute two key measures for each party for the individual issue categories: salience and left-right position (see Appendix A.3). Salience for each party on an individual issue is simply the share of core sentences that a party devotes to a given issue compared to all core sentences coded for that party during the election campaign. The left-right position for a party on a given issue is the average direction of all statements about that particular issue, which ranges from -1 to $+1$, where -1 is the left end of the spectrum and $+1$ is the right end of the spectrum. Afterwards, I also calculate the salience and left-right position for every party on the aggregate level, i.e. for all economic issues. In this case, salience is simply the sum of the salience for all three issue individual categories. The aggregate left-right position for any given party is calculated as the mean of all statements from the three economic categories, weighted by the salience of the individual categories.

First, I use these measures descriptively to compare the strategies of left-wing parties before and after the beginning of the crisis. In each section, I start by analysing the aggregate changes, but I also analyse the changes with respect to each individual issue category in order to examine the sources of the aggregate changes. Second, I use regression analysis to test whether the effects of the crisis are statistically significant. For this purpose, my unit of the analysis is a given party for each national election campaign. In total, this gives me a dataset with 198 observations across eleven countries. Note that my data is heavily “cross-sectional dominant” (Stimson, 1985) but that it also has a time dimension and, therefore, I use the pooled ordinary least square regression to analyse the data. As listed in Appendix A.4, the dependent variables for my analysis are (1) the salience that parties attribute to economic issues and (2) the left-right position that parties take on these issues. My key independent variables are party family (operationalised as shown in Appendix A.5) and a dummy variable that equals one when the election occurred after 2008 and zero otherwise. The effect of the crisis on any given party family is then tested through an interaction effect between these two variables. Specifically, I estimate the following model

$$Y_{it} = \beta_0 + x'_{it}\beta + z_i * \lambda_t + \varepsilon_{it} \quad (3.1)$$

where $Y_{i,t}$ is the salience or the left-right position of parties on a specific issue, β_0 is the constant, $x'_{i,t}$ is a vector of time-varying explanatory variables, z_i is a variable for party family and λ_t is the crisis dummy variable. This allows the effect for the party families to vary across the two periods and, hence, the regression coefficient λ_t measures the impact of the crisis on the party competition. To further test the

conditionality of the crisis effect, I use a three-way interaction term between party family, my dummy variable, and the unemployment rate.⁵ Finally, I also include other control variables that could potentially explain party positions on economic issues, including unemployment, GDP growth, government debt and deficit, government status, and country fixed effects. Other confounding variables are not included in the regression model shown here due to the small number of observations.⁶

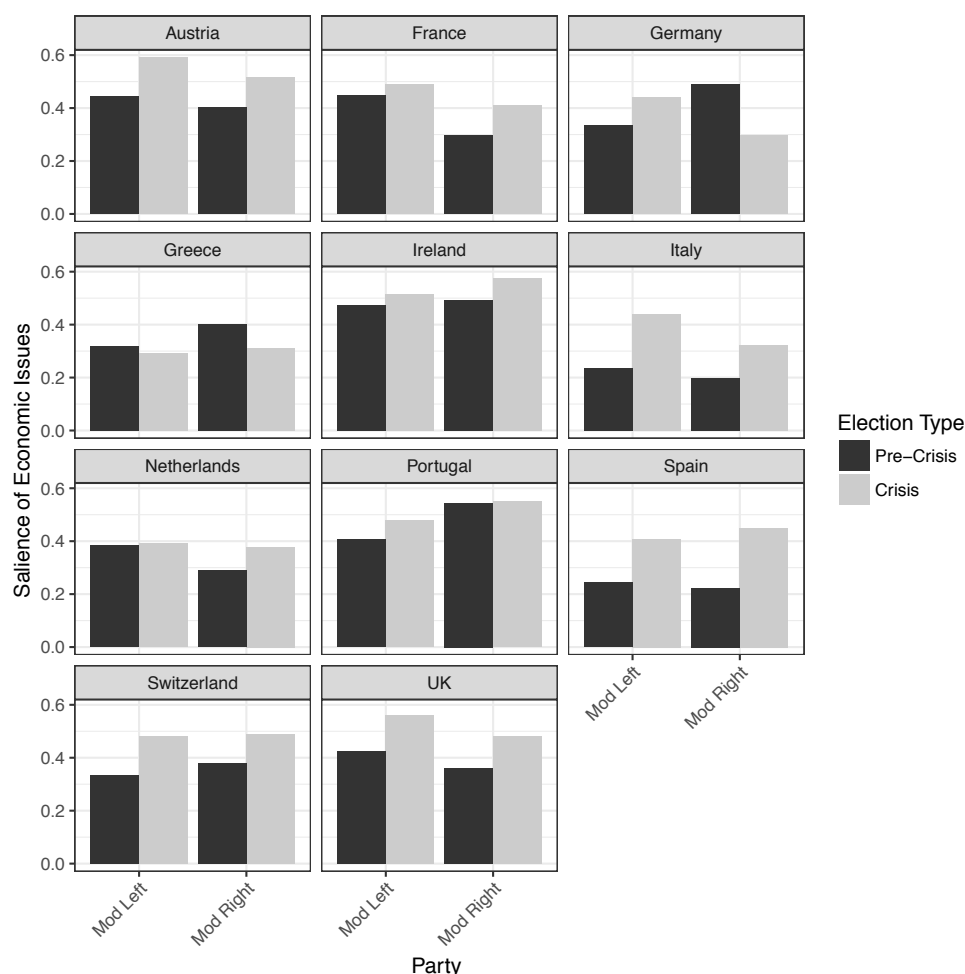
Social democratic parties and the crisis: Changes in issue emphasis

In response to the Great Recession political parties were forced to address ‘old’ economic issues (like unemployment) more resolutely, but they also had to find answers to ‘new’ issues (like bank bailouts or the stability of the financial system). As a result, the salience that mainstream parties attribute to economic issues increased during the crisis in almost all countries (see Figure 3.1). This change was large in countries that were hit particularly hard by the crisis (e.g. Italy, Spain, and Portugal), but the salience of economic issues also dramatically increased in other countries (Austria, Switzerland, and the UK). Moreover, this increase in salience was largely systemic, i.e. changes in salience were not idiosyncratic to individual party families. Instead, the salience of economic issues in the media increased for all party families and, in particular, mainstream parties moved in tandem in response to the crisis. It is, therefore, difficult to distinguish between an effect at the party level and an effect at the level of the party system descriptively.

In order to test whether the differences between party families are statistically significant, I use regression analysis, as described above. The results of this analysis are shown in model 1 of Table 3.2. They indicate that far right parties as well as green parties consistently emphasized economic issues less than the moderate right (the baseline). Moreover, the crisis had a positive and statistically significant impact on salience, as indicated by the coefficient for the crisis dummy variable. Yet, all the

⁵The unemployment rate is used as an indicator for the depth of the economic crisis for three reasons. First, it measures the impact of the financial crisis on the real economy. Second, and related, the unemployment rate is a proxy for the level of economic grievances that the population of any country experiences during an economic crisis. Third, unemployment is a good measure because it is easily comparable across countries. Other possible specifications of this variable were used as a robustness check but they did not change the results (e.g. GDP growth, inflation, sovereign debt and deficit).

⁶Other variables were included in further models (e.g. Eurozone membership, being a recipient of bail-outs, the presence of far right and far left parties, or the type of economic system). None of these variables turned out to be significant.

Figure 3.1: Issue salience of all economic issues by party family by country

interaction terms between party families and this dummy are small and not statistically significant, which indicates that the crisis did not systematically alter the pattern of party competition with regards to salience. In particular, the salience of economic issues for moderate left-wing parties and moderate right-parties increased in tandem in response to the economic crisis, which is contrary to my expectation. Similarly, there is no evidence that the response of social democratic parties to the crisis was influenced by the strength of the crisis. The three-way interaction term in the second model in Table 3.2 is not statistically significant, which suggests that the response of social democratic parties was similar in all countries independent of the depth of the crisis.

Still, it is important to disaggregate these changes into the three categories identified above. Figure 3.2 plots the salience of these issues separately for social democratic

Table 3.2: OLS Regression - Salience of Economic Issues by Different Party Families

	Dependent Variable				
	Aggregate I	Aggregate II	Welfare	Eco Lib	Budget
	(1)	(2)	(3)	(4)	(5)
Far Right	−0.16*** (0.06)	−0.27 (0.21)	−0.04 (0.04)	−0.03 (0.04)	−0.08** (0.03)
Liberal	−0.05 (0.06)	−0.08 (0.18)	−0.0000 (0.04)	0.02 (0.04)	−0.07** (0.03)
Moderate Left	−0.03 (0.05)	0.03 (0.16)	0.03 (0.03)	0.01 (0.03)	−0.07** (0.03)
Far Left	−0.01 (0.05)	0.24 (0.19)	0.03 (0.03)	0.08** (0.03)	−0.11*** (0.03)
Green	−0.18*** (0.06)	−0.26 (0.18)	−0.05 (0.04)	−0.05 (0.04)	−0.08** (0.03)
Other	−0.16*** (0.06)	−0.02 (0.19)	−0.04 (0.04)	−0.05 (0.04)	−0.07** (0.03)
Crisis Election	0.07 (0.04)	0.10 (0.13)	0.03 (0.03)	0.09*** (0.03)	−0.05** (0.02)
Unemployment (t-1)	0.002 (0.01)	0.01 (0.02)	−0.003 (0.004)	0.003 (0.004)	0.003 (0.003)
Inflation (t-1)	0.02 (0.02)	0.02 (0.02)	−0.01 (0.01)	0.01 (0.01)	0.01 (0.01)
GDP Growth (t-1)	0.001 (0.005)	0.004 (0.005)	−0.002 (0.003)	0.003 (0.003)	−0.0000 (0.003)
Gov Deficit (t-1)	−0.005** (0.002)	−0.005** (0.002)	0.001 (0.001)	−0.005*** (0.001)	−0.002 (0.001)
Gov Debt (t-1)	−0.001 (0.001)	−0.001 (0.001)	−0.001 (0.001)	−0.001 (0.001)	0.0003 (0.001)
Government (t-1)	−0.02 (0.03)	−0.02 (0.03)	−0.03* (0.02)	0.03 (0.02)	−0.01 (0.02)
Prime Minister (t-1)	−0.01 (0.04)	−0.02 (0.04)	0.02 (0.03)	−0.02 (0.02)	−0.01 (0.02)
Far Right x Crisis Election	−0.03 (0.07)	0.02 (0.22)	−0.05 (0.04)	−0.04 (0.04)	0.06 (0.04)
Liberal x Crisis Election	0.02 (0.07)	0.19 (0.19)	0.002 (0.04)	−0.05 (0.04)	0.07* (0.04)
Moderate Left x Crisis Election	0.03 (0.06)	0.05 (0.17)	0.01 (0.04)	−0.03 (0.04)	0.06* (0.03)
Far Left x Crisis Election	0.01 (0.06)	−0.22 (0.20)	−0.01 (0.04)	−0.06 (0.04)	0.07** (0.03)
Green x Crisis Election	−0.01 (0.07)	0.01 (0.19)	−0.02 (0.05)	−0.01 (0.04)	0.03 (0.04)
Other x Crisis Election	0.03 (0.07)	−0.13 (0.21)	0.005 (0.05)	−0.03 (0.05)	0.05 (0.04)
Moderate Left x Unemployment (t-1)		−0.01 (0.02)			
Crisis Election x Unemployment (t-1)		−0.004 (0.02)			
Mod Left x Crisis x Unempl (t-1)		0.003 (0.02)			
Constant	0.39*** (0.09)	0.35** (0.14)	0.28*** (0.06)	0.02 (0.06)	0.08* (0.05)
Observations	198	198	198	198	198
R ²	0.52	0.58	0.50	0.53	0.36
Adjusted R ²	0.44	0.46	0.40	0.45	0.24
Residual Std. Error	0.12 (df = 167)	0.12 (df = 154)	0.08 (df = 167)	0.08 (df = 167)	0.07 (df = 167)
F Statistic	6.11***	4.88***	5.46***	6.30***	3.10***

Note:

*p<0.1; **p<0.05; ***p<0.01
Reference party: Moderate Right
Reference country: United Kingdom

Note: Country fixed effects are included in the models but not shown. Similarly, three-way interaction terms for other party families are included in model 2 but not shown.

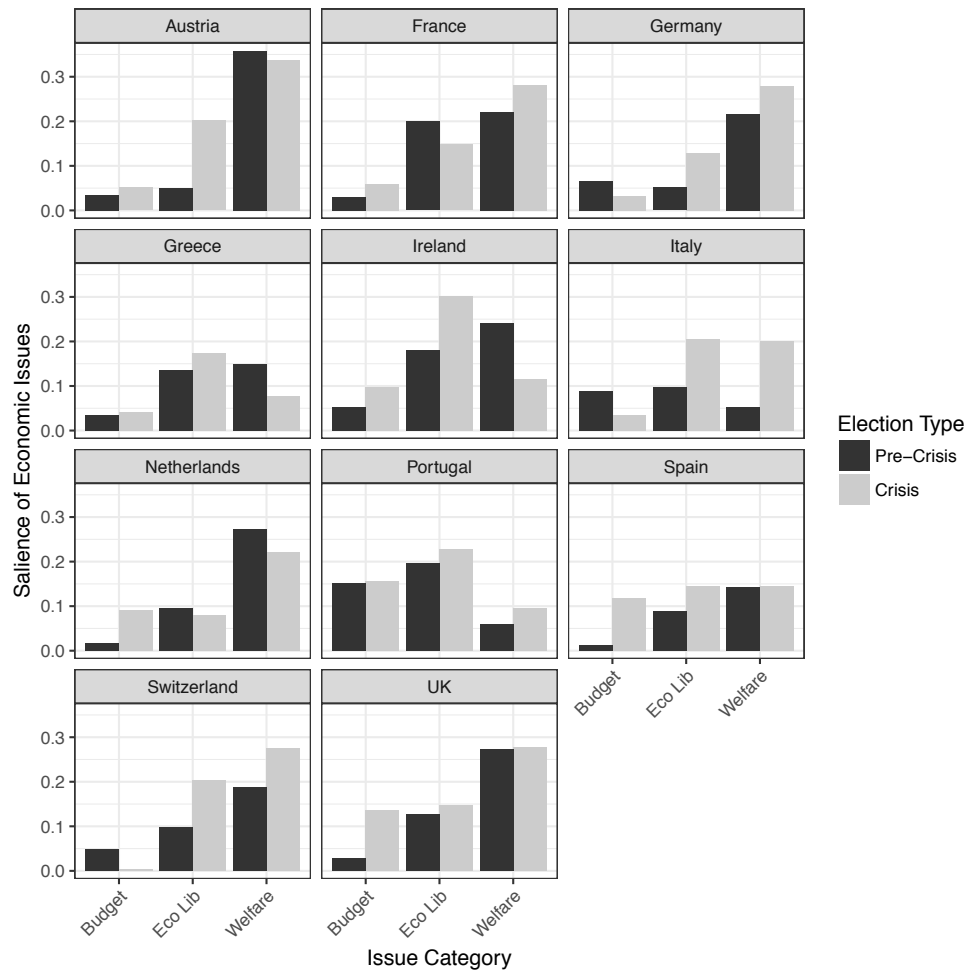
parties.⁷ It indicates that the crisis did not systematically change party competition for welfare and economic liberalism. Generally, the salience of issues relating to the welfare state is higher in Northern than in Southern European countries, which is confirmed by the country fixed effects in model 3 that are not shown in the table. Except in Italy, this general divide between Northern and Southern Europe survived the Great Recession, suggesting that differences in salience between countries might reflect deeper structural differences between the two regions (e.g. different welfare state traditions). At the same time, some social democratic parties increased the salience of economic liberalism during the crisis whereas their sister parties in other countries decreased the salience. Thus, there is not a single pattern that captures changes in salience across all countries, which is confirmed by the regression analyses in model 3 and 4 of Table 3.2. However, model 5 of the same table shows that this is not true for the third category. The results indicate that moderate right-wing parties addressed issues relating to budgetary rigour more than other parties before 2008, but that social democratic parties, liberal, and far left parties increased the salience of budgetary rigour after 2008. As shown in Figure 3.2, the salience of budgetary issues increased for moderate centre-left parties in nearly all countries. In sum, this suggests that social democratic parties increasingly spoke about budgetary issues during the crisis, but in the absence of evidence about the positions of social democratic parties it is not clear whether this happened because social democratic parties opposed or supported budgetary rigour.⁸ Therefore, I now turn towards analysing the positions of social democratic parties.

Social democratic parties and the crisis: Changes in issue positions

The economic crisis did not only change the salience of economic issues, but it also influenced the positions that parties took on these issues. Figure 3.3 compares the left-right position before and after 2008 for the centre-left and centre-right parties. It illustrates that every social democratic party shifted to the left after 2008, except the Labour Party in Ireland and the PvdA in the Netherlands. On average, these parties shifted their aggregate left-right position by 0.15 points. Furthermore, in most countries the moderate right as well as other parties (not shown in Figure 3.3) moved in the

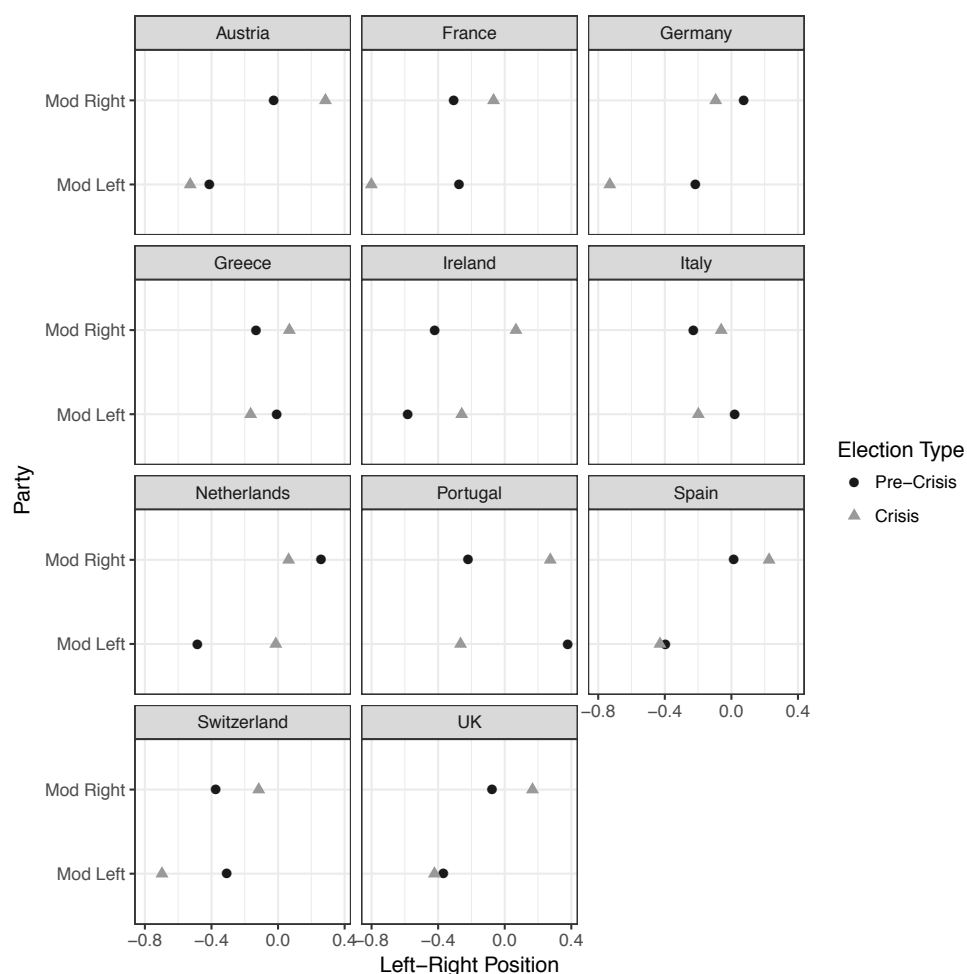
⁷Appendix A.6 shows the nominal changes for each issue category. In Appendix A.7 parties are clustered according to these changes.

⁸These effects were again not systematically affected by the depth of the crisis. The three-way interaction used above is not significant for any of the categories, as shown in Appendix A.8.

Figure 3.2: Salience of different economic issues for social democratic parties by country

opposite direction as social democratic parties. Hence, there is evidence that the crisis led to a divergence of mainstream parties and, thereby, partly reversed the neoliberal convergence among mainstream parties that had occurred prior to the crisis.

In order to test whether these differences are statistically significant, I again use regression analysis. The results in model 1 of Table 3.3 show that the moderate left- and right-wing parties indeed had programmes that were very similar prior to the crisis because the coefficient for moderate left-wing parties is not statistically significant when the moderate right is used as the reference category. The differences between mainstream parties on economic issues had all but eroded and only far left parties had programmes that were significantly different from the mainstream in economic terms. However, the Great Recession changed this picture. As indicated by the interaction term, social democratic parties shifted leftwards and competed on a

Figure 3.3: Average party positions on economic issues by party family by country

programme that was different from the programme of the moderate right. This is true even when controlling for other factors that could potentially influence a party's position on the left-right dimension of political conflict, including economic conditions and potential constraints from government responsibility. Thus, there is evidence that the Great Recession ended the neoliberal convergence, i.e. parties distinguished themselves again by different economic positions, as partisan theory expects (e.g. Hibbs, 1977).

Model 2 in Table 3.3 examines whether these changes were conditional on the depth of the crisis. Given that the three-way interaction term is not statistically significant, this does not seem to be the case. Contrary to my expectation, social democratic parties shifted to the left independently of the depth of the crisis. Instead, the crisis

Table 3.3: OLS Regression - Left Right Positions of Different Party Families

	Dependent Variable				
	Aggregate I	Aggregate II	Welfare	Eco Lib	Budget
	(1)	(2)	(3)	(4)	(5)
Far Right	0.21 (0.17)	-0.48 (0.62)	0.10 (0.21)	0.43* (0.24)	0.17 (0.28)
Liberal	0.22 (0.17)	-0.04 (0.52)	0.12 (0.20)	0.32 (0.23)	0.03 (0.28)
Moderate Left	0.05 (0.14)	-0.12 (0.46)	0.07 (0.17)	0.12 (0.19)	0.02 (0.23)
Far Left	-0.39*** (0.14)	-0.70 (0.57)	-0.32* (0.17)	-0.53*** (0.20)	-0.11 (0.24)
Green	0.04 (0.17)	0.13 (0.52)	-0.22 (0.21)	0.16 (0.24)	-0.23 (0.28)
Other	-0.21 (0.17)	0.20 (0.55)	-0.18 (0.21)	0.09 (0.24)	-0.29 (0.29)
Crisis Election	0.28** (0.12)	0.35 (0.37)	0.34** (0.15)	0.07 (0.17)	0.39* (0.20)
Unemployment (t-1)	0.002 (0.02)	0.03 (0.05)	0.04* (0.02)	-0.002 (0.02)	-0.05* (0.03)
Inflation (t-1)	-0.06 (0.05)	-0.03 (0.05)	0.03 (0.06)	-0.09 (0.07)	-0.12 (0.08)
Gov Deficit (t-1)	0.01 (0.01)	0.02 (0.01)	0.002 (0.02)	0.01 (0.02)	-0.03 (0.02)
GDP Growth (t-1)	-0.004 (0.01)	-0.003 (0.01)	-0.004 (0.01)	-0.005 (0.01)	0.02 (0.01)
Gov Debt (t-1)	-0.003 (0.003)	-0.002 (0.003)	-0.01* (0.003)	-0.004 (0.004)	0.001 (0.004)
Government (t-1)	0.08 (0.09)	0.08 (0.10)	0.16 (0.11)	0.05 (0.13)	0.21 (0.15)
Prime Minister (t-1)	0.09 (0.11)	0.10 (0.12)	-0.11 (0.14)	0.10 (0.16)	-0.05 (0.19)
Far Right x Crisis Election	-0.23 (0.20)	0.56 (0.66)	-0.06 (0.24)	-0.64** (0.28)	-0.25 (0.33)
Liberal x Crisis Election	-0.08 (0.20)	0.52 (0.56)	0.04 (0.24)	-0.04 (0.28)	-0.13 (0.33)
Moderate Left x Crisis Election	-0.47*** (0.17)	-0.28 (0.50)	-0.46** (0.20)	-0.56** (0.23)	-0.43 (0.28)
Far Left x Crisis Election	-0.37** (0.17)	0.07 (0.61)	-0.25 (0.20)	-0.12 (0.23)	-0.86*** (0.28)
Green x Crisis Election	-0.32 (0.20)	-0.33 (0.56)	-0.15 (0.25)	-0.26 (0.28)	-0.04 (0.33)
Other x Crisis Election	0.17 (0.21)	-0.21 (0.62)	0.11 (0.26)	0.04 (0.30)	0.11 (0.35)
Moderate Left x Unemployment (t-1)		0.02 (0.06)			
Crisis Election x Unemployment (t-1)		-0.02 (0.05)			
Mod Left x Crisis x Unempl (t-1)		-0.03 (0.06)			
Constant	-0.12 (0.25)	-0.38 (0.43)	-0.58* (0.30)	0.23 (0.35)	0.78* (0.41)
Observations	198	198	198	198	198
R ²	0.50	0.53	0.37	0.36	0.31
Adjusted R ²	0.41	0.40	0.26	0.24	0.18
Residual Std. Error	0.35 (df = 167)	0.35 (df = 154)	0.43 (df = 167)	0.49 (df = 167)	0.58 (df = 167)
F Statistic	5.58***	4.08***	3.25***	3.10***	2.49***

Note:

*p<0.1; **p<0.05; ***p<0.01
Reference party: Moderate Right
Reference country: United Kingdom

Note: Country fixed effects are included in the models but not shown. Similarly, three-way interaction terms for other party families are included in model 2 but not shown.

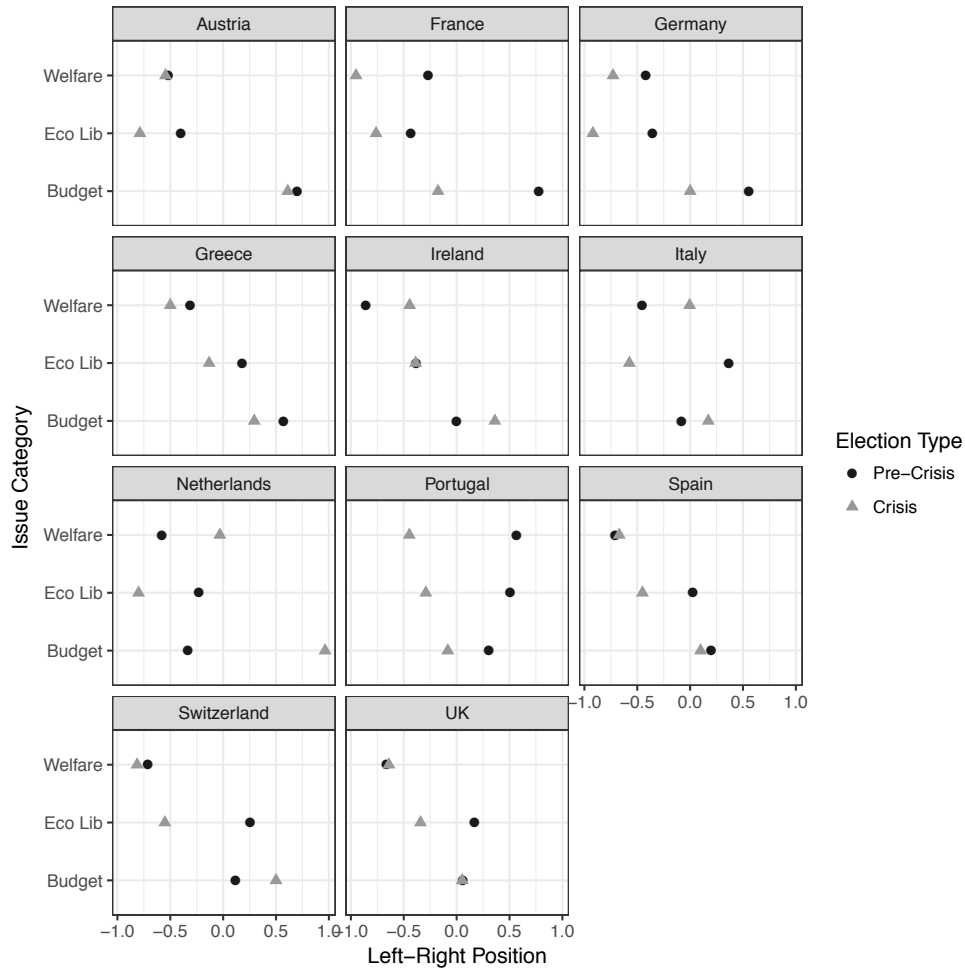
was apparently deep enough to induce social democratic parties to shift their positions in all the countries studied here. Still, it remains unclear whether this shift occurred with respect to all the issues category identified above.

Figure 3.4 plots the attitudes towards these issues on a scale from -1 to +1, where +1 means that a party is completely opposed to welfare, completely in favour of economic liberalism or completely in favour of budgetary rigour, respectively. The graph shows that many moderate left-wing parties had been strongly pro welfare even before 2008, but as the welfare state came under attack during the economic crisis, social democratic parties defended it even more resolutely. Only the Dutch PvdA and the Italian PD shifted to the right and adopted a more ambiguous position towards the welfare state during the crisis. This picture is similar for the position of social democratic parties towards economic liberalism, except that many social democratic parties had more ambiguous positions towards economic liberalism before the crisis. Reflecting the policies of the Third Way, social democratic parties in Italy, Greece, the Netherlands, Portugal, Spain, Switzerland, and the UK were in favour or had an ambivalent position towards economic liberalism prior to 2008. The social democratic parties in the other countries were not clearly opposed to it, either. However, after 2008 social democratic parties shifted strongly towards the left, thereby moving closer to their core ideology again. Thus, most social democratic parties campaigned again *for* the welfare state and *against* economic liberalism during the crisis.

The positions of social democratic parties with regards to fiscal policy do not follow the same pattern. Many parties already had an ambivalent position towards fiscal policies before the crisis, but some became even more supportive of budgetary rigour during the crisis, and thereby, shifted their position further to the right. The centre-left parties in France and Portugal were the only parties that adopted a weakly negative position towards budgetary rigour during the crisis after they had shifted their positions towards the left compared to the pre-crisis period. Nonetheless, their positions on budgetary rigour were still a lot further to the right compared to their positions on welfare and economic liberalism, as shown in Figure 3.4. Therefore, in general the centre-left mirrored the positions of the political right and campaigned for lower government budget deficits and government debt in response to the crisis. Contrary to existing evidence from parliamentary speeches (Maatsch, 2014), this happened in both creditor and debtor countries.

Again, these impressions can be substantiated by regression analysis. For this purpose, I repeat the analysis from above and use the party's average position on each individual issue category as dependent variables. The results show that prior to 2008,

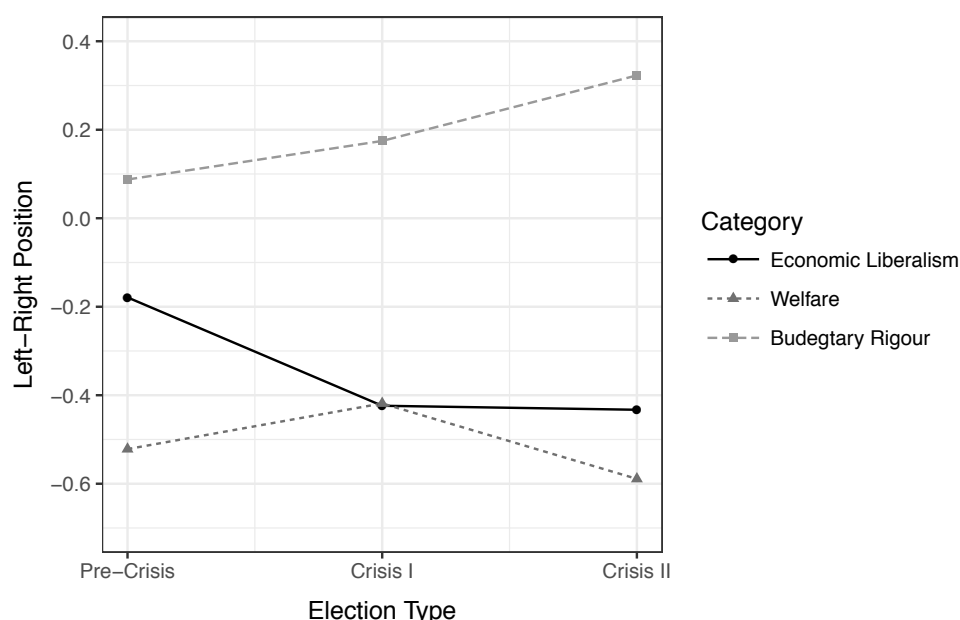
Figure 3.4: Average positions of social democratic parties on different economic issues by country



social democratic parties had not campaigned on programmes that were significantly different from other parties. However, during the crisis social democratic parties changed their programmes with regard to both welfare and economic liberalism, as indicated in model 3 and 4 of Table 3.3. Reflecting the new-found scepticism of the moderate left towards (financial) markets, this shift was particularly large for economic liberalism, as suggested above. The crisis, however, did not lead to a differentiation between centre-left and centre-right parties with regards to budgetary policies. The crisis induced centre-right parties to become more ‘austere’, which is indicated by the positive and statistically significant dummy variable in model 5 of Table 3.3. Yet, the interaction term (Moderate Left x Crisis Election) is not statistically significant, indicating that social democratic parties had no position on austerity that was significantly different from the position of centre-right parties after 2008.

This convergence on budgetary rigour, importantly, occurred in most countries and did not depend on the depth of crisis (Appendix A.8). Consequently, the Great Recession did not affect all aspects of party competition (on economic issues) equally. Contrary to the common assumption that parties bundle issues together, which leads to consistent policy packages, social democratic parties had a differentiated programmatic response to the crisis as they adopted positions with regard to different issue categories that are usually considered to be on different ends of the left-right spectrum.

Figure 3.5: Average positions of social democratic parties on different economic issues by election type



Note: Countries that only had one election from 2009 to 2015 are not shown in the graph. The two elections in Greece in 2012 are treated as a single observation.

Finally, for countries with more than one election during the economic crisis, we can analyse how stable the positions of social democratic parties were during the crisis. Figure 3.5 shows the average position of social democratic parties in eight countries by election type. It suggests that the most important change in the programmes of social democratic parties happened before the first crisis election: they shifted towards the left on economic liberalism and, hence, their positions on welfare and economic liberalism converged. At the same time, they slightly shifted towards the right on budgetary rigour. Prior to the second crisis elections, social democratic parties followed up on these initial shifts by shifting further to the left with regard

to economic liberalism, while shifting further to the right on budgetary rigour. This is further evidence that social democratic parties turned away from their Third Way during the Great Recession, but that they did not attempt to engineer a paradigm shift with regard to fiscal policies. Importantly, this created some inconsistencies within their programmes: while austerity might be compatible with state intervention (e.g. minimum wage or financial regulation), defending the welfare state is not. Instead, austerity usually leads to welfare state retrenchment (Armingeon et al., 2016), which would make it very difficult for social democratic parties to implement their programmes if they were voted into government again. Further evidence from countries with additional elections during the crisis suggests that there are two different ways that social democratic parties might resolve this tension (as shown in Appendix A.9). On the one hand, the PS in Portugal shifted its position on austerity towards the left prior to the election in 2015. On the other hand, PASOK in Greece shifted its position on economic liberalism and welfare to the centre again in 2015 after the far left party Syriza had successfully established itself as the main actor on the left of the party system. This indicates that social democratic parties are likely to further adjust their programmatic positions in the wake of the crisis but that they might not resolve the internal tensions within their platforms in a uniform way across Europe.

Conclusion

In conclusion, the Great Recession systematically changed the platform on which the European moderate left competed in elections. In terms of salience, social democratic parties paid more attention towards economic issues again, but this was mirrored by a general increase of salience for all parties. Centre-left parties moved in tandem with centre-right and liberal parties and emphasised economic issues more during the Great Recession. In this way, the crisis halted a previous trend that saw mainstream parties appeal to cultural issues prior to the crisis. However, in terms of positions, left-wing parties set themselves apart from other parties in response to the Great Recession. Despite the popular perception that the left was missing and failed to defend its core ideology during the crisis, my findings paint a more nuanced picture. In office, social democratic parties might have struggled to implement their desired policies, but in programmatic terms social democrats responded to the crisis distinctively: in almost all countries studied here, they defended the welfare state and became more sceptical of economic liberalism again. Thereby, the centre-left retracted large parts of its Third Way policies and reversed the neoliberal convergence

that scholars had observed prior to the Great Recession. Yet, these parties did not shift to the left in response to the crisis with regard to all categories. Importantly, social democratic parties accepted the need for fiscal consolidation and budgetary rigour, which created some tensions within their platforms.

In light of these tensions it is even more puzzling that social democratic parties accepted the austerity settlement in Europe since 2010. According to my evidence, the Great Recession had the potential for a critical juncture for party competition in some respect: while parties changed the salience that they attribute to economic issues in tandem, they changed their programmes in different directions in response to the economic shock. Although we cannot be certain that parties will not shift back to their pre-crisis position, this confirms that parties are strategic actors that respond to changes in their economic context. Still, social democratic parties adopted a rather inconsistent programme in response to the Great Recession. They did not change their positions on all economic issue categories in the same direction and bundled together policy packages that do not fall on the same end of the left-right dimension. Especially the fiscal policies that social democratic parties have put forward can neither be easily squared with their support for the welfare state nor with their own core ideology. The next chapters will attempt to make sense of this puzzling response of the Great Recession.

Chapter 4

Attitudes Towards Austerity: Analysing the Public's Debt Aversion During the Eurozone Crisis

Introduction

In advanced economies, government revenues and expenditures make up close to 50 percent of GDP and both have significant distributive consequences. Citizens benefit from a large amount of government spending ranging from welfare benefits to infrastructure investment, but they also pay for most of this spending through direct and indirect taxation. Government revenues and expenditures are, therefore, a constant source of political conflict in democratic countries. Yet, in the context of the sovereign debt crisis in Europe, government debt also became strongly politicised: beginning with the Greek crisis that erupted in spring 2010, austerity policies, including deep cuts in government expenditures, tax increases, and structural adjustment programmes, became the only game in town.

Based on a large amount of research in economics and political science this dominance of austerity is surprising. For a long time, the simple working assumption had been that ‘voters may simply prefer low taxes and high spending, and reward politicians who deliver these, even though such a response requires some sort of “fiscal illusion” ’ (Brender and Drazen, 2008, p. 2204). For example, the literature on po-

litical business cycles is based on the idea that politicians have an incentive to buy off voters and thus increase government spending or reduce taxes prior to elections (e.g. Nordhaus, 1975; Golden and Poterba, 1980). Yet, during the recent economic crisis governments across Europe did the opposite and endorsed fiscal orthodoxy. As the previous chapter has shown, even social democratic parties accepted this turn towards austerity in the wake of the Great Recession. Echoing the policy debates of the 1980s, TINA – there is no alternative – became the catch-phrase of economic policy once again.

The prominent rise of anti-austerity parties, movements, and politicians like Syriza, Podemos or Jeremy Corbyn seems to suggest that austerity caused a large amount of political discontent among voters. This is also supported by emerging research on the political effects of austerity episodes during the economic crisis (e.g. Bojar et al., 2018; Hübscher and Sattler, 2017; Talving, 2017). However, across most of Europe, the austerity settlement has only been challenged on the margins. Although the urgency to consolidate sovereign debt has faded in recent years, austerity continues to shape Europe’s post-crisis political economy. Given that politicians are accountable to their electorate, this persistence of austerity cannot easily be squared with the common belief that citizens support expansionary fiscal policies.

In this chapter, I thus attempt to analyse the public’s preferences towards government debt more carefully.¹ This analysis is necessary because the cost of government deficits and debt are not entirely obvious for citizens, which also distinguishes government debt from other macroeconomic indicators. As Hibbs (1977) argued, the cost of unemployment, for example, is straight-forward: it represents lost output and hence a large majority of citizens care about it. Yet, with regard to fiscal policies citizens might be more concerned with the distributive consequences of individual policies (e.g. lower social spending or higher income taxes) rather than their effect on government debt. In other words, it remains unclear what drives the public’s “debt aversion”, that is, the public’s support for fiscal consolidation.

To explore this issue, this chapter is – to the best of my knowledge – the first study to systematically investigate the debt aversion of individuals across a large amount of countries. I use data from the Eurobarometer, which has regularly asked respondents about their attitudes towards fiscal consolidation since 2010. The data shows that a large majority of citizens felt uneasy about their country’s government deficit and debt during the Eurozone crisis and my empirical analysis tests how different

¹In the overall thesis, public opinion is used as a independent variable. In this thesis specifically it is used as the dependent variable, in order to understand the pressures for austerity fully

individual and national-level factors affect the public's debt aversion. To this end, the chapter draws on a broader literature on macroeconomic policy preferences to derive some theoretical expectations about different determinants of debt aversion. These expectations will then be tested using time-series cross-sectional and micro-level regression analysis.

Public preferences towards fiscal consolidation

Although a large amount of research shows that individual preferences matter for policy outcomes (e.g. [Brooks and Manza, 2007](#); [Iversen and Soskice, 2001](#)), the existing research is inconclusive about public preferences towards fiscal consolidation. Originally, the literature on political business cycles assumed that voters support higher government spending due to self-interest (e.g. [Nordhaus, 1975](#); [Golden and Poterba, 1980](#)) and as a result, it should be difficult for governments to reduce spending. This claim is also supported by a large literature on public choice theory, which argued that parties look after the interests of their constituency but ignore the collective interest. Governments are, therefore, expected to spend excessively on their constituencies while discounting the cost of excessive government deficits and debt ([Alesina and Drazen, 1989](#); [Franzese, 2002](#); [Weingast et al., 1981](#)).

The prominent literature on the 'new politics of the welfare state' implicitly shared this view. [Pierson \(1996, 2001b\)](#) argued that existing welfare state programmes are difficult to cut because key social groups and voters would oppose such policies. Depending on the constitutional rules, these groups would use institutional veto points to block retrenchment ([Immergut, 1992](#)). [Pierson \(1996, p. 178\)](#) thus emphasised that 'frontal assaults on the welfare state carry tremendous electoral risks' and that 'even halting efforts to dismantle the welfare state have usually exacted a high political price' ([Pierson, 1996](#), pp. 174-175). Even in the face of high deficits, welfare state retrenchment was seen as unlikely.

However, empirically the evidence is mixed. While some authors showed that fiscal retrenchment on the aggregate level reduces support for the government among voters (e.g. [Hübscher and Sattler, 2017](#); [Talving, 2017](#); [Bojar et al., 2018](#)), others argued that the opposite is true (e.g. [Alesina et al., 1998](#); [Giger and Nelson, 2011](#); [Arias and Stasavage, 2018](#)). Much of the former research has been motivated by the experience of the Great Recession, during which austerity contributed to the current political upheavals across Europe. In this context, [Talving \(2017\)](#) showed that austerity significantly reduced the support for the incumbent government, while [Hübscher and](#)

Sattler (2017, p. 151) argued that governments ‘associate significant electoral risks with consolidations because electorally vulnerable governments strategically avoid consolidations towards the end of the legislative term in order to minimise electoral punishment.’ Similarly, (Bojar et al., 2018) studied the aggregate response in opinion polls to austerity showing that austerity indeed exacts a high price on the popularity of governments. In combination with emerging research on the impact of austerity on Brexit (Fetzer, 2018), the rise of the NSDAP in Germany in the 1930s (Galofré-Vilà et al., 2017), and social unrest (Ponticelli and Voth, 2011, 2017), this research supports the notion that voters oppose fiscal consolidation.

Until today the dominant finding in the literature is the opposite, though. Alesina et al. (1998, 198) argued that there is ‘no evidence of a systematic electoral penalty or fall in popularity for governments that follow restrained fiscal policies’ and even governments that ‘are willing to cut transfers and the government wage bill – traditionally considered the two most politically charged components of spending – are not punished by the voters.’ Recent research has supported this finding. Alesina et al. (2011) analysed data from 19 OECD countries from 1975 to 2008, showing that governments which quickly reduce the budget deficits are not systematically punished. Similarly, Giger and Nelson (2011) found that parties do not face the wrath of the voter when they retrench social policies; instead, some parties even gain votes following retrenchment. This finding has been supported by a recent study from Arias and Stasavage (2018), who do not find evidence for austerity in a broad set of countries from 1870 to 2011, either.

Recently, Barnes and Hicks (2018) argued that these findings can be explained by the power of media and elite cues. They marshal an impressive array of evidence to show that the framing of austerity in the media strongly influences attitudes towards fiscal consolidation, allowing them to conclude that ‘even if people may not have liked austerity, they have tended to think that it is necessary’ (Barnes and Hicks, 2018, p. 352). Yet, there is even a burgeoning literature that views voters as fiscally conservative in the first place (Brender and Drazen, 2008; Hayo and Neumeier, 2016; Heinemann and Hennighausen, 2012; Kalbhenn and Stracca, 2015; Stix, 2013; Stokes, 1996). From this perspective, voters are opposed to large government deficits and debt. They seem to equate the budget of their government with that of a private household and favour balanced budgets (Blinder and Holtz-Eakin, 1984; Peltzman, 1992). Fiscal consolidation therefore may not be as unpopular as it is commonly thought. Alesina et al.

(1998) even argue that voters systematically punish deficit spending and tax cuts and reward governments that pursue fiscal consolidation.²

Differences in debt aversion across individuals and countries

The finding that voters are fiscally conservative does not imply that the public's debt aversion does not vary. The costs of fiscal consolidation differ across individuals and countries, which should systematically affect citizens' macroeconomic priorities. It is unlikely that fiscal consolidation is a priority for all voters; rather there should be variation in the extent to which voters care about government debt for two reasons. First, the level of government debt is an abstract number that many voters do not fully understand; and second, fiscal consolidation usually has significant costs for the electorate because it is often achieved through the reduction of government spending or increases in taxation. Consequently, it seems likely that there are many voters 'fiscal conservatives', who in principle agree with the notion of fiscal consolidation. Yet, there are fewer 'fiscal hawks', who strongly support fiscal consolidation and view it as a priority, thereby accepting the costs associated with budget consolidation. This is supported by results from Armingeon and Giger (2008), who show that the effect of fiscal retrenchment depends on the politicisation of these policies during electoral campaigns, as well as by evidence from Spain (Fernández-Albertos and Kuo, 2016), which suggests that only some voters turn against austerity while others do not. If this is true, however, it begs the question what determines the citizen's debt aversion?

The existing literature cannot answer this question. Existing studies usually focus on individual countries (e.g. Stix, 2013; Hayo and Neumeier, 2016; Heinemann and Hennighausen, 2012; Fernández-Albertos and Kuo, 2016) and they use different measures to capture preferences towards fiscal consolidation. As a result, the literature is very idiosyncratic and it is not clear how well findings travel across countries. Moreover, previous research on the individual-level determinants of preferences towards fiscal consolidation suggests that individual-level differences are poor predictors for these preferences. For example, Blinder and Holtz-Eakin (1984, p. 146) claim that there is a '[long] list of socio-economic variables that apparently, and often surprisingly, have no bearing on support for the balanced budget'. Barnes and Hicks

²These findings conveniently supplement Alesina's "expansionary fiscal contraction" thesis (Alesina et al., 1998; Giavazzi and Pagano, 1990): not only can fiscal consolidations have an expansionary economic effect, but these consolidation initiatives are also rewarded by voters.

(2018) recently confirmed this finding. Yet, there is broader literature about citizens' macroeconomic policy preferences (e.g. Hibbs, 1987b; Hibbs et al., 1982; van Lelyveld, 1999; Scheve, 2004; Barnes and Hicks, 2018; Jayadev, 2006), which can be used as a starting point to discuss the individual- and national-level characteristics that might be important to explain the public's debt aversion.

Individual-level determinants

Research on citizen's macroeconomic policy preferences has uncovered a list of variables that are important determinants of individual preferences. First and foremost, the literature shows that the distributive consequences of variables like unemployment and inflation affect the macroeconomic policy preferences of individuals (Hibbs, 1987b; Hibbs et al., 1982; van Lelyveld, 1999; Scheve, 2004; Barnes and Hicks, 2018), which should also be true for government debt. Lower income-groups are more at risk of unemployment and low or negative wage growth as a result of fiscal consolidation. In addition, they are also more likely to rely on government spending – whether in the form of benefits or through the use of public services – to finance consumption. People with lower incomes should thus be more concerned about the costs of fiscal consolidation, which leads to a positive relationship between income and debt aversion.

Apart from the distributive consequences in the labour market, the macroeconomic priorities of citizens – especially with regard to government debt – should also depend on the ownership of nominal assets. Kalecki (1943, p. 5) already argued that it is important to distinguish between creditors and debtors. Price increases are to disadvantage of small and big “rentiers” because they reduce the real value of their assets. Therefore, individuals who own assets should be relatively more inflation averse than debtors.³ Scheve (2004) finds evidence that this translates into macroeconomic policy preferences and there are reasons to believe that it also influences the debt aversion of citizens. Creditors rely less on active employment for their income, but they should be concerned about the value of their assets. Moreover, they can expect to pay for higher government debt through future taxation and thus they are likely to internalise the costs of fiscal expansions. In contrast, individuals that are credit constrained benefit from government deficits. They rely on active employ-

³ An emerging literature also finds that asset ownership influences other public preferences towards other economic policies, including redistribution and the welfare state (Ansell, 2014, 2012) and financial policies (Pagliari et al., 2018). Also see Fligstein and Goldstein (2015) Mau (2015), and Langley (2008) for studies about the impact of financialisation from a sociological perspective.

ment to make a living and are more likely to profit from a demand stimulus, which raises employment and wages. They also benefit from deficits because government debt shifts the tax burden into the future and thereby effectively provides taxpayers with a loan (Heinemann and Hennighausen, 2012). Thus, creditors should be more supportive of fiscal consolidation than debtors.

Government debt does not only have redistributive implications for labour and capital, but it also has distributive effects across generations. As many European societies are ageing, a shrinking active labour market population has to shoulder a greater economic burden, which increases the salience of the inter-generational redistributive conflict (e.g. Vlandas, 2018). Public debt is an obvious way that taps into this conflict. Governments can use debt to finance today's consumption through tomorrow's taxation and older generations should expect to repay a smaller amount of the debt through taxation. Based on self-interest, there should be a negative relationship between age and support for fiscal consolidation.⁴ Yet, research on preferences towards inflation has also focused on pensioners and others groups that receive fixed incomes, arguing that they are more sensitive towards inflation if pensions are not automatically inflation-adjusted (Howarth and Rommerskirchen, 2017). In a similar vein, retired people and benefit recipients might be more debt averse than other people, which could undermine the relationship between age and debt aversion.

However, research has also shown that the macroeconomic priorities of individuals reflect their political ideology (Scheve, 2004; Alt, 1979; Hibbs, 1987a). As Kalecki (1943, 2) already argued, 'there is a political background in the opposition to the full employment doctrine, even though the arguments advanced are economic.' To a large extent this political opposition might be endogenous to different material interest, though. For example, Hibbs (1977) argued that left-wing and right-wing parties have different preferences regarding unemployment and inflation because their respective constituencies are differently affected by unemployment and inflation. Yet, the supply of policies by elites, including political parties, also shapes the demand and therefore policy preferences are also influenced by partisanship. Although some argue that there has been a "neo-liberal convergence" (Roberts, 2014) of mainstream parties (e.g. Glyn, 2001; Mishra, 1999), there are still differences between the macroeconomic priorities of the left and the right in most European countries (see chapter 3): while parties on the left are more concerned about unemployment, parties of the right are traditionally more concerned about inflation and government debt. Assum-

⁴This relationship might be mediated by whether or not individuals have children. Citizens with children might be less inclined to forego the interests of future generations and consequently, they might be more debt averse than people without children.

ing that there is an alignment of popular attitudes and party positions, voters that are further on the left should be more opposed to fiscal consolidation than voters on the right.

Country-level determinants

Many factors that affect the public's preferences for fiscal consolidation may, however, be to a certain extent endogenous to macroeconomic policy and existing economic conditions. First and foremost, the costs of an increase in the rate of the deficit and debt, just like the costs of inflation and unemployment increase in the inflation and the unemployment rate, respectively (Scheve, 2004). If voters adjust their debt aversion according to the costs that the government incurs, public concern over government debt should vary according to the existing deficit and level of government debt. In other words, there should be a positive link between debt aversion and government deficit and debt, respectively.

The prevailing economic climate should also influence debt aversion. In response to economic crises governments can, in the short-run, either use deficit-spending or cut spending and raise taxes. Assuming that Keynes was right, the latter has significant economic costs: by decreasing aggregate demand, it leads to lower growth and higher unemployment. If voters adopt a Keynesian perspective, they should recognize this and adjust their debt aversion according to the economic circumstances. In other words, citizens in countries with low growth and a high unemployment rate should be more opposed to fiscal consolidation than citizens in countries with a thriving economy.

However, there are strong reasons to believe that, on average, public opinion does not follow a Keynesian logic. Keynesian economic theory relies on complex arguments (like the paradox of thrift) that are difficult to grasp for policy-makers, let alone for the general public. Instead, it is more likely that voters draw on the personal experience of their household to form their opinion towards government debt (Gamble, 2013b; Skidelsky, 2013). For example, Stanley (2014) showed 'how an individual logic of excess borrowing and consumption translates to views on public deficits' (Barnes and Hicks, 2018, p. 343). In the past few years, politicians have often tapped into this sentiment, showing the force of the household analogy. We may, therefore, expect that voters are, on average, non-Keynesians and support fiscal consolidation when the budget deficit and government debt are high.

Still, [Walter \(2016\)](#) already showed that austerity is easier to implement in some countries than in others due to the national vulnerability profile of countries, which is structurally determined. In general, countries can choose to pursue external or internal devaluation in the face of a crisis and the path that countries choose depends on the relative cost of each path. Importantly, monetary integration in Europe strongly influences the relative costs of these paths. The general argument is that for countries inside the Eurozone, external evaluation is extremely difficult: they would have to leave the Eurozone, which would come with significant macroeconomic costs.⁵ Countries within the Eurozone are thus more likely to pursue internal devaluation, and given that this internal devaluation comes with significant (social) costs, citizens in these countries may be more debt averse than citizens in countries with a floating exchange rate.

Finally, there is a literature arguing that there are different ‘stability cultures’ in Europe ([Dyson, 2014, 2000](#); [Hayo, 1998](#)). The common fault-line identified is one between Northern and Southern Europe, which was evident prior to the creation of the EU: while Germany and its neighbours experienced relatively low rates of inflation and stable currencies, Southern European countries battled with inflationary pressures and the resulting need for currency depreciation. As [Howarth and Rommerskirchen \(2017, p. 387\)](#) argue, it is a common assumption that this stability cultures goes beyond the elites and is also reflected in public opinion. This should also have an influence on debt aversion because a central claim behind the stability culture is that high deficits cause inflation. Although there has been a low-inflation environment in Europe in the last few years, this is still the case today, i.e. ‘in the ongoing debate on the speed and scope of budgetary consolidation efforts, the link between fiscal profligacy and rising inflation has been presented as justification for fiscal consolidation’ ([Howarth and Rommerskirchen, 2017, 387-388](#)). Therefore, we can expect that there are cross-national differences in debt aversion across countries according to different stability cultures in Europe.

Data and Methods

To study preferences for austerity during the European sovereign debt crisis, I use data from the Eurobarometer. The survey is fielded twice a year by the European Commission to gauge trends in public opinion in all member states. Since spring

⁵For countries with a fixed-exchange rate the cost of external adjustment is also very high because they would have to leave the fixed-exchange rate mechanism to adjust externally.

2010, it has repeatedly asked respondents about their attitudes towards fiscal consolidation. Specifically, respondents were asked to agree or disagree with the statement that ‘measures to reduce the public deficit and debt in (OUR COUNTRY) cannot be delayed.’ I use the answers to this question as a dependent variable in my analysis. For this purpose, I first pool all Eurobarometer surveys from 2010 to 2016, including data from the beginning of the crisis, the height of the storm, and the slow subsequent recovery. I thus study fiscal consolidation across 14 waves in all EU member states.⁶ In the pooled dataset I operationalise debt aversion in two different ways by creating two variables called “strong” and “weak” debt aversion, respectively: first, strong debt aversion is a binary variable that equals 1 if the respondent strongly agrees with the statement and 0 otherwise (i.e. it includes *only* fiscal hawks); second, weak debt aversion is a binary variables that equals 1 if the respondent strongly *or* somewhat agrees with the statement (i.e. it includes both fiscal hawks *and* fiscal conservatives).⁷

My empirical analysis then aims to analyse how different independent variables affect support for support fiscal consolidation. In particular, I analyse this data in several different ways. First, I create a summary file, which includes the average level of support for fiscal consolidation across the 28 countries over the 14 waves of the Eurobarometer, resulting in 392 observations. I use this file to descriptively evaluate trends in the level of support for fiscal consolidation across the EU countries between 2010 and 2016.

Second, I merge the aggregate file with a set of relevant control variables on the national level, including GDP growth, unemployment, and information about the government’s debt and deficit. The exact coding and sources for each variable are shown in Appendix B.1. I then use a random effects model to evaluate the national-level determinants of support for strong and weak debt aversion, i.e. I use a range of independent variables (in time $t-1$) to predict variation in a country’s share of fiscal hawks and fiscal conservatives (in time t). I primarily use a random effects model because it allows me to test the effect of time-invariant variables. Given that I have $i = 1, \dots, N$ countries at several time periods $t = 1, \dots, T$, my model has the form

$$Y_{it} = \beta_0 + x'_{it}\beta + z'_i\gamma + \varepsilon_{it} \quad (4.1)$$

⁶The countries include Austria, Belgium, Bulgaria, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden.

⁷Appendix B.2 reports the summary statistics of the debt aversion measures.

where $Y_{i,t}$ is debt aversion, β_0 is the constant, $x'_{i,t}$ is a vector of time-varying explanatory variables, z'_i is a vector of time-invariant variables, and β and γ are the respective vectors of regression coefficients.

For large time series, fixed-effect models are often more appropriate (e.g. Judson and Owen, 1999), but my panel only includes observations from fourteen waves. Formally, the Hausman test also suggests that the random effects models provide efficient and consistent estimates in my case⁸ while the augmented Augmented Dickey-Fuller test suggests that the series of my dependent variable is stationary.

Third, I study preferences towards fiscal policies on the individual level by using the merged file of all 14 Eurobarometer surveys. In total, I have more than 380,000 respondents, who were asked about their preferences towards fiscal consolidation between 2010 and 2016 and I use this data to analyse the individual-level determinants of support for fiscal consolidation. For this purpose, I construct a set of control variables from the Eurobarometer to test my expectations. These variables include a respondent's education, occupation, labour market status, age, financial situation, their left-right ideology, house ownership, as well as a range of control variables (e.g. marital status, gender). The exact coding of these variables is shown in B.1. I use these variables to explain variation in the two binary dependent variables that I constructed, as explained above. Specifically, I now use a binary logit model of the following form

$$\ln\left(\frac{p}{1-p}\right) = \beta_0 + x'_i\beta \quad (4.2)$$

where p is the probability that an individual is debt averse ($Y = 1$), x'_i is a vector of explanatory variables, and β is a vector of regression coefficients.⁹

Finally, I integrate the study of the national-level determinants with the study of individual-level determinants. For this purpose, I include the national-level variables as independent variables in the previous analysis. Given that disturbances might now be correlated within countries, the standard errors from the Logit models can be seriously biased. Therefore, I use multi-level analysis with random intercepts to test

⁸The Hausman test examines whether the coefficients from the random effects model are systematically different from the coefficients from the fixed effect model. In my case, the tests suggests that random effects models are appropriate, but the results from the fixed effect models are included in Appendix B.3 as a robustness test.

⁹Unfortunately, there are two questions which were not asked across all twelve survey: the left-right placement of individuals and whether individuals own a house. The models shown below, therefore, only draw on respondents from seven waves, but the results with all waves are shown in Appendix B.4 as a robustness test.

the effect of individual-level and national-level determinants simultaneously. In this analysis individuals are nested in countries, recognising that debt aversion depends on the economic context in which the question is asked. To explore this issue further, I also use cross-level interactions, which allows me to test how the effect of individual-level variables varies across different economic contexts. Assuming that there are $i = 1, \dots, N$ individuals clustered in $j = 1, \dots, N$ countries, I am estimating a model of the following form

$$\ln\left(\frac{P}{1-p}\right) = \beta_0 + x'_{ij}\beta + u_j + e_{ij} \quad (4.3)$$

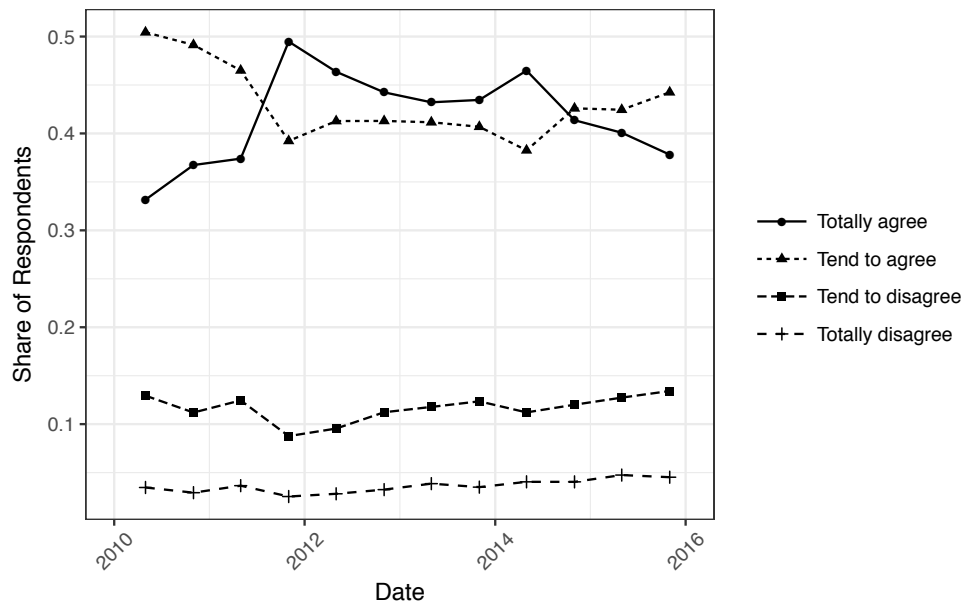
where the probability p that an individual is debt averse is influenced by the random error component u_j , i.e. a deviation of the intercept of a country from the overall intercept β_0 .

Empirical results

Differences in debt aversion across countries

In the last few years, austerity created a large amount of political discontent across Europe, but there was still a majority of citizens who supported fiscal consolidation as measured by the Eurobarometer. Figure 4.1 plots average debt aversion in Europe over time. It shows the average share of respondents that agreed or disagreed with the statement that debt reduction could not be delayed in all 28 countries from 2010 to 2016. The Figure indicates that in the first two years of the crisis around 85 percent of respondents agreed that fiscal consolidation cannot be delayed. More specifically, according to my definition from above, more than 50 percent of respondents were fiscal conservatives in 2010, whereas more than 30 percent were fiscal hawks. As the sovereign debt crisis in Europe intensified, the share of fiscal hawks even increased and in November 2011 nearly 50 percent of respondents strongly agreed that fiscal consolidation in their country could not be delayed. At the same time, the share of people who weakly agreed that this was the case dropped to around 40 percent.

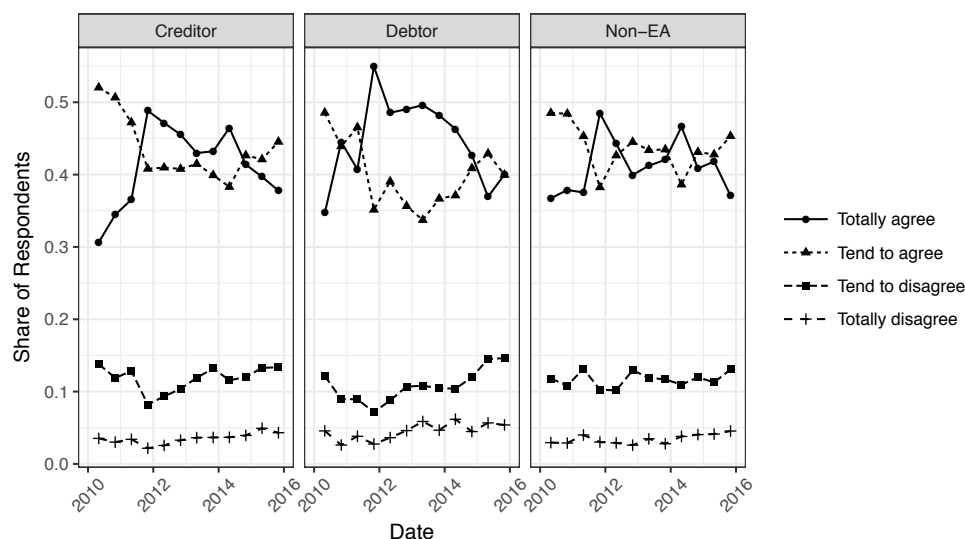
This support for fiscal consolidation decreased over time during the crisis. The share of people who tended to agree with the need for fiscal consolidation remained constant at around 40 percent from 2011 onwards, but the share of people who strongly agreed decreased from around 50 percent in November 2011 to 36 percent. This might indicate that there was a thermostatic effect (Wlezien, 1995; Soroka and

Figure 4.1: Share of respondents by debt aversion

[Wlezien, 2010](#)): as Europe suffered from the effects of austerity, citizens became more sceptical of the merits of fiscal consolidation. However, the support for fiscal consolidation still remained high even until the end of the crisis. In autumn 2016, still nearly 80 percent of citizens supported fiscal consolidation.

The support for fiscal consolidation was also high across different European regions and in countries with different structural positions vis-a-vis the Eurozone. Figure [4.2](#) shows that there are only very small differences between the three geographic regions within the Eurozone. In Southern Europe, there were more fiscal hawks at the height of the crisis than in Northern or Eastern Europe, but otherwise debt aversion was remarkably similar in all three regions. Figure [4.2](#) shows that there were also only small differences between countries with different structural positions vis-a-vis the Eurozone. For most of the period covered, the share of fiscal hawks was higher in debtor countries, which were battling with the sovereign debt crisis, than in other countries. This indicates that support for fiscal consolidation was possibly influenced by the size of the problem: in debtor countries, the government's deficit and debt were a particularly salient issue, which also influenced public opinion. This also shows that, at least with respect to public opinion, Northern Europe does not set itself apart by a particular strong stability culture (also see [Howarth and Rommerskirchen, 2017](#));

Figure 4.2: Share of respondents by debt aversion in countries with different structural positions



during the economic crisis, the public was equally supportive of fiscal consolidation in different regions across Europe.

Nonetheless, according to the data from the Eurobarometer, there was also significant variation in the aggregate level of debt aversion across countries. Figure 4.4 and 4.5 plot the share of fiscal hawks and fiscal conservatives by country, respectively. It shows that citizens in some countries strongly supported fiscal consolidation. Interestingly, this group includes countries that were at the heart of the sovereign debt crisis like Cyprus and Ireland, but also creditor countries like Germany and Finland. In contrast, in other EU member states the aggregate debt aversion was significantly smaller, but this group again includes both creditor countries (e.g. the Netherlands, Austria) as well as debtor countries (e.g. Greece and Spain). In other words, there is no clear pattern in a country's debt aversion and thus we need to better understand the underlying determinants of aggregate public opinion towards fiscal consolidation.

Country-level determinants

Turning to a simple regression analysis confirms that it is very difficult to explain debt aversion across countries. Table 4.1 the results from regression models with two different dependent variables: following the operationalisation from above, strong

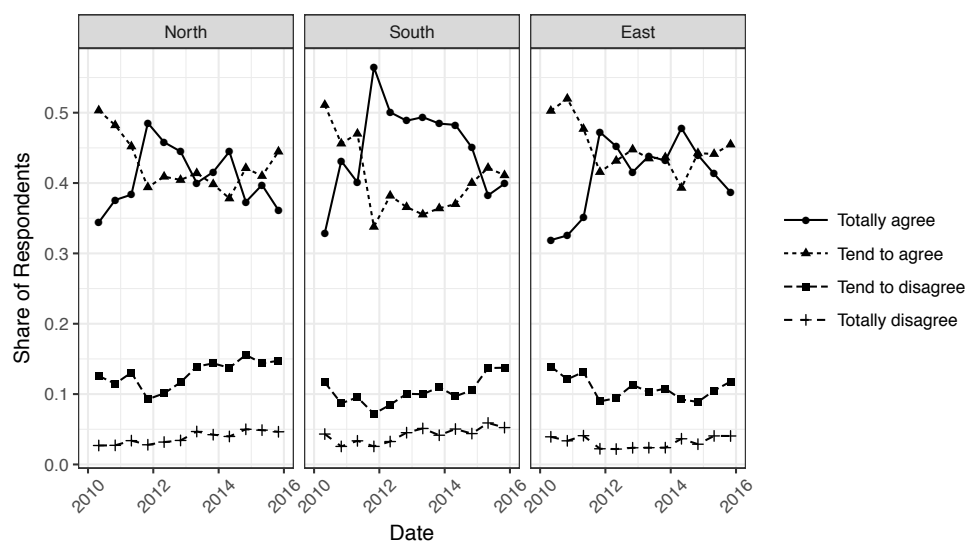
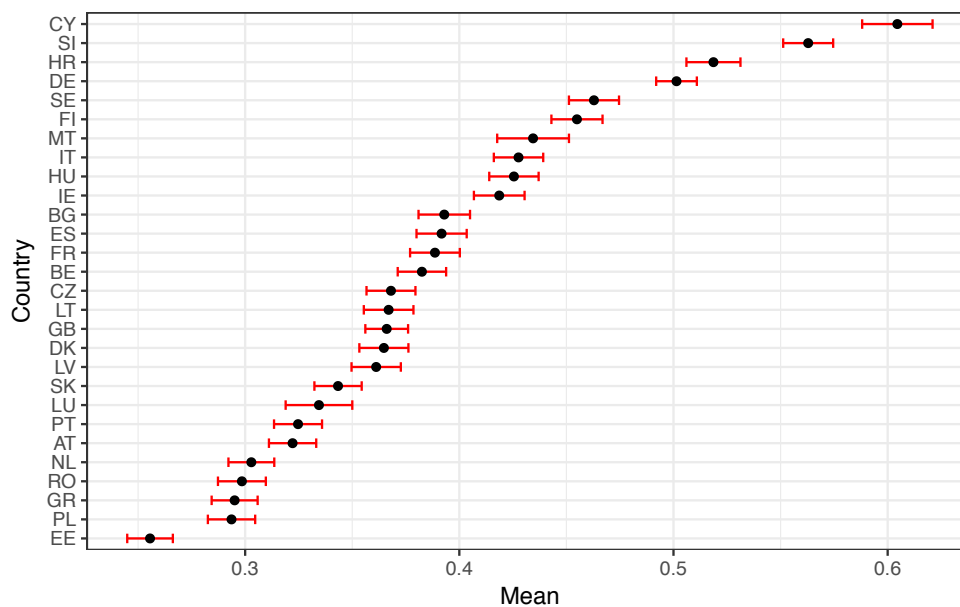
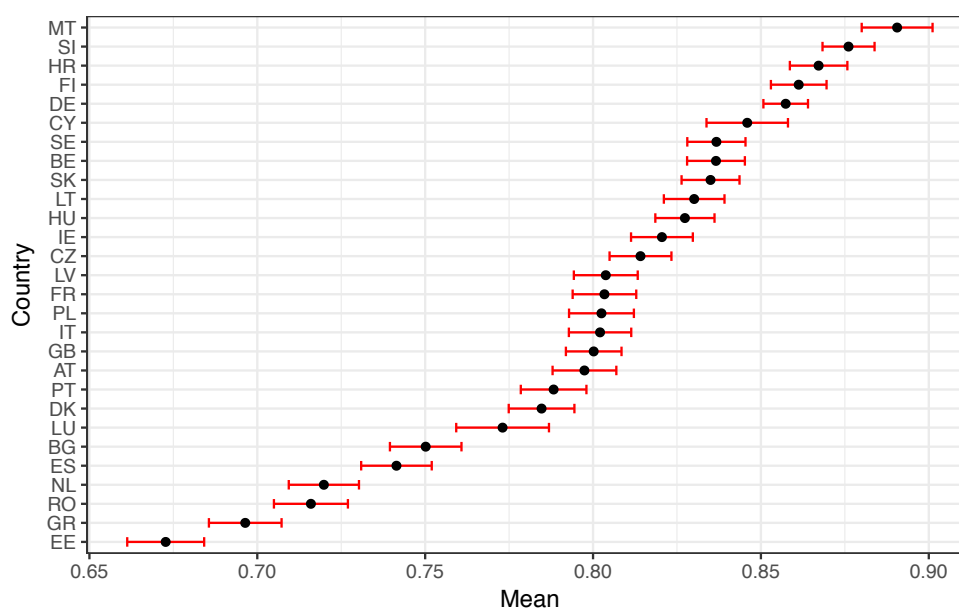
Figure 4.3: Share of respondents by debt aversion in different regions**Figure 4.4:** Share of fiscal hawks by country

Figure 4.5: Share of fiscal conservatives by country

debt aversion refers to the share of fiscal hawks, whereas weak debt aversion refers to the share of fiscal hawks *and* conservatives. In all four models, the regression coefficients are very small and only a few variables are statistically significant. In the first two models the R-2 is also extremely small, indicating that the independent variables can only explain a small share of the variance in the dependent variable.

Still, a few interesting results emerge from the regression analysis. First, in all four models the time-invariant variables do not have any effect whatsoever. Attitudes towards government debt neither differ systematically across regions nor across countries with different economic structural positions. Between 2010 and 2016, there was neither a systematic difference in the debt aversion between Northern, Southern, or Eastern Europe nor between creditor and debtor countries. Mirroring the findings from [Howarth and Rommerskirchen \(2017\)](#), this suggests that the stability culture in Northern Europe is a myth.¹⁰

Second, there is no evidence that public opinion follows a Keynesian logic; if anything the public's preferences go against the Keynesian logic. The results from all four models show that growth and the government's budget balance in the previous

¹⁰It is important to note that my analysis cannot say anything about whether a distinct stability culture existed in Northern Europe prior to the sovereign debt crisis. It is, of course, possible that public opinion only converged in the context of the recent crisis, when the costs of public debt became more obvious.

Table 4.1: Random effects model: Macro-level support for fiscal consolidation

	Debt aversion			
	Strong I	Strong II	Weak I	Weak II
	(1)	(2)	(3)	(4)
Growth (t-1)	-0.004** (0.001)	-0.004** (0.001)	-0.002 (0.001)	-0.002 (0.001)
Unemployment (t-1)	0.001 (0.002)	0.002 (0.002)	0.002 (0.002)	0.003 (0.002)
Debt (t-1)	-0.0000 (0.0004)	-0.0001 (0.0004)	-0.001*** (0.0003)	-0.001*** (0.0003)
Budget balance (t-1)	-0.004** (0.002)	-0.004** (0.002)	-0.01*** (0.001)	-0.01*** (0.001)
Status (Ref.: Creditor)				
. Debtor	0.03 (0.05)		-0.02 (0.03)	
. Non-EA	0.01 (0.04)		-0.02 (0.02)	
Region (Ref.: North)				
. South		0.04 (0.05)		0.02 (0.03)
. East		-0.002 (0.04)		-0.04 (0.03)
Constant	0.36*** (0.03)	0.37*** (0.04)	0.85*** (0.03)	0.86*** (0.03)
Observations	390	390	390	390
R ²	0.08	0.08	0.18	0.18
Adjusted R ²	0.06	0.06	0.16	0.17
F Statistic (df = 6; 383)	5.33***	5.45***	13.73***	14.26***

Note:

*p<0.05; **p<0.01; ***p<0.001

quarter are negatively correlated with debt aversion. On the one hand, growth is associated with a lower debt aversion among the public. This indicates that when growth is high, the public puts less emphasis on the importance of debt reduction; when growth is low, the public puts more emphasis on debt reduction. On the other hand, there is also a negative relationship between the government's budget balance and debt aversion. In other words, debt aversion is high when the government runs a deficit, while debt aversion is low when the government runs a surplus. Again this suggests that there might be a thermostatic effect in public opinion, i.e. that the public become more concerned about the government's debt when the issue is salient.

Interestingly, the share of fiscal conservatives in a country is also influenced by the level of debt, as model 3 and 4 of Table 4.1 show. Controlling for the government's deficit, government debt has a very small negative effect on weak debt aversion, whereas it does not have an effect on strong debt aversion. This suggests that debt aversion is smallest in countries with a high level of public debt, but a low government deficit. In these countries, the salience of government debt may have been smaller during the European sovereign debt crisis due to the historic size of it, i.e. citizens had already gotten used to high levels of government debt even prior to the crisis.

However, in general it is important to keep in mind that, as Figure 4.4 and 4.5 show, overall debt aversion was strong across most of Europe between 2010 and 2016. In light of the previous literature on political business cycles as well recent evidence that budget consolidation hurts the electoral prospects of parties (e.g. Bojar et al., 2018; Hübscher and Sattler, 2017; Talving, 2017), this support is puzzling. It is thus useful to dig deeper and to explore how different individual-level factors affect debt aversion.

Individual-level determinants

Table 4.2 shows the results of Logit regression with two different dependent variables: strong and debt aversion. Analogously to above, strong debt aversion measures whether individual respondents are fiscal hawks, while weak debt aversion measures whether they are fiscal hawks *or* fiscal conservatives. The models include common demographic variables like education, occupation, and age as well as a measure of an individual's financial situation and the individual's evaluation of the national economy. In line with my expectations, the regression models also include a measure for house ownership and the left-right placement of respondents.

Table 4.2: Logit regression: Individual-level determinants of debt aversion

	Debt aversion	
	Strong (1)	Weak (2)
Education (Ref.: No education)		
. Primary	0.17 (0.10)	0.23* (0.10)
. Secondary	0.32** (0.10)	0.39*** (0.10)
. Tertiary	0.38*** (0.10)	0.44*** (0.10)
Occupation (Ref.: Upper class)		
. Middle class	-0.07* (0.03)	0.05 (0.04)
. Skilled worker	-0.12** (0.04)	0.02 (0.05)
. Unskilled worker	-0.01 (0.06)	0.03 (0.06)
. Other	-0.10** (0.04)	0.03 (0.05)
Unemployed	0.03 (0.04)	-0.12** (0.04)
Financial difficulties (Ref.: Often)		
. Sometimes	-0.10** (0.03)	0.17*** (0.03)
. Rarely	0.10*** (0.03)	0.34*** (0.03)
Positive evaluation of economy	-0.10*** (0.02)	0.16*** (0.02)
Age	0.001 (0.001)	-0.004*** (0.001)
Retired	0.11** (0.04)	0.03 (0.04)
Children	-0.01 (0.02)	0.02 (0.02)
Female	-0.13*** (0.02)	-0.05** (0.02)
Married	0.04* (0.02)	0.11*** (0.02)
Home ownership (Ref.: No house)		
. With mortgage	0.09*** (0.02)	0.11*** (0.03)
. Fully paid	0.14*** (0.02)	0.21*** (0.03)
Left-right placement (Ref.: Left)		
. Centre	0.14*** (0.02)	0.26*** (0.02)
. Right	0.33*** (0.02)	0.38*** (0.02)
Constant	-1.05*** (0.12)	0.96*** (0.13)
Country fixed effects	Yes	Yes
Wave fixed effects	Yes	Yes
Observations	73,800	73,800
Log Likelihood	-47,169.15	-37,739.51
Akaike Inf. Crit.	94,446.29	75,587.02

Note:

*p<0.05; **p<0.01; ***p<0.001

Although the effect of individual variables is relatively small according to the results shown Table 4.2, they present evidence that debt aversion is correlated with several different variables, including education, house ownership, and left-right placement. First, education increases debt aversion in both models shown in the table. Given that education is ‘a common indicator of both labour market skills and cognitive abilities’ (Scheve, 2004, p.11), it is usually a good proxy for income. As expected, the results thus suggests that there is a positive relationship between income and debt aversion. Individuals who are better off have a higher aversion to public debt because they are less likely to experience unemployment and to rely on social benefits, which are often threatened by efforts of fiscal consolidation.

Second, the regression models also indicate that debt aversion is influenced by asset ownership. In both models the coefficients for house ownership are positive and among the largest coefficients in the respective models. The resulting predicted probabilities are plotted in Figure 4.6, showing that respondents who own a home are more likely to be fiscal conservatives than respondents without a house: individuals that own a house or apartment that is fully paid have a 0.82 predicted probability of being a fiscal conservative and a predicted probability of 0.41 of being a fiscal hawk. In contrast, individuals that do not own a house or an apartment have a predicted probability of being a fiscal conservative of 0.77 and a predicted probability of being a fiscal hawk of 0.37. Respondents who own their home but still have to repay their mortgage neatly fall in between these two groups. These effects are very small, but to some extent they suggest that preferences towards fiscal consolidation are also influenced by the position of individuals in the capital market.

Third, debt aversion is also influenced by ideology. Both regression tables indicate that people on the left of the political spectrum are less averse to debt than people on the right. Figure 4.7 shows that people on the left have a predicted probability of 0.33 and 0.77 of being fiscal hawk or a fiscal conservative, respectively. In contrast, people on the right have a 0.40 and a 0.83 predicted probability of being a fiscal hawk or a fiscal conservative. People in the centre again fall in between these two groups. This suggests that ideology (in terms of an individual’s placement on the left-right scale) is also related to debt aversion even though its impact is (in substantive terms) small.

Despite these differences it is important to note, however, that respondents that identify as left, centre, and right all have a very high chance of being fiscally conservative. This is also shown in Table 4.3, indicating that the share of left-wing supporters who are fiscal conservatives never dropped below 70 percent during the period under

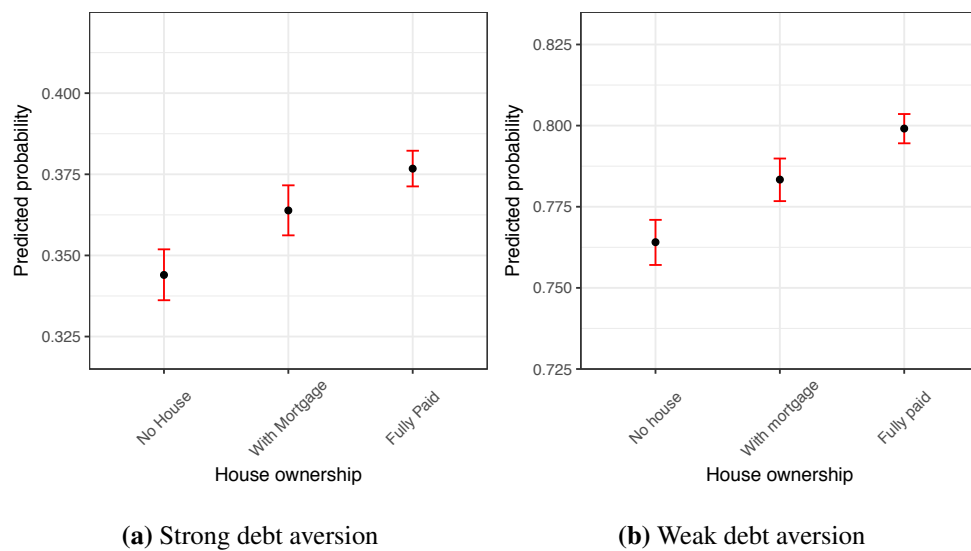
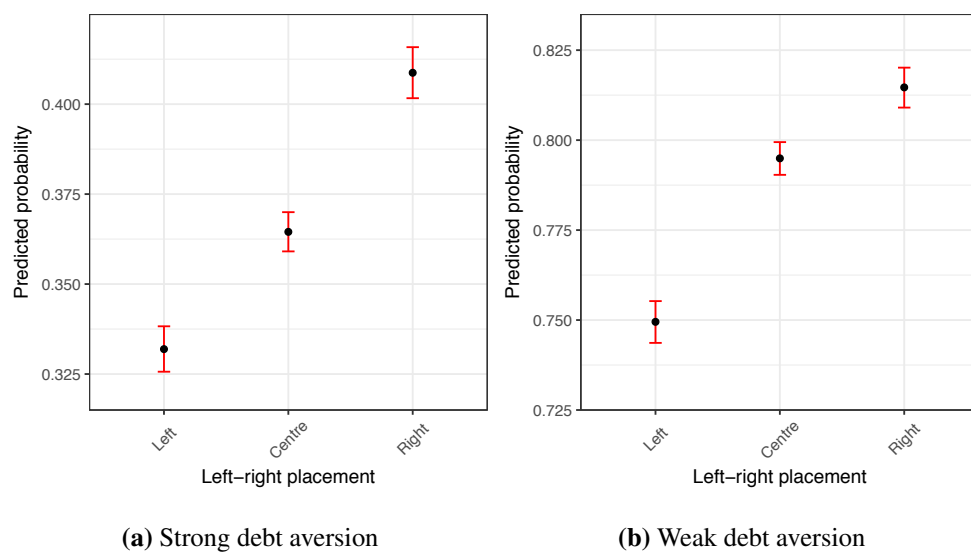
Figure 4.6: Predicted probabilities of debt aversion by home ownership**Figure 4.7:** Predicted probabilities of debt aversion by left-right ideology

Table 4.3: Debt aversion by ideology

	Left		Centre		Right	
	Weak	Strong	Weak	Strong	Weak	Strong
May 2010	0.32	0.82	0.33	0.84	0.37	0.86
Nov 2010	0.34	0.83	0.36	0.87	0.42	0.88
May 2011	0.36	0.81	0.36	0.85	0.42	0.86
May 2014	0.40	0.81	0.43	0.86	0.48	0.86
Nov 2014	0.36	0.80	0.39	0.85	0.41	0.86
May 2015	0.34	0.76	0.36	0.84	0.43	0.86
Nov 2015	0.31	0.77	0.35	0.84	0.39	0.85
May 2016	0.30	0.70	0.33	0.76	0.39	0.78
Nov 2016	0.31	0.73	0.33	0.76	0.37	0.78

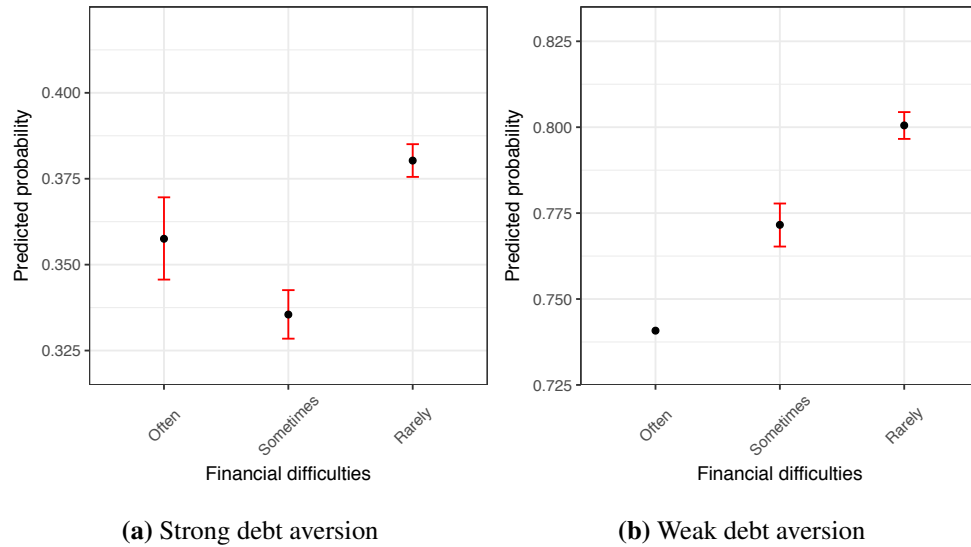
investigation. Moreover, there is still a significant number of fiscal hawks among respondents that are left-wing, as shown in Table 4.3. In fact, the share of fiscal hawks among left-wing respondents varied between 0.30 and 0.40 during the crisis, indicating that debt aversion was common across the left-right spectrum during the economic crisis.

Finally, gender also has a consistent influence on both strong and weak aversion: women have a lower debt aversion than men according to both models in Table 4.2. Given that women often face more volatile employment situations than men and that they are still the primary care-takers in families, they rely to a greater extent on the welfare state. Consequently, austerity policies often also have a greater effect on women than men, who tend to be less supportive of the welfare state in the first place (Shapiro and Mahajan, 1986).

Apart from the variables discussed so far, there are some differences depending on the operationalisation of debt aversion. The results from model 1 and 2 shown in Table 4.2 differ in some respect, suggesting that different factors explain whether individuals are fiscal conservatives or fiscal hawks.¹¹ In line with the effect of income, unemployed people, who are more vulnerable to austerity policies, are less likely to be fiscal conservatives than employed people. Yet, the labour market status does not influence strong debt aversion, i.e. according to model 1 of Table 4.2 unemployed people are as likely to be fiscal hawks as employed people.¹² In contrast, occupa-

¹¹This also explains why the parallel trends assumption does not hold, when using an ordinal logistic analysis. The results of this analysis are nonetheless presented as a robustness test in Appendix B.5

¹²This effect is also very small, though. Unemployed people have a 0.80 predicted probability of being a fiscal conservative, whereas the probability for employed people is only marginally higher at 0.82.

Figure 4.8: Predicted probabilities of debt aversion by financial situation

tion has an effect on strong debt aversion but not on weak debt aversion.¹³ Model 1 shows that the upper class (the reference group) and unskilled workers generally have a higher debt aversion than all other occupational groups. Strong debt aversion is thus widespread among very different occupations, but occupation does not have an effect on weak debt aversion. In combination, the results suggest that debt aversion is high among very different segments of the labour market, which presents an important challenge for parties that want to rally against austerity.

In line with my expectations, age and retirement also affect debt aversion, but in surprising ways. Retired people are more likely to be fiscal hawks than people in the active working population but they are not less likely to be fiscal conservatives. In contrast, age has an influence on weak debt aversion but not on strong debt aversion: older people are less likely to weakly oppose government debt than others.¹⁴ Given that weak debt aversion includes both fiscal conservatives and fiscal hawks, this result is puzzling. It shows that government debt does tap into the generational conflict, but that the effect of age might be mediated by the fact that older people are more likely to rely on fixed incomes.

¹³According to the data, occupation is only weakly correlated with education. However, even when excluding education from the analysis, the results do not change substantially.

¹⁴The effect is of age very small, though. While a 20 year-old is predicted to have a 0.82 probability of being weakly debt averse, a 80-year old is predicted to have a 0.81 probability of being weakly opposed to debt.

Two subjective variables also have a significant effect on debt aversion. In line with the evidence from above, the financial situation of households is an important variable relating to debt aversion. Generally, people with more financial difficulties are less likely to favour fiscal consolidation than people with no financial difficulties (Figure 4.8). However, there is an interesting exception: people that sometimes experience financial difficulties are less likely to be fiscal hawks than people, which often or rarely experience financial difficulties. It indicates that, indeed, the personal experience of government debt and consumption is important to explain debt aversion. People who sometimes struggle to pay their bills may experience these situations as particularly daunting because, unlikely people who continuously face financial difficulties, they are not used to them. Finally, on top of the subjective evaluation of their personal situation, an individual's evaluation of the national economy also influences their debt aversion. People with a positive evaluation are less likely to strongly oppose government debt, but they are more likely to be weakly opposed to government debt. In combination with the findings from above, this suggests that an individual's subjective economic experience also influences debt aversion.

Individual- and country-level determinants

Finally, Table 4.4 integrates the analysis of individual and macro-level determinants. In this analysis, I use multi-level models to add the national-level variables to the analysis presented in 4.2. This exercise hardly changes the coefficients for the individual-level determinants, but it does suggest that there are a few important country-level determinants of debt aversion. First, the likelihood that respondents are fiscal conservatives decreases with growth and increases with unemployment. It confirms the findings from above that public opinion follows a non-Keynesian intuition, i.e. respondents are more debt averse when growth is low and unemployment is high. Second, the analysis confirms that the government's deficit and debt influence debt aversion. Respondents are more likely to be strongly opposed to government debt in countries with a larger government deficit (i.e. a negative budget balance), while the existing level of government debt decreases debt aversion. In other words, individuals are most likely to be debt averse in countries with a high deficit but a low level of government debt. In these countries, fiscal consolidation might be especially salient given that citizens are not used to high levels of government.

The results thus indicate that debt aversion follows the economic context in a thermostatic fashion (Wlezien, 1995; Soroka and Wlezien, 2010) on both the individual and the country-level. Yet, subjective evaluations of the predominant economic cir-

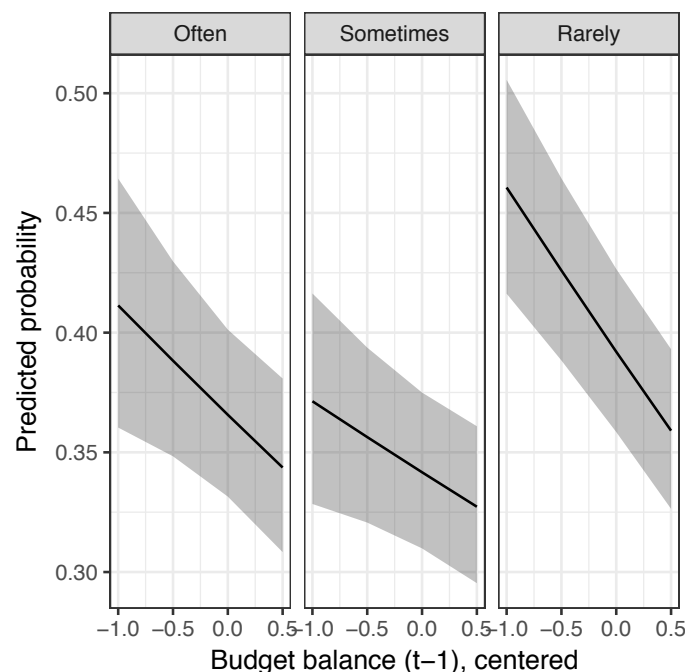
Table 4.4: Logistic multi-level regression: Individual- and national-level determinants of debt aversion

	Debt aversion			
	Strong I	Strong II	Weak I	Weak II
	(1)	(2)	(3)	(4)
Education (Ref.: No education) . Primary	0.15*	0.15*	0.24*	0.24*
	(0.10)	(0.10)	(0.10)	(0.10)
. Secondary	0.30**	0.30**	0.38***	0.39***
	(0.10)	(0.10)	(0.10)	(0.10)
. Tertiary	0.36***	0.36***	0.43***	0.43***
	(0.10)	(0.10)	(0.10)	(0.10)
Occupation (Ref.: Upper class) . Middle class	−0.07*	−0.07*	0.05*	0.05*
	(0.03)	(0.03)	(0.04)	(0.04)
. Skilled worker	−0.12**	−0.12**	0.02	0.02
	(0.04)	(0.04)	(0.05)	(0.05)
. Unskilled worker	−0.01	−0.01	0.02	0.02
	(0.06)	(0.06)	(0.06)	(0.06)
. Other	−0.10**	−0.10*	0.03	0.03
	(0.04)	(0.04)	(0.05)	(0.05)
Unemployed	0.04*	0.04*	−0.12**	−0.12**
	(0.04)	(0.04)	(0.04)	(0.04)
Financial difficulties (Ref.: Often) . Sometimes	−0.10**	−0.11***	0.17***	0.17***
	(0.03)	(0.03)	(0.03)	(0.03)
. Rarely	0.10***	0.11***	0.33***	0.35***
	(0.03)	(0.03)	(0.03)	(0.03)
Positive evaluation of economy	−0.09***	−0.12***	0.15***	0.11***
	(0.02)	(0.02)	(0.02)	(0.02)
Age	0.001*	0.001*	−0.004***	−0.004***
	(0.001)	(0.001)	(0.001)	(0.001)
Retired	0.11**	0.11**	0.03*	0.03*
	(0.04)	(0.04)	(0.04)	(0.04)
Children	−0.01	−0.01	0.02*	0.02*
	(0.02)	(0.02)	(0.02)	(0.02)
Female	−0.13***	−0.13***	−0.05**	−0.05**
	(0.02)	(0.02)	(0.02)	(0.02)
Married	0.05*	0.05**	0.11***	0.11***
	(0.02)	(0.02)	(0.02)	(0.02)
House ownership (Ref.: No house) . With Mortgage	0.09***	0.09***	0.11***	0.11***
	(0.02)	(0.02)	(0.03)	(0.03)
. Fully Paid	0.14***	0.14***	0.21***	0.21***
	(0.02)	(0.02)	(0.03)	(0.03)
Left-right placement (Ref.: Left) . Centre	0.14***	0.14***	0.26***	0.26***
	(0.02)	(0.02)	(0.02)	(0.02)
. Right	0.33***	0.33***	0.39***	0.39***
	(0.02)	(0.02)	(0.02)	(0.02)
Growth (t-1)	−0.002	−0.07**	0.07**	−0.02*
	(0.02)	(0.03)	(0.02)	(0.03)
Unemployment (t-1)	0.25***	0.26***	0.36***	0.38***
	(0.05)	(0.05)	(0.06)	(0.06)
Debt (t-1)	−0.07*	−0.06*	−0.70***	−0.68***
	(0.08)	(0.08)	(0.12)	(0.11)
Budget balance (t-1)	−0.23***	−0.19**	−0.39***	−0.26***
	(0.04)	(0.07)	(0.05)	(0.08)
Budget balance:Fin. difficulties (Ref.: Often) . Sometimes		0.06*		−0.08*
		(0.08)		(0.09)
. Rarely		−0.09*		−0.17*
		(0.08)		(0.08)
Growth:Positive evaluation of economy		0.14***		0.21***
		(0.03)		(0.04)
Constant	−1.00***	−1.00***	0.49**	0.49**
	(0.13)	(0.13)	(0.15)	(0.15)
Observations	73,800	73,800	73,800	73,800
Log Likelihood	−47,354.12	−47,342.45	−37,901.56	−37,885.76
Akaike Inf. Crit.	94,760.25	94,742.91	75,855.11	75,829.52
Bayesian Inf. Crit.	94,999.68	95,009.97	76,094.55	76,096.58

Note:

*p<0.5; **p<0.01; ***p<0.001

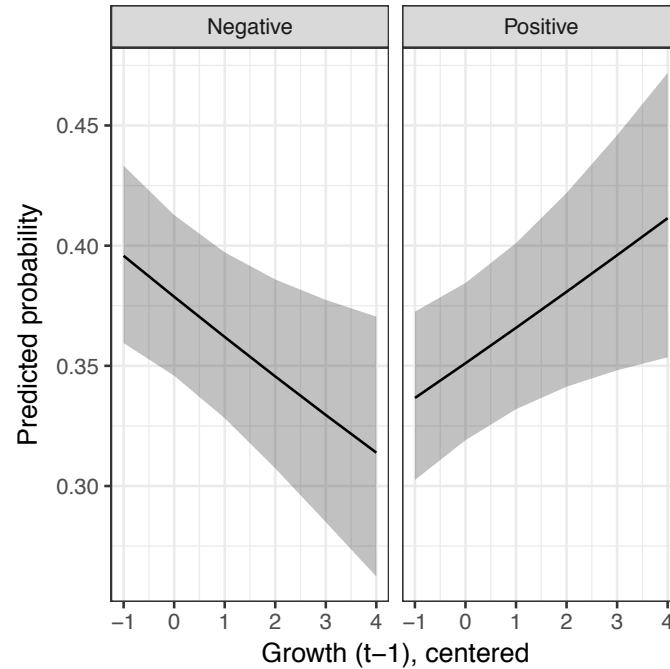
Figure 4.9: Interaction effect of the budget balance and an individual's financial situation on the predicted probabilities of debt aversion



cumstances differ across individuals. In other words, the economic context might be mediated by an individual's experience of the economy. To explore this issue, model 2 and 4 in table 4.2 include interaction effects between “hard” macroeconomic variables and “soft” subjective economic variables. Both models indicate that the interaction effects are statistically significant, but following advice from Brambor et al. (2006), the results are best interpreted graphically. Figure 4.9 shows the interaction between the government's budget balance and a respondent's financial situation. The graph confirms that there is a negative association between the government's budget balance and debt aversion, but the strength of this relationship varies across the three groups. For people that sometimes have financial difficulties debt aversion varies relatively little across the range of the budget's balance, while it varies a lot more for people who often or rarely experience such difficulties. This confirms the notion that an individual's experience of the household budget also influences aversion to government debt.

Figure 4.10 shows the interaction effect between economic growth and an individual's evaluation of the state of the economy. It suggests that growth has a negative effect for individuals that evaluate the state of the economy as bad, whereas it has a positive effect for individuals that evaluate the state of the economy as good. In other

Figure 4.10: Interaction effect of growth and subjective evaluation of the economy on the predicted probabilities of debt aversion



words, debt aversion is lowest among individuals whose evaluations of the economy diverge from the actual macro-economic situation. Although many citizens adjust their assessment of the economy according to the macroeconomic context, there are some who do not. For these individuals, subjective economic experiences also seem to influence their debt aversion.

Conclusion

In conclusion, the data from the Eurobarometer shows that a large majority of citizens felt uneasy about their country's government deficit and debt during the European sovereign debt crisis and my empirical analysis attempted to test how different factors affected this public debt aversion. On the one hand, my analysis shows that there is indeed a set of socio-economic variables that influences debt aversion, even if that influence is often small. Importantly, people that are less well-off are relatively less concerned about their government's debt, which results in a positive relationship between income (and wealth) and debt aversion.

On the other hand, debt aversion is also related to the country-level determinants and the macroeconomic context. The results show that the stability culture in Northern Europe is a myth (Howarth and Rommerskirchen, 2017), but citizens systematically adjust their debt aversion according to the economic conditions. However, by and large voters respond to changes in the economy in a anti-Keynesian fashion: they are more likely to support fiscal consolidation when the economic conditions are bad and the government deficit is large. Voters seem to equate the public deficit with that of a private household, which crowns balance as the ultimate aim. This is also supported by the fact that the subjective economic assessment of the economy mediates the influence of macroeconomic variables on debt aversion, as my multi-level analysis shows. It suggests that the individual experience of the economy translates into views on fiscal consolidation, which the existing literature has largely neglected.

Despite this variation in fiscal preferences among respondents to the Eurobarometer, it is important to note that on average, debt aversion was strong in Europe from 2010 to 2016. Assuming that individual preferences matter for policy outcomes (e.g. Brooks and Manza, 2007; Iversen and Soskice, 2001), is it likely that this debt aversion contributed to the dominance of austerity in Europe. Although respondents on the left were less enthusiastic about fiscal consolidation debt, an overwhelmingly number of them still expressed fiscal conservative views. Chapter 6 and 7 will analyse how social democratic politicians and policy-makers in Germany and the UK, respectively, responded to this public opinion environment, attempting to resolve the tension between their ideology and their quest for fiscal credibility (Kraft, 2017).

Before the thesis proceeds with the case studies, however, it is useful to further analyse the demand side because the high level of debt aversion in Europe during the Great Recession is still puzzling. Up to this point, my analysis suggests three different explanations for this pattern. First, government deficits and debt was an extremely salient topic in spring 2010, when the European sovereign debt crisis began. It became widely debated by politicians, journalists, and economists, who largely spoke out in favour of the austerity settlement. It is possible that public opinion followed this high level of salience, but given that the public's debt aversion remained widespread after the height of the Eurozone crisis, this can only be one part of the answer.

Second, fiscal conservatism might be widespread among voters because they falsely equate the budget of the government with that of a household, as discussed above. Extrapolating from their own experiences, voters have a strong dislike for government debt. They only have an intuitive understanding of debt, which draws on the

voter's personal experience of the economy and which is deeply rooted in "folk economics" (Rubin, 2003). Fiscal consolidation therefore may become a "valence issue" on which most voters share a common position (Stokes, 1963). Put simply, voters do not have a Keynesian understanding of the economy, which makes it very difficult for parties to rally against austerity. The basic problem for the left, therefore, is that their policies are opposed to the folk theories about debt, whereas the policies of the right are in line with them. As all office-seeking parties search for economic credibility, public opinion pushes the centre-left towards the right.

Third, the evidence shown above supports the notion that debt aversion is not absolute: a large share of respondents are fiscal conservatives and support budget consolidation in principle, but they are not necessarily fiscal hawks who think that budget consolidation should be a priority for their government. This points to an important weakness of the data from the Eurobarometer (as well as many other surveys). Although governments can rely on growth to consolidate their finance in the medium- or long-run, they usually face tough choices in the short-run. They can either reduce their budget deficit by cutting government spending or by increasing taxes. Yet, most existing surveys are uni-dimensional, i.e. they ignore the trade-offs that are inherent in the design of fiscal policies, and thus they might overstate the support of citizens towards fiscal consolidation. The next chapter attempts to address this short-coming of the existing data by using novel conjoint and split-sample experiments conducted in four European countries.

Chapter 5

Public Opinion Towards Fiscal Consolidation in the Face of Trade-Offs: Evidence from Survey Experiments

Introduction

Chapter 4 showed that there was a strong debt aversion among voters across Europe in the wake of the Great Recession. Consistently more than 80 percent of respondents agreed that fiscal consolidation could not be delayed in their country, indicating that there were strong electoral pressures for fiscal orthodoxy. However, the data from the Eurobarometer suffers from severe shortcomings. The question on fiscal consolidation is badly phrased and suggestive. Furthermore, it does not account for the potential costs of fiscal consolidation, i.e. it ignores that governments have to make difficult choices when implementing austerity policies. In the short-run, they usually have to cut spending or increase taxes to plug the hole in the public deficit and reduce debt. In other words, governments face trade-offs and have to make compromises between different ideal worlds when they design budgets.¹

¹According to Keynesian theory, governments can actually also decrease public debt by *raising* spending or *cutting* taxes if the fiscal multiplier is positive and larger than one. However, given that there is usually a time lag associated with fiscal policies, such an approach would still increase the government's debt and deficit in the short-run. Immediate fiscal consolidation therefore usually involves tough choices.

This is important because existing research also has shown that people, on average, support higher government spending and lower taxation. Taken together, this finding is puzzling: there seems to be a “schizophrenia” among voters who want ‘something for nothing’ (Sears and Citrin, 1982) or ‘more for less’ (Welch, 1985). However, governments always need to raise taxes or issue debt in exchange for providing public goods (Schumpeter, 1991) and therefore they constantly have to make trade-offs. The existing literature has mostly ignored these trade-offs, largely because survey data often only includes unidimensional questions (similar to the question from the Eurobarometer used in Chapter 4). These questions do not capture the priorities that citizens have with regard to fiscal policies, and in the presence of salient trade-offs, they risk misrepresenting public opinion towards individual policies like fiscal consolidation. This, therefore, begs the question whether voters still support fiscal consolidation when the trade-offs are fully acknowledged, i.e. whether voters are willing to decrease government spending or increase taxes to reduce public debt.

To answer this question, this chapter uses novel data from two survey experiments. It re-evaluates the demand for fiscal consolidation in Europe by building on an emerging field of research that has tried to capture the importance of policy trade-offs for public opinion research (e.g. Häusermann et al., 2018; Gallego and Marx, 2017; Busemeyer and Garritzmann, 2017). The experiments were conducted in four European countries (Germany, Italy, Spain, and the UK) in January 2018 with the aim to isolate attitudes towards different elements of fiscal policies including government spending, taxation, and public debt. However, in this chapter, I explicitly focus on attitudes towards debt, analysing to what extent voters are willing to slash government spending or raise taxation to pursue fiscal consolidation. Moreover, I build on the analysis from the previous chapter and explore how support for fiscal consolidation varies across socio-economic groups.

The results are two-fold. First, they indicate that people strongly react to trade-offs and that the schizophrenia among the public vanishes when one accounts for the multidimensionality of fiscal policies. Using a split-sample experiment, the chapter shows that support for fiscal consolidation is, on average, much lower when respondents are primed about the costs of it. Going further, a conjoint survey experiment shows that fiscal consolidation, on average, is not a priority for citizens. Regular opinion polls consistently overestimate the support for fiscal consolidation, which has important consequences for (social democratic) policy-makers: as voters prioritise other policies, they should have more freedom to oppose austerity than Chapter 4 indicated.

Second, the chapter also suggests that political conflicts about fiscal consolidation in the face of trade-offs exhibit a different dynamic than conflicts about support for fiscal consolidation in principle. In the split-sample experiment, the effect of explanatory variables differs significantly depending on whether and which kind of fiscal trade-offs are presented to individuals. Moreover, the conjoint survey experiment reveals a clear priority ordering with regards to fiscal policies. In terms of priorities, the public does not attach a high premium to fiscal consolidation, but there is a strong commitment to a progressive tax system and government spending. This commitment hardly changes across socio-economic groups, suggesting that it is rooted in deeper social norms.

To make these arguments, the remainder of this chapter is structured as follows. First, I briefly review the literature on fiscal policy preferences and explain the motivation for the chapter. Second, I develop theoretical expectations about how citizens prioritise different fiscal policies when they are confronted with policy trade-offs. Then I explain the research design in detail, before I discuss the results from the experiments. The final section concludes by discussing the implications of this chapter for the thesis.

Literature review and motivation

Public opinion has a strong conditioning effect on policy-makers (e.g. [Brooks and Manza, 2007](#); [Page and Shapiro, 1983, 1992](#)). In liberal democracies, citizens can hold governments accountable, establishing a close link between policy and public opinion. Policy-makers anticipate the public's reaction to policies at the next election ([Stimson et al., 1995](#)) and they respond to changing preferences of voters over time ([Jacobs, 1993](#); [Wlezien, 1995](#); [Soroka and Wlezien, 2010](#)). Thus, public opinion should also be important for the design of fiscal policies, which are a constant source of political debate. They determine how much taxes citizens pay and what services they receive in return. The existing literature, however, has pointed to a puzzling inconsistency in public opinion.

First, a large literature has studied public opinion towards government spending and towards redistribution more generally. Existing research indicates that most forms of government spending such as education, old-age pensions, and family policies are very popular among the wider public. This omnipresent support for the welfare state is also used to explain the difficulty of full-frontal attacks on major welfare state programmes ([Pierson, 2001b](#); [Brooks and Manza, 2007](#)). More recently, the litera-

ture on the multidimensional nature of welfare politics has shown that the main issue of conflict does not revolve around more or less spending *per se*, but rather around more fine-grained distributional issues between different orientations of the welfare state (Pierson, 2001b; Häusermann, 2010, 2012; Morel et al., 2012; Bonoli and Natali, 2012). Scholars have started to emphasize differences in voters' preferences between consumption-oriented and investment-oriented government spending (e.g. Bonoli, 2013; Fossati and Häusermann, 2014; Beramendi et al., 2015; Busemeyer and Garritzmann, 2017). Yet, notwithstanding these differences, public support is high for both types of social spending and generally fiscal retrenchment is unpopular.

Second, there is also an increasing literature on the preferences towards taxation (e.g. Scheve and Stasavage, 2010, 2016; Barnes, 2015; Ballard-Rosa et al., 2017). Although the micro-determinants of attitudes towards taxation are less well understood than attitudes towards government spending, the literature shows that most voters are reluctant to pay higher taxes. Historically, a large increase in tax revenues occurred in advanced economies in the late nineteenth and early twentieth century (Kiser and Karceski, 2017). This increase was largely generated through progressive income taxation, which was used to finance the expansion of the welfare state,² and during the heyday of Keynesianism, policy-makers and voters alike had a rather positive view of taxation. Yet, the new tax doctrine from the 1980s onwards was more concerned with efficiency than equity. Progressive taxation and taxes on capital were lowered and Myles (2017, p. 353) argues that this “anti-tax doctrine” is grounded in public opinion. In terms of public opinion, however, it is important to distinguish between tax preferences for the level and the structure of taxation (i.e. the tax progressivity) (Barnes, 2015): while modal respondents favour lower tax levels, they support more progressive taxes. This is also confirmed by recent evidence from the US (Ballard-Rosa et al., 2017), where citizens' preferences for taxes are very progressive but do not systematically vary from the relatively low level of taxation that the US enjoys.

At the same time, there is a third strand of the literature that the previous chapter engaged with. It shows that voters are unwilling to finance additional government spending through deficit-spending. Early researchers assumed that politicians had an interest to run fiscal deficits in the short-run to finance government programmes. For example, the literature on political business cycles presumes that politicians would

²Scheve and Stasavage (2010, 2016) show that the introduction of progressive income taxation was mainly driven by mass conscription for warfare. It led to demands for taxation on the rich in order to distribute the burden of war across society.

use macroeconomic policy, including deficit-spending, to engineer a boom prior to elections (e.g. Nordhaus, 1975; Golden and Poterba, 1980). However, there is an increasing amount of empirical evidence that voters are fiscally conservative and do not support large fiscal deficits (e.g. Blinder and Holtz-Eakin, 1984; Peltzman, 1992; Brender and Drazen, 2008; Stix, 2013; Hayo and Neumeier, 2016; Barnes and Hicks, 2018; Arias and Stasavage, 2018). According to this literature, voters favour balanced budgets and systematically punish deficit spending and tax cuts in election years (e.g. Brender and Drazen, 2008; Alesina et al., 1998). They seem to equate the government budget with that of a private household, ignoring Keynesian arguments in favour of deficit-spending during. As a result, voters support fiscal consolidation (e.g. Heinemann and Hennighausen, 2012; Stix, 2013) and fiscal rules (Hayo and Neumeier, 2016).

Consequently, the findings from the existing literature are puzzling: while citizens support existing levels of government spending, they do not want to pay for it through tax increases or deficit-spending. Mueller (1963, p. 223-23) already identified this contradiction and put it aptly:

[There] is lack of congruence in people's thinking about fiscal programs. Although there is strong support for the extension of a number of government programs, only a minority of the people...would like to see taxes raised, and hardly anyone would like to see these expenditures financed by deficits.

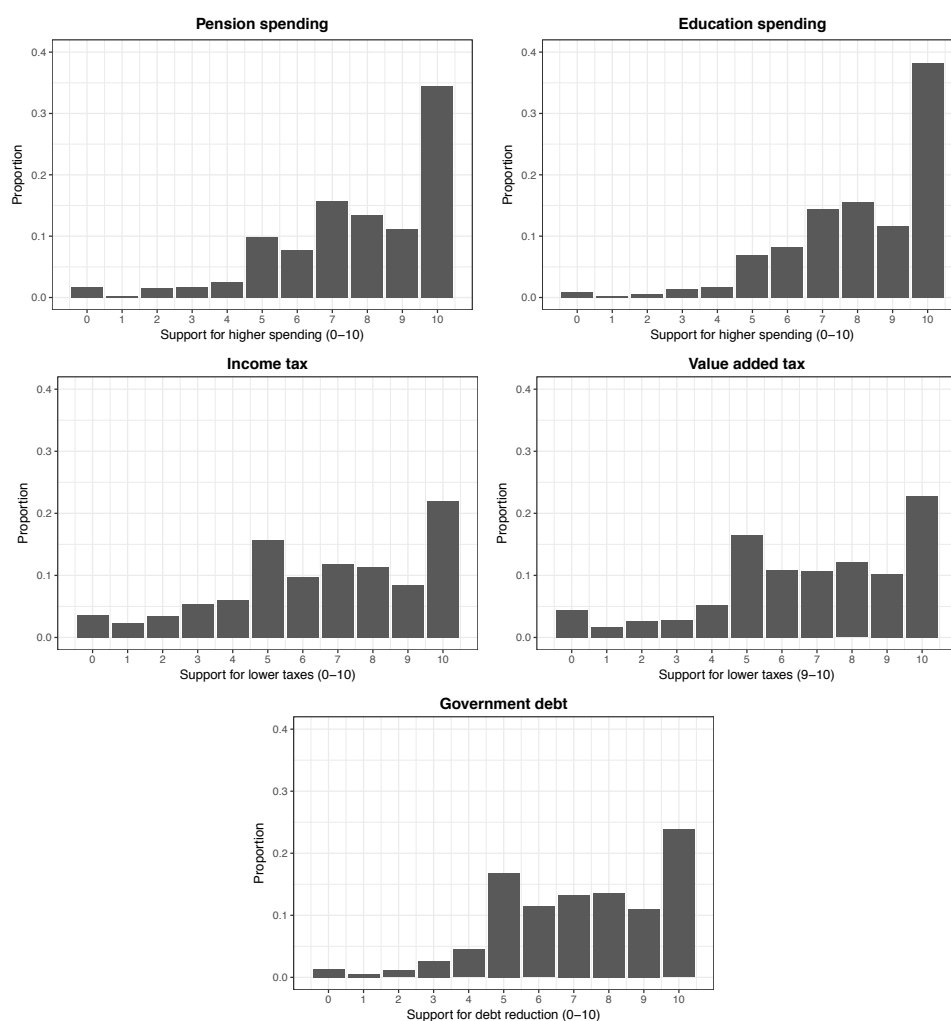
As a result, academics have identified an 'ideological schizophrenia' (Free and Cantril, 1967) among the public (e.g. Sears and Citrin, 1982; Welch, 1985). For example, Citrin (1979, p. 113) argued that 'the public's readiness to demand and consume government programmes is understandably greater than its willingness to pay for it', whereas Eismeier (1982, p. 142-43) found a 'widening gap between public demands for government spending and public willingness to pay for this spending.'

These claims are confirmed by evidence from the online survey used in this chapter. Figure 5.1 shows the distribution of preference towards government spending, taxes, and public debt. All distributions are clearly skewed towards the left, indicating that the public's attitudes towards fiscal consolidation are inconsistent: a majority of citizens support both higher government spending as well as lower taxes and public debt.³ This creates a dilemma for politicians and political parties, who have to square

³For example, if we count all responses from 6 to 10 as agreement, 88 percent of citizens support higher education spending, 63 percent support lower income taxes (for all citizens), and 73 percent support lower government debt.

the circle when they design government budgets. As Nicklaus-Thomas Symonds, a British Labour MP, puts it, ‘the strange thing about public opinion is that it sometimes gives you contradictory things. There seems to be a desire for high public spending but very low taxes, and politicians have to find some alchemy to make those things possible’ (personal interview, October 2016). But do voters really not know better?

Figure 5.1: Distribution of support for higher government spending, lower taxes, and lower government debt



Theory: The importance of trade-offs and priorities for attitudes towards fiscal consolidation

Some of the existing research suggests that voters' preferences are logically incoherent and fundamentally irrational. Voters may not have real political preferences all together (Zaller, 1992), they may be 'fiscally ignorant' (Lewis, 1982) and wilfully ignore the trade-offs between different policies, or they could be cognitively overwhelmed, failing to appreciate these trade-offs (Achen and Bartels, 2016). Yet, the existing research about public opinion towards fiscal policies is limited by its empirical foundations. Most research assesses public opinion to individual policies independent of other policies. This approach is misleading because it fails to capture the multidimensionality of fiscal policies and ignores that governments face difficult trade-offs.

There is some sparse research, however, that has attempted to explicitly capture the importance of these trade-offs. Hockley and Harbour (1983) used a survey in the UK that was designed to reduce the nature of "fiscal illusion", which showed that voters could make meaningful decisions about how they allocated a hypothetical budget increment. Similarly, Hansen (1998) showed that when citizens are primed about trade-offs, opinions about budgetary alternatives became more consistent. More recently, research by Busemeyer and Garritzmann (2017) explicitly tried to study how respondents change their attitudes towards education spending when they are confronted with trade-offs. Their findings show that increasing education spending is less popular when this comes at the cost of existing social policies, higher taxes or higher government debt.

A few novel studies have also explored public opinion towards policy trade-offs in an innovative way by using conjoint survey experiments. For example, Kölln and Wlezien (2016) used an experiment in Sweden to show that political support for government spending is overall high and that the average voter would prefer further increases – especially in education and health care. Focusing only on labour market policies in Spain, Gallego and Marx (2017) found that increases in unemployment benefits are more popular than increases in their coverage. An increase in training programmes for the unemployed is only marginally preferred (as long as they are not provided by trade unions). Surprisingly, the costs of the programme are not very important, but the way that the reform is funded is. Spending cuts in education and health are strongly disliked, whereas increases in income tax and public debt are preferred. Finally, a recent study by Häusermann et al. (2018) on the recent attempt to

reform the Swiss pension system also highlighted the importance of carefully balanced reforms in order to find enough public support. This is especially true if the financing of the reform is connected to taxation.

Based on this evidence, I expect that citizens also change their preferences towards fiscal consolidation when they are confronted with trade-offs. In principle, support for lower government debt is high among the public (see Chapter 4), as is support for lower taxes and higher spending. Yet, there are reasons to believe that reducing government debt is not a priority for most citizens. Public debt is very abstract and its impact on citizens is less direct than taxes (which they pay regularly) or spending on public benefits or services (which many receive/use constantly). Compared to other dimensions of fiscal policy, government debt has little direct consequences for citizens. In theory, it can be seen as a form of future taxation and, according to the Ricardian equivalence theorem, rational and forward-looking individuals should thus internalise changes in public debt and adjust their behaviour accordingly. However, we know from the literature on inter-temporal trade-offs that citizens are strongly myopic (Jacobs, 2008, 2011, 2016; Jacobs and Matthews, 2012), i.e. when voters evaluate government policy programmes, they give less weight to long-term policy consequences than to those that emerge in the short-term. They have rather high discount rates and, as a result, they should not care very much about government debt, either.⁴

The first hypothesis that I want to test in this chapter is, therefore, that voters care more about protecting their benefits (from government spending) and their disposable income (from taxation) than reducing government debt. Following Pierson (1996, 2001b), I assume that existing social policies create strong electoral constituencies, which are reluctant to accept retrenchment. Instead, voters may even be supportive of additional spending if this benefits a large group of them. For example, pensions are thought to be the most popular form of social spending in advanced welfare states because most people expect to retire at some point and thus support the public pension system. Similarly, voters should be reluctant to increase taxation, which reduces the disposable income of almost all citizens – especially consumption taxes (VAT) and income taxes. Consequently, it seems likely that fiscal consolidation is not a priority for citizens. By this, I do not mean to say that voters do not care at all about public debt. Citizens seem to have a tendency to be fiscally conservative and to equate the

⁴In general, it seems reasonable to assume that budgetary decisions that effect current cost and benefits have a stronger impact on voter preferences than budgetary decisions effecting future costs and benefits. This is, however, not to say that reforms improving welfare in the long-term at the cost of the short-term are impossible. Jacobs (2011) actually presents examples of pension reforms and infrastructure investment where this was achieved.

government budget with that of a private household. However, given the abstractness of public debt and the uncertainty how public debt impacts citizens in the future, I assume that taxation and government spending are more salient and important to voters.

The way that citizens respond to trade-offs might also vary across citizens, i.e. there may be some heterogeneous effects across different socio-economic groups. However, it is likely that conflicts about the trade-offs of fiscal policies inhibit a different political dynamic than conflicts about individual policies like fiscal consolidation. In other words, I expect that the explanatory effect of individual variables differs significantly depending on whether and which kind of fiscal trade-offs are presented to citizens.⁵ Specifically, the second hypothesis that I want to test in this chapter is that differences in attitudes across socio-economic groups become smaller when fiscal trade-offs are fully acknowledged.

At first, this argument might seem counter-intuitive, given that trade-offs raise the stakes for individuals and groups by sharpening distributive conflicts. Yet, the existing literature has shown that in Europe there is a strong normative commitment to the welfare state and progressive taxation. If this normative commitment is shared by citizens across the population, the explanatory power of variables that are traditionally used to explain support for individual policies should become smaller. In other words, in terms of public opinion, there may be a “priority ordering” that is rooted in normative beliefs about what is right and what is wrong. For example, it could be based on a historic compromise between different social groups, which affects public opinion through on feedback effects (Korpi and Palme, 1998; Kumlin, 2004; Brooks and Manza, 2007; Larsen, 2008; Gingrich and Ansell, 2012). Priority orderings may thus be endogenous to the design of the welfare state and the socio-economic institutions more generally. Yet, these institutions are ultimately also rooted in different norms and concepts of reciprocal altruism (e.g. Alesina et al., 2001), which may also explain the social and political support for different welfare state regimes (Esping-Andersen, 1990) or growth models (Baccaro and Pontusson, 2016), which have previously been under-explained.

⁵In a similar way, Bussemeyer and Garritzmann (2017) argue that conflicts about the distribution of resources within the welfare state differ significantly from those about the size of the welfare state.

Research Design

Existing surveys do not allow me to test these arguments because they largely pose unidimensional questions (Giger and Nelson, 2013). As Jacoby (1994, p. 338) already put it, ‘the underlying structures [of public opinion]... cannot be discerned from responses to a single survey item.’ To overcome this limitation of existing research, we must instead examine preferences across separate fiscal policies at the same time. To this end, I use a research design that overcomes the problems associated with conventional surveys. It is based on a survey, which confronted respondents with a series of questions that try to measure individuals’ support for government spending, taxation, and government debt given different kinds of budgetary trade-offs. In doing so, I follow the existing literature (e.g. Sanders, 1988; Hansen, 1998) and assume that people do not need to know a lot about government budgets to evaluate different alternatives. As governments usually decide on their budgets annually, budgetary debates are a regular feature of the political debate that is familiar to many citizens. Thus, voters only need to know the rough outline of a policy to evaluate it. This is also true because citizens can use a lot of information to help them decide. The media covers budgetary debates extensively and political parties act as mediators. They develop and formulate different policy positions, which they continuously communicate to voters, and I levy this knowledge in two different survey experiments.

Part 1: Experiment with split-sample questions

The first survey experiment tests how individuals change their preferences towards fiscal consolidation when they are confronted with two-dimensional trade-offs. Following Busemeyer and Garritzmann (2017), respondents were randomly assigned to four different groups, including one “control” group and three different “treatment” groups. In each group, respondents were asked to evaluate a statement about government debt. Respondents in the treatment groups were presented with different statements that raised awareness of budgetary trade-offs, while the control group was presented with a statement that did not allude them to any kind of trade-offs. Subsequently, respondents were asked to evaluate to what extent they agree or disagree with these different statements. Table 5.1 shows the full statements that were included in the different groups.⁶

⁶The full experiment included six different statements about government spending, taxation, and debt. All statements are shown in the table in Appendix C.2

Table 5.1: Design of the split experiment

Split	Treatment	Question
1	Control group	The government should reduce the level of government debt.
2	Treatment 1	The government should reduce the level of government debt, <i>even if that implies lower government spending.</i>
3	Treatment 2	The government should reduce the level of government debt, <i>even if that implies higher taxes.</i>
4	Treatment 3	The government should reduce the level of government debt, <i>if that implies lower government spending or higher taxes.</i>

To analyse whether support for fiscal consolidation varies across our four groups, I first explore the results descriptively. I graphically present the means and 95 per cent confidence intervals of the control group and the three different treatment groups. To assess whether there are differences across countries and electoral constituencies, I will also plot the results by country and electoral constituency. The significance of these observed differences will furthermore be tested through unpaired t-tests of differences in means.

Afterwards, I use multivariate regression analysis to identify individual-level characteristics that correlate with people's support for different forms of government spending, depending on which trade-offs they were presented with. For this purpose, I use support for the different statements as the dependent variable, which I regress on a number of independent variables (e.g. age, sex, income level, education, employment status, partisanship, preferences for redistribution). The dependent variable is measured on a linear scale from 0 to 10 and therefore I use OLS regression models. I include country-fixed effects in the models to account for possible contextual effects and the results are robust to a number of different specifications, including binary logistic regression analysis, ordinal logistic regression analysis, and country-clustered standard errors.

Part 2: Conjoint survey experiment

Before confronting respondents with the questions from above, the survey also included a conjoint survey experiment to study attitudes towards fiscal policies in a multidimensional setting. Conjoint surveys have been widely used in product anal-

ysis for a long a time in order to measure how people value different attributes of a product or service. Recently, conjoint experiments have also successfully been employed by social scientists (e.g. [Bechtel and Scheve, 2013](#); [Hainmueller et al., 2014](#); [Hainmueller and Hopkins, 2015](#); [Bansak et al., 2016](#)) and they are increasingly used in comparative political economy to capture the importance of trade-offs ([Gallego and Marx, 2017](#); [Häusermann et al., 2018](#); [Kölln and Wlezien, 2016](#)). Conjoint analysis is well suited for this purpose because it requires respondents to evaluate entire packages instead of simply asking about support for individual measures ([Häusermann et al., 2018](#)). Therefore, I apply conjoint survey experiments to the study of fiscal policies. Specifically, in the survey respondents had to evaluate different changes to the government budget in a set of choice tasks. Each task presented them with two profiles of possible budgetary changes, asking them to select their most preferred alternative. The profiles comprised six attributes corresponding to particular elements of a government budget and each attribute could take on a set of discrete and pre-defined levels, representing different policy options. The profiles were then generated randomly, i.e. they contained a fixed number of attributes, which were shown to respondents in random order and with a random display of attribute levels.⁷

Concretely, the reform profiles contain six attributes (as shown in Table [5.2](#)) that were chosen to represent the three dimensions that are salient for government budgets: spending, taxation, and government debt. With regard to spending, the profiles include two categories in order to distinguish between attitudes towards investment versus consumption spending: education was used as a proxy for investment spending, while pension spending was used as a proxy for consumption spending. With regard to taxation, the profiles distinguish between three different characteristics that influence the amount of taxes that citizens pay: the level of income taxes, the progressivity of income taxes, and the level of indirect taxes. Finally, debt was also included as an attribute given that governments also use debt to finance deficit spending.

Note that the profiles only include government policies that have an explicit social character with a direct impact on citizens, i.e. the profiles exclude some important areas of government spending (like defence) and taxation (like corporate tax). Furthermore, the profiles do not include spending on health care for two reasons: first, there are large differences between the funding of health care in the countries that I study, which makes a comparison difficult; second, spending on health care has both an element of investment and consumption and, hence, it is difficult to categorize.

⁷The instructions for the conjoint experiment and an example of the task that respondents had to complete are shown in Appendix [C.6](#)

Table 5.2: Attributes and Levels of the Conjoint Experiment

	Attribute	Attribute Levels
Spending	Old-age pensions	Increase spending No change Decrease spending
	Education	Increase spending No change Decrease spending
Taxation	Income tax (for all citizens)	Decrease No change Increase
	Top income tax	Decrease No change Increase
	Value added tax (VAT)	Decrease No change Increase
Debt	Government Debt	Decrease No change Increase

For each attribute, there are three levels, allowing me to test attitudes towards different combinations of government spending, taxation, and government debt, as shown in Table 5.2. In theory, there would be 729 combinations of the levels in a fully randomised setting but since taxes and government debt are used to pay for government spending, restrictions were necessary to avoid illogical combinations. For example, when government spending increases while taxation decreases in a given profile, government debt cannot decrease or stay the same. To address this problem, the profiles were only allowed to include combinations in which every increase in expenditure or decrease in revenues is matched by a simultaneous decreases in expenditure or increase in revenues. As a result, 588 combinations were excluded, leaving 141 possible combinations. Importantly, when the profiles are randomly generated, the likelihood that a given level is shown remains the same for all possible levels. Hence, as Hainmueller et al. (2014) have shown, respondents do not need to be shown every possible combination of attributes and levels to identify the component-specific effect. The research design exploits this important feature of conjoint experiments, allowing me to efficiently run multiple-treatment choice experiments without needing a sample size large enough to present respondents with every possible comparison.

Respondents are asked five times to choose (i) between two fiscal packages (“choice” variable) and (ii) to indicate how likely they are to support each of the proposals

(“ranking” variable). Through randomisation and several pairwise comparisons, conjoint analysis allows me to quantify the causal effect that individual attribute levels have on the support for the entire package, compared to a package that contains the baseline category on a particular attribute. The order in which the attributes are presented to different respondents is randomised to avoid that it influences the relative impact of attributes on the acceptance of different proposals. However, the order is held constant within individual respondents across the five different tasks and all attributes relating to government spending as well as all attributes relating to taxation are also presented as a block to avoid confusion.

The main variable of interest that I generate from the conjoint experiment is the so-called average component-specific marginal effect (ACME). It measures the average marginal effect of a change in the value of one of our six dimensions on the probability that the budgetary package is chosen by the respondent. The variable is binary and it takes the value of 1 if a package is chosen and 0 if a package is not chosen. Following the recommendations from [Hainmueller et al. \(2014\)](#), I estimate the ACMEs by using linear probability models and regress the dependent variable on dummy variables for each of our levels (where the status quo is used as the baseline for each dummy). To estimate the effects I use Ridge regression as developed by [Hoerl and Kennard \(1970\)](#), which is a common regularization method that [Horiuchi et al. \(2018\)](#) also used for conjoint analysis.⁸ To estimate the AMCEs, I use the R package `glmnet` and afterwards I rely on bootstrapping to calculate non-parametric confidence intervals.

Below I will first present the AMCEs for the entire sample, but afterwards I will test whether the AMCEs differ between different social groups by using split-sample analyses. I will present this analysis of heterogeneous effects graphically by showing plots with results for different groups side by side. This subgroup analysis is based on a few selected variables (country, income, class, and partisanship) but additional tests for heterogeneous effects are also included in Appendix [C.7](#). Following the recommendations by [Hainmueller et al. \(2014\)](#), I also conducted several robustness tests, which did not change the results, as discussed in Appendix [C.8](#).

⁸I use this method because in my design the values that each attribute can take are linearly dependent on the other attributes to ensure that the budget is balanced.

Sample

The survey was fielded in four large European countries: Germany, Italy, Spain, and the United Kingdom (UK). The countries were selected to represent major European economies with advanced welfare states, including different variants of capitalism (Hall and Soskice, 2001). Given the salience of macroeconomic policies and fiscal adjustment during the European sovereign debt crisis, two Southern European countries (Italy and Spain) were included in the survey along with Germany (a coordinated market economy) and the UK (a liberal market economy). In each country, 1,200 respondents were recruited to participate in the survey. For this purpose, a large online panel provided by *Qualtrics* was used. Respondents were drawn from a pool of eligible voters in each country and the sample was representative of all eligible voters based on gender and age. The survey was fielded simultaneously in January 2018 in all four countries.

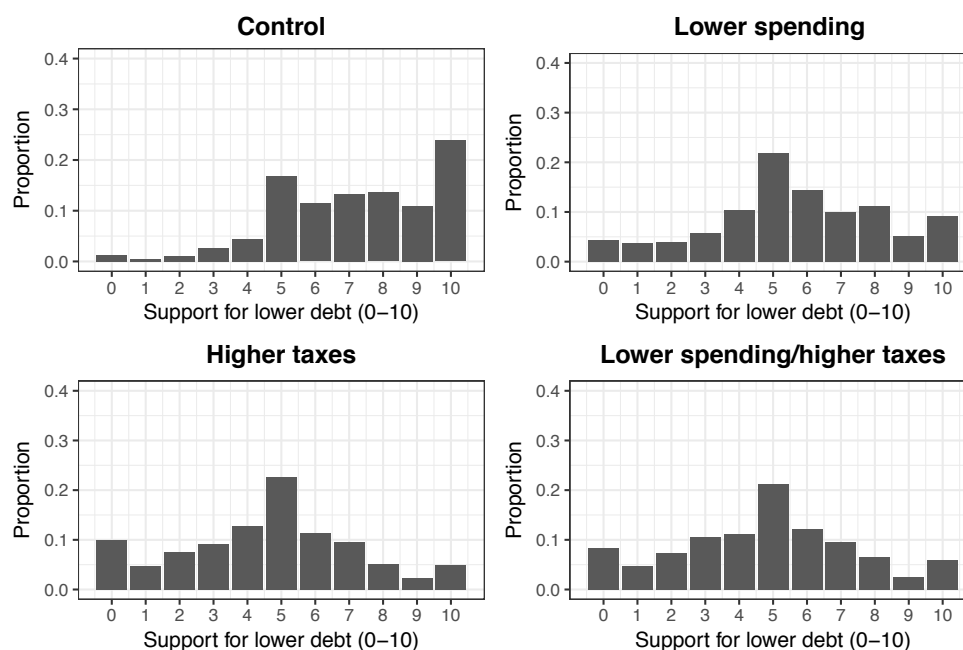
Results: Measuring attitudes towards fiscal consolidation with trade-offs

Descriptive results of preferences towards two-dimensional trade-offs

The survey confirms that a majority of voters in Europe are fiscal conservatives and in principle agree that the government should reduce government debt in the unconstrained setting. This is shown in Figure 5.2, where the distribution of preferences towards fiscal consolidation for the control group is strongly skewed towards the left. Yet, the distribution of responses to the question whether individuals support higher government spending and lower taxes/government debt changes dramatically when respondents are alerted to trade-offs. For all three treatment groups, the distribution of respondents becomes more normally distributed, indicating that, on average, support for fiscal consolidation is much lower when respondents are primed about its possible consequences.⁹

To estimate the impact of the treatments and to highlight the importance of trade-offs, Figure 5.3 shows the mean support and 95 percent confidence intervals for fiscal consolidation without trade-offs (control group) as well as with three different trade-offs (treatment groups). The results clearly show that people's support for fiscal

⁹This happens in all four countries. The distributions of responses for all treatment groups by country are shown in Appendix C.3

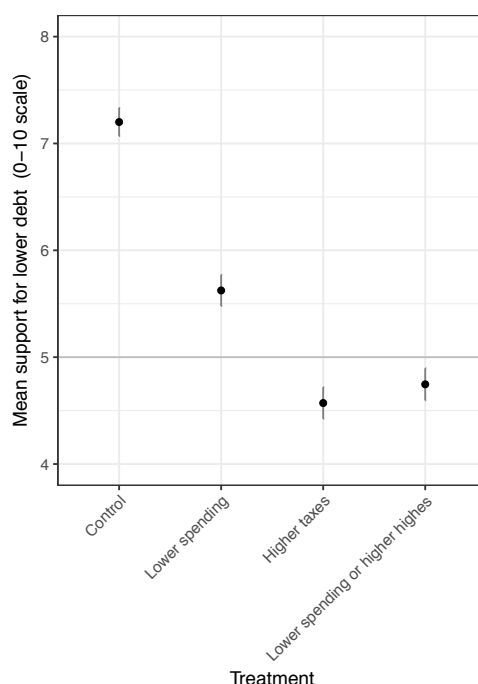
Figure 5.2: Distribution of support for fiscal consolidation by treatment

consolidation drops significantly for the treatment groups. In fact, the magnitude of the differences in means between the four groups is striking.¹⁰ Average support for lower government debt without trade-offs is 7.2, but this drops to 5.6 when it comes at the cost of lower government spending. Fiscal consolidation that leads to higher taxes are even more unpopular as average support for fiscal consolidation drops below 5 and becomes a minority position.

For the latter two treatments, support for fiscal consolidation also becomes a clear minority position.¹¹ In an unconstrained setting, roughly three quarters of the respondents (73 percent) support fiscal consolidation. But when fiscal consolidation comes at the cost of higher taxes, only 33percent support it; when fiscal consolidation has ambiguous consequences, 37 percent support it. Support for expenditure-based fiscal consolidation is somewhat higher but still highly contested with exactly 50 percent supporting it.

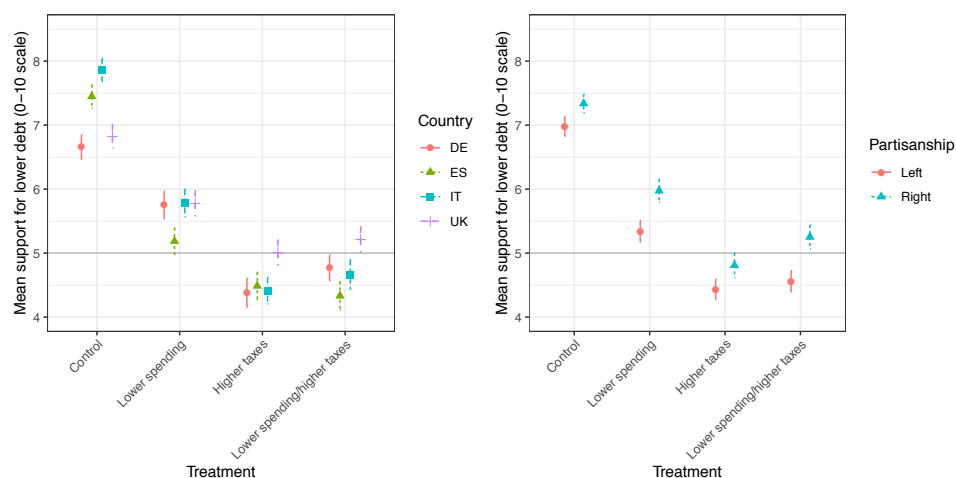
¹⁰All the differences are statistically also highly significant, which is confirmed by simple unpaired t-tests of differences in means.

¹¹To estimate the share of respondents' support, preferences towards fiscal consolidation is transformed into a binary variable where 5 is the cut-off, i.e. responses from 6-10 are counted as agreement, while responses from 0-5 are counted as disagreement.

Figure 5.3: Average support for fiscal consolidation with trade-offs, pooled

To test whether there are differences across countries or different electoral constituencies, Figure 5.4 shows the effect of the treatments for different groups. The results show that there is some variation across countries and electoral constituencies, but this variation is much smaller than the differences between the group averages. The graph on the left-hand side indicates that respondents in Southern Europe, where government debt is still relatively high, are more fiscally conservative in the unconstrained setting. In these countries, however, the average support drops more than in the other two countries and, therefore, the cross-national variation is smaller in the treatment groups. There are only two outliers: support for fiscal consolidation that leads to a reduction in government spending is somewhat lower in Spain than in the other three countries, while support for fiscal consolidation that comes at the cost of higher taxes is slightly more popular in the UK than in continental Europe.

The right-hand side of Figure 5.4 also shows that there are small differences across between people on the left and the right. In the unconstrained setting left-wing voters are only marginally less fiscally conservative than right-wing voters, confirming results from Chapter 4. This is also true when fiscal consolidation comes at the cost of higher taxes, which are disliked by both people on the left and the right. However, when fiscal consolidation comes at the cost of lower government spending, there is a small but significant difference between voters on the left and the right. This in-

Figure 5.4: Average support for fiscal consolidation by trade-off, country, and partisanship

indicates that left-wing voters are more attached to the services and benefits that the government provides, and they may be more likely to oppose tough austerity policies that cut these programmes.

In sum, the results suggest that support for fiscal consolidation decreases significantly, when salient trade-offs are introduced across different contexts and for different electoral constituencies. It even becomes a minority position for some trade-offs, which suggests that the existing literature has significantly overstated the support for fiscal consolidation.

Regression analysis of preferences towards two-dimensional trade-offs

To identify individual-level characteristics that correlate with people's debt aversion depending on which trade-offs scenario is presented, I use multivariate regression analysis. The results of simple OLS regressions are shown in Table 5.3, where support for fiscal consolidation from the four different groups is used as the dependent variable. Interestingly, they indicate that it is easier to establish the determinants of debt aversion in the unconstrained setting than in the constrained setting. In other words, there are several variables, which only have an effect for the control group. These variables include education and income, which have the expected effect: while income is positively associated with debt aversion, education is negatively associated with debt aversion (controlling for income)¹² Yet, these differences wash out when

¹²Other demographic variables only have a limited effect according to the regression analysis. Contrary to findings from Chapter 4, age and occupation have no significant effect on debt aversion in any of the four models.

trade-offs come into play,¹³ which is also the case for wealth, as shown in the regression table included in Appendix C.5: debtors are less likely to be fiscal conservatives in the control group, but this effect does not exist in the other three groups.¹⁴

The effect of partisanship is also stronger for the control group than for the three treatment groups. Supporters of social democratic parties and the far left are less likely to support fiscal consolidations than conservative voters, but this effect is substantially smaller when fiscal consolidation comes at the cost of tax increases. In this case, only support for the far left has a significant effect of debt aversion. Supporters of parties that compete mostly on the second dimension of political competition (e.g. Green, Liberals, Far Right) are hardly different from conservative voters, although voters of Green parties are an exception. In the control group, they are less likely to be fiscally conservative, but this effect also disappears in the treatment groups.

Finally, some political and attitudinal variables also have an effect on debt aversion in the control group but not when respondents are primed about trade-offs. Support for both social insurance and social investment are positively correlated with debt aversion in the control group, which indicates that these voters have internalised the “progressive consolidation thesis” (Haffert and Mehrtens, 2015). They are concerned about government debt because it threatens to undermine the ability of governments to provide the benefits and services associated with these policies. Yet, when fiscal consolidation comes at the cost of lower government spending or higher taxes, these attitudes have a smaller influence.¹⁵ Finally, political interest is also negatively associated with debt aversion in the control group, but there is no such effect in the treatment groups. This indicates that people with a high amount of political interest may already take into account the costs of fiscal consolidation, even without being explicitly primed about them.

There are two variables that are an exception to the general trend. First, gender does not have an effect on support for debt aversion in the control group, but it has a large and statistically significant effect in all three treatment groups. In other words,

¹³The effect of education in the control model might also be driven by the experimental design because people with a high level of education are more likely to realise that fiscal consolidations come at a cost even without explicitly being primed about it. Put differently, in the control groups the trade-offs are implicit and they are only made explicit in the treatment group. This might explain some of the differences observed for the control group.

¹⁴Wealth is included in separate models in the appendix because there are a large number of respondents, who did not reveal their wealth in the survey. Consequently, the number of observations drops when information about wealth is included in the regression analysis.

¹⁵Support for social investment is still positively correlated with support for fiscal consolidation that comes at the cost of lower government spending, which is ironic given that most governments first cut investment spending when they attempt to consolidate their budget (Breunig and Busemeyer, 2012).

Table 5.3: OLS regression: Preferences towards government debt

	Support for lower debt			
	Control	Lower spending	Higher taxes	Ambiguous
	(1)	(2)	(3)	(4)
Age	−0.005 (0.01)	0.0001 (0.01)	−0.01 (0.01)	−0.0004 (0.01)
Female	−0.14 (0.15)	−0.41* (0.17)	−0.40* (0.16)	−0.66*** (0.16)
Married	0.03 (0.16)	0.12 (0.19)	−0.18 (0.19)	0.26 (0.19)
Children	0.29 (0.16)	0.43* (0.18)	−0.35 (0.18)	0.05 (0.18)
Education (ref.: Primary) . Secondary	−0.46* (0.23)	−0.25 (0.26)	−0.15 (0.25)	0.08 (0.25)
. Tertiary	−0.62* (0.25)	−0.43 (0.29)	−0.17 (0.28)	−0.04 (0.29)
Income	0.07* (0.03)	−0.01 (0.03)	−0.02 (0.03)	−0.01 (0.03)
Unemployed	0.51 (0.30)	0.05 (0.35)	0.02 (0.33)	−0.41 (0.34)
Retired	0.43 (0.24)	−0.15 (0.27)	0.09 (0.26)	−0.19 (0.25)
Occupation (ref.: Manager) . Middle class	0.06 (0.21)	0.16 (0.24)	0.41 (0.24)	0.23 (0.24)
. Skilled working class	0.20 (0.27)	−0.04 (0.32)	0.05 (0.30)	−0.05 (0.32)
. Unskilled working class	0.53 (0.35)	0.18 (0.40)	0.11 (0.36)	0.11 (0.38)
. Other occupation	−0.003 (0.33)	0.11 (0.36)	−0.43 (0.37)	0.83* (0.36)
. Inactive	−0.15 (0.35)	0.17 (0.37)	0.29 (0.39)	0.71 (0.38)
Partisanship (ref.: Conservative) . Far left	−0.73** (0.26)	−0.74* (0.30)	0.01 (0.29)	−0.62* (0.30)
. Social democrats	−0.78*** (0.22)	−0.77** (0.25)	−0.36 (0.25)	−0.43 (0.25)
. Liberals	−0.28 (0.49)	−0.93 (0.51)	0.21 (0.53)	−0.19 (0.47)
. Greens	−0.58* (0.29)	−0.51 (0.33)	−0.04 (0.32)	−0.23 (0.32)
. Far right	−0.41 (0.31)	−0.27 (0.37)	−0.04 (0.36)	0.10 (0.37)
. Other party	−0.14 (0.38)	−0.47 (0.38)	−0.12 (0.44)	−0.79* (0.40)
. Abstention	−0.42 (0.27)	−0.24 (0.31)	−0.20 (0.30)	−0.32 (0.30)
Pol. interest	−0.08** (0.03)	−0.04 (0.03)	0.04 (0.04)	0.02 (0.03)
Trust in gov.	0.05 (0.03)	0.12*** (0.03)	0.18*** (0.03)	0.18*** (0.03)
Support for soc. insurance	0.11* (0.05)	−0.05 (0.05)	−0.05 (0.06)	−0.05 (0.06)
Support for soc. investment	0.15** (0.05)	0.10* (0.05)	0.08 (0.05)	0.01 (0.05)
Support for redistribution	0.05 (0.04)	−0.02 (0.04)	−0.06 (0.04)	−0.02 (0.04)
Country (ref.: Germany) . Spain	0.81*** (0.21)	−0.58* (0.24)	0.60* (0.24)	−0.19 (0.24)
. Italy	1.23*** (0.22)	0.04 (0.25)	0.43 (0.25)	0.33 (0.25)
. UK	0.40 (0.22)	0.03 (0.25)	1.06*** (0.25)	0.38 (0.24)
Constant	4.87*** (0.62)	6.00*** (0.69)	4.24*** (0.62)	4.76*** (0.66)
Country fixed effects	Yes	Yes	Yes	Yes
Observations	1,052	1,070	1,069	1,068
R ²	0.11	0.06	0.09	0.10
Adjusted R ²	0.09	0.04	0.06	0.08
Residual Std. Error	2.23	2.59	2.53	2.54
F Statistic	4.52***	2.39***	3.37***	4.13***

Note:

*p<0.05; **p<0.01; ***p<0.001

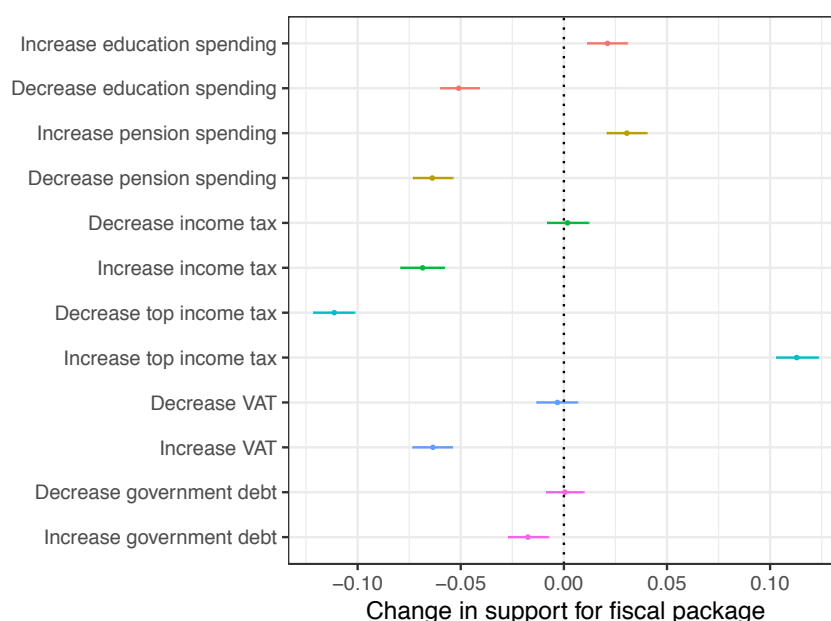
women are more likely to oppose fiscal consolidations when there are trade-offs, confirming existing findings that women tend to be more supportive of the welfare state (e.g. [Shapiro and Mahajan, 1986](#)). Second, trust in the government has no effect in the control group but it does have a strong effect on support for fiscal consolidation in all three treatment groups. This suggests that support for fiscal consolidation is conditional if it comes at a cost: people who trust the government apparently have more faith in the ability of the government to cut spending or raise taxes without large social remedies and hence they are more likely to support fiscal consolidation.

In general, the results indicate that different variables explain preferences towards fiscal consolidation when citizens are confronted with trade-offs compared to the baseline scenario without trade-offs. In other words, citizens' priorities in the face of trade-offs are determined differently than preferences in the unconstrained setting. However, the results presented above also have short-comings given that they only measure the effect of two-dimensional trade-offs. In reality, governments use a variety of different policy levers at the same time in order to achieve their preferred outcome. To tease out the preferences and priorities of citizens fully, we therefore need to study them in a multidimensional setting.

Preferences towards multidimensional trade-offs

To study trade-offs in a multidimensional setting, I use the conjoint survey experiment. The benefit of this research design is that it allows me to study how public opinion changes when policies vary on several dimensions simultaneously. This is particularly true for the “forced choice” outcome in which respondents have to choose one of the two profiles in each pairing that they support. In this exercise respondents have to support one profile from each pair that is shown to them. Therefore, they have to choose between different packages of policies that vary across different dimensions simultaneously, allowing me to observe how they evaluate policy trade-offs. The results from the experiment are shown in [Figure 5.5](#). For each attribute, the plot shows the AMCEs of increasing or decreasing spending, taxes, or government debt relative to the baseline (“no change”) on the probability that a given package of policies is supported. In this instance, the AMCEs can be interpreted as the change in the probability that a package will win support when it includes the listed attribute value instead of the baseline attribute value.

Given that respondents have to make difficult choices when completing the exercise, [Figure 5.5](#) essentially provides for a priority ordering. First of all, the results in-

Figure 5.5: AMCEs from conjoint survey experiment, pooled

indicate that respondents are reluctant to decrease government spending or increase taxation. Lower pension spending reduces the probability that respondents chose a fiscal package by 6.4 percent, while lower education spending reduces the probability by 5.0 percent.¹⁶ Similarly, increasing both income tax or VAT have effects of the same magnitude, reducing the probability that respondents support the fiscal package.

Second, increasing government spending and reducing taxation are less popular than commonly thought. Increasing pension spending has a small effect on support for the overall package, but the effect of increasing education spending is not statistically significant. Importantly, decreasing income tax or VAT has no negative effect at all, indicating that the low tax doctrine is not strongly rooted in public opinion.¹⁷ At the same time, the results confirm findings from other research that voters strongly support progressive taxes: raising top income tax increases support for the overall package by 11.3 percent, while reducing top income tax lowers the probability that respondents support the package by 11.1 percent (compared to the status quo).

¹⁶All these effects are relative to the baseline, which is “no change” (the status quo) for all attributes included.

¹⁷This indicates that most respondents consider the current level of taxes appropriate, as Ballard-Rosa et al. (2017) also found for the US.

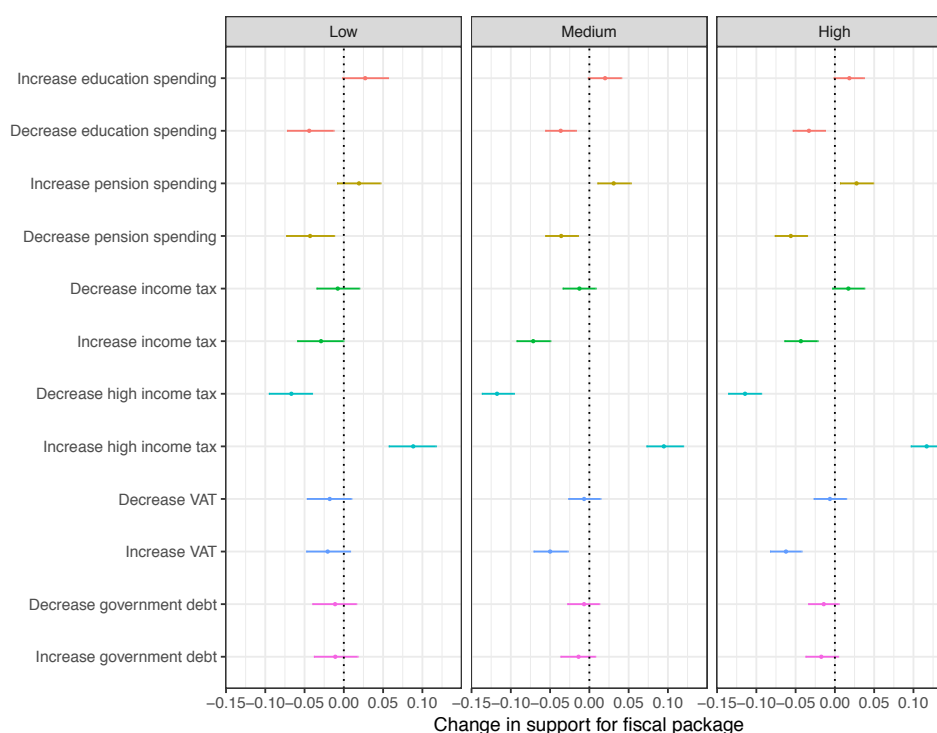
Finally, and most importantly for the purposes of this chapter, government debt does not have a very strong impact on the overall level of support for a fiscal package. Decreasing government debt does not have a statistically significant effect, suggesting that respondents are not as fiscally conservative as the existing literature assumes. The effect is very close to zero and this effect is robust across several robustness tests presented in the appendix. Increasing government debt has a negative effect on the likelihood that individuals support a given fiscal package, but this effect is extremely small (1.7 percent). The results therefore seem to suggest that government debt is essentially irrelevant for the evaluation of the packages that were presented to respondents. Decreasing government debt is not a priority for citizens, who care more about protecting the benefits that they receive from government spending without having to pay additional taxes for them.

Heterogeneous effects: Analysis of conjoint experiment by subgroups

There are some reasons to believe that the priority ordering varies across individuals, i.e. that there is a heterogeneity in the effects estimated above. Conjoint analysis does not allow me to test this explicitly because respondents are not shown all of the possible budgetary proposals (due to the relatively high number of combinations). To test whether the priority ordering identified above is stable across respondents, however, I can use sub-group analysis, which is common practice in conjoint analysis. Initially, I consider four different individual-level variables that could be associated with heterogeneity in effects, including income (Figure 5.6), class (Figure 5.7), and electoral constituencies (Figure 5.8).

The most striking aspect of all three figures shown below is that there are only very small differences across the sub-groups. The direction of the effects does not vary at all, while the magnitude of these effects also remains remarkably similar. In each case there are some differences, but they are very small. For example, the effect of increasing education spending is positive for left-wing voters, but fails to reach statistical significance for people on the right (Figure 5.8). Similarly, according to Figure 5.7, increasing education only has a statistically significant effect for the middle class, while the opposite is true for increasing government debt. In other words, the middle classes put a higher premium on education spending but they also prioritise balanced budgets more than other social groups.

The additional analyses shown in Appendix C.7 confirm that the heterogeneity of effects is very small across different socio-economic groups. The appendix includes

Figure 5.6: AMCEs from conjoint survey experiment by income group

sub-group analyses for left-right self-placement, wealth, employment status, and attitudes towards redistribution, which confirm that the priority ordering identified above remains remarkably stable across different groups. In other words, in terms of public opinion, there seems to be a consensus about fiscal priorities in the case of strong trade-offs.

However, as suggested above, there may still be differences across different contexts. To test this, Figure 5.9 shows the results from the conjoint experiment by country. They indicate again that the general pattern from above also holds across the four countries. There are some small differences across countries, but most of them fail to reach statistical significance. One interesting exception is the effect of “increasing government debt”, given that Italy is the only country where this attribute has a negative effect. This supports the conclusion from Chapter 4 that the alleged stability culture in Northern Europe is a myth. Voters in Germany do not prioritise reducing government debt more than voters in other countries; rather, fiscal consolidation is supported most in the country with the highest level of government debt, indicating that public opinion might follow a thermostatic logic, as argued in Chapter 4.

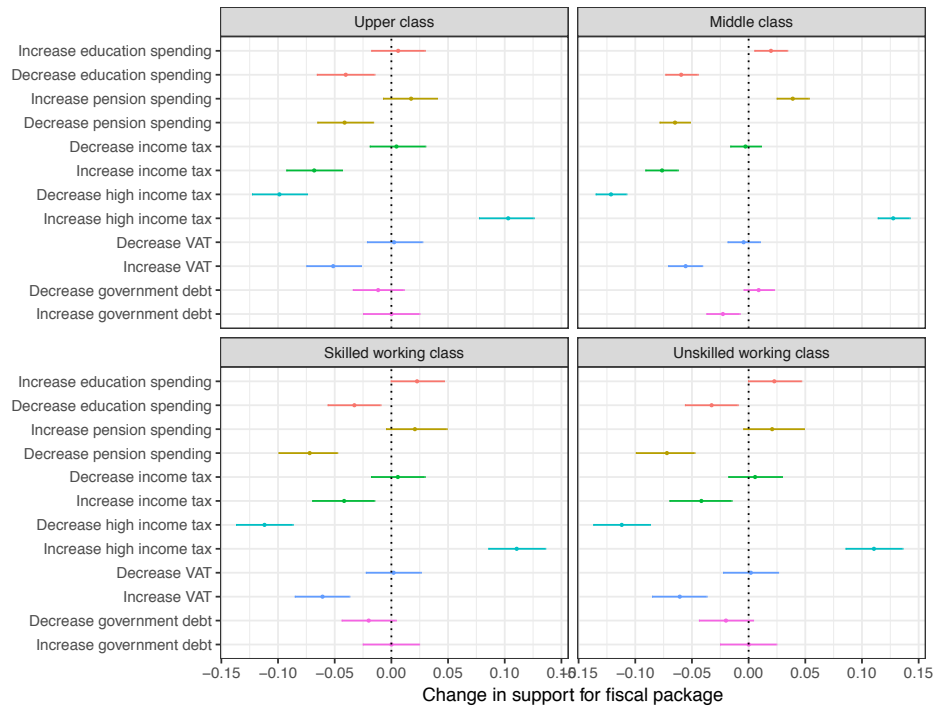
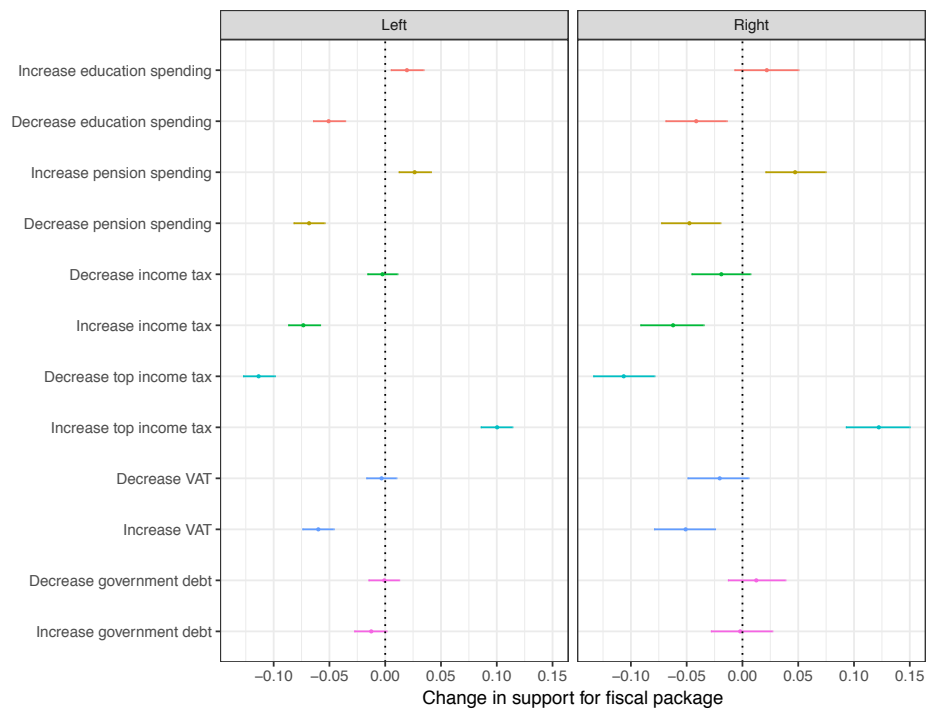
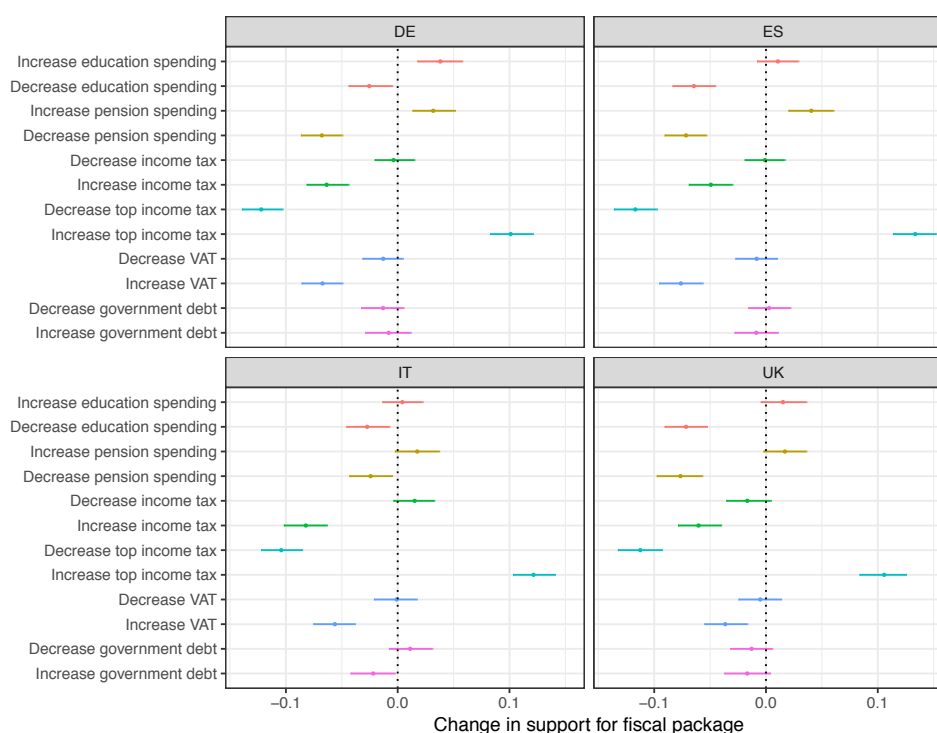
Figure 5.7: AMCEs from conjoint survey experiment by occupation**Figure 5.8:** AMCEs from conjoint survey experiment by partisanship

Figure 5.9: AMCEs from conjoint survey experiment by country

Conclusion

In conclusion, the chapter presented evidence that citizens change their preferences towards fiscal policies when they are confronted with trade-offs. In fact, the schizophrenia that many scholars have identified among the public with regard to fiscal attitudes vanishes when one accounts for the multidimensionality of fiscal policies. According to the split-sample experiment, support for fiscal consolidation drops significantly when individuals are confronted with different possible trade-offs that these policies might have.

The conjoint survey experiment confirmed this finding. It tested how respondents prioritise different policies when they are forced to consider fiscal policy trade-offs on several dimensions simultaneously. The results indicate that the public has a clear priority ordering. On average, people are still opposed to retrenchment but they do not support lowering the *level* of taxation or government debt; instead, they support a more *progressive* tax system to pay for higher government spending. Support for fiscal consolidation, in other words, is not as strong as the data from the previous chapter suggests. Importantly, this finding helps us to make sense of some of the

political turmoil in Europe in the wake of the Great Recession. As austerity has become the predominant response to the economic crisis, political actors have prioritized a policy - lowering government debt - that the public apparently cares very little about.

This finding is in line with emerging research that austerity is more costly than the existing literature suggest (Hübscher and Sattler, 2017; Hübscher et al., 2018; Bojar et al., 2018) and it helps us to make sense of the political turmoil that we have observed in Europe in the last few second, including the electoral crisis of social democratic parties (see discussion in the conclusion 8). In the past few years, governments implemented austerity by cutting spending and increasing taxation across Europe. In many cases these cuts were combined with structural reforms. The brunt costs of these packages were often directed at individual groups (e.g. unemployed, pensioners, public servants) and thus the costs of austerity were very clear. Put differently, the trade-offs associated with austerity became explicit and, in line with the evidence from above, austerity policies had significant costs for governments and parties, which implemented them.

Future research should further investigate how and why the conflicts about fiscal consolidation exhibit a different political dynamic when the trade-offs are fully acknowledged. In the split-sample experiment used above, the effects of explanatory variables differ significantly depending on whether and which fiscal trade-off is presented to individuals. Furthermore, the conjoint survey experiment revealed a clear priority ordering with regards to fiscal policies, which hardly changes across socio-economic groups. In other words, there seems to be a normative commitment to certain policies, which is shared widely across the different sub-groups analysed above. In order to fully explain public opinion towards fiscal consolidation, future research should further analyse the determinants of this priority ordering.

However, for the purposes of this thesis, the implications of the above findings are already two-fold. First, regular opinion polls on attitudes towards fiscal consolidation may consistently overstate the support for these policies. Although a majority of people agrees that fiscal consolidation is important in principle, the results from above indicates that this is less so the case when the trade-offs are fully acknowledged. In this case, fiscal consolidation is not a priority. Second, at least in theory, this also makes the electoral pressures for fiscal consolidation, which the previous chapter revealed, less binding. If parties from the left manage to convince voters that fiscal consolidation is costly, they may be able to find sufficient support for mobilising against austerity.

In the following, Chapter 6 and Chapter 7 will turn to the question why social democratic parties did not do this during the Great Recession. They will show how electoral-strategic considerations were combined with economic and ideational arguments in favour of austerity policies within the British Labour party and the German SPD. To briefly foreshadow the results, the analysis suggests that parties had a flawed conception of public opinion, failing to grasp how contested austerity policies would be. Moreover, they drew on a specific set of economic ideas that legitimised austerity among social democratic policy-makers, which made it unlikely for them to contest austerity. The conclusion (Chapter 8) will take up the findings from this chapter again, considering whether social democratic parties could have pursued a different policy and with what kind of success.

Chapter 6

The Fiscal Policies of the British Labour Party in Times of Crisis: Where are all the Keynesians Gone?

Introduction

In the UK, Labour's party response to the Great Recession felt like a roller-coaster ride. In the immediate aftermath of the 2008 financial crisis, the Labour government under Gordon Brown recapitalised the banks and implemented a Keynesian stimulus programme to reflate the economy. As a result, the government's budget deficit increased to nearly 10 percent of GDP in 2009 and ahead of the 2010 election Labour's reversed course. It proposed a deficit reduction plan including cuts that were supposed to be "deeper and tougher" than Margaret Thatcher's cuts in the 1980s. Labour still lost the elections in 2010 and found itself in opposition when a coalition government of the Conservatives and the Liberal Democrats (LibDems) implemented austerity. In the beginning, Labour criticised this programme on Keynesian grounds, but over the electoral cycle the party shifted back towards fiscal conservatism, and eventually included a triple budget responsibility lock on the first page of its manifesto for the 2015 election.

In this chapter, I attempt to analyse this puzzling roller-coaster ride. To this end, the chapter combines a quantitative content analysis of election campaigns from before

and after the financial crisis with a qualitative case study. The quantitative content analysis shows that Labour remained wedded to a centrist fiscal policies in response to the crisis, whereas it attempted to shift its position on welfare and economic liberalism. This resulted in an inconsistent economic programme that combined policies in a piecemeal fashion. The qualitative case study uses “explaining-outcome process tracing” (Beach and Pedersen, 2013), attempting to explain this response. Mainly based on 20 interviews with Labour politicians and policy-makers, it argues that both electoral-strategic calculations and the influence of lingering economic ideas from the Third Way shaped Labour’s response.

The party was driven by New Keynesian ideas, which it had maintained despite the dominance of neoliberal economic paradigm since the 1970s (Blyth and Matthijs, 2017). Leaders like Gordon Brown, Ed Miliband, Alistair Darling, and Ed Balls were clearly influenced by Keynesian theory and initially tried to implement a strategy that would take Keynes’ insights seriously. However, as the deficit of the government’s budget nearly grew into the double digits, the public discourse became increasingly concerned with the sustainability of the government’s levels of debt. Warnings by the Conservatives and large parts of the British government resonated with voters, who tend to equate the government’s budget with that of a private household (see Chapters 4 and 5). The Labour government was, consequently, pre-occupied with the need to establish economic credibility. Influenced by the extreme conservatism of the economic debate in the UK, the party took a page from New Labour’s play book and tried to reassure voters that it could be trusted with the public finances. It sacrificed aggressive Keynesian demand-stimulus on the altar of economic credibility, but among social democratic policy-makers this strategy was also legitimised by ideas based on supply-side Keynesianism. These ideas had already shaped the party’s programme prior to crisis, and in the absence of a new economic paradigm, they still influenced the Labour party in the wake of the financial crisis.

To make this argument, the chapter proceeds in five steps. First, I briefly review the economic policies that Labour espoused since 1945. This analysis will necessarily remain incomplete, but it is important to contextualise the policies that Labour adopted in response to the economic crisis. Second, I use the dataset from Chapter 3 to analyse the response of the Labour party to the economic crisis before I attempt to explain this response by way of process-tracing. This analysis distinguishes four different periods in Labour’s response to the Great Recession and pays close attention to the nature and timings of policy shifts. In this way, it shows how electoral-strategic considerations were combined with economic arguments to justify fiscal orthodoxy.

Fourth, I consider the legacy of the Third Way, which Labour had embarked upon prior to the crisis. I argue that there was an element of path dependency (due to feedback effects from the Third Way), which constrained the Labour party in the context of the Great Recession. Finally, I conclude by analysing the implications of Labour's trajectory since 2015 for my analysis.

Labour's economic policies before the Great Recession

The Labour party had a complicated relationship with economic policies in the 20th century and in particular with fiscal policies. In the post-war period, there are three broad phases in which Labour had different policies and I refer to these periods as "The reign of Keynesianism" (1945-1976), "In the Shade of Monetarism" (1976-1997), and "New Labour's Symbiosis" (1997-2008).

The reign of Keynesianism (1945-1979)

After the end of the Second World War, Clement Attlee won a resounding election victory in 1945 and faced a herculean task: he had to rebuild the economy and develop a welfare state that the Labour movement demanded, while the British government was virtually bankrupt. The Labour government lived up to the task and built the British welfare state from the ashes of the war largely by following the recommendations of the Beveridge report.^[1] Based on the 1944 White Paper on Employment Policy, the government made full employment the primary aim of government policies.^[2] This marked the beginning of the British post-war Keynesian consensus: for the next thirty years, Labour and the Conservative Party agreed that governments should use macroeconomic policies to maintain a high and stable level of employment. Following Keynes, who told governments to 'look after unemployment and the budget will look after itself', there was a general expectation that the state would not allow deep recessions and high levels of unemployment to persist. Instead, successive British governments used government spending to fine-tune the economy, creating the economic confidence that would enable long-term investments in the economy (Jones, 2014).

¹The Beveridge report had already proposed widespread reforms to address the most pressing social problems in the UK in 1942.

²The White Paper took up the economic thinking of John Maynard Keynes, and stated that 'the government accepts as one of their primary aims and responsibilities the maintenance of a high and stable level of employment after the war.'

Although Keynesianism evolved in response to new economic challenges (Hall, 1986), governments generally accepted that they should use fiscal policy to stabilise the economy during the post-war era.³ The Keynesian consensus was only challenged by new economic developments in the 1970s. Following the end of the Bretton Woods system and repeated oil shocks in the early 1970s, “stagflation” shed doubt on Keynesianism. It questioned the Phillips curve, which described a historical inverse relationship between unemployment and inflation, and in combination with repeated balance of payment problems, it created problems that Keynesian economists could not easily make sense of.⁴ In response to the recurring crises, the Conservative government under Edward Heath initially adopted a muddled response. Prior to the 1970 election, Heath had endorsed free-market solutions, but when unemployment rose significantly, he made a u-turn in economic policy and reverted to a Keynesian stimulus. Yet, the so-called “Barber” boom (named after chancellor Anthony Barber) did not last long and soon the government was embroiled in a conflict with the trade unions. Trying to bolster his government, Heath called for an early election, which he narrowly lost to Harold Wilson, who was able to form a Labour minority government.

Wilson had campaigned on the maintenance of the welfare state and initially increased government spending. Yet, the Keynesian tools seemed powerless in the face of stagflation and by 1975 Chancellor Dennis Healey felt compelled to increase taxes and decrease public expenditure in order to tackle the budget deficit. However, as Healey recalls, ‘almost all of the spending cuts ran against the Labour party’s principles and many also ran against our campaign promises’ (cited in Burton, 2016, p. 32). As a result, the left wing of the Labour party rebelled and defeated proposals for further cuts by Healey in the House of Commons in March 1976. Eventually, Harold Wilson resigned as Prime Minister, but when James Callaghan became the new leader of the Labour Party and Prime Minister, the situation further escalated. Investors believed that the British pound was overvalued and there was significant downward pressure on the currency. Moreover, the Labour government struggled to

³The Labour party fully supported this consensus, but most Labour governments were still internally divided about their spending plans. This division was often related to successive balance of payment crises that the UK faced after the Second World War. For example, in the early 1950s chancellor Hugh Gaitskell felt compelled to propose an “austerity-budget” after the Korea war had begun, imposing a heavy financial burden on the British government. Similarly, in 1970 chancellor Roy Jenkins infuriated large parts of the Labour movement by presenting a budget that contained few pre-election sweeteners. In both instances, Labour lost the following elections but even the Conservatives remained wedded to the basic tenets of the Keynesian consensus.

⁴The Phillips curve was named after the Keynesian economist William Phillips, who showed that this relationship existed empirically. Based on it British governments had sought to reach an acceptable point on the Phillips curve by trading-off some inflation for lower unemployment (Hall, 1986).

honour its fiscal obligations, and against this background, James Callaghan addressed his own party in a speech at the Labour conference in September 1976, which is often viewed as the hallmark that ended the Keynesian consensus (Hall, 1986, p. 95). In this speech, Callaghan argued that ‘the cosy world we were told would go on for ever, where full employment would be guaranteed by a stroke of the Chancellor’s pen, cutting taxes, deficit spending, that cosy world is gone.’ He continued by being even more explicit:

We used to think that you could spend your way out of a recession, and increase employment by cutting taxes and boosting Government spending. I tell you in all candour that that option no longer exists, and that in so far as it ever did exist, it only worked on each occasion since the war by injecting a bigger dose of inflation into the economy, followed by a higher level of unemployment as the next step (Callaghan, 1976).

In that same month, the government turned to the IMF and requested a loan to solve its difficult fiscal situation. In and of itself, this was not a dramatic event given that the UK had repeatedly borrowed from the IMF since the end of the Second World War. Based on pessimistic Treasury forecasts in 1976, however, the UK asked for the largest loan that had ever been requested up to this point. Moreover, the IMF tied the loan to economic conditions, which committed Labour to rigid spending cuts. After long negotiations with his own cabinet and the IMF, the government eventually agreed to such cuts in return for a loan worth \$3.9 billion. This paved the way for a bitter battle within Labour and eventually contributed to the so-called “Winter of Discontent”, when a series of strikes against Labour’s income policy undermined the common notion that Labour could control the unions.

In the shadow of monetarism (1979-1997)

Following the IMF crisis and the Winter of Discontent, Labour’s reputation for economic management was severely damaged, and in 1979 James Callaghan lost the election to Margaret Thatcher. Thatcher’s arrival heralded the rise of monetarism (Hall, 1986), but the Labour party had dealt the first blow to Keynesianism. Even if the party’s policy was not fully monetarist under Harold Wilson and James Callaghan, Labour had already given more weight to inflation and less to unemployment than before (Hill, 2001, p. 124-25). This was also expressed by James Callaghan in his 1976 speech cited above, when he said that ‘the first priority of the Labour Government must be a determined attack on inflation’ (Callaghan, 1976). Moreover, the budget

deficit became a concern as the Labour government was unable to spend its way out of the recession, leaving both unemployment and inflation at a high level. This helped Thatcher to engineer a wholesale paradigm change. She made inflation the main goal of her “Medium Term Financial Strategy” announced in 1979. Limiting the growth of money supply and the budget deficit, she ushered in the turn from Keynesianism towards a monetarism (Blyth, 2002; Matthijs, 2011).

The failure of Keynesian policies to cure the economic problems of the 1970s contributed to the internal conflict that emerged within the Labour party after the defeat in the 1979 election. When Michael Foot from the left-wing of the Labour party won the leadership, a group of MPs around the former chancellor Roy Jenkins broke away and formed the Social Democratic Party (SDP) in 1981. Michael Foot initially tried to reassert Keynesian principles, but after the election loss in 1983 the tide turned within the Labour party. Under the leadership of Neil Kinnock and the Shadow Chancellor Roy Hattersley, Labour developed supply-side policies, indicating a greater focus on the need for structural change to tackle unemployment. As Hill (2001, p. 147) argues, ‘full employment remained the objective, [but] it was recognised that traditional Keynesian reflation of the economy would not only run into a balance of payments constraint but, more seriously, a lack of industrial capacity that would be needed to cope with any such increase in demand and so generate employment.’

The Conservative government also constantly reminded the electorate about Labour’s economic record in the 1970s and Labour thus became concerned with increasing its economic credibility. The party decided that all policy proposals in Labour’s manifesto would undergo a careful cost assessment prior to the 1992 election. Still, the Conservatives claimed that a Labour government would raise taxes and cause inflation, which the Conservatives called “Labour’s Double Whammy”. In particular, the claim that Labour would raise taxes to fund increases in government spending – dubbed Labour’s “tax bombshell” – was an effective campaign message, which undermined Kinnock’s efforts to overcome Labour’s image as a “tax-and-spend” party. Labour even developed a shadow budget, which was supposed to give clarity about Labour’s tax and spending proposals, but the party still lost the election in 1992.

This electoral loss had a scarring impact on the Labour party and in the next few years Labour’s economic policy was guided by the aim to further enhance its economic credibility. Although there was a brief shift back to Keynesianism and demand-side policies immediately after the election (Corry, 1994; Hill, 2001), the party increasingly emphasised its ability to control inflation. This was particularly true after Tony

Blair became leader of the Labour party and Labour adopted the Third Way. In his 1995 Mais Lecture he argued that ‘low inflation... is the essential prerequisite both of ensuring that business can invest and that supply side measures can work to raise the capacity of the economy to grow’ (cited in [Hill, 2001](#), p. 158). Led by Gordon Brown and his advisor Ed Balls, the party sought to assure the electorate and the business community that Labour could be trusted to run the economy. Labour, therefore, also accepted orthodox spending policies, which Gordon Brown outlined in a major speech in 1995 (cited in [Keegan, 2004](#), p. 145):

First, Labour will be committed to meeting the golden rule of borrowing – over the economic cycle, government will only borrow to finance public investment and not to fund public consumption. Second, alongside this golden commitment, we will keep the ratio of government debt to GDP stable on average over the economic cycle and at a prudent and sensible level.

On top of these fiscal rules, Brown and Balls attempted to assure voters that Labour would not increase taxes in order to avoid a repetition of the 1992 election. Going into the 1997 election, they pledged to maintain the Conservatives’ spending plans for two years and the levels of direct taxation for the entire parliament. In this way, Labour’s fiscal policies had become more a political tool to win the election than an economic tool to manage the economy.

New Labour’s symbiosis (1997-2008)

The 1997 election swept Labour into office with a landslide victory. Afterwards, Gordon Brown moved quickly to implement his economic policies. Four days after the election, he made the Bank of England operationally independent and committed the government to the fiscal rules that he had first set out in 1995. He fortified his reputation for prudence ([Keegan, 2004](#)) by sticking to the spending and tax plans of the Conservative party, as he had promised before the election. As a result, many observers claim that New Labour wholeheartedly accepted the conservative economic doctrine based on monetarism (e.g. [Hay, 1999, 2004](#); [Hutton, 1999](#); [Carstensen and Matthijs, 2018](#)). However, in retrospect the picture is more complicated both in terms of New Labour’s economic doctrine and the policies that the Blair and Brown governments actually implemented ([Keegan, 2004](#); [Clift and Tomlinson, 2007](#)).

First, New Labour’s economic doctrine did have a strong focus on the supply-side, but it was still influenced by Keynesian economic thinking. Their economic texts and

speeches were still sprinkled with Keynesian references (e.g. [Brown, 1998, 1999a, 2001](#); [Balls, 1998](#); [Balls and O'Donnell, 2001](#)) and they never explicitly gave up fiscal policy. According to [Clift and Tomlinson \(2007\)](#), the central theme of New Labour's argument was the creation of a framework which would allow the government "constrained discretion" in fiscal terms. It was 'developed to reconcile both the securing credibility with international financial markets and substantial fiscal policy space to pursue domestic economic policies of broadly Keynesian character' ([Clift and Tomlinson, 2007](#), p. 48). In the words of Ed Balls himself 'the scope for, and likely success of, using fiscal policy to support monetary policy during a down swing in the economic cycle is likely to depend on the soundness of the medium term fiscal position' ([Balls and O'Donnell, 2001](#), p. 135).

Although New Labour emphasised that the government cannot fine-tune the economy, they also argued that this was a misapplication of Keynes himself ([Brown, 2001](#), p. 37). Instead, governments had to gain the credibility of international markets by keeping inflation and fiscal deficits low in order to use an activist fiscal policy when it was needed. In line with the dominant macroeconomic paradigm at the time, New Labour identified inflation as an important problem but it also recognised that macroeconomic policy should be used for other purposes.⁵ In other words, Brown believed in the importance of full employment as an economic objective, but in line with supply-side Keynesianism, he argued that macro- and microeconomic concerns cannot be separated. Thereby the Chancellor situated his analysis in the macroeconomic mainstream of the time.⁶ He took a strong interest in supply-side policies and changed the role of the Treasury in the British economy accordingly ([Keegan, 2004](#), p. 247). In the short-run, New Labour 'carefully reserve[d] a role for demand management in determining the level of employment, albeit alongside supply-side policies' ([Clift and Tomlinson, 2007](#), p. 57).

Second, the importance of Keynes for New Labour also became obvious in the policies that Labour pursued in government. After coming to office they implemented a sequential strategy ([Keegan, 2004](#), p. 242). In the first two years in office, Brown stuck to the Conservative freeze on public spending, as New Labour had pledged before the 1997 election. In these two years, fiscal policy was mostly used for a political objective: to gain the trust of voters and markets by proving that Labour could control

⁵For example, in his Mais Lecture in 1999 Brown said that 'the role of a macro-economic policy is not simply to bear down on inflation but by creating a platform of stability to promote growth and employment... in other words, macro-economic and micro-economic policy are both essential – working together – to growth and employment' (cited in [Clift and Tomlinson, 2007](#), p. 55).

⁶Brown was strongly influenced by his advisor Ed Balls, who had studied under New Keynesian economists like Lawrence Summers or Larry Katz at Harvard University.

and direct spending in a responsible manner (cf. Keegan, 2004, p. 250). Brown and Balls repeatedly rejected the concept of tax and spend ‘for political and vote-catching purposes’, which was ‘a reaction, indeed an overreaction, not only to all those successive electoral defeats but also to the prevailing climate of the times’ (Keegan, 2004, p. 239). As Hopkin and Alexander Shaw (2016, p. 356) argue, ‘by signing up to the economic orthodoxy of the time... Labour could gain credibility in the financial markets and reassure markets and voters that the party would run the economy competently.’ After Labour had proven that they could control public spending in the first two years, they changed course, though: in the Comprehensive Spending Review 1998, the government laid out their plans to increase government spending⁷

In hindsight, this bifurcated strategy was remarkably successful: by increasing Labour’s economic credibility, it allowed them to shape the popular consensus that investment in public services was both necessary and affordable. Labour built on this success and increased government spending again beginning in 1999, which became imperative in the context of sluggish international growth in the early 2000s. By investing in Britain’s public services, it enabled Labour to achieve its political objectives.⁸ it brought welfare standards closer to the levels of provisions in continental Europe (Gamble, 2005) and pursued “redistribution by stealth” (Keegan, 2004). As the Guardian’s economics editor Larry Elliott (2000) already wrote in 2000, this led to the rehabilitation of Keynes in the Treasury and ‘the big increase in departmental spending... was, according to Brown’s advisers, the beautiful Keynesian butterfly emerging from the ugly monetarist chrysalis.’

As Keegan (2004, p. 252) argues, Brown’s ultimate aim was a ‘return to the politics of “tax and spend” after the Labour government had demonstrated how fiscally responsible it was.’ Although the economic doctrine of New Labour was not always clear, its fiscal policy was strongly influenced by supply-side Keynesianism.⁹ On the one hand, the architects of New Labour accepted the importance of stability and low inflation as well as the dominance of supply-side factors to determine long-term economic growth. On the other hand, New Labour also emphasised that the state

⁷In the introduction to the Comprehensive Spending Review 1998 of the government, Blair wrote that investment would not be possible ‘if the economy lurched from boom one year to bust the next. That is why we have taken a prudent approach to public finances. We have stuck rigidly to tough spending plans since the Election... This government will spend only what it can afford’ (cited in Burton, 2016, p. 65).

⁸New Labour increased the ratio of government expenditures to GDP from under 36 percent in 1998 to 41.4 percent in 2007. This increase was mostly achieved by focusing spending on investment in education and health (Carstensen and Matthijs, 2018) but, more generally, New Labour used government spending to improve the British public services.

⁹This is in line with Hodson and Mabbett (2009, p. 1042), who also argued that New Labour’s paradigm ‘was based on the dominant New Keynesian consensus in macroeconomic theory.’

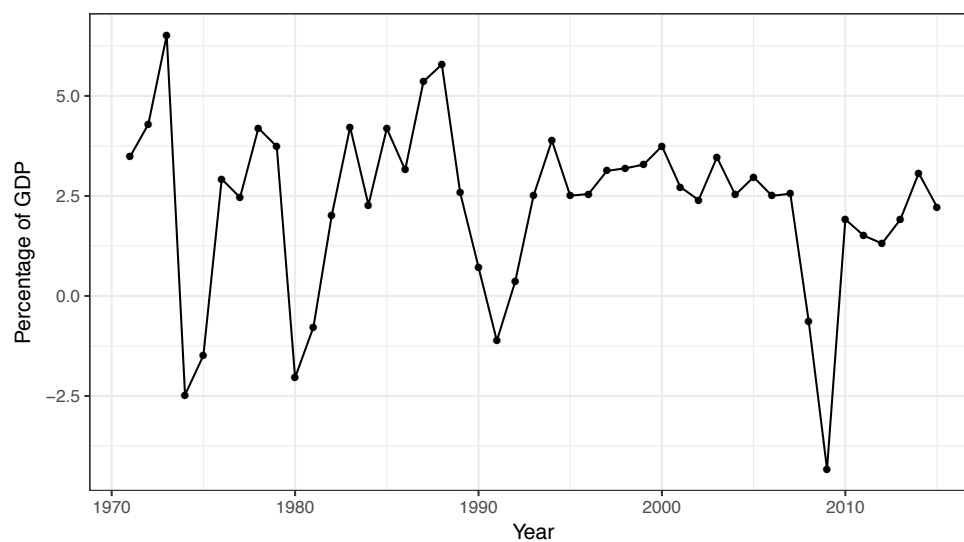
had an important role to play in the economy. In response to economic crises, governments should maintain demand in the short-term, thereby preventing hysteresis and ensuring long-term growth. Contrary to what Carstensen and Matthijs (2018) suggest, New Labour did not become a full-fledged convert of neoliberalism — at least not with respect to fiscal policy. Initially, fiscal prudence was a political strategy to gain credibility, but it later gave way to a fiscal policy in line with supply-side Keynesianism.

Economic crisis and the response of the Labour party

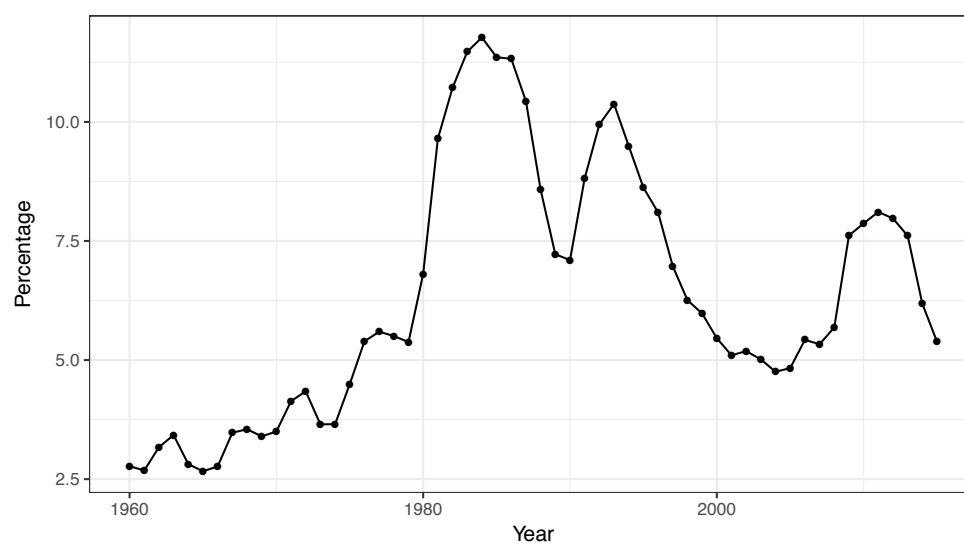
Labour had been in government for eleven years, when the financial crisis struck in September 2008. In the uncertainty following the collapse of the US American investment bank Lehman Brothers, there was a large fall in the British stock market and some of the largest British banks were pushed to the brink of default. Moreover, the financial crisis also had a significant impact on the British real economy. Despite attempts to reflate the economy, British GDP contracted sharply by 4.3 percent (Figure 6.1) and unemployment increased to 7.6 percent in 2009 (Figure 6.2). The fall in GDP had been unprecedented since the 1930s, creating fears that the UK would face a long depression. In the end, the UK recovered fairly quickly as it returned to growth again in 2010. Still, the economy continued to experience meagre growth until 2013 and it nearly entered a double-dip recession in 2012 when GDP only grew marginally.

To examine the response of the Labour party to this economic crisis, I use the data from Chapter 3. The advantage of this data is that it allows me to again classify economic issues into the three meta-categories used above, i.e. welfare, economic liberalism, and budgetary rigour. For six North-Western European countries, the dataset also includes data from elections since the 1990s and one election from the 1970s as a historical benchmark. The data thus enables me to put Labour's economic response to the Great Recession into a historic perspective. To focus on the larger programmatic shifts of Labour over time, I classify the elections into five different periods shown in Table 6.1. For each period, I first calculate the aggregate left-right position for the Labour party and the Conservatives to examine whether there was a neoliberal convergence prior to the crisis.

The results are shown in Figure 6.3. It indicates that historically the difference between the Labour and the Conservatives was not very large in terms of their economic programme; in the 1970s, the weighted left-right position of the two mainstream

Figure 6.1: UK GDP Growth, 1970-2015

Source: OECD

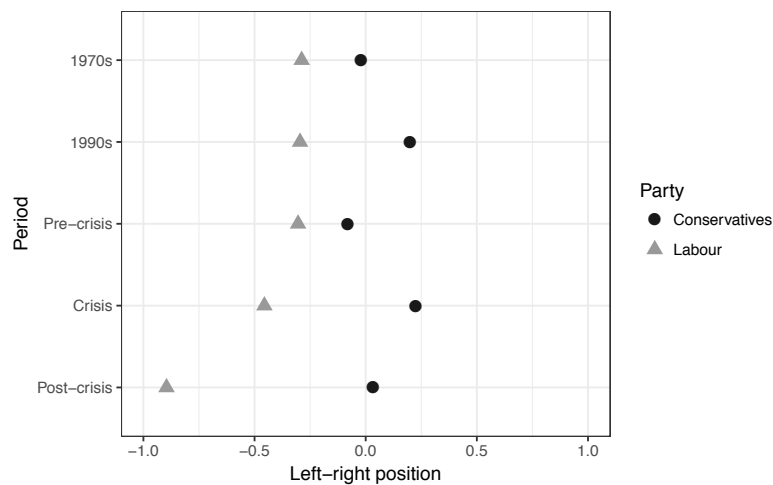
Figure 6.2: UK Unemployment, 1960-2015

Source: OECD

Table 6.1: List of elections by time period

Time Period	Election
1970s	1974
1990s	1992, 1997
Pre-crisis	2001, 2005
Crisis	2010, 2015
Post-crisis	2017

British parties was already fairly close. Following the logic of the majoritarian electoral system, both parties usually attempted to occupy the centre-ground and compete for the median voter. Nonetheless, it is surprising that Labour's left-right position during electoral campaigns in the 1990s and the early 2000s was very similar to the position in 1976. Although New Labour's Third Way distinctively changed the economic programme of the party, this did not translate into a radical different electoral programme.

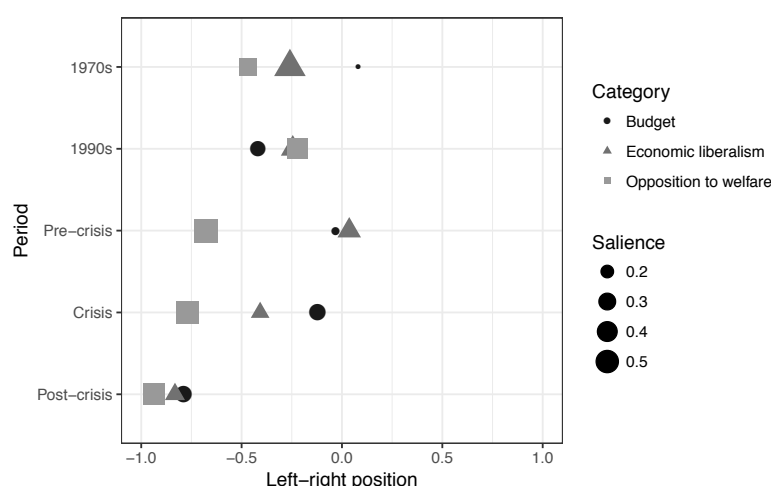
Figure 6.3: Left-right position of Labour and the Conservatives over time

Note: The figure shows the weighted average position of Labour party and the Conservative party on all economic issue categories (welfare, economic liberalism, budgetary rigour). The positions are weighted by the relative salience of each category.

In the context of the crisis, however, Labour did shift its position towards the left, as indicated by Figure 6.3. The shift was largest after Jeremy Corbyn had become the leader of the Labour party, but it was already substantial during the Great Recession. This crisis partly reversed the convergence of the Labour party and the Conservatives, as the gap between the two parties widened in the 2010 and 2015 elections.

To properly characterise Labour's response to the crisis, it is thus useful to distinguish between the position on the three different economic categories identified above. The results of this exercise are plotted in Figure 6.4. It shows that in the 1970s, there was already a certain degree of variation in Labour's economic position. Its position on the welfare state was more left-wing than its position on economic liberalism, while it adopted centrist fiscal positions, as described above. In the 1990s, these differences disappeared as the party moved towards the right on welfare and to the left on budgetary rigour. In this period, which combines the 1992 election under Neil Kinnock and Tony Blair's first election from 1997, the Labour party had a very consistent programme.

Figure 6.4: Left-right position of the Labour party for different economic categories over time



Note: The figure shows the position of Labour on different economic issue categories. +1 refers to support for budgetary rigour, economic liberalism, and opposition to welfare, respectively. The size of the symbols corresponds to the relative salience of each category for each party.

However, this consistency was short-lived and undermined as the Third Way took shape. As part of the Third Way, Labour moved to the left on welfare, but it noticeably adopted more centrist positions on economic liberalism and budgetary rigour. The Labour party bought into the dogma of the day and supported a flexibilisation of labour markets and a deregulation of the economy. Despite increasing government spending from the late 1990s onwards, rhetorically it also continued to support a prudent fiscal programme. Yet, at least in electoral campaigns, this programme was combined with a commitment to the welfare state and public service provision.

The financial crisis undermined this Third Way programme, though. The party shifted its positions on welfare further to the left and it reversed its support for economic liberalism. It became noticeably less enthusiastic about free markets and begun to champion state intervention again. For example, the party's leadership supported tighter financial regulations, attempted to rekindle its relationship with the unions, and developed new ideas for state intervention. Still, Labour hardly changed its position with regards to budgetary rigour. It endorsed orthodox fiscal policies that only marginally differed from the Conservative position, as shown above. This only changed when Jeremy Corbyn was elected as the leader of the Labour party in the wake of the 2015 election that the Labour party lost. By the 2017 elections, Corbyn had changed the party's programme significantly, competing with left-wing positions with regard to all three issue categories.

In retrospect, it is puzzling that this did not happen earlier. The Labour party under Gordon Brown and Ed Miliband lacked a coherent platform based on an economic paradigm, as defined by [Hall \(1993\)](#); rather it combined individual policy initiatives in a piecemeal fashion. In this way, it did not only fail to win the elections in 2010 and 2015, but it also paved the way for Corbyn and his allies to take over the Labour party. Therefore, the analysis above begs the question why the Labour party under the leadership of Brown or Miliband did not change its position on budgetary rigour in response to the economic crisis.

Explaining austerity from the left in the UK

To explain Labour's puzzling fiscal policy in response to the Great Recession, I use "explaining-outcome process tracing" ([Beach and Pedersen, 2013](#)). The analysis starts with the beginning of the 2008 financial crisis and it ends in 2015 when Labour lost the election and Jeremy Corbyn was elected as the leader of the party. My main source are 20 elite interviews with Labour politicians and policy-makers conducted between September 2016 and April 2016. I complement these interviews with evidence from primary and secondary sources, including official documents and public statements from leading social democrats. As argued in Chapter [1](#), the interviews allow me to unpack the official narrative behind Labour's economic programme and to elucidate the causal mechanism behind the party's response to the crisis. A list of all interviews conducted is available in Appendix [D.1](#), which also explains the rationale for selecting the interviewees.

2008-2010: The crisis years – Labour’s response to the financial crisis

Priming the pump: Bank bailouts and Keynesian demand stimulus

In response to the financial crisis in autumn 2008, the Labour government took decisive action. Chancellor Alistair Darling announced a large bank rescue package before stock markets opened on Monday morning, 8 October 2008. As Darling said in a statement in the House of Commons on the same day, the rescue package was ‘designed to restore confidence in the banking system and to put banks on a stronger footing’ [Darling \(2008\)](#). The package went a long way in achieving these aims, but the British government soon became concerned with the effects of the financial crisis on the real economy (Dan Corry, personal interview, 17/11/2016). Consequently, the government also prepared a large fiscal stimulus programme, which was mostly announced in the annual Pre-Budget Report in November 2008. The measures included a tax cut for basic rate tax payers, a temporary cut in VAT as well as investment spending worth £3 billion brought forward from 2010. On top of the automatic stabilisers, the discretionary fiscal measures totalled around £20 billion, as estimated in the Pre-Budget Report.

Both the recapitalisation of the banks and the stimulus programme were a clear return to Keynesian economic policies. After New Labour had emphasised the importance of fiscal prudence for more than a decade, the rhetoric of the government radically changed. Brown and Darling were ‘fearful that the recession could turn into the depression’ (Alistair Darling, personal interview, 13/12/2016). As a former adviser at the Treasury emphasised, ‘there was a strong consensus that we had to support the economy in response to the biggest recession in history since the 1930s and our actions were guided by this need to protect the economy’ (Thorsten Bell, personal interview, 13/12/2016). Therefore, the government followed a classic Keynesian response. Although some of the government’s policies were based on the common sense that the government had to act, the most important actors were heavily influenced by Keynesian thinking (John Denhman, personal interview, 21/04/2017). For example, [Darling \(2011\)](#), p. 176) justified the stimulus in the following way:

When households and companies spend less, and governments cut public spending, recession risks turning into depression. The argument for maintaining public spending is therefore quite straightforward... certainly, to start cutting public spending midway through 2008 would have jeopardised millions of jobs.

He continued by saying that

In late 2008, I was influenced hugely by Keynes's thinking... I could see that if we did not maintain our spending levels, we ran the severe risk of an inevitable recession turning into a deep depression which might last for years. More than that, I felt the government would have to do something extra to stimulate economic growth (Darling, 2011, p. 177).

To this end, Gordon Brown also formed the National Economic Council, a new body that became known as an "economic war council", which was supposed to develop strategies to respond to the economic crisis. Co-chaired by Gordon Brown and Alistair Darling, the body was designed to 'try to get Departments and the Treasury to clear the deck, abandon old plans, and force everyone to think anew' (Dan Corry, personal interview, 17/12/2016). Brown knew that the financial crisis challenged the prevailing economic doctrine and was hoping to take quick and coherent action that would not be obstructed by bureaucratic reasons. As one economic adviser recalls, 'it was like bang, bang, bang. We went from the Bank recap into the fiscal stimulus, into asset protection and then quantitative easing. It was just like a series of horrific events' (Seldon, 2011, p. 253).

However, Gordon Brown was also acutely aware of the international dimension of the crisis (Patrick Diamond, personal interview, 25/10/2016; John Denham, personal interview, 24/04/2017). He realized that action by a single government would not be sufficient to address the adverse impact of the crisis. Therefore, on top of reflation of the domestic economy, Gordon Brown worked hard to create an international consensus on the need for stimulus programmes. He was instrumental in initiating a G-20 summit in Washington in November 2008 where leaders agreed on the need to stabilise financial markets and limit the effects of the crisis. As Neil Kinnock put it, 'Gordon Brown used his contacts in the finance ministries around the world to orchestrate global action in a Keynesian way' (personal interview, 06/12/2016).

Given the importance of New Keynesianism for New Labour's economic doctrine, this response was actually not very surprising. Hay (2011, p. 253) views it as a case of "inter-paradigm borrowing", but the discussion above suggests that there was a clear continuation of ideas. New Labour did not '[rediscover] the political economy... of John Maynard Keynes' (Lee, 2009, p. 30) in 2008; rather the crisis revealed how important Keynesian ideas had remained for them. New Labour had never fully bought into the monetarist paradigm but its resolve to use Keynesian deficit spending had not been tested prior to 2008. This is true even though the increase in discretionary fiscal spending was actually modest compared to what some other countries

(like France and Germany) did in 2008 and 2009 (Hodson and Mabbett, 2009).¹⁰ On top of the discretionary changes in spending and taxation, the government also allowed the automatic stabilisers to work, which contributed to the stimulus more than in other countries (Darling, 2011). Moreover, as emphasized above, the British government was also instrumental in orchestrating the international response to the financial crisis that was very much inspired by Keynesian economic thinking.

The Darling Plan: Labour's disagreement about how to manage the deficit

Despite the government's attempts to boost demand, the British economy contracted significantly in 2009. Paradoxically, a few months after the beginning of the financial crisis, the most salient economic problem discussed in the public was not growth or unemployment but the government's deficit. The deficit grew to nearly 10 percent of GDP in 2009 (Figure 6.5) as the bank rescue packages, the automatic stabilisers, and the stimulus programme increased government spending to a level that had not existed in Britain for several decades (see Figure 6.6).¹¹ At the same time, the government's revenues took a sharp hit, as the government cut the value added tax (VAT) in 2008, and the financial crisis significantly reduced the revenues that the government could collect from the financial sector.

In response to the large deficit, the public discourse increasingly became concerned with the sustainability of the rising level of government debt (see Figure 6.7). Although most economists and observers had initially agreed that government spending was absolutely crucial to prevent an even deeper fall in output, the crisis was soon viewed as a "crisis of debt" instead of a "crisis of growth" in the public discourse. This discursive environment presented a new problem for the Labour government, as it raised the question about how to respond to the rising deficit. The answer to this question was non-trivial, exposing a split within the government and the Labour party as a whole that would undermine the coherence of Labour's fiscal policies for years to come.

The split first emerged in spring 2009 during the preparations for the annual budget when senior officials in the Treasury became nervous about the size of the deficit.

¹⁰For example, the temporary cut in VAT was central to the government's plan to maintain consumption and the UK thus relied more on tax cuts than increases in government spending to fight the recession.

¹¹In Britain, the magnitude of this deficit was truly unprecedented since the 1970s. Although the ratio of government spending to GDP had increased steadily under New Labour since 2000, it clearly shot up during the economic crisis. Partly this was caused by the fall in GDP shown in Figure 6.1 but even in absolute terms the increase of spending was significant.

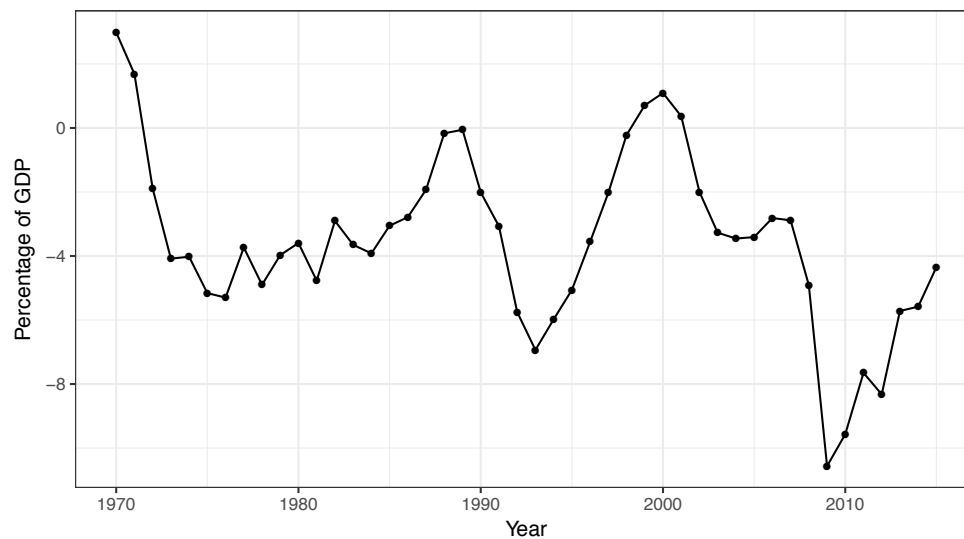
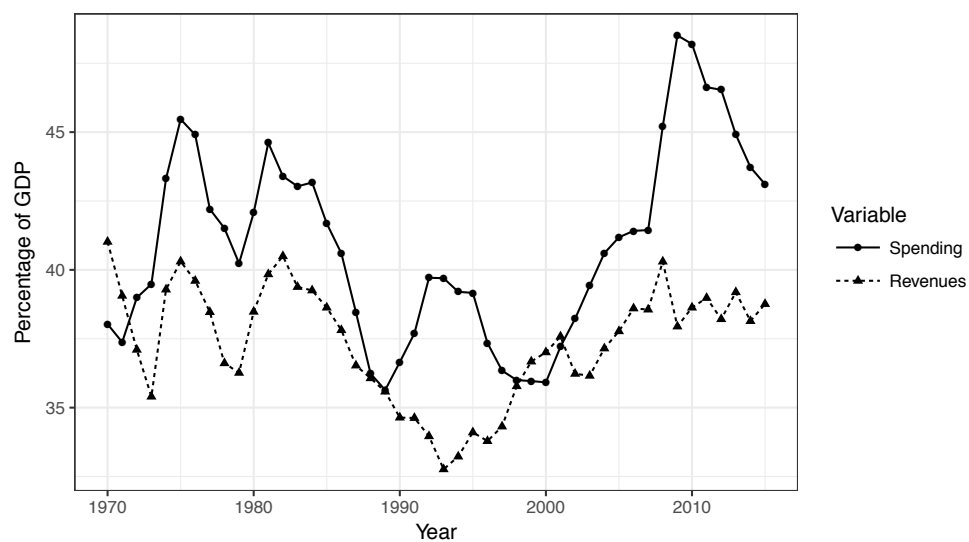
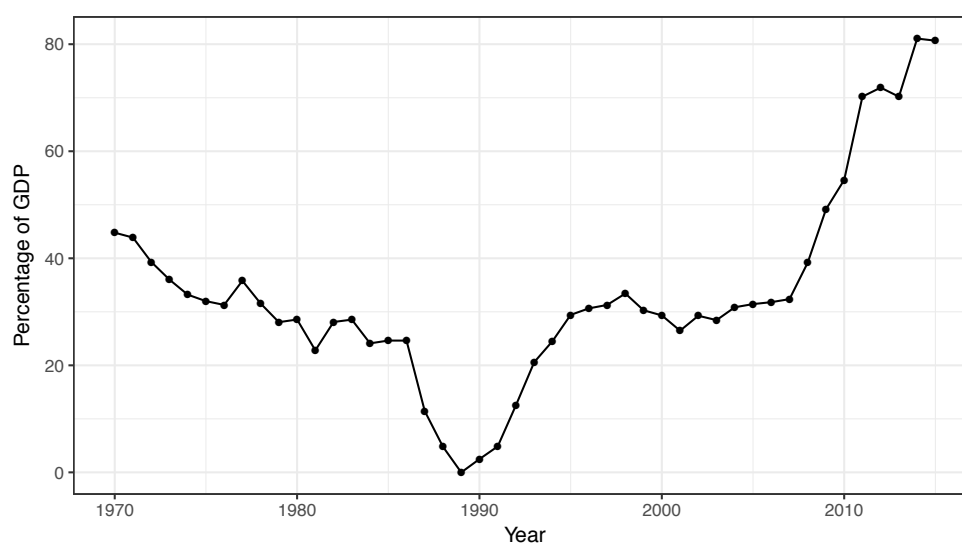
Figure 6.5: UK government net lending, 1970-2015*Source: OECD***Figure 6.6:** UK government spending and revenues, 1970-2015*Source: OECD*

Figure 6.7: UK government net financial liabilities, 1970-2015

Source: OECD

They feared that the government was ‘skating on thin ice’ with regard to the bond and currency markets (Rawnsley, 2010, p. 680).¹² Many key actors recalled the 1976 crisis when the Labour government had to request a loan from the IMF (Nick Thomas-Symonds, personal interview, 05/10/2016), and the most senior civil servant in the Treasury Nick Macpherson was determined that this would not happen again (Seldon, 2011, p. 368). These concerns were fuelled by a series of events in early 2009. In March 2009, the British government failed to sell all government bonds in an auction for the first time in seven years (BBC News, 2009). Moreover, in May 2009 the rating agency Standard and Poor’s placed the British Triple A rating under review for the first time in three decades (Conway, 2009). In this situation, the Chancellor Alistair Darling increasingly believed that the government would have to present a plan on how to handle the deficit. He wanted to retain the confidence of both capital markets and voters by committing the government to halve the deficit over a four-year period – which became known as the “Darling plan”. To this end, Darling and his advisers at the Treasury also believed that there would have to be cuts in government spending in order to make the numbers work (economic advisor A, personal interview, 13/12/2016).

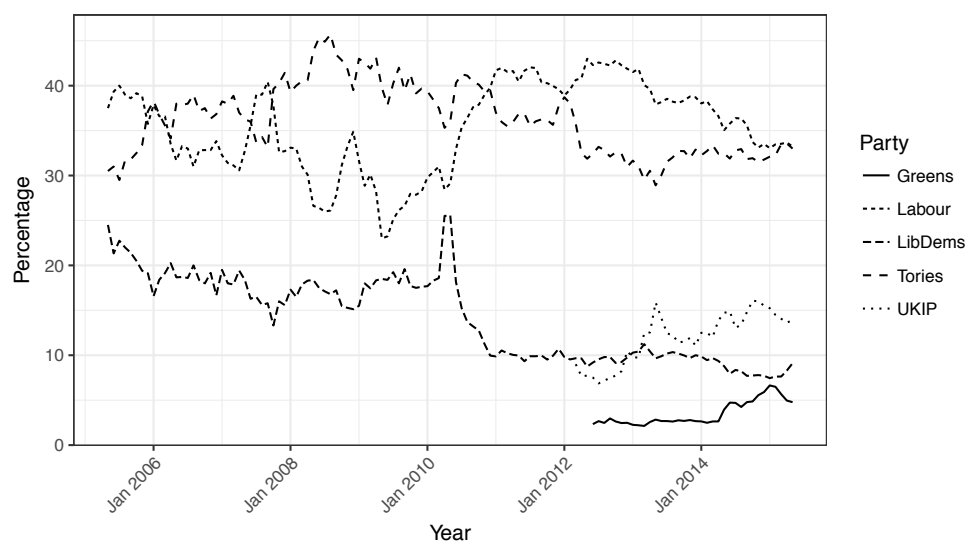
¹²For example, the former Financial Services Secretary Paul Myners recalls saying to Alistair Darling that ‘we have to be careful, Alistair. If the markets refuse to buy sterling paper, we’ll be in really big trouble’ (quoted in Rawnsley (2010, p. 680)).

The Prime Minister Gordon Brown resisted this turn towards economic orthodoxy. He believed that the Treasury's forecasts for growth and the size of the structural deficit were too pessimistic in 2009 and that the government had to maintain its role as spender of last resort. He was supported by Ed Balls, who recalls saying to Brown and Darling that it would be 'unachievable to halve the deficit until 2015' and that the government 'should not be cutting spending until the economic recovery was secured' (personal interview, 12/12/2016). For both Brown and Balls, the deficit was secondary in importance to growth, which would eventually also reduce the deficit and level of debt. As an economic historian Brown thought extensively about the experience of the Great Depression when the actions of the British government worsened the economic crisis by implementing orthodox economic policies (Patrick Diamond, personal interview, 25/10/2016). As Seldon (2011, p. 368) argues 'for Brown... a reluctance to talk about cuts, and turn away from a single-minded focus on growth was simply consistent with his Keynesian beliefs.'

However, Brown was also reluctant to cut government spending for political reasons, let alone to use the word "cuts" in public statements. He was very aware of the potential implications that such a pledge could have on the Labour movement. Influenced by the work of economic historians like Robert Skidelsky (1970), he knew very well that in the 1930s Labour Prime Minister Ramsay MacDonald and Chancellor Philipp Snowden had divided the Labour movement by implementing austerity. Allegedly, Brown even said that to some of his advisers: 'I refuse to be the next Ramsay MacDonald' (Patrick Diamond, personal interview, 25/10/2016).¹³ Furthermore, Brown believed that New Labour owed much of its success in the 2001 and 2005 elections to the political narrative that pitted Labour investment against Tory cuts. He wanted to maintain this division ahead of the 2010 election, fighting the election on the back of Labour's successful investment in public services.

Throughout 2009, this division within the government created tensions and the 2009 budget became a compromise between Downing Street Number 10 and the Treasury. It included Darling's pledge to halve the deficit over a four-year period, but it did not include any immediate measures to reduce government spending; rather, the budget announced future spending cuts and increased taxes to close the deficit. The budget was not well received by the press, however, and the relationship between Darling and Brown remained strained. Brown even made plans to replace Alistair Darling with Ed Balls, whose opinions on the deficit were much closer to his own (Seldon,

¹³According to Seldon (2011, p. 367), Gordon Brown said: 'I want a Labour budget, I don't want a Snowden budget' and directed at his Principal Private Secretary Jeremy Heywood he said that 'you are not going to turn me into Snowden'.

Figure 6.8: UK polls, 2005-2015

Source: Various polling agencies

2011; Rawnsley, 2010). Yet, during the summer of 2009, the pressures on Gordon Brown's government increased. After a disastrous result for Labour in the local and European elections, there were several resignations from his cabinet and Brown was widely criticised for mishandling the MP's expense scandal. In the face of very low support for the Labour party in the polls (as shown below in Figure 6.8), there were even rumours of a coup against Gordon Brown.

Gordon Brown thus operated from a position of weakness and did not go through with his plan to replace Alistair Darling with Ed Balls; rather Brown lost the economic argument within the government. This became obvious in September 2009, when he first used the words "cuts" in public. At the annual conference of the Trade Union Congress (TUC) in Liverpool, Brown agreed to say that 'Labour will cut costs, cut inefficiencies, cut unnecessary programmes and cut lower priority budgets' (Brown, 2009). The speech, however, was fiercely criticised by the trade unions and afterwards Brown was furious that his advisers and the Treasury had urged him to speak about cuts. Directed at Peter Mandelson, who had returned from the European Commission to join Gordon Brown's cabinet, he said that 'we should not be in this place! Don't give me all this about spending cuts! We should not have gone down this course. It's got to be about growth, not deficit. Cuts versus cuts will just kill us'

(quoted in Rawnsley, 2010, 679-80). Yet, his advisers remained firm.¹⁴ Like Darling, they argued that the public had moved on from the old dividing line of Labour investment versus Tory cuts. In their opinion, the fundamental lesson from New Labour was that Labour's economic plans would only receive a fair hearing if the media and the public believed that they are fiscally prudent.

As Labour's political fortune looked increasingly wobbly throughout 2009, these arguments gained traction within the government because Brown also realised that the politics of the deficit were becoming a problem (Patrick Diamond, personal interview, 25/10/2016). Furthermore, Peter Mandelson weighted into the debate and sided with Alistair Darling. After the media had accused Brown of a disregard for reality throughout 2009, Mandelson believed that Brown was wrong to create 'the impression that we would simply keep on spending, borrowing, and taking on debt' (Mandelson, 2010, p. 477).¹⁵ In the course of 2009, this position became dominant within the government. As the elections in 2010 came closer, the politics of the deficit became more important than the economics. In the words of Neil Kinnock, a widespread belief crystallised that 'Labour needed to prove that they got the arithmetic right' (personal interview, 6/12/2016).

Consequently, Gordon Brown was pushed away from his Keynesian message that opposed spending cuts; instead, Darling's position prevailed. Alistair Darling and his advisers were no fiscal hawks either, though. Darling agreed with Brown that there should not be a three-year spending review ahead of the election and he believed that the prevailing uncertainty would make clear predictions very difficult (Darling, 2011). He also agreed to a list of protected spending areas (including health, schools, police, and development), but he was adamant that the voters and the markets demanded a medium-term plan for getting spending and debt under control. In his own words, opinion polls showed that voters were 'angry about the recession and the threat to their jobs and they couldn't readily comprehend how increased borrowing or spending would make things better' (Darling, 2011, p. 225). Therefore, Darling believed that the government had to gain the voters' trust, showing that Labour was prepared to tackle the deficit in order to get borrowing down (personal interview,

¹⁴In retrospect, Dan Corry said that 'politically it was difficult to manage the situation. You cannot possibly say that the deficit is going up this high without planning to do anything about it. That would have just been bonkers' (personal interview, 17/11/2016).

¹⁵In more length, Mandelson recalls this episode in the following way: Gordon was resisting any talk of new cuts in spending to reduce the deficit and debt. I was sure he was right to argue that the last thing the economy needed at a time of recession was any early reduction in government stimulus. But there was also politics involved, and the inevitable impression that we were simply in denial about the scale of the financial hole we found ourselves in... as long as no-one believed us about the public finances, they wouldn't believe us on anything else (Mandelson, 2010, pp. 476, 504).

13/12/2016). To this end, after the presentation of his budget in 2010, Darling even promised that Labour's cuts would be "deeper and tougher" than Margaret Thatcher's cuts had been in the 1980s.

With this language of cuts, the Labour party all but abandoned Keynesian notions in public discourse before the 2010 election. Still, the discourse did not have the desired effect and, arguably, it even played into the hands of the Tories: by moving its own discourse towards economic orthodoxy, the Labour party allowed the Tories to criticise their handling of the economic crisis more easily. As [D'Ancona \(2013, p. 42\)](#) notes, 'one of the great achievements of the Conservative campaign was to force the idea of the deficit across voters' doorsteps, explain that it was a bad thing, and persuade them that Brown and his gang would never deal with it' (cited in [Burton, 2016, p. 75](#)). This helped the Conservatives to win the election in 2010, when they ousted the Labour party from power. Labour was punished for having been in government when the crisis struck, which all but destroyed the party's reputation for economic competence.

2010-2015: The austere years – Labour in opposition

"Too far, too fast": Labour's critique of austerity

After the 2010 General Election, the Conservatives and the Liberal Democrats formed a coalition government and quickly implemented austerity. The new Chancellor George Osborne first announced spending cuts of £6.2 billion a few weeks after the election. At the same time, he warned that more measures would be necessary and announced that there would be an Emergency Budget. He laid the ground for this Emergency Budget in his Mansion House speech in June 2010. In the shadow of the first Greek bailout, he warned of the danger of a sovereign debt crisis and blamed Labour for the size of the budget deficit. He said that 'dealing with this inheritance from its predecessor is the single greatest economic challenge the new Government faces' ([Osborne, 2010](#)). With the aim of balancing the structural deficit by 2015-16, he introduced spending cuts and tax increases in the Emergency Budget in 2010. In line with the thesis of expansionary fiscal consolidation, he argued that 'reducing the deficit is a necessary pre-condition for sustained economic growth' ([HM Treasury, 2010, p. 1](#)).

Labour, which found itself in opposition for the first time in thirteen years, struggled to respond to this policy. After the election, Gordon Brown quickly resigned as the

leader of the Labour party, paving the way for a leadership election during the summer 2010. As a result, Labour lacked a leader while the Coalition government set the terms of the fiscal debate: they blamed the Labour government for the state of public finances and argued that exceptional measures were necessary to reduce the deficit that they inherited from Labour. This narrative became especially powerful because Labour became “a punching bag” for both the Tories and the LibDems (Robert Skidelsky, personal interview, 24/04/2017). The latter had not been in favour of deep spending cuts before the 2010 election, but they made a u-turn when they entered the Coalition government. They justified this turn with the exceptionally bad state of the public finances that Labour had left them. A note by Liam Byrne, the Labour Chief Secretary in the Treasury, which he left to his successor from the LibDems helped their case. He wrote that ‘I’m afraid to tell you there’s no money left’, which became the dominant perception of Labour’s record in government even though it was intended as a joke (Nick Thomas-Symonds, personal interview, 05/10/2016).

Labour’s response to the Coalition government became more effective after the leadership election in September 2010 was decided. With the support of the trade unions, Ed Miliband won a surprise victory against his older brother David Miliband and he was determined to build a strong opposition against the Tory government. He ‘was the first leader since Michael Foot [who] believed that Labour’s route to power was to move to the left’ (Balls, 2016, p. 261) and he also had Keynesian instincts. Addressing the Labour conference after his election as the leader of the party, he argued that ‘economics teaches us that at times of recession governments run up deficits’ and that ‘what we should not do as a country is make a bad situation worse by embarking on deficit reduction at a pace and in a way that endangers our recovery’ (Miliband, 2010). Still, Miliband was concerned that a ‘forthright Keynesian critique of the government’s austerity programme could be painted as “deficit denial”’ (Bale, 2015, p. 32). He first appointed Alan Johnson as his Shadow Chancellor of the Exchequer, who tried to stick to the Darling plan. For example, in response to the Coalition’s Spending Review Johnson argued ‘that there is another way, a balanced approach that gets the deficit down, but recognises that growth and jobs are not a sideshow to an economic strategy’ (Mulholland, 2010). Yet, Johnson resigned after three months as Shadow Chancellor and made way for Ed Balls in January 2011, who was to lead Labour’s opposition to austerity.

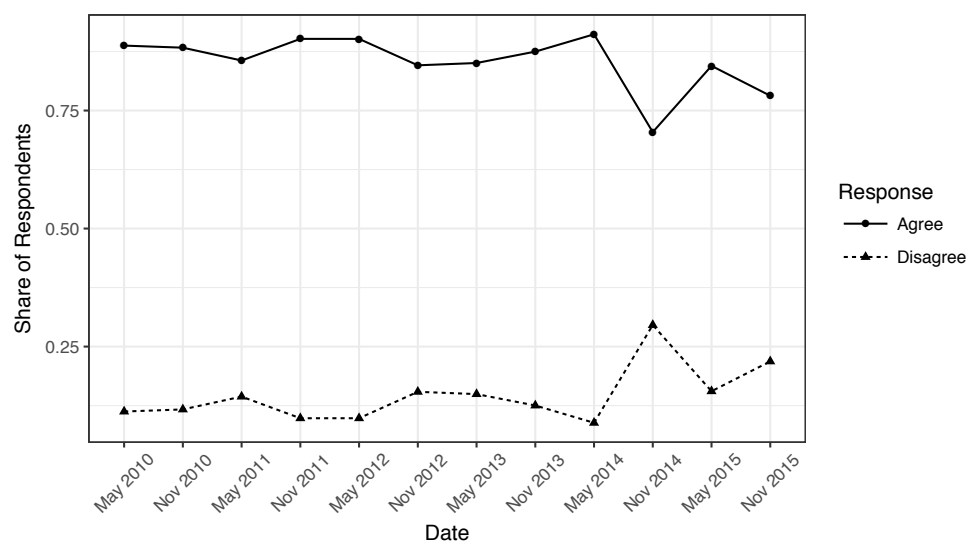
Ed Balls had outlined his arguments about the right response to the economic crisis in a speech at Bloomberg that he made during Labour’s leadership election in August 2010. Drawing on Keynesian ideas, he argued that ‘the Coalition’s plans for

rapid deficit reduction now are not just unfair but also unnecessary and economically-unsafe' (Balls, 2010). In his opinion, growth and jobs should be the priority in 2010 and 2011 because 'the danger of too rapid deficit reduction is that it proves counter-productive.' He called on Labour 'to set out a clear plan for growth, a more sensible timetable for deficit reduction, and a robust explanation of why that will better support our economy and public finances' (Balls, 2010). Miliband initially worried that these arguments would not strike the correct chord with the public and was hesitant to appoint Ed Balls as his Shadow Chancellor. However, once Ed Balls agreed to stick to the Darling plan as Labour's official policy, Ed Miliband dropped his reservations (Bale, 2015, p. 40).

Once Ed Balls had become Shadow Chancellor, he still attempted to set out an alternative to the Coalition government and translated his argument from the Bloomberg speech into Labour policy. He claimed that the government's spending cuts were a "reckless gamble", which was harming the country's economy. Balls argued that the cuts were going "too far, too fast", and in retrospect, he maintains that this position was correct:

In 2010, at a time when the recovery was vulnerable and when the Eurozone crisis had just erupted, it was absolute not the right time to have a rapid tightening of fiscal policy... it was a dangerous time to cut fiscal spending. Once monetary policy had gotten to the zero lower bound, it was non-sense to argue that tighter fiscal policy allowed for looser monetary policy (Ed Ball, personal interview, 12/12/2016).

The argument made by Ed Balls, however, failed to gain a lot of traction with voters. As shown in Figure 6.9, a large share of the electorate thought in 2010 that the reduction of the country's level of debt could not be delayed. This relatively broad support for fiscal consolidation was also shown in a variety of public polls that were conducted throughout the Parliament (Bale, 2015). However, the problem for Labour was even bigger: a large share of the electorate did not only believe that fiscal consolidation was necessary, but they also blamed Labour for these austerity policies. According to internal polling and focus group work that Labour commissioned, they blamed the party for the state of the public's finances in 2010 and criticised the party for wasteful spending and bad economic management (Marc Stears, personal interview, 09/11/2016; John Denham, personal interview, 24/04/2017). Following the narrative that the Coalition government had set in the summer of 2010, the deficit was seen as "Labour's mess". As Goes (2016, p. 77) argues, 'the Conservatives and the Liberal Democrats had successfully managed to convince the public that

Figure 6.9: Attitudes towards government debt in the UK, 2010-2015

Source: Eurobarometer

Labour’s “irresponsible” policies... were responsible for the country’s public deficit and debt.’

Therefore, the question about how to address their own past became important for Labour and several internal memos were written in search for an answer, for example by former journalist Thomas Baldwin or pollster James Morris (Thomas Baldwin, personal interview, 13/12/2016). In private Labour’s leadership did not think that New Labour had overspent before the crisis. While they accepted that its lax attitude towards the financial sector had been a mistake, both Miliband and Balls believed that New Labour’s investments in the early 2000s had been key to save British public services. Moreover, they believed that government spending prior to the crisis had certainly not caused the UK budget deficit, which was largely the result of the financial crisis. Although some Labour advisers thought that the party should make these arguments in public (Thomas Baldwin, personal interview, 13/12/2016, Marc Stears, personal interview, 09/11/2016), the results from focus group research were discouraging. The evidence showed that the voters could theoretically be convinced that the crisis and the deficit was not “Labour’s mess”, but this would take a large amount of time and effort, thereby crowding out any possible communication about Labour’s plans for the future. In other words, the evidence ‘showed that there were two options: either you can have a debate about the past or about the future but you

cannot do both' (John Denham, personal interview, 24/04/2017). Based on this evidence, the Labour party made the political judgement that it was more important to speak about Labour's future plans than the past and they never addressed the claims by the Coalition government that Labour was to blame for the crisis head on. They believed Labour's position was 'not strong enough to take on the Tories, the LibDems and the media all at the same time' and that 'an argument about what happened in the past would take it onto Osborne's ground, whereas an argument about what we would actually do in the future would be more fruitful for us' (Ed Ball, personal interview, 12/12/2016).

In response to these electoral pressures, Labour's strategy was twofold. On the one hand, Labour accepted that fiscal consolidation was necessary but Balls continued to criticise the government for the speed of the deficit reduction. He argued that under Osborne's watch the economy was "flat-lining" and that austerity choked off the recession and would eventually cause a double-dip recession. Although he did not believe that the deficit could be ignored, Balls thought 'that a balanced, more Keynesian plan in the middle was more sensible' and would protect growth and jobs in the British economy (Ed Ball, personal interview, 12/12/2016). At a joint press conference in 2011, Ed Miliband and Ed Balls argued that 'the best way to get the deficit down was to develop a plan that puts jobs and growth first' (Goes, 2016, p. 78). Further, at the Labour conference in 2011, they unveiled a five-point plan for economic growth, which included temporary action on VAT, a levy on bank bonuses, initiatives for housing and youth employment, as well as the idea to bring forward infrastructure projects (Balls, 2011).¹⁶

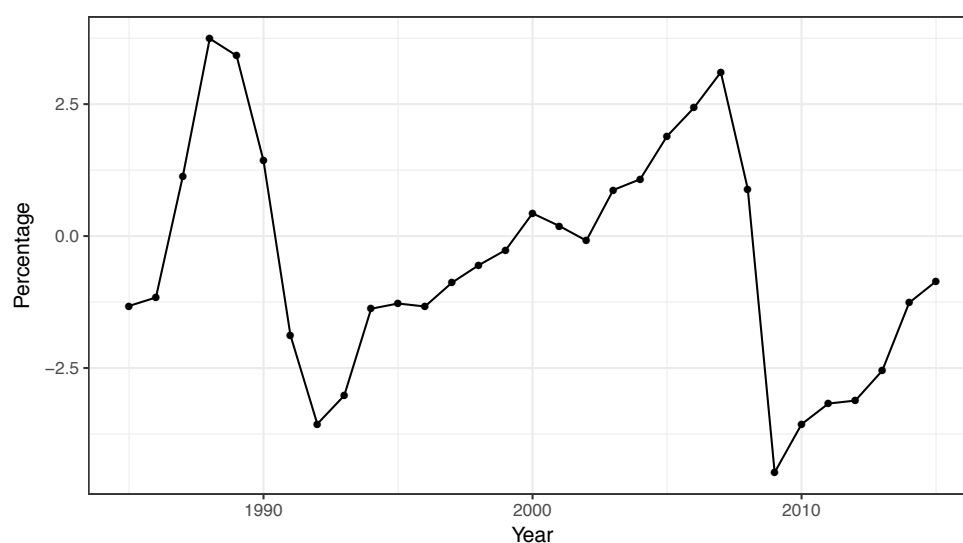
On the other hand, Ed Miliband tried to re-frame the economic debate and move it into more favourable ground. To this end, he set out a fundamental critique of British capitalism and increasingly spoke about inequality (Miliband, 2010, 2011). Influenced by his economic adviser Steward Wood, who had been a student of David Soskice, he criticised the British growth model for its excessive reliance on finance and distinguished between companies that are "predators" and those that are "producers". He believed that a reform of the British political economy in the direction of continental capitalism would create a more prosperous and equal society and attempted to set out an agenda in line with this belief.

¹⁶At the same time, Ed Balls kept criticising the Coalition's insistence on austerity. For example, in response to the 2012 budget he wittingly argued in Parliament that 'the Chancellor is not Robin Hood, he's the Sheriff of Nottingham. And as for jobs and growth, he couldn't give a Friar Tuck' (Balls, 2016).

The return to prudence: Labour's shift towards fiscal responsibility

Labour's dual economic agenda was undermined mid-way through the Parliament by the changing economic conditions themselves. In early 2013, it emerged that the UK had narrowly averted a double-dip recession in 2012, and in 2013 growth returned more strongly than expected (Figure 6.1), while unemployment dropped again (Figure 6.2). Although austerity weakened the UK recovery that begun in 2010, the effects of the Coalition's economic programme were not as dramatic as Labour and many economists had expected. The monetary policy pursued by the Bank of England had offset the negative consequences of the austerity programme to a certain extent: contrary to the popular notion that monetary policy is powerless at the zero-lower bound, quantitative easing was relatively successful and acted as 'an insurance policy for the Conservatives' (Robert Skidelski, personal interview, 25/04/2017). Unemployment in the UK remained relatively low and dropped again in 2013 as new jobs were created. The quality of these jobs was worse than those lost during the recession and there was a large amount of workers, who worked part-time or remained underemployment. Yet, this did not show up in the headline figure of unemployment, which defied Labour's warnings.

This created a difficult situation for Labour. Neil Kinnock recalled that 'only the Tory back-bench was more surprised than Labour that the double-dip recession did not happen' (personal interview, 06/12/2016) and Robert Skidelsky argued that 'the Keynesians had logically overstated their case [against austerity] based on the counterfactual' (personal interview, 25/04/2017). Balls had tied himself to the notion that austerity would lead to economic failure by predicting that the British economy was flat-lining due to Osborne's policies. As the Financial Times wrote in 2013, 'the shadow chancellor's predictions of a 'lost decade' of slow growth... left him politically exposed' (Parker and Pickard, 2013). How should Labour have reacted to these changing economic circumstances? In line with New Keynesian thinking, the Labour leadership came to believe in 2013 that the output gap was closing as shown in Figure 6.10, albeit at a diminished trend compared to the pre-crisis period (Ed Balls, personal interview, 12/12/2016; Rachel Reeves, personal interview, 07/12/2016). In other words, Labour believed that the financial crisis and the austerity programme had been a negative supply-shock, reducing the potential output in the UK. The state of employment was inferior compared to the pre-crisis period and wages were still stagnating but this was not due to a lack of demand in the British economy. In retrospect, Ed Balls explains his way of thinking in the following way (personal interview, 12/12/2016):

Figure 6.10: UK output gap, 1985-2015

Source: OECD

By 2013, I had to plan on my inheritance being not an economy below trend but an economy which was on par with a diminished trend. In those circumstances, I could not be in fiscal denial... Whatever I said about growth, it was becoming clear that there would have to be some form of fiscal consolidation because there was absolutely a structural deficit, not only a cyclical deficit.

The need to reconsider Labour's macroeconomic programme also emerged due to political reasons. Since the beginning of 2012, the Labour party had enjoyed a lead in the polls, but this lead was not very large. There was still a large "credibility gap" with regards to the economy between Labour and the Conservatives (Bale, 2015, p. 147) and, contrary to the beliefs of the Labour leadership, internal polling showed that most people in the UK thought that the economy was going in the right direction (Rachel Reeves, personal interview, 07/10/2016). After disappointing results in the local elections in 2013, powerful voices emerged within the leadership of the Labour party that argued for a new economic approach. Individuals like Greg Beales, James Morris, or David Axelrod had always urged Ed Miliband to pay attention to the polls but when Alexander Douglas and Spencer Livermore joined Ed Miliband's team as new advisers, the argument became even louder (Marc Stears, personal interview, 09/11/2016). They believed that Labour's poll lead was soft and very vulnerable to

possible attacks from the Conservative party. Drawing on the experiences of New Labour in the mid-1990s, they argued that Labour would have to nail the question of the deficit and increase its “economic credibility” in order to win the general election. Although, they denied that they had a so-called 35-percent strategy, Labour had to play its cards well to benefit from the political currents. As both LibDem and Conservative voters were disappointed with the Coalition government, Ed Miliband’s advisers identified two likely trends: while disappointed LibDem voters would turn towards Labour, disappointed Tory voters would support UKIP (Jon Cruddas, personal interview, 05/12/2016; Thomas Baldwin, personal interview, 13/12/2016). Both developments would favour Labour, but the party still had to increase its economic credibility to appeal to centrist voters; otherwise Labour’s lead in the polls would crumble if Labour was attacked on its fiscal position.

As a result, Labour shifted its economic position in June 2013 by way of coordinated speeches from Ed Miliband and Ed Balls. First, Ed Miliband (2013) gave a speech to activists at the Labour National Policy Forum in Birmingham where he said that ‘our starting point for 2015-16 is that we won’t be able to reverse the cuts in day to day, current spending unless it is fully funded from savings elsewhere or extra revenue, not from more borrowing.’ Moreover, he invoked the experience of Atlee’s post-war government and argued that Labour could be both prudent with public finances but still implement a radical economic programme. A few days later, Balls followed up on Miliband’s speech with his own speech at Thomson Reuters. He argued that ‘we will inherit a substantial deficit. We will have to govern with much less money around. We will need to show an iron discipline’ (Balls, 2013b). Moreover, he promised that

Labour will set out, in our general election manifesto, tough fiscal rules that the next Labour government will have to stick to – to get our country’s current budget back to balance and national debt on a downward path. Tough rules, which will be independently monitored by the Office for Budget Responsibility (Balls, 2013b).

Therefore, in June 2013 austerity’s victory over Keynesianism was complete (Robert Skidelski, personal interview, 25/04/2017). Although Ed Balls denies that he had ever advocated austerity (personal interview, 12/12/2016), Labour yielded to the language of cuts and returned to a platform based on prudence in 2013. As Matthew D’Ancona (2013, p. 340) argues ‘Osborne, of course, had missed his own targets and had been mocked for doing so. But he had defined the rules of the game, the terms of the debate’ (cited in Burton, 2016, p. 101).

In the run-up to the General Election 2015, Miliband and Balls continued to develop orthodox fiscal position in their quest for economic credibility. For example, in his speech to the Labour conference in September 2013 Balls argued that ‘in tough times it’s even more important that all our policies and commitment are properly costed and funded. The British people rightly want to know that the sums add up’ (Balls, 2013a). In January 2014, he then promised a binding fiscal commitment in his speech to a conference from the Fabian Society, announcing that ‘the next Labour government will balance the books and deliver a surplus on the current budget and falling national debt in the next Parliament’ (Balls, 2014c).

Going into the 2015 election, the party’s headline measure on fiscal consolidation was that, if elected, it would balance the current budget and get public debt falling ‘as soon as possible’ in the next parliament (Labour Party, 2015, p. 1). Labour planned to match Conservative spending plans for 2015-16, pledged to not reverse key spending cuts, and promised that Labour did not contain any promises that made additional borrowing for day-to-day spending necessary. The main difference between Labour and the Conservatives in the election campaign was, therefore, one of timing: while the Conservatives promised to eliminate the deficit by 2018, Labour pledged to reduce the government deficit every year and to achieve a balanced budget by the end of the Parliament. This was enshrined in a triple “Budget Responsibility Lock”, which featured on the first page of Labour’s election manifesto. Thus, the election campaign 2015 completed Labour’s return to fiscal prudence under Ed Miliband and Ed Balls.¹⁷

Although Labour conceded much ground to fiscal orthodoxy, its credibility remained weak for several reasons. First, there were several slip-ups that showed that Labour’s heart was not fully convinced by the need to appear fiscally conservative. Ed Miliband forgot to mention the deficit in his speech to the Labour Conference in September 2014, which was heavily mocked by the media and his political opponents. Second, many people within Labour remained sceptical towards its new orthodox fiscal position. There was a general agreement that Labour could not tie its hands too much with respect to the investment spending and Labour’s economic position therefore was twofold: although the party ruled out extra borrowing for current (day-to-day) spending, it still allowed for borrowing for capital (investment) spending. This position may have been economically sound, but it was too complex to resonate with

¹⁷Ed Balls still maintains that ‘there was a big gap between George Osborne and my plans in 2015’ but that these were not emphasised during ahead of the election. He argues that ‘I didn’t want the election campaign to be about relative fiscal plans. I didn’t think that this would be an argument that was easy to win’ (personal interview, 12/12/2016).

voters. According to Thomas Baldwin, ‘even half of the Shadow cabinet did not understand our economic position’ (personal interview, 13/12/2016). Third, the Labour party tried to shift the economic debate away from the deficit and government spending. For example, after the UK had avoided a double-dip recession, Ed Miliband repeatedly spoke of the so-called “cost of living crisis” and the “squeezed middle”. Focusing on the level of wages and the perceived well-being of citizens, he argued that many people struggled to get by. To counter this trend, Labour tried to develop new policies, but since they had yielded to the language of cuts and prudence, this was difficult. After all, how should a government help the squeezed middle and address the cost of living crisis, when it would continue to cut spending? They tried to argue that Labour was for “big reform, not big spending” but this argument was not very effective, either. As Labour tried to reconcile their different objectives, the party had to square too many circles.

Discussion: Electoral and ideational pressures for austerity

The politics of austerity

Despite these problems, Labour remained committed to austerity for political reasons until 2015. In response to the economic crisis, there was a large consensus among the British public that the government had to reduce its deficit and debt. Opinion polls did not only show that a vast majority of the population accepted the spending cuts (Dorey, 2010, p. 414), but fiscal consolidation also spoke to the concerns that British citizens had over unfair redistribution to supposedly “undeserving groups” (Stanley, 2016). Especially after the 2010 election, the newly elected Conservative-Liberal Democratic Coalition government was able to effectively construe the crisis as the product of Labour’s fiscal profligacy and present its austerity programme as the appropriate policy response (Gamble, 2015; Hay, 2013). This proved to be an extremely effective tactic creating a strong perception amongst voters that the Coalition government’s austerity measures were largely “Labour’s fault.”

The Labour leadership was very aware of these opinions. It regularly commissioned internal polls and focus groups but also paid attention to public polls (Ed Balls, personal interview, 12/12/2016, Rachel Reeves, personal interview, 07/12/2016, Thomas Baldwin, personal interview, 13/12/2016).¹⁸ Initially, some people within the Labour

¹⁸There were some members in the team who were classical pollsters, but there were also some people that were more instinctive. For example, Ed Miliband and his adviser Marc Stears used anecdotes and experiences of conversations with voters to inform their political decisions. To this end, for

party thought that public opinion would shift. For example, in his Bloomberg speech in 2010, Ed Balls acknowledged polls that showed that the public was supportive of the spending cuts, but he also predicted that the public would become increasingly concerned ‘as the impact of deflation on job and the economy feeds through’ (Balls, 2010).

Yet, over time Labour came to believe that the consensus among the electorate was too strong to be moved (Rachel Reeves, personal interview, 07/12/2016; Marc Stears, personal interview, 09/11/2016). Miliband and Balls both shared a Keynesian outlook (Torsten Bell, personal interview, 13/12/2016), but concerned with Labour’s already weak economic credibility with the electorate, Miliband did not want to present Labour as an anti-austerity party. The Labour leadership accepted that voters have an intrinsic scepticism towards government deficits due to the popular conception that the “public household” is analogous to the “private household”. In the UK, this household analogy was popularised by Margaret Thatcher and had become rooted in ‘the everyday “common sense” that dominates discourses’ (Schmidt and Thatcher, 2013 p. 75). Moreover, Labour believed that citizens are sceptical towards government deficits because ‘to the public a deficit means that they have to pay higher taxes in the future’ (Roger Liddle, personal interview, 27/10/2016). Remembering the 1992 election, when Labour lost due to its ‘tax bombshell’ and the “double-whammy”, the party was afraid of being portrayed as advocating “tax and spend” policies. Believing that they could not explain Keynesianism to voters on the door-step, Labour’s leadership yielded to the orthodox organising assumption that deficits and debt are problematic. Labour was thus torn between its economic instincts and the pollsters: how could it reconcile its economic agenda with the prevailing public opinion? In the words of Ed Balls (personal interview, 12/12/2016),

we had a political economy problem because it was just impossible to say that deficits at this scale will become permanent; that is just impossible for the public to deal with... For us to say that it was not a priority to get the deficit down was just killing us politically.

Similar to the German case (see 7), the result was a political fudge: both in 2010 and 2015 the party tried to demonstrate that it was serious on the deficit but still maintain enough wiggle room to implement (investment) spending if it was to win the election. According to Marc Stears, however, in 2015 this was nothing more than ‘an attempt

example, Miliband regularly spoke to people in his constituency or in the park near Ed Miliband’s home in Northern London, an exercise that he called “cruising the Hampstead Heath” (Marc Stears, personal interview, 09/11/2016).

to avoid the debate because, in reality, the two Eds believed that they could spend more' (personal interview, 09/11/2016).

In both instances, in 2010 and 2015, this fudge was driven by the electoral cycle. After Gordon Brown became Leader of the Labour party in 2007, he shied away from calling an early election. Eventually, however, he became concerned with his place in history as an unelected Prime Minister, if he was to lose the 2010 election. He carefully listened to pollsters and was ready to put the politics first. Similarly, Ed Miliband was driven by his desire to win the election in 2015. Labour politicians and advisers of his generation had been used to being in government and they had a very instrumental approach to politics. They wholeheartedly wanted to get back into government in 2015 and reclaim their "place in the sun". Electoral considerations, therefore, influenced their decisions at every turn over the Parliament. After Labour gained a poll lead in 2012 'that they have not earned' (Jon Cruddas, personal interview, 05/12/2016), he and his advisers became very risk averse and shied away from radical economic positions (John Denham, personal interview, 24/04/2016). Although he had begun to spell out such ideas at the beginning of his tenure as party leader, he lacked the conviction to follow up on them. Jon Cruddas, who was the Policy Coordinator under Ed Miliband, emphasised that 'many people still had more radical ideas but they were marginalised by the pollsters. The ideas that you had to play it safe dominated as the electoral instincts kicked back in' (personal interview, 05/12/2016).

The argument by the pollsters was especially forceful within the Labour party because the party's brand had been tarnished by its own past. Historically, the party was less trusted to run the economy for most of the 20th century and, in particular, the memory of the IMF crisis in 1976 and the Winter of Discontent had undermined its claim to economic expertise. The crisis of the European Exchange Rate Mechanism (ERM) in 1992 under the Conservatives helped the Labour party in this regard, but the problem became acute again in the shadow of the Great Recession. Labour took a lot of blame for the crisis, which occurred under its watch, and never forcefully rejected claims that its "fiscal profligacy" had created Britain's economic mess. Marc Stears argued that the messenger was key: 'people might have been open to hear about Keynesian demand stimulus, but they were unwilling to hear about this from Labour' (personal interview, 09/11/2016).

The Labour, therefore, returned to the strategy of New Labour: the historic victory in 1997 had taught the Labour leadership that they had to establish Labour's credibility first before they could set out their own economic agenda (Rachel Reeves, per-

sonal interview, 07/12/2016; Kieren Walters, personal interview, 08/11/2016). This thinking was deeply ‘ingrained within the mindset’ (Jon Cruddas, personal interview, 05/12/2016) of the Labour leadership and it guided their action in response to the crisis. Based on the idea that ‘once you have lost credibility, you have to go further to re-establish it than you might want to’ (Patrick Diamond, personal interview, 25/10/2016), they shelved their Keynesian ideas. Miliband and Balls essentially ‘decided that if [Labour] was to have a chance of winning the election, [we] had to put the politics first’ (Ed Ball, personal interview, 12/12/2016).

In the context of Britain’s first-past-the-post electoral system, this meant that Labour tacked towards the centre and accepted fiscal orthodoxy. Although, the leadership denied that they had a so-called “35-percent strategy” (as mentioned above), Labour’s economic programme was clearly focused on winning the centre. As Ed Balls argued,

the only reason that I ran an argument about deficit reduction was that I thought this was necessary to win the centre, the centre-left voters. The centre-left was never willing to listen to a big expansionary argument from Labour... they thought that the deficit was a big deal (personal interview, 12/12/2016).

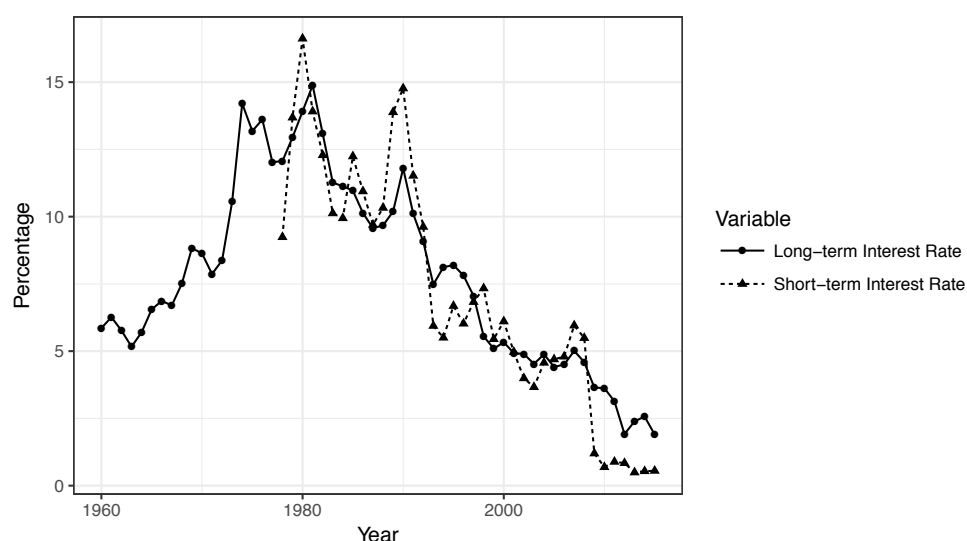
Influenced by the decreasing connection between the British working class and Labour, as well as Labour’s experience of the 1990s, the party believed that it could only gain power by increasing its economic credibility (Marc Stears, personal interview, 09/2016; Thomas Baldwin, personal interview, 13/12/2016). In the absence of a challenger on the far left, it (falsely) believed that the working class did not have anywhere else to go.¹⁹

The economics of austerity²⁰

The political arguments for austerity were also combined with economic arguments. Within the Labour party there was a real concern that rapid deficit reduction was necessary because the UK’s weak macroeconomic position made it liable to further damage if a new exogenous shock was to hit the economy. However, as shown in Figure 6.11, the interest rates on the UK long and short-term bonds remained rela-

¹⁹In hindsight this belief proved wrong. In 2015, a sizeable share of older, white, working class voters supported UKIP, while others abstained. Moreover, in Scotland Labour’s vote share collapsed, as many voters supported the SNP

²⁰This section partly draws on a paper jointly written with Sean McDaniel entitled ‘The Ideational Foundations of Social Democratic Austerity’ published in the *Socio-Economic Review*.

Figure 6.11: UK interest rates on government bonds, 1960-2015

Source: OECD

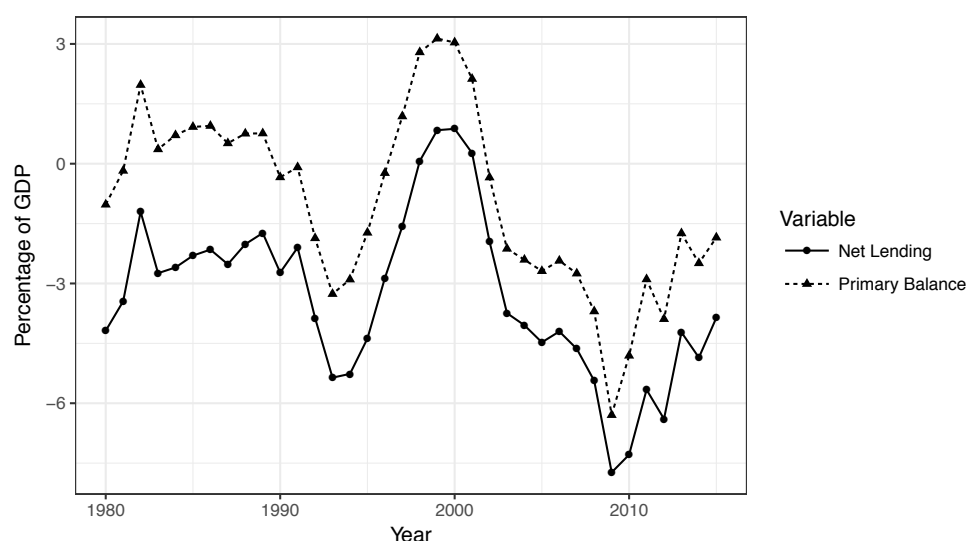
tively low in the context of the crisis. In fact, during the crisis the UK benefited from being a “safe haven” as investors were looking to limit their exposure to risky assets in the context of the financial crisis. The British government had never defaulted on its obligations and the government borrowed on a relatively long period compared to other governments. This made UK government bonds very attractive investments in the context of market turbulence, as the risk of default was essentially non-existent. The Labour government knew this and former Chancellor Alistair Darling (2011, p. 179) argued that the government was ‘never at any time at risk of being unable to raise the money that was needed.’

Still, irrespective of a hypothesised new economic shock, policy-makers believed that the deficit was simply too high and needed to be brought down. In the first phase, when the party was in government, domestic and international institutions strongly shaped this perception. In 2009, both the Treasury and the Bank of England argued that the deficit became unsustainable and encouraged reductions in government spending. Labour had been in power for eleven years, but after the financial crisis the “Treasury view” resurfaced as the economic paradigm within the institutions. Even civil servants that had previously worked closely with Gordon Brown lost their faith in New Labour policies (Seldon, 2011, p. 255) and they argued against his Keynesian instincts. Similarly, the Bank of England became concerned with the increasing

deficit. For example, in March 2009 the Governor of the Bank of England Mervyn King intervened by saying that ‘we are confronted with a situation where the scale of deficits is truly extraordinary.’ Over time, international institutions like the IMF and OECD also began to voice their scepticism towards Keynesian policies and called for an end to the period of government stimulus. In 2009, this contributed to a political discourse where Labour’s shift towards fiscal consolidation became more likely (Robert Skidelski, personal interview, 25/04/2017).

In opposition, the party initially had a very ambiguous policy as described above; as Simon Wren-Lewis (personal e-mail, 10 December 2016) argues, this was partly because Labour did not get the economics clear. There was not a lack of alternative ideas among British economists when the Coalition government implemented austerity and certainly there was no consensus among economists that austerity was the right economic policy. However, after the economy had started to grow again after 2013, the belief that the deficit had to be brought down was widespread among Labour policy-makers (e.g. Nick Pearce, personal interview, 03/12/2016). This adjustment had to be achieved via austerity measures because, in their opinion, there was no stimulus available that would yield a multiplier effect significant enough to bring down the deficit by itself. Underlying this position was a more restricted conception of the output gap and the new potential of the UK economy (Rachel Reeves, personal interview, 7/12/2016), consistent with the New Keynesian theoretical framework and similar to the German case discussed in Chapter 7. As argued above, leading Labour politicians believed that the economic crisis and Osborne’s austerity programme had effectively resulted in a negative supply-shock (Ed Balls, personal interview, 12/12/2016). As the economy returned to a diminished economic trend, the output gap closed and, hence, Labour saw less urgency in opposing austerity. Indeed, (Balls, 2014b) sought to explicitly differentiate the theoretical underpinning of his arguments from those he called “naïve Keynesians.”

However, Labour’s position was also shaped by the austerity programme itself that the government implemented. A large share of the successive cuts fell on local governments, who were very good at limiting the effect of austerity. They cut the services that were the least protected and limited the damage on front-line services (Burton, 2016, p. 34). Moreover, the high-profile services of education and health were protected and actually ‘cuts in welfare were generally well-received by those in work’, according to Burton (2016, p. 34). As a result, the consequences of austerity were initially only felt by a small share of the population. Additionally, Osborne used strong rhetoric to justify his spending cuts, but over time the Coalition government

Figure 6.12: UK cyclically adjusted government lending, 1980-2015

Source: OECD

actually eased austerity. Osborne adjusted the fiscal path of the British government, as shown in Figure 6.12.²¹ In combination with the quantitative easing (QE) programme that the Bank of England implemented, this limited the impact of austerity on the British economy. Beginning in 2013, the British economy actually began to grow again and, as a result, Labour's initial warning that austerity would lead to a "lost decade" seemed hollow and made it difficult for the party to vigorously oppose austerity.²²

The perceived superiority of monetary policy over fiscal policy in managing the economy also plays a role in this story. As an influential economic adviser to Gordon Brown in the 1990s, Balls was the leading voice in pushing New Labour's decision to grant independence to the Bank of England. This was an attempt to bolster New Labour's credibility with financial markets (Keegan, 2004, p. 153), but it also reflected New Keynesian ideas that an independent, technocratic central bank could most effectively respond to economic crises (Carstensen and Matthijs, 2018; Matthijs,

²¹ According to one of his biographers, Osborne lost the intellectual confidence in the expansionary fiscal consolidation thesis and in 2011 and 2012 he was very worried about the economic conditions in the UK (Ganesh, 2012).

²² This was especially true because the headline figure of unemployment remained relatively stable throughout the economic crisis. While unemployment rapidly increased in other European countries during the Great Recession, it remained relatively modest in the UK. Instead, the UK experienced a "crisis of under-employment" (Robert Skidelski, personal interview, 25/04/2017), which went largely unnoticed (John Denhman, personal interview, 24/04/2017).

2011, p. 140-177). Of course, following the financial crisis, the Bank of England also implemented a massive QE programme from March 2009 onwards. In this context, a debate came up within the Labour Shadow Cabinet over whether QE should run through the financial system (by making it easier for banks to lend) or whether a more direct fiscal or investment-led stimulus was required (John Denham, personal interview, 21/04/2017). Ultimately, however, under Miliband's leadership, this debate never gained traction within the party and the dominance of monetary policy was not questioned. The party leadership supported additional investment spending, but there was also a feeling among the Labour leadership that there was a lack of shovel-ready projects, which could quickly support growth and produce a counter-cyclical fiscal policy effect.

Alongside this, there is also evidence of the “progressive consolidation thesis” (Haffert and Mehrtens, 2015). Led by New Labour politicians and activists, the argument that fiscal conservatism and social justice go hand-in-hand gained traction during the parliamentary term. This type of argument underpinned what Balls came to term, ‘fiscal responsibility in the national interest’ (e.g. Balls, 2014a). It meant committing to policies such as devoting all windfall gains from the sale of bank shares to repay the national debt burden and holding a “zero-based review” of spending, ‘examining every pound spent by government to cut out waste and make different choices’ (Balls, 2014c). Underlying this approach was the issue of the size of UK's public debt and the country's debt interest payments. In fact, the missing section that Miliband (2014) forgot to mention in his 2014 Party Conference speech stated that ‘there won't be money to spend after the next election. Britain will be spending £75 billion on the interest on our debt alone. That's more than the entire budget for our schools.’ Consistent with supply-side Keynesianism, the concept of fiscal responsibility in the national interest, therefore, linked the decision to pursue debt with the promise of renewed fiscal capacity to pursue progressive ends in the future.

Part and parcel of Labour's approach was to differentiate itself from Conservative plans for consolidation by demonstrating how it could once again enable the state to act in the interests of growth and prosperity. This is reflected, for example, in Labour's plans for extra investment. According to Marc Stears, there was a general agreement within the leadership that Labour could not tie its hands too much with respect to investment (personal interview, 09/11/2016). Going into the election 2015, Labour thus ruled out extra borrowing for current (day-to-day) spending, but it still allowed for borrowing for capital (investment) spending. These calls for more capital

spending were also strongly shaped by the social investment paradigm.²³ Influenced by lingering ideas from the Third Way, leading Labour politicians wanted to increase investment in skills and education. The party tried to give itself some financial leeway but, as in the German case (Chapter 7), these arguments were mostly based on supply-side ideas around improving productivity and not straightforward demand management.

Labour trapped and divided

Labour's struggle to develop a clear fiscal policy was made worse by the legacy of the Third Way, which trapped and divided the party. Initially, the Third Way was successful because it addressed the strategic dilemma of electoral socialism that Przeworski and Sprague (1986) described. After the financial crisis, however, Labour's electoral coalition broke apart: while the centre-left voters lost faith in Labour's ability to manage the economy, the working class had been alienated by the Third Way. Consequently, Labour was pulled into different direction: the logic of Britain's first-past-the-post electoral system pulled Labour towards fiscal prudence (as described above), but austerity was against the interest of Labour's traditional constituencies. Labour was thus deeply divided over the question of austerity (John Denham, personal interview, 24/04/2017; Thomas Baldwin, personal interview, 13/12/2016; Patrick Diamond, personal interview, 25/10/2016).

On the one hand, there was a large part of the Labour movement which opposed austerity. In particular, the trade unions vigorously campaigned against the Coalition's cut and led some of the largest anti-austerity protests. For example, on 26 March 2011, the Trade Union Congress (TUC) organised a protest in London that was called "March for the Alternative" and which attracted more than 250,000 people. The left-wing of the Labour party and many of the party's members were involved in these protests and even Ed Miliband addressed the crowd. Moreover, in February 2013 prominent members from the Labour party and the Labour movement more generally launched the "People's Assembly Against Austerity", including Tony Benn, Labour MPs Jeremy Corbyn, John McDonnell, and Katy Clark, as well as the leader of the largest British trade union Len McCluskey. The assembly was launched with an open letter in the Guardian with the aim of bringing 'together campaigns against

²³There were some attempts by Labour to "own" the issue of economic growth in this way. It attempted to contrast a right-wing focus on deficit reduction with their own programme for growth rooted in education and investment.

cuts and privatisation with trade unionists in a movement for social justice' (People's Assembly Against Austerity, 2013).

On the other hand, there was another faction within the Labour party that took a different view. This position was best expressed in a discussion paper by the Policy Network written by Graeme Cooke, Adam Lent, Anthony Painter and Hopi Sen (2011) and titled "In the Black Labour". The authors argued that the Labour party would need to ensure long-term fiscal sustainability while trying to 'advance centre-left goals in the context of limited resources through clear and bold reforms' (Cooke et al., 2011, p. 3). They emphasised that there was less money to go around and that social justice could not be achieved through higher government spending but only 'through prioritisation, institutional innovation, and reform' (Cooke et al., 2011, p. 4). This view was shared by influential MPs from New Labour, but it was not the dominant view within the Labour party, as one of the original authors of the discussion paper recounts (Anthony Painter, phone interview, 2 December 2016).

The divisions within the Labour party made the leadership's task more difficult. Gordon Brown was already concerned with holding the party together and his position was severely weakened by attacks from inside the Labour party. The challenge of holding the Labour party together became even greater after 2010 when Miliband was elected as the leader of the Labour party in a divisive leadership contest; not only did he oppose his own brother, but the election was also seen as a fight for the future of the Labour party by the followers of Blair and Brown. Ed Miliband was well aware that his party had often slid into bitter internal conflict (and sometimes even civil war) after previous electoral defeats, for example in the 1950s, the 1970s, and the early 1980s (Bale, 2015, p. 5). He was adamant that he had to avoid such conflict if he wanted to have a chance at winning the next election (Marc Stears, personal interview, 9/11/2016). Yet, unity came at cost of direction. Although Miliband was elected with the help of the trade unions on a left-wing platform, he could not distance himself from The Third Way because his own cabinet and the backbenches were full with New Labour politicians (Marc Stears, personal interview, 9/11/2016; Thomas Baldwin, personal interview, 13/12/2016). As a result, Jon Cruddas (personal interview, 5/12/2016) admits that 'it would have been difficult to promote radical policies among the divisions in the party' and Miliband – like Brown before him – tried to paper over the cracks within the Labour party.

This attempt to paper over the cracks was strongly influenced by the party's previous policies, i.e. there was a significant amount of path dependency in both electoral and ideational terms. Prior to the economic crisis New Labour had used the resources of

the state to invest in public services in pursuit of their social and political goals prior to the economic crisis, but the party never changed the nature of the discourse. Under the mantle of economic efficiency, they attempted to implement “redistribution by stealth” and to use as much space as possible to achieve their social aims without attacking the dominant neoliberal paradigm (Carstensen and Matthijs, 2018). Trying to cling to their social democratic beliefs, the Labour leadership failed to make a case for them with the public.

This also influenced the Labour party in the shadow of the crisis. Although the trade unions and Labour activists were opposed to austerity, the party still drew on supply-side Keynesianism. Leading figures within the party had supported and, to a certain extent even developed, New Labour’s economic policies and they thus found it very difficult to distance themselves from them. Ed Miliband opened up space within the party for the discussion of new ideas, but he lacked the necessary power and resources to initiate a whole-hearted paradigm change. He was surrounded by people who had supported Labour’s Third Way, while more radical voices were still marginalised within the Labour party until 2015. Moreover, influenced by New Labour’s experience, the party leader prioritised tactical consideration over new economic arguments. Concerned with Labour’s weak economic credibility with the electorate, it responded to short-term electoral concerns and used a lot of public opinion research to design its policies. Borrowing from New Labour’s play-book, it tried to appeal to fiscally conservative voters in the centre of British politics. These voters had become very sceptical about Labour’s economic competence after the party presided over the greatest financial crisis since the Great Depression and, according to the view dominant within the leadership, the party had to go a long way to regain their trust.

Conclusion

The Great Recession, and the ensuing debate about how to respond to it, threw Labour into a deep identity crisis. In the immediate aftermath of the financial crisis, Labour resolutely reflatated the economy and Gordon Brown orchestrated a global stimulus in the spirit of John Maynard Keynes. Labour’s policies soon became the victim of their success, though: preventing the recession from turning into a depression, public discourse became increasingly concerned with the public deficit rather than the lack of aggregate demand. Put differently, the crisis was quickly viewed as a “crisis of debt” rather than a “crisis of growth” and Labour took the blame for this

crisis. The party's economic credibility was shattered by the financial crisis, which strongly influenced the presentation of Labour's economic policies after 2008.

Labour thus faced a dilemma in the shadow of the Great Recession: in opposing austerity, and the resulting spending cuts, Labour appeared ignorant about the deficit, but in accepting it, the party risked betraying their own instincts and traditional constituents. As a result, Labour's head and heart pulled in different directions: while Labour's head told them to speak the language of fiscal prudence, its heart wanted to oppose austerity. In the end, the party took a page out of New Labour's play-book and decided that they had to get the politics right before they could implement alternative economic policies. They attempted to appeal to fiscally conservative voters in the centre of British politics at the cost of anti-austerity instincts.

Although this approach worked in the mid-1990s, it failed in the context of the recent economic crisis. On the one hand, Labour's policy failed to appeal to fiscally conservative voters in the centre of British politics. The party lost its reputation for economic competence in the wake the 2008 financial crisis and it was never able to close the "credibility gap" with the Conservatives. They were viewed as more competent in dealing with the deficit and had used a lot of clever messaging to discredit the Labour party.²⁴ By speaking the language of cuts, Labour thus gave voters a reason to vote Conservative. It turned fiscal consolidation into a valence issue, which played the hands of the Tories who owned this issue. Labour was concerned to ensure that its programme for fiscal consolidation was more just than that of the Conservative's plan, but this argument never gained traction.

On the other hand, by supporting fiscal consolidation, Labour disappointed many of its core supporters, including the trade unions that fiercely campaigned against austerity. The Scottish National Party (SNP) and the Green party, which campaigned against austerity, became popular among left-wing voters and within the Labour party a growing gulf between the Parliamentary Labour Party (PLP), on the one side, and Labour's members and activist, on the other side, opened. While Labour's leadership adopted positions that they deemed necessary to win elections, a large share of its members were longing for an anti-austerity programme (Nick Thomas-Symonds, personal interview, 05/10/2016). The leadership 'underestimated the extent to which Labour members and Labour voters could become disconnected' (Ed Balls, personal interview, 12/12/2016).

²⁴The Conservatives had numerous good lines that attacked the Labour's economic credentials. For example, they argued that voters should not 'give the car back to the people that crushed the car' and that the Coalition government had to 'clean up Labour's mess' and was 'fixing the roof while the sun was showing.'

Eventually, Labour's struggle over the right fiscal policy also set the stage for the internal conflict that broke out after the 2015 election, when the disconnect between the PLP and Labour's members became obvious. Jeremy Corbyn ran as the candidate of the far left in Labour's leadership election. He presented himself as the anti-austerity candidate and was greeted with a large amount of enthusiasm by the party's members and supporters. This showed with how much passion the broader Labour party had been longing for an alternative to austerity, and in the end he easily defeated the three other candidates in the leadership election (Quinn, 2016). His victory led to a bitter intra-party conflict and an attempted coup by a large group of MPs one year later. Corbyn, however, survived the coup and won a second leadership election against Owen Smith in the summer of 2016.

Afterwards, Corbyn was able to strengthen his position within the Labour party, cementing it with the 2017 electoral campaign. During this campaign, Jeremy Corbyn and his Shadow Chancellor John McDonnell still adhered to a "fiscal credibility rule" – a fiscal policy that Ed Balls (2016) claims is not much different to his own policy – but they managed to present the party as "anti-austerity". The party supported many distinctively social democratic economic policies that have become extremely popular among the public (e.g. NHS funding, rail nationalisation, abolishment of university fees). Seven years after the Conservatives had begun implementing austerity, this helped Labour to make a surprise performance in the 2017 election. Labour still lost the election, but the Conservatives lost their absolute majority and Labour celebrated the largest ever increase in votes at any election since 1945. Largely this happened because Jeremy Corbyn pulled something off that Labour had struggled to do ever since the financial crisis in 2008: to question the extreme conservatism of the of British economic discourse and to move it onto a more favourable ground for the Labour party. Future leaders of the Labour party will probably thank him for it.

Chapter 7

The Fiscal Policies of the German SPD in Times of Crisis: The Swabian Housewife of the Left?

Introduction

The SPD has played a key role in economic policy-making in Germany during the last two decades. It has been a member of the government for sixteen out of the last twenty years, and the party is best known for implementing a set of liberal labour market and welfare market reforms commonly called “Agenda 2010”. These reforms undermined the social profile of the SPD and contributed to an emergence of the far left party *Die Linke* (Schwander and Manow, 2017). Still, the SPD was also in government for quite some time in the wake of the 2008 financial crisis, albeit as a junior partner in a Grand Coalition with Angela Merkel’s Christian Democrats and its Bavarian sister party (CDU/CSU). During this time, the SPD supported economic policies that are difficult to combine with each other. In the beginning of the crisis, the SPD bailed out the German financial system and implemented two large stimulus packages, which had a distinct Keynesian flavour. However, at the same time, the SPD supported the introduction of a constitutional debt brake (*Schuldenbremse*), limiting the amount of debt that Germany’s federal and state governments are allowed to issue. In this way, the SPD accepted an important cornerstone of economic orthodoxy, which came to dominate Europe in the following year. Even after the SPD was ousted from government and was on the opposition benches in Berlin from 2009

to 2013, the party accepted austerity as the dogma of the day. It was complicit in imposing austerity on crisis-ridden debtor countries abroad and supported the rigid budgetary fiscal policy at home that Wolfgang Schäuble implemented as finance minister.

This chapter attempts to explain why the SPD supported fiscal consolidation during the Great Recession. To examine the fiscal policies of the SPD in response to the crisis, the chapter again combines a quantitative content analysis of election campaigns from before and after the financial crisis with a qualitative case study. The quantitative content analysis shows that the SPD attempted to shift its position on the welfare state and economic liberalism to the left, but that it remained wedded to fiscal orthodox policies in response to the crisis. To explain this puzzling outcome, I again use process tracing. The analysis is mainly based on insights from twenty-one elite interviews with SPD politicians and policy-makers, which I complement with official documents and public statements from leading social democratic politicians during the economic crisis. A list of all people interviewed is shown in Appendix E.1. These interviews allow me to unpack the official narrative that the SPD used to justify fiscal consolidation since 2009 and I hope to elucidate the causal mechanisms behind the SPD's response to the Great Recession in this way.

Based on this analysis, I argue that the policies of the SPD were driven by strategic calculations and lingering economic ideas. On the one hand, the SPD perceived voters to be fiscally conservative, who expected the government to balance its budget and reduce government debt. The SPD therefore attempted to signal fiscal competence by supporting fiscal consolidation (Kraft, 2017). On the other hand, the SPD remained influenced by New Keynesianism and supply-side economics, which had shaped its programme prior to the crisis. Due to the perceived success of the *Agenda 2010* these ideas were particularly prevalent in Germany and pushed the SPD leaders away from traditional Keynesian thinking. At the same time, the *Agenda 2010* also caused a political rift within the SPD, which had a lasting impact. The reforms were very controversial within the party, undermined the SPD's ties with the trade unions, and challenged the social profile of the SPD with significant electoral consequences. Weakened by these internal conflicts, the party lacked a clear economic paradigm and was unwilling to challenge the prevailing economic discourse in Germany, which is still strongly influenced by ordoliberalism (e.g. Blyth, 2013; Woodruff, 2016) and a moral view on the economy (Schulze-Cleven and Weishaupt, 2015; Hien, 2017). In this context, the SPD embraced what Haffert and Mehrtens

(2015) call the “progressive consolidation thesis”, which helped to entrench fiscal orthodoxy in Europe.

To make this argument, the chapter follows the same outline as Chapter 6. First, I briefly review the fiscal policies that the SPD historically espoused. This analysis will necessarily be incomplete, but it is helpful in order to contextualise the fiscal policies that the SPD adopted in response to the economic crisis. Second, I use the dataset from Chapter 3 again to analyse the response of the SPD to the economic crisis before I explain this response by way of process-tracing. This analysis distinguishes four different periods in SPD’s response to the Great Recession and pays close attention to the nature and timings of policy shifts. It attempts to reconcile the SPD’s decision to support both Keynesian demand-stimulus packages as well as the *Schuldenbremse* in response to the financial crisis. Afterwards, it analyses the fiscal policies that the SPD proposed from 2009 to 2015, when the SPD was torn between its role in opposition and government. Finally, I discuss the implications of my analysis, focusing on the economic and politics of austerity and conclude.

The SPD’s fiscal policies before the Great Recession

From Marxism to Keynesianism

The SPD had a complicated relationship with fiscal policy in the 20th century. Unlike other European social democratic parties, the SPD did not enthusiastically embrace Keynesianism after the Second World War. In the beginning of the post-war era, the SPD was still inspired by Marxist ideas that had shaped the party in the previous decades (Berman, 1998). The party initially remained in favour of interventionist policies focused on supply-side policies like nationalization, planning, and worker control that opposed the free market (Allen, 1989, p. 273). However, in 1959 the SPD made a programmatic reversal. By adopting the Godesberger program, the SPD turned away from Marxism and openly embraced Keynesianism (e.g. Held, 1982; Przeworski, 1985, p.32). It accepted the basic logic of the free market and embraced a Keynesian economic programme similar to that of other European social democratic parties. Like other centre-left parties in Europe, the party discovered Keynesianism as a theoretical justification for policies that pursued social democratic ideas (like social justice and solidarity) on the basis of economic arguments. Afterwards the party became a vocal supporter of Keynesianism and this endeavour was led by Karl Schiller, a leading German economics professor. Labour unions soon followed

suit, and in 1963, the German Trade Union Confederation (DGB) adopted a general program that was inspired by Keynesianism.

This programmatic reversion in the late 1950s and early 1960s was electorally successful (Allen, 1989; Walter, 2002, p. 185) and the SPD was able to put its programme into practice after it first entered the federal government in the post-war era in 1966. It joined the CDU/CSU in a grand coalition and Karl Schiller became finance minister. He responded to the economic crisis of 1966 and 1967 with stimulus programme in the Keynesian tradition. Afterwards, he codified Keynesianism into German law by passing the so-called *Stabilitäts- und Wachstumsgesetz* (Nützenadel, 2005, p. 123ff). The law recognized the government's responsibility for employment and mandated the government to act accordingly. Afterwards, in 1969, the grand coalition also changed the debt rule in the Constitution. The Constitution now read that 'the receipts from loans shall not exceed the sum of the planned expenditure on investments in the budget; exceptions are only permissible to prevent a disturbance of the macroeconomic balance' (Law to change the German Constitution from 2 May 1969, BGB1. I, S. 357).¹ These changes ushered in a brief period of Keynesianism in Germany, which persisted during the grand coalition (1966-69) and the centre-left government under Willy Brandt (1969-1974). During this time, the government used active demand management to stabilise the economy, following the example of other Western European governments.

From Schmidt to Schröder

However, in 1974, Helmut Schmidt took over from Willy Brandt and became the second SPD chancellor in the post-war era. Although Schmidt famously said in 1972 that he would prefer five percent of inflation over five percent of unemployment, he was more concerned with economic stability than most other social democrats.² In the context of stagflation, he favoured more conservative policies and he already used his first address to the Bundestag as chancellor to 'repel all exaggerated [budget] demands.' He said that his government would use 'all constitutional and political pos-

¹Own translation; original: 'Die Einnahmen aus Krediten dürfen die Summe der im Haushaltsplan veranschlagten Ausgaben für Investitionen nicht überschreiten; Ausnahmen sind nur zulässig zur Abwehr einer Störung des gesamtwirtschaftlichen Gleichgewichts.'

²That said, Dyson and Featherstone (1999, p. 288) also argue that Schmidt was not follower of ordoliberalism, which he regarded as 'too technocratic and arrogant.'

sibilities to commit the federal, *Länder* and local governments to a thrifty spending policy from 1975 onwards' (Schmidt, 1974, p.20).³

Still, Schmidt was pressured by the left wing of his party and the US President Jimmy Carter to stimulate the economy in the late 1970s. The latter wanted Germany to become the economic locomotive for Europe and the rest of the world, and Schmidt partially conceded (Allen, 1989, p. 279). He implemented two stimulus programmes in 1977 and 1978 worth 29.3 billion Deutsche Mark, and even risked a fall-out with his liberal coalition partner, the FDP. However, the stimulus packages failed to have the desired effect. The autonomy of the central bank as well as pro-cyclical deficit reductions at the state and local level undermined Keynesian demand-management (Scharpf, 1991, p. 239), and eventually Schmidt turned away from deficit spending. He introduced welfare state cuts and tried to consolidate the budget, but was torn into different directions by the FDP, his coalition partner, and his own party: while the left wing of the SPD opposed spending cuts, the FDP began to embrace a monetarist policy. Eventually, in 1982, the coalition government fell apart despite Schmidt's balancing act.

After 1982, the SPD remained in opposition for sixteen years. The party initially remained wedded to some form of Keynesianism, even if it was more open to supply-side policies than other social democratic parties (Allen, 1989, p. 273). In the late 1980s and the early 1990s the SPD became increasingly divided between the so-called "traditionalists" and the "modernisers", but the party's direction of travel was not entirely clear even after the party had won the elections in 1998. Instead, there was a programmatic dualism personified by the chancellor Gerhard Schröder and Oskar Lafontaine, the party leader and finance minister (Nachtwey, 2013, p. 238). This dualism turned into an open conflict, which culminated in the resignation of Lafontaine in March 1999 after he had only served in government for 163 days. Subsequently, the modernisers took control of most levers of government and initiated a reform process.

Germany's Third Way

Following Lafontaine's resignation, Schröder appointed Hans Eichel as the new finance minister. Hans Eichel was concerned with the sustainability of government debt and favoured more orthodox fiscal policies. Even in the context of Germany's

³Own translation; original: 'Die Bundesregierung wird alle verfassungsmäßigen und alle politischen Möglichkeiten voll nutzen, um Bund, Länder und Gemeinden auf eine sparsame Ausgabenpolitik ab 1975 zu verpflichten.'

economic crisis in the early 2000s when Germany was widely called the ‘sick man of the Euro’ (The Economist, 1999), Eichel continued to implement a restrictive fiscal policy. Moreover, Chancellor Schröder attempted to engineer a broader push for reforms. He published a joint paper with Tony Blair, the British Prime Minister and leader of the Labour Party, in which they laid out the rationale for a new economic programme (Blair and Schröder, 1999), often labelled “Third Way” (Giddens, 1998). Although Schröder and Blair stressed that they considered demand- and supply-side policies complementary, the paper is mostly remembered for outlining a new centrist economic strategy for social democratic parties in Europe that focused on supply-side reforms to achieve economic growth.

Despite the initial push by the modernisers to rejuvenate Germany’s economy, the SPD-led government struggled to implement far-reaching reforms based on a corporatist strategy, i.e. an alliance for jobs based on a collaboration with representatives of trade unions and employers. This so-called “Bündnis für Arbeit, Ausbildung und Wettbewerbsfähigkeit” was created in 1998 after the Schröder was first elected, but it eventually failed in the early 2000s. Before the 2002 elections, Schröder thus created the “Hartz commission” with the task to develop recommendations for a labour reform. After the red-green government was narrowly re-elected, Schröder intensified the push for reforms and eventually opted for a post-corporatist strategy (Nachtwey, 2013, p. 240). He announced the Agenda 2010 in March 2003, implementing a set of reforms that liberalised the labour market and the welfare state.

The Agenda 2010 can be seen as a significant re-orientation of Germany’s welfare state and it was politically contested (Hassel and Schiller, 2010; Hegelich et al., 2011). The reforms liberalised Germany’s labour markets and system of welfare provision and had far-reaching political consequences (Schwander and Manow, 2017). The policies were unpopular among a large share of the SPD’s voters and party members and created a lot of political discontent in the mid-2000s. Still, there is not one dominant interpretation of the transformation that the SPD underwent at the turn of the century. Seeleib-Kaiser (2002) argues that the SPD converged with the Christian Democratic Union (CDU), while Merkel et al. (2008) argue that the SPD still stands for a form of “traditional social democracy”. In contrast, Nachtwey (2013) argues that the SPD has undergone a process of adaptive self-transformation and now has a distinct model that he calls “market social democracy.”

These different interpretations of the SPD’s economic programme also emerged because the SPD retreated from fiscal orthodoxy while implementing the Agenda 2010. Although Hans Eichel remained in favour of restrictive fiscal policies and aimed at

a balanced budget, Schröder ordered him to do otherwise. The latter was less concerned with the deficit and level of government debt; rather, he wanted to combine his liberal economic reforms with public investment in education and childcare. As a result, Schröder actively pushed his finance minister to increase the government deficit and Eichel thus had to drop his restrictive economic policy.⁴ In 2004, the federal government incurred the largest deficit in the post-war history and the German government issued an extra 144 billion Euro debt from 1998 to 2005. Germany even repeatedly broke the Maastricht criteria by running a budget deficit larger than three percent of GDP and along with France it was the first country to do so. The party defended this policy as appropriate counter-cyclical economic policy and the SPD-led government even pushed for a controversial reform of the Stability and Growth Pact (SGP). German representatives in Brussels argued that the European rules enshrined in the Maastricht treaty were too rigid and, eventually, the European Council agreed to reforms that relaxed the SGP in spring 2005.

The SPD was therefore instrumental in pushing for a fiscal framework that allowed more fiscal flexibility in Europe before the economic crisis. While budget consolidation became an end in and of itself for social democratic parties in other countries like Sweden or the Netherlands, the German SPD did not prioritise fiscal consolidation (Merkel et al., 2008). Although Hans Eichel and other leading social democrats were already concerned with the sustainability of Germany's government debt in the early 2000s, the party considered other economic objectives and policies more important at that time. As a result, the party did not embrace spending limits and fiscal consolidation and against this background, it remains puzzling why the SPD abandoned this position in the recent past.

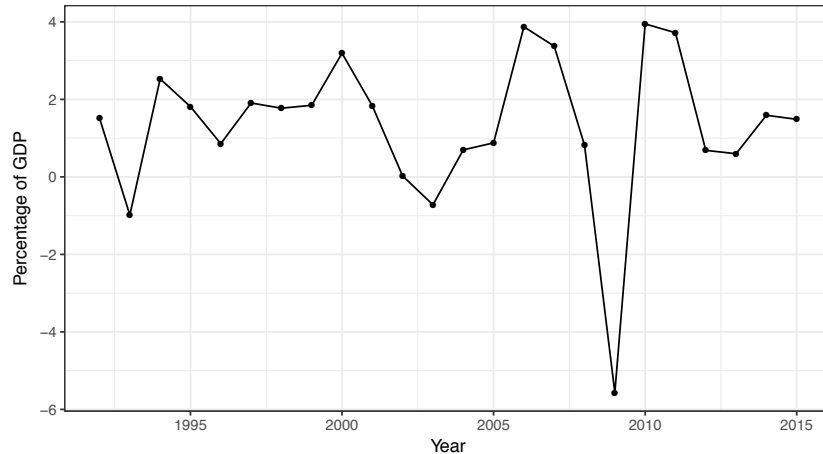
Economic crisis and the response of the SPD

The SPD remained in government until 2009, despite the electoral consequences of the Agenda 2010 (Schwander and Manow, 2017). It lost the election in 2005, but the CDU/CSU and the FDP fell short of a majority. The SPD thus joined a grand coalition under the leadership of Angela Merkel, which governed Germany when the financial crisis hit the advanced economies. After the fall of the American investment bank Lehman Brothers in September 2008, several German banks were on the brink of bankruptcy. Moreover, the financial crisis also led to the deepest recession since

⁴In the coalition negotiations of 2002, Schröder allegedly said to Eichel 'Hans, just leave it ('*Hans, lass mal gut sein*') when the finance minister demanded further cuts.

the Great Depression and Germany's economy shrank dramatically in 2009 (Figure 7.1). Although Germany's domestic economy recovered relatively quickly beginning in 2010, the German government remained in crisis mode for several years because the Eurozone crisis kept a tight grip on the Euro.

Figure 7.1: German real GDP growth, 1991-2015



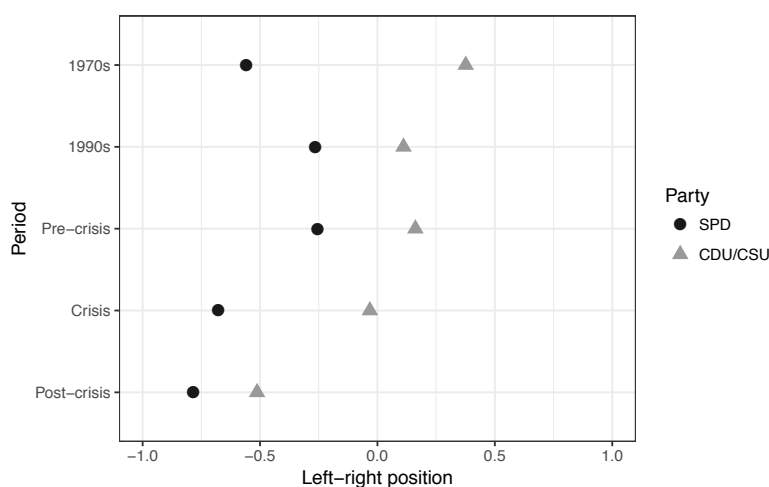
Source: OECD

To examine the response of the Labour party to this economic crisis, I use the data from Chapter 3. Repeating the exercise from Chapter 6 for Germany enables me to put the SPD's economic response to the Great Recession into a historic perspective. To focus on the larger programmatic shifts of the SPD over time, I classify the elections into five different periods shown in Table 7.1. For each period, I first calculate the aggregate left-right position for the SPD party and the CDU/CSU to examine whether there was a neoliberal convergence prior to the crisis.

Table 7.1: List of elections by time period

Time Period	Election
1970s	1976
1990s	1994, 1998
Pre-crisis	2002, 2005
Crisis	2009, 2013
Post-crisis	2017

The results are shown in Figure 7.2. It indicates that in the 1970s, there was a clear difference between the SPD and the CDU/CSU in economic terms, but that this difference became significantly smaller in the 1990s and 2000s. Before the Great Reces-

Figure 7.2: Left-right position of the SPD and CDU/CSU over time

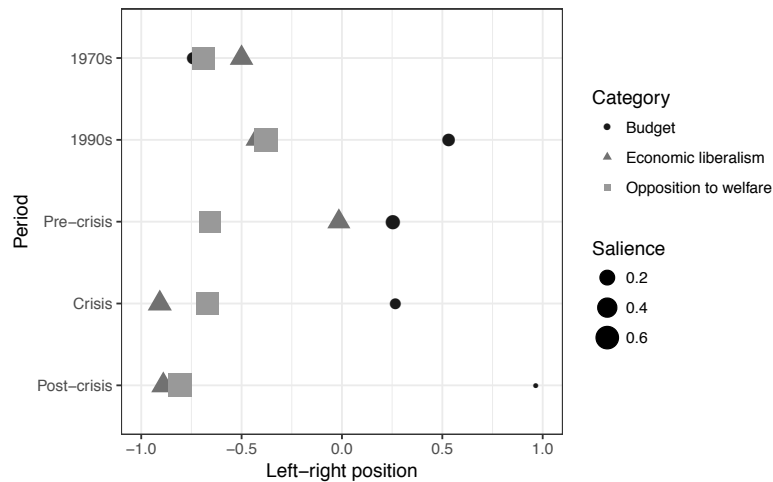
Note: The figure shows the weighted average position of the SPD and the CDU/CSU on all economic issue categories (welfare, economic liberalism, budgetary rigour). The positions are weighted by the relative salience of each category.

sion, both the SPD and the CDU/CSU had moved towards the centre, which limited the programmatic competition on the economy.⁵ This convergence was partly reversed during the crisis, when the SPD markedly moved towards the left, but the leftward shift of the CDU/CSU under Angela Merkel undermined the SPD's programmatic re-orientation. By adopting very similar positions, the CDU/CSU neutralised much of the SPD's programme (Hutter and Kriesi, 2019).⁶

To properly characterise the economic response of the SPD to the crisis, it is useful to distinguish between the positions of the SPD on the three different economic categories identified above. The results of this exercise are plotted in Figure 7.3. It shows that in the 1970s, the SPD still had a very consistent economic platform that is in line with traditional left-wing positions. The party supported the welfare state but opposed both economic liberalism and a rigid budgetary policy. In 1976, the pragmatic Schmidt campaigned in the elections with the slogan "Vote for Recovery", but he also proposed to raise revenues by increasing taxes. In the 1990s, the SPD began its march towards the centre by changing its position on budgetary rigour, though. It shifted towards the right and adopted a position that was not much different from

⁵For the SPD this move was in the the spirit of the Third Blair, which Blair and Schröder had outlined in the early 2000s. As discussed above, this Third Way re-oriented social democracy. It culminated in the Agenda 2010 which aimed to reform the German welfare state and labour market.

⁶During the crisis, the SPD was also challenged by electoral competition from the far left after *Die Linke* had been founded by a merger between the east-German Party of Democratic Socialism (PDS) and the Electoral Alternative for Labour and Social Justice (WASG) in 2007.

Figure 7.3: Left-right position of the SPD for different economic categories over time

Note: The figure shows the position of the SPD on different economic issue categories. +1 refers to support for budgetary rigour (circle), economic liberalism (triangle), and opposition to welfare (square), respectively. The size of the symbols corresponds to the relative salience of each category.

the CDU/CSU. In the 2000s, this convergence of the SPD and the CDU/CSU also extended towards economic liberalism. The SPD bought into the dogma of the day and supported a flexibilisation of labour markets and a deregulation of the economy, as set out by the Third Way (Nachtwey, 2013; Seeleib-Kaiser, 2002). Interestingly, in the early 2000s the SPD hardly changed its position on social policies despite passing the Agenda 2010. The party's commitment to the welfare state remained a cornerstone of its electoral programme even though this commitment might not have been credible with the public.

In the wake of the financial crisis, the SPD changed its economic programme yet again. The party shifted towards the left both on welfare and economic liberalism and this shift was particularly large with respect to economic liberalism as social democrats became a lot more sceptical about the merits of free markets. For example, the SPD supported tighter regulation of financial markets and campaigned for the introduction of a minimum wage. At the same time, the party did not change its position on budgetary rigour and still retained a very centrist position during the post-crisis election. Prior to the 2009 election, it had already supported the introduction of the *German Schuldenbremse* (debt brake) and in the context of the European sovereign debt crisis it retained its commitment to fiscal orthodoxy. This created a significant tension within the programme of the SPD: it attempted to campaign on a left-wing platform with regard to social policies and economic liberalism, but it also

supported conservative fiscal policies. To deflect from this inconsistency, the SPD increased the salience of issues relating to the welfare state and economic liberalism, while reducing the salience of budgetary policies. This was especially the case in 2017, when the SPD competed on a centrist fiscal programme that hardly featured in the election campaign. The SPD, therefore, lacked a coherent platform based on an economic paradigm, as defined by Hall (1993). It combined individual policy initiatives in a piecemeal fashion, which diluted the party's brand and undermined its ability to influence the economic discourse in Germany.

Explaining austerity from the left in Germany

To explain the SPD's puzzling fiscal policy in response to the Great Recession, I again use process-tracing. The analysis starts with the beginning of the 2008 financial crisis and ends in 2015 when the Euro crisis reached its latest climax (with the approval of the third Greek bail-out package) and public attention turned towards the refugee crisis (Hutter and Kriesi, 2019). My main source are 21 elite interviews with SPD politicians and policy-makers conducted between August 2016 and March 2018. As argued above, these interviews allow me to unpack the official narrative behind the SPD's economic programme and to elucidate the causal mechanisms behind the party's response to the Great Recession. A full list of all interviews conducted is included in Appendix E.1, which also explains the rationale for selecting the interviewees.⁷

2008-2010: The crisis years – The SPD's Response to the Financial Crisis

The SPD and Germany's Keynesian moment

The SPD struggled to develop a coherent position on fiscal policies in response to the Great Recession. Although it was the junior member in the grand coalition, it controlled both the finance and labour ministry when the 2008 financial crisis hit. Before the crisis, finance minister Peer Steinbrück had planned to reach a balanced budget by 2011; after the centre-left government under Schröder had been widely criticized for breaking the Maastricht criteria in the early 2000s, Steinbrück was determined to put

⁷ All translations of quotations from both interviews and secondary sources are my own.

Germany on a path of fiscal consolidation. ‘There was a clear anti-Keynesian attitude in the finance ministry’ (economic adviser A, personal interview, 31/01/2018) and several economic advisers reported that Steinbrück was hesitant to mobilise a large amount of financial resources in autumn 2008.

He famously said in September 2008 that the financial crisis was an American problem and ‘held the position for a long time that Germany did not need to a stimulus package’ (economic adviser A, personal interview, 31/01/2018). In December 2008, Steinbrück even criticized the stimulus programmes in the UK and elsewhere, saying that ‘the switch from decades of supply-side politics all the way to a crass Keynesianism is breathtaking’ (Theil, 2008).

Ralf Stegner (personal interview, 19/12/2017), an influential politician from the left of the party and deputy leader of the SPD, argued that in 2008, ‘the party leadership struggled to shift from the Agenda 2010 towards a demand-driven policy.’ As Gustav Horn argued, before the crisis ‘the leading paradigm was that Keynesian demand management does not work, which was also the dominant view among leading politicians in the SPD’ (personal interview, 14/11/2017). Similarly, another economic adviser to the SPD (personal interview, 15/03/2018) emphasised that ‘the German view that debt is problematic had been dominant within the SPD since the departure of Lafontaine and the party did not have the self-confidence to step out of the shadow and argue against this view.’

However, the view within the finance ministry and the SPD leadership did not go unchallenged. According to Michael Dauderstädt (personal interview, 14/11/2017), ‘the SPD was divided in this situation; the left wing argued very clearly for economic stimulus programmes, but the right wing had reservations about the effectiveness of these programmes.’⁸ Yet, the dramatic economic events that unfolded in autumn 2008 eventually undermined the reservations of the moderates. The voices demanding government action became louder both within and outside the SPD as the crisis worsened and the government agreed on a first stimulus package (*Konjunkturpaket I*) in 5 November 2008. This package worth 12 billion Euro was passed by the Bundestag in early December. Joachim Poß, who was responsible within the SPD parliamentary group for budgetary affairs, justified the first stimulus programme by saying that ‘we believe that it is right to let the automatic stabilizers of the budget work in the current situation. We believe it is wrong to save in the downturn... We, in the

⁸For example, in the beginning of the crisis Joachim Poß, who was originally from the left-wing of the paper, already argued that ‘those who demand spending cuts during the crisis must not be in their right mind’ (Deutscher Bundestag, 2008b, p. 19328).

grand coalition, want to actively fight [the crisis]' (Deutscher Bundestag, 2008a, p. 20238).⁹

The first stimulus programme was quickly dismissed as insufficient, though. The collapse of the world economy had a large impact on Germany's export-oriented economy (see Figure 7.1) and criticism of the government from unions and employer associations grew louder towards the end of 2008. They strongly called for additional deficit-spending (Farrell and Quiggin, 2017) and, in response to the grim economic outlook at the end of 2008, the SPD took up these calls for more action. On 4 January 2009, it put forward a *Pact for Stability and Growth* (SPD, 2009), which called for increases in government spending. Among other things, it demanded higher public investment, additional training for the unemployed, a reduction in social security contributions, and cash subsidies for car purchases. The SPD (2009) justified this pact by arguing that

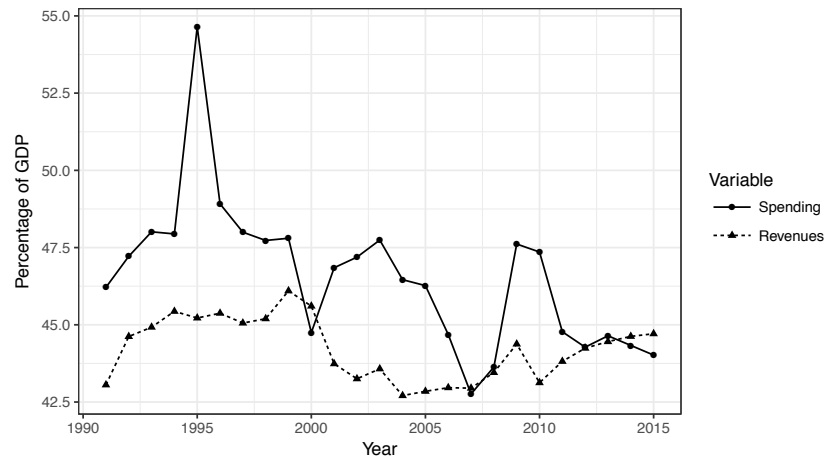
we want to cushion and shorten the imminent crisis with public investments, economic measures and incentives for consumption until the end of 2010. For this purpose, we are prepared to temporarily put aside the goal of balanced state and federal budgets. We act counter-cyclically. Therefore, we believe that it is right and necessary that we pay for the fight against the economic crisis by borrowing more.¹⁰

Within the span of a few days, the German government largely followed the proposals of the SPD and it agreed on a second stimulus package (*Konjunkturpaket II*) on 12 January 2009. The package was worth 50 billion Euro and it contributed to a substantial increase in government spending in 2009 and 2010, as shown in Figure 7.4. Therefore, the SPD eventually also supported two large stimulus packages that can be described as “emergency Keynesianism” (Hall, 2013). Although the government was initially more reluctant to pursue Keynesian deficit-spending than some of its European counter-parts (Vail, 2014; Schulze-Cleven and Weishaupt, 2015), it still came a long way in rediscovering the merits of Keynes.¹¹

⁹Own translation; Original: ‘Wir halten es aber für richtig, in der jetzigen Situation die automatischen Stabilisatoren des Budgets wirken zu lassen. Wir halten es für falsch, dem Abschwung noch hinterherzuspähen... Wir in der Großen Koalition wollen aktiv gegensteuern.’

¹⁰Own translation; original: ‘Wir wollen die bevorstehende Krise mit öffentlichen Investitionen, Wirtschaftsmaßnahmen und Konsumanreizen bis Ende 2010 abfedern und verkürzen. Dafür sind wir bereit, das Ziel eines ausgeglichenen Staats- und Bundeshaushalts vorübergehend zurück zu stellen. Wir handeln antizyklisch. Darum halten wir es für richtig und notwendig, dass wir die Bekämpfung der Konjunkturkrise durch eine Erhöhung der Neuverschuldung gegenfinanzieren.’

¹¹In the end, the German stimulus was even larger than the French stimulus (Schelkle, 2012) and that of many other countries.

Figure 7.4: German government spending and revenues, 1991-2015

Source: OECD

However, the package was not so much influenced by an economic paradigm as by the pressures of the day and the influence of trade unions and employer associations. Poß (personal interview, 22/09/2016) argued that ‘in 2008 we had no textbook that we could follow, but there was not much time to develop economic paradigms, either.’ Instead, Christian Kellermann, a former adviser to the SPD’s executive board and head of the economic policy unit of the SPD, argued that ‘as a result of the pressure, a window of opportunity opened for government stimulus programmes. For a short period of time, this became the new *Zeitgeist* as it became clear that you had to do something in response to the crisis’ (personal interview, 18/12/2017). Another economic adviser emphasised that ‘in retrospect, Peer Steinbrück realized that he had been wrong when all mainstream economists agreed that Germany would need stimulus programmes’ (personal interview, 15/03/2018).

The stimulus programmes were also supported for electoral reasons. With nine months until elections, the SPD believed that voters expected politicians to have ‘courage to take unconditional steps’ and to provide ‘clear guidance’ out of the crisis (SPD, 2009). In this context, the SPD did not only justify additional government spending as demand management pure and simple, but it also emphasised that the additional spending should be used to improve economic productivity. For example, it maintained that the stimulus programmes would ‘improve the infrastructure’ and ‘increase the potential and skills of people’ (SPD, 2009). This was in line with the supply-side policies that the party had implemented before the crisis and helped the party to justify its reversal to demand management.

The SPD and the *Schuldenbremse*

The party's ambiguous position towards Keynesianism also came to light when the grand coalition changed the constitution to include the *Schuldenbremse* in May 2009. The initiative for this debt brake arose several years before the financial crisis, but calls for such a debt brake grew louder as the government adopted deficit spending. Eventually, both the federal and the state governments agreed to constitutionally limit the size of public deficits: while the federal government would only be allowed to run a deficit up to 0.35 percent of GDP, state governments would be prohibited from running budget deficits at all.^[12] The *Schuldenbremse* signalled a clear commitment to fiscal consolidation among German policy-makers, and the SPD was instrumental in ensuring its place in the German constitution.^[13] In the parliamentary debate prior to the vote on the debt brake in March 2009, Steinbrück called the *Schuldenbremse* a 'decision of historic significance' (Deutscher Bundestag, 2009, p. 24866). He argued that Germany was stuck in a vice of indebtedness and emphasised that fifteen percent of the federal budget had to be used for interest rate payments. This reduced the amount of money that the government could spend otherwise and threatened the capacity of the state in the long-term. Therefore, Steinbrück stressed that 'a state that is able to act needs to have public finances that are viable in the long-term' (Deutscher Bundestag, 2009, p. 24868).^[14] The *Schuldenbremse* was designed to ensure that this would be the case.

This position was shared among the right wing of the party. Carsten Schneider (personal interview, 22/10/2016), a budgetary spokesperson for the SPD, emphasized that 'higher debt generally also means that the government has to pay higher interest rates. And I do not want us to use government's current income for interest expenses.'^[15] Even Joachim Poß (personal interview, 22/09/2016), who comes from the left-wing of the party, argued that 'there are also good reasons that the state gives itself room for manoeuvre. The lower the debt, the higher the ability of the state to act.' This is in line with the "progressive consolidation thesis" (Haffert and Mehrrens, 2015),

¹²In exceptional situations and in order to respond to economic downturns the federal government would still be allowed to run larger government deficits.

¹³For example, the debt brake was prepared by the finance ministry, which continuously had been under the control of the SPD since the 1998 election.

¹⁴Own translation; original: 'Ein handlungsfähiger Staat braucht langfristig tragfähige öffentliche Finanzen.'

¹⁵Schneider had already been instrumental in putting the question of government on the table prior to the economic crisis. He was the author of several papers with other SPD politicians and policy-makers demanding immediate action on Germany's debt.

which emphasises that consolidation is necessary to ensure the long-term capacity of the state.

Although this view was popular among some SPD politicians, the *Schuldenbremse* was ‘not a SPD project and it was very controversial within the party’ (Wolfgang Thierse, personal interview, 07/09/2016). The left wing of the party was concerned that the *Schuldenbremse* would undermine the fiscal space available to the state and threaten the provision of social services. They were supported by the trade unions (e.g. [Deutscher Gewerkschaftsbund, 2009](#)) and by a public appeal from economists spearheaded by Peter Bofinger and Gustav Horn. They argued that ‘the restriction of the remaining room for manoeuvre for macroeconomic policies, which the debt brake aims at, endangers the overall economic stability’ ([Bofinger and Horn, 2009](#)).¹⁶ As a result, the *Schuldenbremse* only passed narrowly as nineteen left-wing social democratic MPs voted against the debt brake in the *Bundestag* and three SPD-led state governments rejected the debt brake in the *Bundesrat*.

The stimulus packages implemented by the grand coalition actually made the passage of the *Schuldenbremse* more likely, though. Against the background of the stimulus, concerns about fiscal sustainability grew larger among voters and politicians. Steinbrück explicitly linked the debt brake to the stimulus programmes, arguing that the debt brake was necessary to ensure that the federal and state government would return to the path of fiscal consolidation ([Deutscher Bundestag, 2009](#)). Similarly, the [SPD \(2009\)](#) also supported the debt brake in its *Growth and Stability Pact*. It argued that as soon as the economy would improve again,

with a view to the burden of future generations, we must then quickly return to the policy of budget consolidation. Rising interest rates are a serious mortgage for our children and grandchildren - particularly against the backdrop of demographic change in Germany... That is why we want to maintain the aim of introducing a debt brake in the Constitution.¹⁷

Consequently, the conflict within the SPD about the *Schuldenbremse* was decided by tactical reasons. As Stegner (personal interview, 19/12/2017) argued, ‘there were only very few people in the SPD that defended the *Schuldenbremse* on economic grounds. However, the *Zeitgeist* was extremely powerful, and concerns that we would

¹⁶The appeal was signed by 64 Professors as well as more than 150 other economists.

¹⁷Own translation; original: ‘Mit Blick auf die Belastungen der künftigen Generationen müssen wir dann sehr rasch zur Politik der Haushaltskonsolidierung zurückkehren. Steigende Zinslasten sind eine schwere Hypothek für unsere Kinder und Enkel – besonders vor dem Hintergrund des demografischen Wandels in Deutschland... Deshalb wollen wir daran festhalten, eine gesetzliche Begrenzung der Schuldenaufnahme im Grundgesetz zu verankern.’

be portrayed as a debt- and tax-raising party if we were to object to the debt brake dominated the whole debate.’ Similarly, Poß (personal interview, 22/09/2016) argued that ‘the project was very controversial, but in the political-tactical game we were again and again confronted with the claim from the conservative side that social democrats cannot deal with money. We wanted to counter this claim with the debt brake.’ Philipp Steinberg (personal interview, 22/11/2017), then an economic adviser to the SPD leadership, also argued that

we supported the debt brake because we wanted to throw out a certain safety net for ourselves. We wanted to show that we responded to the crisis, but that it is not a general rule that we – as social democrats – cannot deal with money... There was some effort to make it clear that the SPD is interested in sound fiscal policies.

The finance minister Peer Steinbrück especially pushed for the debt brake to ‘re-assure himself that the government’s actions were still in line with his pre-crisis policies’ (economic adviser B, personal interview, 15/03/2018). Yet, the foreign minister Frank-Walter Steinmeier also put his weight behind the initiative. He had already been chosen as the SPD’s candidate for the upcoming election in 2009 and it was ‘very important for him that he was not being seen as the candidate that could not deal with money’ (Heiko Geue, personal interview, 21/11/2017).¹⁸ In the context of the upcoming electoral campaign, the leadership of the SPD was even able to convince many from the left wing of the party. For example, Lothar Binding, the financial spokesperson of the SPD, argued that ‘the citizens wanted the debt brake and as a party we could not escape this pressure in 2009. I always tried to explain why I did not think it was sound economic policy, but it was not a decision of conscience for me and thus I followed the party line in the parliamentary vote’ (personal interview, 23/11/2017). As Thierse (personal interview, 07/09/2016) emphasised, the SPD realised that ‘to polarise and argue for debt is not popular... the fear of accumulating debt is higher in Germany than it is in other countries.’ Ahead of the elections, the SPD was unwilling to argue against this dominant view.

¹⁸For similar reasons, Steinmeier’s economic programme for the 2009 election, the so-called *Deutschland Plan*, also focused less on the demand-side policies pursued in response to the crisis but more on supply-side policies to generate long-term growth. As one economic adviser put it, the SPD ‘never offensively claimed credit for the stimulus programmes... it did not correspond to the German mainstream economic thinking’ (economic adviser B, personal interview, 15/03/2018).

The austere years - torn between opposition and government

2009-2013: The SPD in opposition

A year after the beginning of the economic crisis, the SPD was neither rewarded for its crisis-management nor for the debt brake. In the federal elections of 2009, the party only won 23.0 percent of the votes, which was its worst result since 1945. After eleven years in government, the party was forced to go into opposition as Merkel's CDU/CSU formed a coalition government with the Free Democratic Party (FDP). Subsequently, the SPD attempted to renew its economic programme. Sigmar Gabriel, the new party leader, and Frank-Walter Steinmeier initiated an economic council, which was supposed to help develop a new economic profile for the SPD. The council included a very diverse range of advisers, but the push for programmatic renewal was undermined by the crisis in the Eurozone that began to overshadow day-to-day discussions (Michael Dauderstädt, personal interview, 28/11/2017).

In response to the crisis, the German government began to preach austerity. It agreed to support other heavily indebted Eurozone countries, but demanded tough austerity measures and structural reforms across Europe in return. Led by Angela Merkel and Wolfgang Schäuble, the government pushed for stricter European rules that were enshrined in the Two-Pack, the Six-Pack and the Fiscal Compact. These rules were designed to limit the fiscal space of national government, allowing the German government to impose economic orthodoxy across the Eurozone. In this context, the SPD struggled to position itself.

In the beginning of the crisis, the SPD opposed the government's policies in the *Bundestag* and abstained from the vote on the first Greek bailout and the vote on the European Financial Stability Facility (EFSF) in May 2010. It criticised the government for failing to share the costs of the bailouts with the private sector and made its support conditional on a financial transaction tax (Wonka, 2016). However, in autumn 2010 the SPD reverted back into grand coalition mode and supported all the other bailout packages passed in response to the crisis (Degner and Leuffen, 2016, p. 11). Social democrats still tried to condemn the austerity regime created by Angela Merkel and Wolfgang Schäuble and argued for more solidarity with Europe crisis-ridden countries. For example, Joachim Deutscher Bundestag (2012, p. 22874) argued that 'solidarity in Europe will cost less for Germans in the end than ever more concessions enforced by Germany.'¹⁹ The party struggled to consistently chal-

¹⁹Own translation; original: 'Solidarität in Europa wird die Deutschen am Ende weniger kosten als immer neu von Deutschland erzwungene Zugeständnisse.'

lenge the government's approach to the Eurozone crisis, though. It largely bowed to the German government's view that reckless fiscal spending by debtor countries had caused the Eurozone crisis and that the crisis-ridden periphery needed to implement structural reforms to get out of it.

Privately leading SPD politicians believed that Merkel's strategy was wrong, but they were lost when it came to developing an alternative strategy (Gesine Schwan, personal interview, 11/08/2016). Importantly, the party was confronted with a public debate that was very critical of European transfers and the SPD was very aware of this sentiment. For example, Johannes Kahrs argued that it was very difficult to explain to voters why Germany should continue to support the Greek government:

When I discuss the issue of Greece in my constituency - whether it's at a house visit, at a public information stand, or even at the *Stammtisch* - a lot of people say: "you are not serious that you want to again give 50, 60, 70, 80 billion Euro to Greece, are you? We vouch with our own money for this. Are you insane?" (Deutscher Bundestag, 2015a, p. 11383).

This perceived unpopularity of European transfers strongly influenced the SPD. Several politicians confirmed that the SPD leadership believed that public opinion could not be changed, i.e. they regarded themselves as unable to counter the dominant public view that had emerged in Germany. For example, Ralf Stegner (personal interview, 19/12/2017) argued that 'to put it bluntly, the SPD was always afraid to debate and propose solutions that had the slightest appearance of leading towards a transfer union. The debates were always conducted aggressively against the SPD, and the party dreaded the debate and the prevailing opinion.' Similarly, Binding (personal interview, 23/11/2017) argued that 'we did not see an opportunity to change public opinion.' In retrospect, SPD deputy leader Thorsten Schäfer-Gümbel (personal interview, 13/12/2017) argued that 'the SPD was too intimidated during the Euro crisis. Especially with difficult questions, you have to maintain your position, which we did not manage at the time.' Instead, social democrats accepted the dominant narrative about the Eurozone crisis, as it was portrayed in the media, and the party leadership chose to run with the majority opinion.²⁰

There was not a lack of ideas for alternative policies within the SPD. During the Euro-crisis many policy proposals were drawn up, discussed, and coordinated with other social democratic parties across Europe, including Eurobonds, a European Marshal-

²⁰Dauderstädt (personal interview, 14/11/2018) put this in the following way: 'The party's position was very strongly driven by public opinion... It rather followed the popular *Volksseele* instead of offensively advocating for other positions.'

plan, a Eurozone budget, a common unemployment insurance, or a European redemption fund. However, the party was torn between contradictory aims: although it was ideologically committed to solidarity and the European project, it did not want to become associated with unpopular European transfers. Therefore, the party eventually always back-tracked when it came to the cost for the German tax-payer (Hacker, 2012, 2015). The case of Eurobonds is illustrative here.

In 2010, in a joint op-ed in the FT, Frank-Walter Steinmeier, then leader of the SPD in Germany's parliament, and Peer Steinbrück called for Germany to take bold actions to end the crisis in the Eurozone. They presented a three-point plan, including Eurobonds 'to send the message that Europe is strong, united and willing to deal jointly with whatever critical market situation emerges.' After push-back from the government and the media, the SPD was initially reluctant to commit to this position, but in summer 2011 Gabriel, Steinmeier, and Steinbrück jointly presented a plan for Eurobonds together with a substantial haircut on Greece's debt (Geis and Krupa, 2011). They criticised Merkel's approach to the crisis in the Eurozone and demanded unpopular decisions. This was integrated into a general strategy, emphasising that 'the one-sided austerity packages, which hurt employees, pensioners, and the social infrastructure are definitely wrong' (SPD Fraktion, 2011).²¹ Yet, after fierce public criticisms and disagreement within the party, the SPD reconsidered its position. Eventually, Gabriel backtracked and publicly rejected the idea of Eurobonds. In spring 2012, after Francois Hollande was elected President in France and a different pro-European policy briefly seemed possible, Gabriel ruled out Eurobonds. He said 'what are Eurobonds: They are jointly guaranteed debts. In general, this will certainly not exist' (Reuters, 2012).²²

Still, a few months later, Gabriel changed direction again. In August 2012, philosophers Jürgen Habermas and Nida-Rümelin jointly drew up a proposal with economist Peter Bofinger, including an equivalent of Eurobonds. In an essay published in the *Frankfurter Allgemeinen Zeitung* they argued for a 'joint liability for government bonds in the Euro area' of up to 60 percent of GDP for each member state (Bofinger et al., 2012). The SPD leader Sigmar Gabriel supported this position and he held a press conference after the essay was published during which he said that 'you will not be able to hold the Euro together without a common financial and tax policy... we have a common currency, but no common finance or budget policy' (EU Observer,

²¹Own translation; original: 'Die einseitigen Sparkonzepte zu Lasten von Arbeitnehmern, Rentnern und sozialer Infrastruktur sind sicher falsch.'

²²Own translation; original: 'Was sind Eurobonds: Das sind gemeinschaftlich garantierte Schulden. Das wird es in der Allgemeinheit garantiert nicht geben.'

2012). In the end, the party did not include Eurobonds in its election programme in 2013, but the constant back and forth undermined the party's credibility.²³

As Gesine Schwan (2012) criticised, the party did not have the courage to keep up positions that might be contrary to the prevailing public opinion. It always made its European policy with reference to national parameters and electoral considerations. This was made explicit when Thomas Oppermann emphasised that 'first, we are responsible for our country' (Monath, 2012).²⁴ Similarly, Carsten Schneider argued that

we as the German parliament have to make decisions based on the legitimation that we received from our voters. The SPD electoral programme from 2009 did not say that we support direct transfers to other national parliaments (Deutscher Bundestag, 2015b, 7224).²⁵

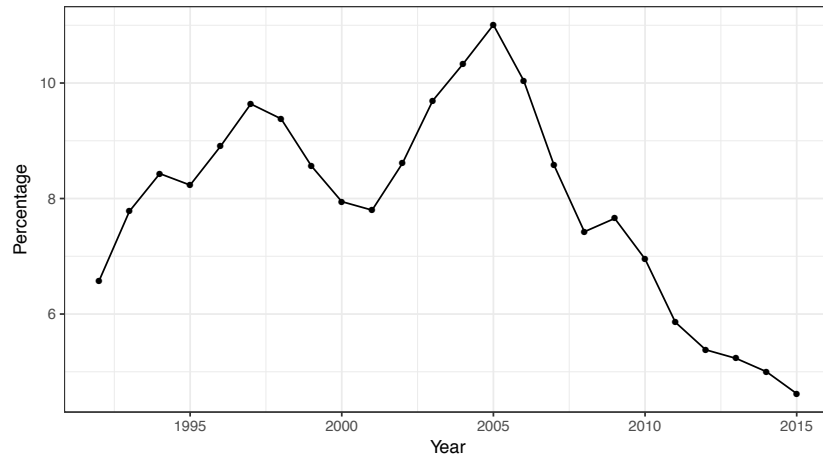
Thus, the SPD bowed to the popular narrative that reckless fiscal spending by debtor countries had caused the economic crisis, and argued that the crisis-ridden periphery needed to do their 'homework' to get out of the crisis.

However, the SPD was not only influenced by electoral considerations, but it was also trapped by its past economic policy. Following the logic of supply-side economics, Germany had undergone painful economic reforms and austerity policies before the crisis. Importantly, during the economic crisis the Agenda 2010 became increasingly seen as a success-story. While other countries were stuck in the crisis, Germany bounced back relatively quickly and the headline figure of unemployment remained low and continuously declined from 2009 to 2015 (Figure 7.5). The right wing of the SPD that had supported the Agenda 2010 claimed that this economic situation was the direct result of the reforms, which facilitated the interpretation of the crisis as a

²³Other SPD leaders played for time. For example, Thomas Chief Whip Oppermann argued in November 2011 that Europe was not ready for Euro-bonds. He said that 'Euro-bonds are only possible after extensive EU treaty changes in a united Europe. This will still take time' (Heithecker and Sturm, 2011). (Own translation; original: 'Euro-Bonds sind nur nach umfangreichen EU-Vertragsänderungen in einem vereinten Europa möglich. Das wird noch dauern.') The party congress in December 2011 made a similar decision. It agreed that 'joint liability – whether under the current rescue package or through jointly guaranteed bonds – is not possible without controls. The SPD is ready to tackle the necessary changes of the European treaties' (SPD 2011). (Own translation; original: 'Gemeinschaftliche Haftung – sei es im Rahmen des derzeitigen Rettungsschirms oder durch gemeinsam garantierte Anleihen – ist ohne eine gemeinschaftliche Kontrolle nicht möglich. Die SPD ist bereit, die dafür notwendige Änderung der Europäischen Verträge in Angriff zu nehmen.')

²⁴Own translation; original: 'Wir sind zuerst für unser Land verantwortlich.'

²⁵Own translation; original: 'Wir als deutsches Parlament haben jedoch Entscheidungen bezogen auf die Legitimation zu treffen, die wir von unseren Wählern bekommen haben. In dem Wahlprogramm der SPD aus dem Jahr 2009 stand nicht, dass wir direkte Transfers, also Überweisungen und Zuschüsse an die jeweiligen anderen nationalen Parlamente, leisten.'

Figure 7.5: German unemployment, 1991-2015*Source: OECD*

morality tale of saints and sinners (Matthijs and McNamara, 2015). As one economic adviser stressed (economic adviser C, personal interview, 18/08/2016), ‘many people in the SPD who pushed for the Agenda 2010 under Schröder felt compelled to support Merkel’s Euro course.’ They argued that ‘policies that were good for us, would also be good for other countries, without considering that in the middle of the crisis austerity might be counter-productive’.

Therefore, the SPD turned towards supply-side economics to justify the lack of European demand-management. Although many politicians were not ideologically convinced by the virtue of austerity, the centrist wing in the party believed that structural reforms were important to solve the crisis and that these reforms would not be pursued if the debtor countries had more fiscal space. According to Schneider (personal interview, 20/10/2016), his experience was that governments would use fiscal space to reduce taxes instead of making productivity-increasing investment. This view was largely in line with the majority of German economists and the CDU/CSU and the, therefore, SPD found it difficult to oppose austerity even though many SPD politicians, and especially those from the left wing of the party, believed that it was the wrong policy (political advisor, personal interview, 19/10/2017).

At the same time, the Euro crisis also had an influence on Germany’s domestic fiscal policy. In Germany, the economy improved in 2010, as shown in figure 7.1 above. In the context of the first Greek bail-out, the German government argued for fiscal consolidation at home and introduced spending cuts in June 2010. While the unions heavily criticised these spending cuts for their redistributive consequences

(Vail, 2014), the SPD only put up mild opposition. For example, Joachim Poß (Deutscher Bundestag, 2010, p. 5278) said in a parliamentary debate that ‘the so-called austerity package lacks a clear goal, a compass. The growth momentum for the period after the economic stimulus packages has expired is missing.’²⁶ However, the right wing of the SPD even criticised the government for not being austere enough as the budgetary spokesperson Carsten Schneider argued that half of the cuts were false accounting entries. In the following years, Schneider continued to criticise Wolfgang Schäuble on this ground and argued that Schäuble weakened Germany’s position in Europe by toying with the debt brake. According to him, the coalition of the CDU/CSU and FDP had not arrived in the ‘new reality, which had changed due to the new debt brake,’ and he demanded that the responsibility for calculating the government budget deficit should be taken away from the finance ministry and given to the Council of Economic Experts (Hulverscheidt, 2010).²⁷

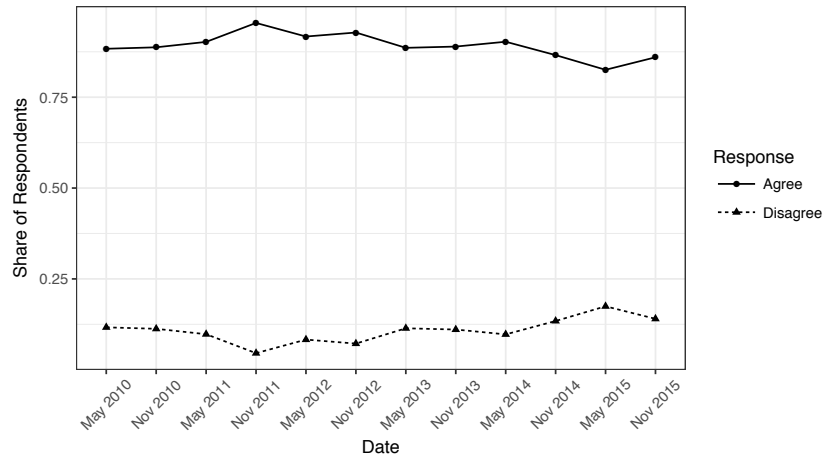
This position on domestic fiscal consolidation was strongly influenced by the European debt crisis. According to the dominant narrative in Germany, the crisis illustrated the dangers of too much government debt, strengthening the German suspicion towards public and private debt.²⁸ Data from the Eurobarometer, shown in Figure 7.6, indicates that a large majority of Germans agreed that the reduction of Germany’s government debt was a priority throughout the crisis. According to the data 88.3 percent of all Germans agreed that the reduction of Germany’s government debt was a priority; in turn, only 11.7 percent of the population believed that it was not a priority. Importantly, in the beginning of the Eurozone crisis, support for fiscal consolidation even increased and remained high throughout the crisis. In 2015, it reached its lowest level, when 82.3 percent of all respondents still believed that fiscal consolidation was a priority for the German government.

This pervasive support for fiscal consolidation also influenced the fiscal policies of the SPD. For example, Schäfer-Gümbel (personal interview, 13/12/2018) argued that ‘it was the majority opinion in the leadership of the SPD that you would not survive a mainstream that is clearly against public debt.’ In 2011, the SPD party conference agreed to a motion, which made the connection between the Euro crisis and domestic policy explicit. The motion said that ‘the crisis in the European Monetary Union shows us with a new urgency that government borrowing needs to be reduced. That

²⁶Own translation; original: ‘Dem sogenannten Sparpaket fehlt das Gestaltungsziel, der Kompass. Es fehlt der Wachstumsimpuls für die Zeit nach dem Auslaufen der Konjunkturpakete.’

²⁷Own translation; original: ‘Die Steuersenker in der Koalition sind immer noch nicht in der Realität angekommen, die sich durch die neue Schuldenbremse verändert hat.’

²⁸This suspicion is, for example, illustrated by the fact that Angela Merkel already referred to the Swabian housewife to whom ‘money saved is money earned’ in 2009 (Benoit, 2009).

Figure 7.6: Attitudes towards government debt in Germany, 2010-2015

Source: Eurobarometer

Note: The figure shows the share of respondents, who agree or disagree with the statement that 'reducing public debt in Germany cannot be delayed.'

is why we will consistently comply with the debt rules and use economic tax revenues to reduce borrowing...' (SPD Fraktion, 2011).²⁹ Still, the SPD argued that it would be in favour of a consolidation process that is growth-friendly and depends on the economic business cycle (a so-called *wachstums- und konjunkturorientierten Konsolidierungsprozess*). In line with the progressive case for austerity and fiscal consolidation, the SPD believed that the fiscal capacity of the state needed to be secured in the long-term. This required fiscal consolidation in the short-term and, hence, the SPD did not oppose the reduction in government spending by the Merkel's government. Instead, it demurred against the tax cuts that the government implemented, which were financed on the pump, arguing that they undermined the tax base of the state.

2013-2015: The SPD's return to government

The SPD continued to support orthodox fiscal policies when it returned to power in 2013 as a member of the second grand coalition under Merkel. The finance ministry remained in the hands of Schäuble, who continued to shape both Germany's and

²⁹Own translation; original: 'Die Krise in der Europäischen Währungsunion, zeigt uns mit neuer Dringlichkeit, dass die Neuverschuldung reduziert werden muss. Deshalb werden wir die Schuldenregel konsequent einhalten und konjunkturelle Steuermehreinnahmen zur Senkung der Neuverschuldung nutzen – und nicht für Steuersenkungsversprechen, die auf Pump finanziert werden!'

Europe's economic policy. In the beginning of the legislative period, he presented a balanced budget (achieving the so-called *Schwarze Null*), and despite national and international demands that Germany's government should spend more, the SPD was hesitant to question this policy. Germany's debt-to-GDP ratio still remained above the criteria laid out in the European Stability and Growth Pact of 60 per cent and the public discourse in Germany was very concerned about lowering debt. Internally the SPD regularly had controversial debates, but in public the SPD even presented the *Schwarze Null* as a success. For example: Kahrs insisted that, 'finally, we are on the way to breaking this dangerous debt spiral... we are reaching a balanced budget... *Wir Roten kämpfen für eine schwarze Null*' (Deutscher Bundestag, 2014c, p. 2244).³⁰ Similarly, Thomas Oppermann justified the SPD's support for the balanced budget by arguing that 'only a state that has financial leeway can invest, shape and redistribute' (Deutscher Bundestag, 2014a, p. 4567).³¹ Several social democrats emphasised that consolidation was not a fetish, but they returned to arguments about intergenerational justice and the capacity of the state to act, in line with the progressive consolidation thesis. For example, Kahrs argued that

we do not save for saving's sake, but we save because our debts and interest rates put our children and our grandchildren in a dangerous position. We are taking away their room for manoeuvre. And that is the point: we save for the benefit of future generations (Deutscher Bundestag, 2014c, p. 2244).³²

This argument was pervasive within the SPD because it allowed the party to legitimise fiscal consolidation on its own terms. In the context of demographic change resulting from an ageing society, the SPD attempted to present fiscal consolidation as an inherently social democratic policy (due to its concern with intergenerational equity).

The *Schwarze Null* was also supported due to its popularity. In a survey from the *Forschungsgruppe Wahlen*, 66 percent of the population were in favour of balanced budgets. Schäuble gleefully cited this survey in a parliamentary debate saying that 'if you criticise this fiscal policy, you speak against the broad conviction of the

³⁰Own translation; original: 'Wir sind auf einem guten Weg, die gefährliche Schuldenspirale endlich zu durchbrechen... wir kommen zu der schwarzen Null... Wir Roten kämpfen für eine schwarze Null.'

³¹Own translation; original: 'Nur ein Staat, der finanziellen Spielraum hat, kann investieren, kann gestalten und kann für sozialen Ausgleich sorgen.'

³²Own translation; original: 'Wir sparen nämlich nicht um des Sparen willens, sondern wir sparen weil wir mit den Schulden und den Schuldenzinsen unsere Kinder und unsere Enkel in eine gefährliche Lage bringen. Wir nehmen ihnen nämlich dauerhafte Spielräume. Und das ist der Punkt: wir sparen dafür, dass es zukünftigen Generationen besser geht.'

population as well as the scientific expertise in Germany' (Deutscher Bundestag, 2014b, p. 6420).³³ This was also important for the SPD. Kahrs (personal interview, 16/08/2016) emphasised that 'we cannot find a majority in Germany for an alternative policy, not with our coalition partner and not with the prevailing public sentiment in Germany.' As Thierse (personal interview, 07/09/2016) recalls, there was a widespread belief within the SPD that you could not oppose the dominant sentiment propagated by the media and supported by voters: 'to polarise and argue for debt is not popular... the fear of accumulating debt is higher in Germany than it is in other countries.' Thus the SPD joined the 'competition in which balanced budgets were used as PR strategy to demonstrate economic competence' (political advisor, personal interview, 19/10/2017).

At the same time, the SPD was also aware that Germany's economic positions was threatened by a lack of investments. Before the federal election of 2013, studies by several economic institutes showed that Germany's public and private investments were chronically low compared to other European countries (e.g. Bach et al., 2013). The SPD took up this agenda, and in August 2014 Sigmar Gabriel asked Marcel Fratzscher, the President of the German Institute for Economic Research, to chair a commission tasked to address the problem. Still, the SPD remained cautious and did not support large increases in government spending to finance public investments. When it became clear in October 2014 that the economy was growing more slowly than expected, the party did not abandon the aim of balancing the budget – rather social democrats perceived it as a dual challenge to simultaneously balance the budget and increase investments. Although some politicians within the party accepted that these aims were partly contradictory, the party resolved this challenge by arguing that Germany's big problem was the lack of private and not public investments. For example, in 2014 Oppermann said that 'we do not need any debt-financed short-term flash in the pan programs for the economy, but strategies for more private investments' (Oppermann, 2014).³⁴ As a result, the SPD only pushed for relatively small increases in public investment and, officially, never questioned the doctrine of balanced budgets. For example, in a joint press release the budgetary spokesmen Schneider and Kahrs emphasised the importance of the balanced budget in 2015 and explicitly argued that 'a balanced budget and higher investments are not a contradiction' (SPD Fraktion, 2015). However, in the same press release they stated that 'with higher pub-

³³Own translation; original: 'Sie reden gegen die breite Überzeugung der Bevölkerung wie des wissenschaftlichen Sachverstands in Deutschland, wenn sie diese Finanzpolitik kritisieren.'

³⁴Own translation, original: 'Wir brauchen keine schuldenfinanzierten Strohfeuerprogramme für die Wirtschaft, sondern Strategien für mehr private Investitionen.'

lic investment, we are securing the maintenance and expansion of the infrastructure and thus the future viability of the country’.³⁵

The SPD also did little to oppose European austerity. In the coalition talks with the CDU/CSU, the party dropped its demand for a European debt redemption fund that had been part of its election manifesto (Reuters, 2013). Moreover, the Eurozone policy remained firmly in the hands of the chancellor’s office and Schäuble’s finance ministry, leaving little space for the SPD to shape it. In the *Bundestag* dissenting votes were extremely rare from the SPD (Degner and Leuffen, 2016, p. 11) and the SPD only attempted to challenge the austerity regime on the margins and with limited success. For example, in 2014 Sigmar Gabriel and Thomas Oppermann demanded a softening of the *Stability and Growth Pact*, supporting demands from southern European governments (Zeit, 2014; Gaugele et al., 2014). The SPD, however, failed to consistently oppose European austerity, often shifting its position back and forth. For example, in 2015 when European leaders negotiated a third bail-out package for Greece, the SPD protested against Schäuble’s proposal for Greece to leave the Eurozone. There were rumours that Gabriel had known and approved of Schäuble’s “Grexit” plans, but most SPD politicians opposed the idea. Gabriel, however, could not maintain a clear position. In a column of the *Bild Zeitung* he said that ‘more and more people feel misled by the Greek government... We are not going to let the German workers and their families pay for the exaggerated electoral promises of a partly communist government’ (Bild, 2015).³⁶ A week later, he softened his remarks and commented again in the same newspaper that ‘we all want to help Greece’, saying that he had asked Merkel to ‘save the small people in Germany and Greece’ (Bild, 2015).³⁷ The leader of the SPD was again caught between his pro-European beliefs and the dominant public discourse, which was critical of additional support for Greece. He failed to maintain a clear position, which was symptomatic for the rest of his tenure as party leader.

Finally, public opinion also influenced the SPD’s position with respect to the discussion of Germany’s current account surplus, which intensified in the course of the Eurozone crisis. The left wing of the party was very critical of Germany’s surplus

³⁵Own translation; original: ‘mit höheren öffentlichen Investitionen sichern wir den Erhalt und Ausbau der Infrastruktur und damit die Zukunftsfähigkeit des Landes... Dabei zeigt sich, dass ein ausgeglichener Haushalt und höhere Investitionen kein Widerspruch sind.’

³⁶Own translation; original: ‘Immer mehr fühlen sich von der griechischen Regierung an der Nase herumgeführt... Wir werden nicht die überzogenen Wahlversprechen einer zum Teil kommunistischen Regierung durch die deutschen Arbeitnehmer und ihre Familien bezahlen lassen.’

³⁷Own translation; original: ‘Vor dem heute beginnenden EU-Gipfel hat Vize-Kanzler Sigmar Gabriel (55, SPD) Bundeskanzlerin Merkel (60, CDU) aufgefordert, ‘die kleinen Leute in Deutschland und Griechenland zu schützen... Wir alle wollen Griechenland helfen’, sagte Sigmar Gabriel.

(economic adviser B, personal interview, 15/03/2018), but the party's leadership took a different position. They did not deny that the current account imbalances in Europe were a problem, but they insisted that reducing them was difficult for the government. Steinberg (personal interview, 22/11/2017) argued that 'reducing current account surpluses is not trivial' and, among other things, he pointed to the limited ability of the government to control wages (due to the so-called *Tarifautonomie* in Germany). Yet, the decision to do little about the current account surpluses was also adopted for political reasons. As one economic adviser (personal interview, 31/01/2018) put it, 'how can you explain to citizens that an economy can be *too* competitive and that the current account surpluses can be *too* high?' The SPD did not have a clear economic paradigm to answer this question, which prevented the SPD from challenging the European imbalances.

Discussion: Electoral and ideational pressures for austerity

The politics of austerity

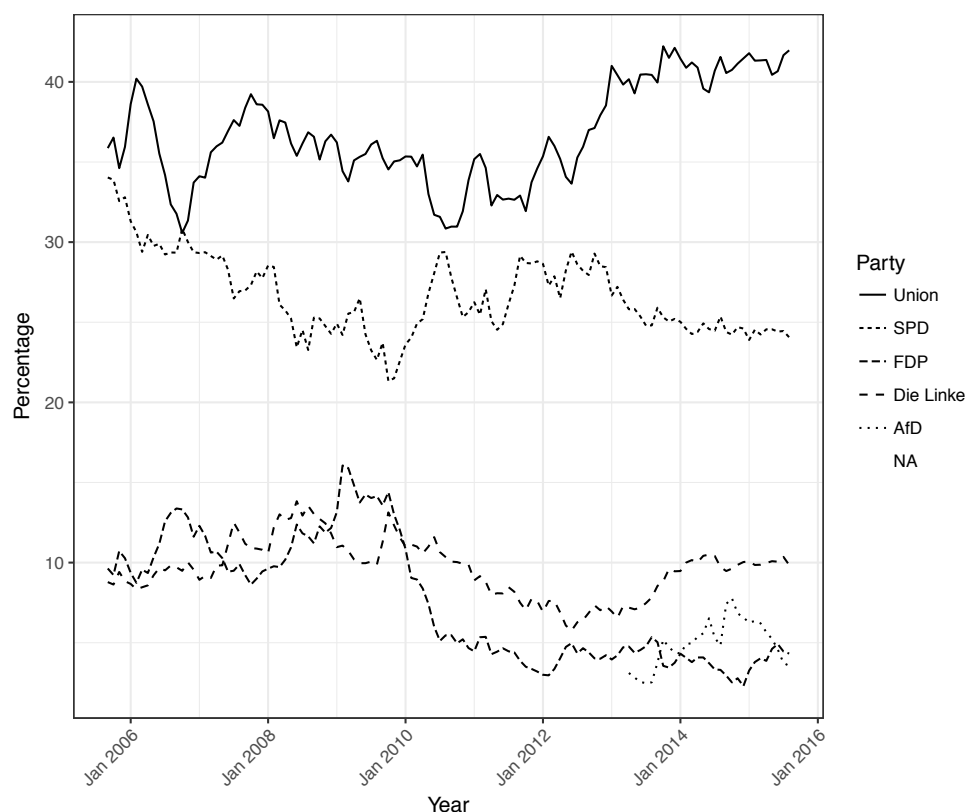
The SPD's fiscal policies were strongly driven by electoral stimulus, as argued above. As concerns about the level of public debt grew larger during the economic crisis, the SPD was quick to ascertain that it was fiscally conservative. In Germany's contemporary political discourse there is a strong suspicion towards private and public debt and Angela Merkel already used the metaphor of the Swabian housewife to whom 'money saved is money earned' in 2008, shortly after the fall of Lehman Brothers (Benoit, 2009). Like the British Labour party (see Chapter 6), the SPD believed that it had take these concerns seriously after Keynesianism had lost its political appeal in the first year of the crisis.³⁸

In this discursive environment, the SPD leadership did not think that they could make a Keynesian argument. The SPD was operating from a position of weakness because it was consistently trailing Angela Merkel's CDU/CSU in the opinion polls (see Figure 7.7) in the period of study. Moreover, in 2009 the SPD experienced its worst election result in the post-war period. Although the party was only a junior partner in Merkel's first grand coalition it had been governed continuously for eleven years. The SPD, which controlled the finance ministry, did not only receive the brunt of the blame for the 2008 financial crisis, but it was also punished for the Agenda 2010.

³⁸ Arguably, Keynesian demand stimulus greatly contributed to Germany's quick recovery after crash in 2008, but it hardly got any credit for it.

The 2009 election, therefore, unsettled the SPD and led to a change in policy because, as Hall (1989, p. 374) already emphasized, ‘the fate of Keynesian ideas ultimately depended on their ability to speak to the interest of the political entrepreneurs who would have to put them into action.’

Figure 7.7: German polls, 2005-2015



Source: Various

One economic adviser recalls that the SPD was ‘always concerned of being portrayed as a party that cannot deal with money’ (personal interview, 31/01/2018) and a party that does not have economic competence’ (Christian Kellermann, personal interview, 17/12/2017). Similarly, another economic adviser argued that ‘the great trauma of the SPD was that it would be portrayed as an irresponsible party’ (personal interview, 15/03/2018) and hence the party leadership joined the conservative frame on fiscal policies. This already became very clear when the SPD supported the *Schuldenbremse*, as shown above. In the words of Ralf Stegner, ‘there were only very few people who really defended the debt break, but it was essentially an opportunistic attitude on the part of the SPD... the concern that we would be portrayed as a

debt-making and tax-raising party if we did not support the debt brake dominated the whole debate' (personal interview, 19/12/2017). In other words, the SPD's support for fiscal consolidation was largely defensive. Reacting to the dominant discourse in Germany, the SPD prioritised electoral calculations over economic ideas. As Dauderstädt said, 'the party was very much driven by public opinion' (personal interview, 05/11/2017).

This was especially true in the context of the European sovereign debt crisis. As the Euro crisis unfolded, voters were constantly presented with warnings about the possible consequences of high public debt and, as a result, 'the European crisis provide[d] critics of government debt powerful images and provides them with great public attention' (Haffert, 2016, p. 27).³⁹ This strengthened the prevailing opinion in Germany and made an alternative domestic and European policy unlikely. In fact, the party leadership came to believe that solid public finances are a useful electoral topic for social democratic parties. Schneider already said in an interview in 2008 that 'I think this is also an absolutely appropriate electoral campaign issue. Balanced budgets and sound finance are a matter of social justice' (Bröcker, 2008).⁴⁰ As Schwan (personal interview, 11/08/2016) emphasised, 'the idea of the Swabian housewife is deeply entrenched in the German society. To oppose it requires a strong counter-argument paired with the courage to make this argument, neither of which existed within the SPD.'

The SPD was particularly afraid of being associated with a position in favour of European debt pooling. In this situation, 'the fear of the *Stammtisch* was always more effective than economic arguments.' (Dierk Hirschel, personal interview, 15/12/2017). Stegner recalls that 'the SPD was concerned about being associated with Eurobonds or other solutions that had even the slightest appearance of a debt union... The SPD feared this debate and the dominant public opinion' (personal interview, 19/12/2017). The SPD therefore made policy with reference to political polls rather than convictions (Dierk Hirschel, personal interview, 15/12/2017; Michael Dauderstädt, personal interview, 05/11/2017). Thierse is critical of this approach in retrospect, but he emphasises that

the perception was that we can neither enforce Eurobonds in our own country nor in Europe... How long do you fight for something in the clear awareness that you can only lose this fight? One should not demand that

³⁹Own translation; original: 'Die europäische Krise stellt den Kritikern staatlicher Verschuldung also mächtige Bilder zur Verfügung und verschafft ihnen große Aufmerksamkeit.'

⁴⁰Own translation; original: 'Ich halte das auch für ein absolut geeignetes Wahlkampfthema. Der Haushaltsausgleich und solide Finanzen haben einen hohen Gerechtigkeitswert.'

a political parties should walk directly into defeat with their heads held high (personal interview, 07/09/2016).

This reveals a very instrumental view among SPD politicians: they prioritised electoral considerations over economic considerations because they did not believe that they could change public opinion (political advisor, personal interview, 19/10/2017). As Binding argues ‘the public discourse was loaded with clichés and stereotypes that an honest discussion was not possible’ (personal interview, 23/11/2017). Instead, the party was always concerned about ‘the mood among the people and... what was written in the tabloid press. If the party had the feeling that a position was not popular, it was dropped due to concerns about the next election’ (Dauderstädt, personal interview, 05/11/2017). Given that in Germany’s federal system, the next important election was never far away, many programmatic decisions were taken ad hoc based on strategic considerations. As Christian Kellermann argued, most SPD politicians were ‘not interested in an academic, system-critical debate’ (personal interview, 17/12/2017).

This path was charted by Sigmar Gabriel, who became the party leader in October 2009. He was a strategic opportunist, who carefully listened to the public mood and opinion polls.⁴¹ One advisor, who closely worked with Sigmar Gabriel, argued that ‘he never gave much thought to any economic theory’ (personal interview, 19/12/2017); another economic adviser recalls that ‘he often followed the majority opinion rather than trying to find a consistent approach’ (personal interview, 31/01/2018). Gabriel did not have a clear economic line and in the context of the Eurozone crisis, he took opposing positions on several occasions, as described above. For example, after he had again proposed Eurobonds with Steinmeier and Steinbrück in the summer of 2011, the SPD was strongly criticised in the media and fell again in the polls. In this context, Gabriel did not dare to stick to his pro-European position and reverted back to German orthodoxy.⁴²

⁴¹ Gabriel even made his decision to step down as a party leader in January 2017 with reference to an opinion poll, which he had commissioned. This style of making decisions was representative for his tenure as party leader from 2009 to 2015.

⁴² Another economic adviser argued that ‘Sigmar Gabriel himself had no clear idea of economic policy and was very much guided by what he perceives to be well received in the surveys and is accepted by the bourgeois press’ (personal interview, 31/01/2018).

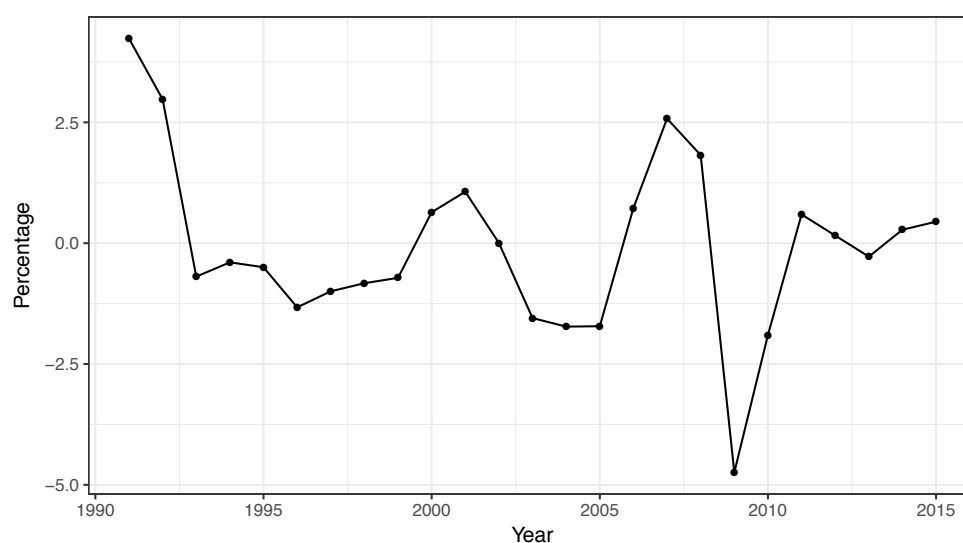
The economics of austerity⁴³

The SPD also lacked the necessary convictions to challenge austerity. Since 1959, the SPD has historically been associated with Keynesianism and an appreciation for Keynes still exist within the party today. Even Johannes Kahrs, who is the head of the so-called *Seeheimer Kreis* (the right-wing of the SPD), agreed with Keynes' theory and argued that 'governments should spend in bad times but in good times they should save so that they can invest in bad times' (Johannes Kahrs, personal interview, 16/08/2016). Keynesianism also influenced the party in the wake of the financial crisis and, eventually, contributed to the party's support stimulus packages that the SPD supported and implemented as part of the grand coalition. However, in the decades prior to the crisis, the SPD had already been strongly influenced by economic ideas that can be described as supply-side Keynesianism and the SPD's support for the austerity settlement was legitimised among social democratic politicians by several tenets of this ideational framework.

As with the British Labour party, there were clear limitations to the SPD's faith in the growth potential of demand-management, which had been largely abandoned by the party after Oskar Lafontaine's departure from government in 1999 (economic adviser B, personal interview, 15/03/2018). Although the SPD supported the fiscal stimulus in 2008 and 2009, these packages did not mark a return to a more comprehensive form of demand management. As argued above, Peer Steinbrück initially even criticised the stimulus programmes in the UK and elsewhere. Due to the size of the economic shock, the SPD ultimately supported two stimulus programmes, but — in line with New Keynesian ideas — the SPD leadership believed that the demand stimulus should only be a short-term remedy to the crisis (Dierk Hirschel, personal interview, 15/12/2017). Furthermore, it did not only justify the stimulus by the necessity to stimulate domestic demand, but it argued that the government had to intervene in order to ensure the long-term productivity of the economy (e.g. SPD, 2009). As a result, the SPD quickly moved away from calls for further demand stimulus as the German output gap narrowed over time (see Figure 7.8) and the economy returned to growth again in 2010. Especially since German unemployment remained relatively low during the crisis, there was a feeling that additional fiscal stimulus was not needed to support the recovery (Christian Kellermann, personal interview, 18/12/2017).

At the same time, influenced by the long-standing German tradition of a strong and independent central bank, leading SPD politicians were convinced during the crisis

⁴³This section partly draws on a paper jointly written with Sean McDaniel entitled 'The Ideational Foundations of Social Democratic Austerity' published in the *Socio-Economic Review*.

Figure 7.8: German output gap, 1985-2015

Source: OECD

period that macroeconomic policy should be left to monetary policy (Gustav Horn, personal interview, 14/11/2017). The SPD leadership never questioned the independence of the ECB and was relatively quiet when other political actors in Germany started to criticise its expansive monetary policy. It understood that monetary policy measures were necessary and also contributed significantly to the stabilization of Europe (Dierk Hirschel, personal interview, 15/12/2017). For example, the spokesman for economic policies Carsten Schneider (2017) argued that ‘we Germans know very well that the independence of monetary policy is a great asset that must be protected: protected against external attacks and political influence. . .’ Despite the SPD’s support for a European growth and employment pact, the party was not convinced that there was a need to shift from monetary dominance towards a different macroeconomic policy mix and remained unwilling to embrace a large European-wide fiscal effort.

The strongest argument for fiscal consolidation within the SPD was based on the notion that it was necessary to ensure the long-term capacity of the state. Since the early 2000s, leading SPD advisers and politicians had argued that consolidating government debt should be a priority. For example, in 2002 Carsten Schneider, a young MP, and Jörg Asmussen, then-chief of staff of finance minister Hans Eichel, wrote a joint position paper in which they argued that ‘saving is not an end in itself.

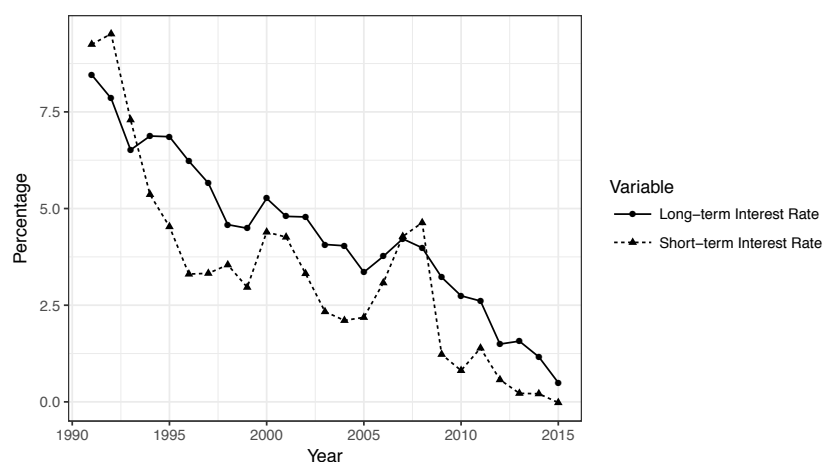
It is a step towards a viable state. It is about creating capacity for an activating state' (Schneider and Asmussen, 2002, p. 8).⁴⁴ This view gained traction during the crisis of the Eurzone as leading politicians from the *Seeheimer Kreis* pushed the progressive consolidation thesis.

This thesis even resonated with some people from the left-wing of the party and found support among the party leadership because it could easily be combined with an argument about generational justice. It allowed the SPD to internally legitimise fiscal consolidation on its own terms. For example, Kahrs (personal interview, 16/08/2016) argued, 'higher debts are a burden on future generations, and it is not fair, from the point of view of generational justice, that we burden future generations with debts that take away all room for manoeuvre.' Similarly, Joachim Poß (personal interview, 22/09/2016) argued that 'there are good reasons that the state gives itself room for manoeuvre: the lower the debt, the higher the ability to act.'

When confronted with arguments about the lack of investment in Germany, the SPD, therefore, also struggled to develop a clear policy. Like the British Labour party, a large part of the SPD had endorsed the Third Way in the early 2000s, accepting that the welfare state should become a social investment state. In the wake of the crisis, the party thus tried to push for more investment – both in human and physical capital. Higher investment in education and childcare was seen as a key to increase the productivity of the economy and Sigmar Gabriel, then party leader and economics minister, actively promoted this policy. Constrained by the coalition partner, however, the SPD was reluctant to call for large increase in government spending. Despite the extremely low interest rates on German government bonds, which would have allowed the government to finance public investment programmes on a very favourable rate (as shown in Figure 7.9), the party was very hesitant to question the *Schwarze Null*; rather, it maintained that the lack of investment could largely be addressed by facilitating private investment and not by public spending. Influenced by the Eurozone crisis, which created an environment where the public consensus against government spending and debt was extremely strong (e.g. Thorsten Schäfer-Gümbel, personal interview, 13/12/2017), the SPD denounced government debt and remained wedded to supply-side Keynesianism, thus believing that public spending would be the cure to the German investment gap.

By adopting this supply-side Keynesianism, the centrist wing within the SPD abandoned Keynes's view that any form of demand stimulus is better than no stimulus.

⁴⁴ Author's own translation. Original: 'Sparen ist kein Selbstzweck. Es ist ein Schritt hin zu einem handlungsfähigen Staat. Es geht darum, Gestaltungsfähigkeit für einen aktivierenden Staat zu schaffen.'

Figure 7.9: Interest rates on German government bonds, 1991-2015

Source: OECD

In the words of Carsten Schneider (personal interview, 20/10/2016), ‘the SPD does not want to build lighthouses that do not have light.’ The party’s leadership still believed that ‘structural problems, and downturns in the economic cycle, need to be addressed with government spending, but we cannot spend for spending’s sake’ (Johannes Kahrs, personal interview, 16/08/2016). In the context of the Eurozone crisis, these ideas also made the party sympathetic to the view that the crisis could not be solved with additional government spending. Instead, the debtor countries needed to follow the German example by implementing productivity increasing reforms. In the words of Steinberg, the SPD does not support ‘vulgar’ Keynesianism but ‘the SPD is concerned about both demand and supply. Sigmar Gabriel always said that “God has given people two arms and not just one.” In other words, the SPD is always concerned with both supply-side and demand-side instruments’ (personal interview, 22/11/2017).

Thus, supply-side Keynesianism undermined the ability of the party to speak out against orthodox economic policies. As a SPD adviser (personal interview, 18/08/2016) emphasised, ‘ideologically, the SPD is not close to ordoliberalism, but it lacks the intellectual rigour to question German dogmatic positions. For most of its history, the party did not have a clear economic and social programme. And even when it had a clear policy, these were often inspired by supply-side economics rather than demand-side economics.’

The SPD trapped and divided

In the context of the economic crisis, the SPD party initially tried to renew its economic programme. Following the 2009 election and the SPD's historic loss, Sigmar Gabriel installed an economic commission, as described above. The commission included a wide range of advisers, including several Keynesian economists.⁴⁵ However, beginning in 2010, when the European sovereign debt crisis unfolded, the party leadership was not focused on developing long-term strategies: 'after the election defeat in 2009, the SPD was willing to debate a new economic policy programme, but this willingness disappeared relatively quickly' (economic adviser A, personal interview, 31/01/2018). Instead, the SPD leadership only reacted to the recurring crises, closely following public sentiment in developing its response (Michael Dauderstädt, personal interview, 05/11/2017). As one economic adviser explains, 'this meant that many of the radical proposal were off the table relatively quickly' and the SPD, instead, chose 'sound bites and positions that seemed acceptable to the German public' (personal interview, 31/01/2018).

However, the SPD was also unable to oppose the prevailing public discourse in Germany and push for an ideational renewal because it was deeply unsettled by its recent past. The *Agenda 2010* destabilised the party and alienated a large part of its core clientèle. Specifically, the SPD was constrained by its past in three different ways. First, the reforms exaggerated changes in the make-up the SPD's electorate and fuelled the rise of *Die Linke* (Schwander and Manow, 2017). Like many other social democratic parties, the SPD had lost the support of many working-class voters and the relationship with the unions had been undermined. Instead, the party was increasingly supported by middle-class voters (Kitschelt, 1994; Gingrich and Häusermann, 2015), who also are more fiscally conservative. The reforms strengthened the narrative that the SPD could only win elections in the centre, which made it more difficult for the SPD to oppose austerity.

This electoral trap was exacerbated because the SPD was in some ways traumatized by experience of the *Agenda 2010*. In 2003, the party leadership dared to push through the reforms against the support of the public and their own party members. Since then, the SPD has been wary of policies and positions that might go against the perceived majority opinion in Germany, which also influenced the SPD in the context of economic crisis. The party was constantly hedging and unwilling to take a clear stance against the conservative position. With regard to fiscal policies, this problem

⁴⁵ As a result, Hirschel argues that 'it was not a lack of ideas, but a lack of political will to implement these ideas' during the crisis (personal interview, 15/12/2017).

was exacerbated because the SPD's leaders were concerned about their reputation for economic competence. They were 'haunted by the reputation that social democrats cannot deal with money' (Björn Hacker, personal interview, 18/08/2016).

Second, the SPD was also caught in an ideational trap as a result of path dependency. The departure of Lafontaine from the party had already discredited Keynesian demand-management in the SPD (economic adviser A, personal interview, 31/01/2018). Since then the 'dominant German narrative that sovereign debt is bad had become firmly established in the party, which undermined Keynesian arguments during the crisis' (economic adviser B, personal interview, 15/03/2018). Instead, it led to the dominance of what Haffert and Mehrtens (2015) call the "progressive consolidation thesis", emphasising that consolidation is necessary to ensure the long-term capacity of the state.

As argued above, this position became more entrenched as Germany emerged from the recession more quickly than most other European countries. Germany's liberal supply-side reforms from the early 2000s were increasingly seen as the reason for Germany recovery in public discourse (Gustav Horn, personal interview, 14/11/2017). As many people from the Schröder-era were still in positions of influence within the party and leadership, they defended the Agenda's legacy. The perceived success of these supply-side reforms entrenched the notion that the economic crisis in Europe should be addressed by structural reforms and supply-side policies rather than by traditional Keynesian demand-management. This undermined the ability of actors inside and outside of the SPD to argue for demand stimulus beyond 2009.

Finally, the *Agenda 2010* exposed the divisions within the SPD. The different factions within the party evaluated the legacies of the liberal reforms differently and disagreed about the lessons from the reforms for the future. These divisions were also very salient in the context of the Great Recession. There were 'fierce debates within the party' (Stegner, personal interview, 19/12/2017) as the left wing made a strong plea for Keynesian stimulus programmes, while the right believed that such Keynesian policies would not work. Importantly, the right wing of the party always maintained its upper hand in these discussions. There were many leading (budgetary) politicians from the influential *Seeheimer Kreis*, who shifted the party platform in their favour. As the European sovereign debt crisis unfolded it gave the the upper hand to this centrist wing, legitimising their argument for orthodox fiscal policies.

Conclusion

In conclusion, the SPD's fiscal policies in the context of the Great Recession were largely driven by electoral calculus and distinct economic ideas. On the one hand, the party's fiscal policies became part of an electoral strategy that the SPD inherited from its recent past. Assuming that elections are won in the centre, the SPD tried to win over fiscally conservative voters (that equate the government's budget with that of a household). Therefore, the party did not challenge the prevailing public sentiment and common wisdom in Germany that is extremely critical of debt. On the other hand, this was also unlikely because the centrist wing of the SPD was influenced by economic ideas that undermined the party's commitment to traditional social democratic fiscal policies. In the tradition of supply-side Keynesianism, the party had already championed supply-side policies prior to the Great Recession. As these supply-side policies helped Germany to come through the Great Recession relatively unscathed, they undermined the ability of traditional Keynesians inside and outside of the SPD to argue for demand stimulus beyond 2009. It limited the ability of the left to challenge the dominant narrative of the Eurozone crisis, which blamed government spending and debt for the economic by the creditor countries for Europe's malaise. The SPD, instead, endorsed fiscal orthodoxy, denounced debt, and joined the chorus of austerity.

In the long-term, this acceptance of fiscal orthodoxy was bad politics, independently of the economics (as further discussed in Chapter 8). It was based on a fundamentally flawed interpretation of representative democracy according to which mainstream parties have to follow popular opinion closely. From this perspective, parties have to represent to gauge public opinion and aim to crafting a programme that creates a winning coalition. The problem with this perspective, however, is threefold: first, it expects voters to have elaborate and coherent positions on a wide range of issues that are often extremely complicated to understand; second, it incentives political parties to move to the centre and appeal to the median voter; and third it turns contentious policies into valence issues. In combination, this leads to a programmatic convergence of mainstream parties and contributes to a hollowing out of Western democracies.

These problems came to haunt the SPD in Germany in recent years because it undermined party's ability to present a coherent economic policy following 2008. While the SPD supported some distinctively left-wing policies in some areas, including the so-called *Kurzarbeitergeld* and the minimum wage, 'the baseline position was not

clear enough' (Thorsten Schäfer-Gümbel, personal interview, 13/12/2017). The SPD lacked a clear economic profile and the orthodox fiscal framework was often even contrary to the policies in some other areas. Moreover, the problem with the fiscal orthodox framework was that the SPD was trying to be *plus royaliste que le roi* or "more royal than the king": it tried to win voters by imitating the fiscal policies of the opponent. This turned fiscal consolidation into a valence issue (Stokes, 1963), which played into the hands of the CDU/CSU. The latter is perceived as the political force that is better at cutting deficits and government debt.^{ss} When the centre-left offers economic policies that become indistinguishable from the centre-right, voters may thus ask why they should vote for the "red" copy if they can also vote for the original. In Germany this situation was made even more difficult for the SPD because under Angela Merkel the CDU/CSU had dramatically shifted its position on social policy toward the left, thereby neutralising much of the SPD's programme on welfare and economic liberalism.

Nine years after the beginning of the Great Recession, this contributed to the defeat of the SPD in the federal election 2017, when the party did even worse than in 2009. The causes of this electoral crisis are multifaceted, but the inability of voters to differentiate between the mainstream parties contributed to the SPD's decline. Accepting the dominant fiscal and economic framework of the CDU/CSU, the party was unwilling to introduce more radical economic policies (like tax increases for the rich or large public investments programmes) that could have given the party a new profile. These positions directly result from the core ideology of the left: if a social democratic party has any meaning, it is the belief that government can improve the livelihoods of people. Austerity challenges this core belief and undermines the electoral appeal of social democratic parties. Although the SPD attempted to campaign on a platform that put social justice front and centre, it thus lacked a coherent vision that challenges the dominant conservative economic discourse in Germany. As long as the SPD does not break free from this discourse, it will remain trapped by its own triangulation.

Chapter 8

Conclusion

Introduction

This chapter summarises the main argument and the empirical findings of the thesis. It discusses the limitations of my argument, but it also highlights the broader contributions and implications of my research. It argues that in recent years the field of comparative political economy has paid too little attention to the politics of macroeconomic policies, and in particular that it has ignored the importance of electoral considerations. The thesis attempted to address this short-coming. It focused on social democratic parties and explored whether and how political parties matter for the development of macroeconomic policies. Importantly, in doing so, the thesis helps to explain the dominance of the austerity settlement in post-crisis Europe. Beyond highlighting the contributions and limitations of the thesis, this final chapter re-evaluates why social democratic austerity failed as both a political and an economic strategy. It links the findings from the previous chapter to (1) the main economic problems of our time as well as to (2) the current crisis of social democracy. In other words, the thesis ends by discussing the fate of social democracy in Europe in the 21st century. It considers whether and how social democratic parties can move beyond the austerity settlement after the Great Recession and argues that social democratic parties need to push for an ideational renewal and abandon their focus on short-term electoral gains in order to regain their place in heart of European politics.

Summary of the Argument

The thesis argued that social democratic parties accepted austerity as the dominant economic policy in Europe's post-crisis political economy. As Chapter 3 showed, social democrats had an ambiguous response to the Great Recession. They acted strategically and increased the salience of economic issues, but they also moved to the left on many economic issues. Among other things, they again became more sceptical of economic liberalism and questioned the dominance of unregulated (financial) markets. This reversed key elements of the Third Way, which social democratic parties had embarked upon prior to the Great Recession. However, Chapter 3 also shows that social democratic parties did not shift to the left in post-crisis Europe on all issues; rather, social democratic parties supported the reduction of government deficits and taxes during the crisis. In some countries, social democrats shifted towards the right on questions relating to budgetary rigour (e.g. the Netherlands, Greece), while they retained very centrist positions in many other countries (e.g. Germany, France, UK). As a result, social democratic parties generally bought into the austerity settlement that has dominated Europe's post-crisis political economy, and the remaining parts of the thesis attempted to explain this surprising outcome.

Electoral foundations of social democratic austerity

Concretely, the thesis explained social democratic austerity in three steps. First, it argued that social democratic austerity was conceived as an electoral strategy to appeal to fiscally conservative voters. Chapter 4 used data from the Eurobarometer and showed that a large amount of voters felt uneasy about their country's government debt. At the beginning of the crisis, more than 70 percent of respondents in the EU agreed that fiscal consolidation could not be delayed and even in 2015, after Europe had endured a large amount of austerity, there was still a majority of respondents who supported fiscal consolidation. Chapter 4 attempted to explain this staggering support for fiscal consolidation, and it is – to my knowledge – the first study to systematically investigate the public's "debt aversion" across a large amount of countries. The results suggest that the household analogy was very strong during the economic crisis in Europe: voters equated the public deficit with that of a private household and responded to changes in the economy in an anti-Keynesian fashion. They endorsed the popular notion of tightening one's belt during hard economic times, precluding any discussion about large-scale fiscal stimulus packages, infrastructure investments,

or debt relief – all of which would have undermined the austerity settlement and strengthened the recovery in Europe.

The thesis thus argues that social democrats accepted austerity for strategic reasons. Based on the voter's personal experience of balancing their private budget, fiscal consolidation resonates more with the median voter than Keynesian deficit spending, and the case studies in Chapter 6 and Chapter 7 showed that both the British Labour party and the German SPD were very concerned with appealing to this voter. Both parties were portrayed as strategic actors that are confronted with a common problem: the need to establish economic competence and credibility in the eye of the electorate. This need became larger in the wake of the 2008 financial crisis because many social democratic parties, including the British Labour party and the German SPD, had been in government prior and during the financial crash. They received most of the blame for the crash and saw their economic competence shattered. In combination with a large amount of distrust among voters towards government debt, this pushed them towards fiscal orthodoxy, as they attempted to regain a reputation for fiscal credibility. In Germany this pressure towards fiscal orthodoxy was especially large as Chapter 4 showed, but it was also significant in the UK. Based on their prior experience in the 1990s and 2000s, the leading social democrats were convinced that their path to power leads through the centre. They were hoping to win this centre-ground by adopting austerity even though such policies hurt their traditional constituencies.

However, based on evidence from Chapter 5, my thesis suggests that social democratic parties actually had more leeway to develop alternative fiscal policies than they realised. The chapter used survey experiments to study preferences towards fiscal policies more carefully. Concretely, it used a split-survey experiment and a conjoint survey experiment to show that fiscal consolidation is less popular than social democrats assumed. Citizens support fiscal consolidation in principle, but it is not a priority for them; rather, they are more concerned about the level of government spending and taxation. Especially voters on the left seem to be more concerned about protecting government spending and thus they should also be less supportive of austerity, which has largely come at the cost of government spending across Europe. Despite the consensus on fiscal consolidation that Chapter 4 identified, social democrats, therefore, had more scope to interpret and influence public opinion than they thought. Put differently, the electoral-strategic concerns that strongly influenced the social democratic fiscal policies in response to the Great Recession were restricted by their limited understanding of public opinion.

Ideational foundations of social democratic austerity

Going beyond the demand-side of politics, the thesis showed that these electoral-strategic pressures for social democratic austerity interacted with ideational pressures. Social democrats essentially interpreted the Great Recession through the lens of the 1970s, and not through the lens of the 1930s: they believed that the crisis was not due to a lack of aggregate demand – at least not after the initial “fire fighting phase” in response to the 2008 financial crisis was over. To a certain extent, of course, the early crisis response in 2008 and 2009 was a success: it did not only prevent a total collapse of the financial system, but it also prevented a collapse in employment and a flight into protectionism. Consequently, the most common interpretation was that the system “worked” (e.g. [Drezner, 2014](#)) and most policy-makers remained wedded to their old economic models and ideas.

This was also true among social democratic policy-makers, which undermined their ability to challenge the dominant economic paradigm. In response to the economic upheavals of the 1970s and the 1980s, many actors from the centre-left had bought into a new set of new economic models, which I collectively call “supply-side Keynesianism”. Based on New Keynesianism, endogenous growth theory and the social investment paradigm, they argued that the state needs to intervene in the economy and manage demand in the short-run, but that the state should only intervene to improve the supply-side in the long-run. During the crisis, this focus on the supply-side helped to legitimise austerity among social democratic politicians and policy-makers.

In particular, supply-side Keynesianism contains three key tenets of significance to understand this: a reduced importance of the output gap compared to Keynes’ original theory; a prioritisation of monetary over fiscal policy; and a focus on utilising the state to generate long-run growth and more equitable outcomes, alongside a belief that the state’s fiscal capacity must be protected to ensure this, the so-called progressive consolidation thesis ([Haffert and Mehrrens, 2015](#)). To a certain extent, of course, these ideas may overlap with neo- and ordoliberalism. Moreover, it is clear from the case studies above that the central tenets of supply-side Keynesianism have been drawn upon and utilised in subtly different ways by social democrats depending upon their specific national and economic contexts and policy legacies. However, as the two case studies illustrated, together they provided for a distinct ideational foundation which has shaped the way in which social democratic actors engaged with austerity post-crisis. Especially the German SPD firmly embraced supply-side reforms in the pre-crisis era, and they remained wedded to the underlying economic models during

the Great Recession even though Germany had more fiscal leeway than most other countries.

Therefore, my thesis confirms that the problem for social democratic parties during the crisis was ‘one of ideas and politics, rather than ineluctable economic necessities’ (Keating and McCrone, 2013, p. 10). Unwilling to support “old” Keynesian policies and unable to develop new economic policies, contemporary social democratic parties were trapped by their economic ideas and failed to lead the opposition against the dominant macroeconomic regime (Blyth and Matthijs, 2017).

Social democracy trapped and divided

Accepting that there were strategic as well as ideational pressures for austerity during the crisis, however, begs the question why there were not more actors among the centre-left that attempted to push for an anti-austerity agenda. It remains puzzling why social democratic parties were not trying to engineer a paradigm change, as defined by Hall (1993). The answer that emerged from the case studies in this thesis considers the legacy of the Third Way. Based on the notion of path dependence, the thesis argued that the Third Way trapped and divided social democratic parties: they were electorally trapped because the Third Way had alienated some of its traditional electorate; they were ideationally trapped because the implementation of supply-side Keynesianism had marginalised ideas and actors who were committed to a demand-side view of the economy; and it left the centre-left divided.

In response to the Great Recession, social democratic parties thus looked backward as they were afraid to look ahead. They failed to develop new ideas and programmes and did not attempt to challenge austerity. Partly, this was also a question of leadership: the centre-left lacked strong leaders, who were willing and/or able to overcome the legacy of the Third Way. Mobilising public opinion against austerity would, of course, have been a challenge for any leader (given the difficulty to explain Keynesianism to voters), but arguably the leaders of the British Labour party and the German SPD were especially ill equipped to do so.

In the UK, neither Gordon Brown nor Ed Miliband were strong enough to assert their authority on the party. The Third Way and the divisions between its main architects, Tony Blair and Gordon Brown, had divided the party into different warring camps. Consequently, both Gordon Brown and Ed Miliband, were attacked from all sides and unable to formulate a coherent anti-austerity agenda. As an unelected Prime Minister, Gordon Brown was extremely concerned about winning the election in 2010, and

although his economic instincts were right, he gave in to strategic-electoral considerations when he accepted the “Darling plan”. Similarly, Ed Miliband, who succeeded Gordon Brown as the leader of the Labour party, was unable to ignore these considerations. He was concerned with holding the party together, and when the Labour party gained a lead in the poll mid-way through the parliamentary term, the promise to return to government in 2015 made him very cautious in programmatic terms.

Similarly, in Germany the SPD was left without clear leadership after the end of the Schröder era in 2005. Several party leaders failed to establish their authority on the party from 2005 to 2009, and when Sigmar Gabriel became the leader of the party in 2009, a position that he held for more than seven years, he was unable and unwilling to push for new economic models. As emphasized in Chapter 7, he was a strategic pragmatist, who did not have a clear economic vision. Despite promising a renewal of the party’s programme in 2009, Gabriel was less interested in academic debates about the role of the state vis-a-vis the markets and more interested in policy initiatives that would bring short-term electoral gains. Although Gabriel was able to unite the party and to renew its relationship with the trade unions, he also undermined the party’s ability to position itself clearly and develop new ideas for the future.

However, in both countries it is wrong to place the blame on the party leaders alone. For a long time there were no actors in sight in either Germany or the UK, who were able to lead a broad alliance against austerity. Jeremy Corbyn has emerged as the only politician willing to attempt this formidable task. His change in rhetoric towards an anti-austerity platform has revived the Labour party, but until this day Jeremy Corbyn and his shadow Chancellor John McDonnell have not put forward fiscal policies that are very different from the policies under Ed Miliband and Ed Balls, either. They, too, are committed to a “fiscal credibility rule” and, ahead of the 2017 election, they even pledged not to reverse many of the spending cuts that the Conservatives had implemented. Even for the most radical social democratic actors it thus remains a challenge to move beyond the austerity settlement, as the Great Recession is still viewed as a fiscal crisis of the state.

Contributions and limitations of the thesis

Limitations

Like any scholarly work, my thesis has several limitations, which are important to recognise. In particular, these limitations can be grouped into three different themes.

First, the thesis focused on a few selected parties, despite wanting to explain social democratic austerity in general. By focusing on the broad acceptance of austerity across Europe, it focused on the similarities across cases rather than the differences between them. In other words, it fell short in considering variation in the extent to which different social democratic parties accepted austerity during the Great Recession. In order to live up to this task, future research should consider the dilemma and strategic positions of social democratic parties in a broader range of countries. In particular, it would be useful to study parties in Southern Europe and other debtor countries, where external constraints from the EU and financial markets were stronger. I would expect that even in these countries social democrats were influenced by strategic-electoral considerations as well as their economic ideas, but it would be useful to probe into this more carefully, and to analyse the interaction of the variables identified in this thesis with external constraints.

Similarly, further research should test whether the argument of this thesis also holds in Scandinavian countries. In these countries, social democracy has been dominant for most of the 20th and 21st century and it is unclear whether and how this dominance influences the strategic considerations of parties. Given that the SAP in Sweden was one of the first social democratic parties to pursue fiscal consolidation in the 1990s (see Chapter 2), I expect that the argument still holds, but it would be useful to study this explicitly. Such an addition of further cases would also help scholars in comparative political economy to better understand the politics of fiscal policies in countries with different growth models (Baccaro and Pontusson, 2016) or welfare state regimes (Esping-Andersen, 1990).

Second, the thesis also largely ignored important variables internal and external to social democratic parties, which future research should focus on. On the one hand, social democratic parties do not operate in isolation, but they are inevitably linked to other parties in a complex array of interactions. My framework could not fully take into account the importance that these actors play for social democratic austerity. Does social democratic austerity become more or less likely when there is a challenger on the radical left? To what extent does the position of the centre-right influence social democratic parties? Are social democratic parties more likely to accept austerity in certain electoral or party systems? And how is social democratic austerity influenced by the position of trade unions and other actors on the left? These questions touch upon the relationship between social democratic parties and other actors in different political arenas, which may well influence whether and to what extent social democratic parties accept austerity.

On the other hand, the election of Jeremy Corbyn as the leader of the Labour party in 2015 also suggests that variables internal to parties are important in order to explain social democratic policies. Corbyn was elected by the membership of the Labour party after Ed Miliband had changed the rules for electing the party leader. This change in rules paved the way for a bottom-up mobilisation, enabling an insurgent candidate from the far-left of the party to win the leadership. Afterwards, Corbyn attempted to move beyond austerity and, at least rhetorically, he was able to position the party further towards the left than Ed Miliband and Gordon Brown had done before him. This shows that the intra-party organisation, including the rules for electing party leaders, can be extremely important to understand the economic policies of parties. Following the example of [Kitschelt \(1994, 1999\)](#), scholars at the intersection of political economy and electoral politics should take this into account in future research, considering more carefully how the strategic environment that parties face and different intra-party organisations matter for economic policy-making.

Finally, the thesis paid little attention to the actual implementation of austerity by social democratic parties. But even if there are common electoral and ideational foundations of social democratic austerity, this does not mean that austerity will always look the same in practice. For example, a cursory glance at the headline figures suggest that the French Socialists, which implemented austerity during the presidency of François Hollande, pursued austerity by focusing more on taxation of income and wealth than spending cuts. Based on campaign promises and their programmatic stances, both the Labour government in the UK (in a single-party government) as well as the German SPD (in coalition government with other centre-left parties) might have done this less so. Consequently, future research in this area should provide a more systematic comparison of the way in which different political families in Europe have implemented austerity and analyse whether and to what extent there is also a distinct form of social democratic austerity in practice.

Contributions

Despite these limitations, there are also several contributions of this thesis that are worth highlighting. First, the thesis contributes to a growing literature on the politics of macroeconomic policies. It attempted to bring the electoral turn to the study of fiscal policies and showed that in order to understand the economic crisis, and policy-makers' reactions to it, we do not only need to study economic interests and institutions; rather, we also need to understand the constantly shifting field of electoral politics. The failure of the existing literature to adequately explain social demo-

cratic austerity is partly due to the focus of comparative political economy on elites and the institutions within which these elites operate. The literature has paid little or no attention to the ideas that appeal to the public at large, i.e. to the demand-side of politics, and this is particularly true for the literature on fiscal policies. Given that government revenue and spending both have enormous consequences for citizens in advanced economies, this should be changed. My thesis attempted to make a first step in this direction by (1) analysing people's attitudes towards fiscal consolidation and by (2) considering if and how parties respond to these pressures from the demand-side.

Second, the thesis developed a distinct ideational conception of social democratic austerity. It contributes to a constructivist literature, which shows that different ideas mean different things to people and highlights the importance of how differential ideational processes serve to legitimise policies among different actors (Ban, 2016). This is more than an exercise in typology building or ideational hair-splitting; rather, the thesis suggest that one can only fully understand the prevalence of austerity across the mainstream European political spectrum through acknowledging the ideational foundations of social democratic austerity, i.e. the ideas and economic theories on which it is built and legitimised. That is not to suggest that social democrats have never previously employed austerity policies, nor that there is no overlap between these ideas and neo- and ordoliberalism. However, the core tenets of supply-side Keynesianism outlined above are distinct and significantly influenced social democrats in Europe's post-crisis period in particular.

Third, by acknowledging the electoral-strategic as well as the ideational pressures for social democratic austerity, the thesis also helps to explain the dominance of austerity in post-crisis Europe. It emphasises that the austerity settlement was so strong for two reasons because it was both politically and economically powerful. It builds on an intuitive understanding of the economy that resonates with a broad spectrum of the population, endowing it with enormous political force. Supported by the differential ideational processes that have served to legitimise austerity among very different political actors, this has contributed to the dominance of the austerity settlement in Europe. In this way, the thesis helps to explain the ideological dominance of an economically flawed policy.

Fourth, the thesis also helps to explain why paradigm change is slow and difficult. It emphasises that office-seeking politicians are constrained in their ability to push for paradigm change. They have an incentive to respond to public opinion, which is relatively fixed in the short-run. Given that politicians' discourse and rhetoric

have a decisive impact on public opinion in the long-run (see e.g., O'Grady, 2018), the previous paradigm is usually deeply entrenched in public opinion. Even during economic crises political reality is rarely clear enough for the public to recognise the anomalies within a given paradigm. This constrains office-seeking politicians, who first and foremost care about their electoral prospects, and gives them an incentive to look backward and not ahead. Politicians and parties are thus not in the best position to engineer paradigm change and scholars in political economy need to re-think when paradigm is likely, and who the actors are that are most capable to push for such a paradigm change. To this end, political economy should invest further in research on the relationship between the supply- and demand-side and analyse the conditions under which politicians and other actors have been able to change public opinion.

Social democratic austerity and its consequences

Beyond these contributions, the reader might be left wondering whether social democratic austerity worked. In the end, my argument highlighted that austerity was a powerful idea because it was portrayed as a political *and* economic virtuous policy among social democrats: austerity was as politically powerful because it appealed to a popular understanding of the economy and it was economically powerful because it was supposed to safeguarded the fiscal position of the state (thereby ensuring the ability of the state to intervene in the economy in the long-run). To answer whether social democratic austerity lived up to this promise then requires to consider two different question: (1) did social democratic austerity work as an economic strategy? and (2) did social democratic austerity work as an electoral strategy? Below, I will attempt to answer both questions.

Social democratic austerity and the economic predicaments of our time

The debate about the merits of austerity are ongoing, but there is a growing consensus that austerity in Europe was harmful. To begin with, high levels of government debt or high government deficits did not cause the crisis. To the contrary: the crisis caused high deficits. The sharp fall in GDP in 2008 and 2009 reduced the revenues that governments could collect through taxation, but it increased governments' expenditures as the automatic stabilisers kicked in. At the same time, massive bank bailouts further increased government deficits across Europe, and the broad turn towards fiscal ortho-

doxy that began in 2009 confused cause with effect (Tooze, 2018). High government deficits were the result of a global fall in demand and austerity, therefore, also made little sense as a policy in the post-crisis context (Matthijs and Blyth, 2018; Matthijs, 2016; Blyth, 2013). As a result, there is increasing evidence that austerity made the crisis worse (e.g. Blanchard and Leigh, 2013; Heimberger, 2017), and in fact, it can be argued that austerity contributed to the most important economic predicaments of our time.

First, the recovery in post-crisis Europe and in other advanced economies (but especially in Europe) was very slow. In this context, Lawrence Summers (2014) rehabilitated the concept of “secular stagnation” by Alvin Hansen. Hansen had developed the term with reference to the US economy in the 1930s, arguing that the essence of secular stagnation ‘were sick recoveries which die in their infancy and depressions which feed on themselves and leave a hard and seemingly immovable core of unemployment’ (Hansen, 1939, p. 4). In 2014, Summers used this concept to talk about the economic recovery after 2008. Scholars have since debated the question of secular stagnation (see e.g., Gordon, 2015; Eichengreen, 2015a; Teulings and Baldwin, 2014; Eggertsson and Mehrotra, 2014), but there is growing consensus that the post-crisis environment is characterised by a lack of aggregate economic demand.

In this sense, the Great Recession was very different from the crisis of the 1970s and 1980s, which many policy-makers failed to realise. As Hansen (1939, p. 4) already argued, an economy needs strong and healthy levels of investment to maintain full employment. Yet, in post-crisis Europe, austerity undermined the conditions for such investment. By cutting government spending and/or raising taxes, governments reduced aggregate demand and thereby prevented, or at least significantly hampered, the recovery in Europe. The argument that governments can spend the money that they save on interest to pay for teacher and nurses sounds intuitive, but it assumes that governments find places to cut spending and to reduce debt in the first place. Evidence shows that governments first cut spending on investments (Breunig and Busemeyer, 2012; Haffert and Mehrtens, 2015), which is bad for the long-term health of the economy, and therefore, also reduces the resources that governments have available to spend on nurses and teachers.

Consequently, the austerity settlement in general, and social democratic austerity in particular, has had significant economic costs in the short- and long-run. It failed to recognise that the simple comparison of the government budget and the private household is wrong. Cutting government spending did not only deepen the slump by reducing aggregate demand further, but by reducing growth, it also worsened gov-

ernments' debt burden (since debt is usually measured in relative terms to GDP). Austerity was thus bound to be a failure from a Keynesian perspective, as it ignored the fallacy of composition. Given that the income of one economic agent is the expenditure of another agent, it is impossible for everyone to deleverage at the same time without creating economic disaster. Austerity, therefore, contributed to a deflationary bias in Europe and undermined the conditions for long-term productivity increasing investments.

However, the austerity settlement was also particularly harmful for the development of individual regions. Increasingly, there are growing regional disparities in economic growth and wealth in advanced economies. Many individual regions are left behind, leading to pocketbooks of economic stagnation. While some areas recovered quickly from the Great Recession, including those with strong financial centres that were at the heart of the original crash to begin with, others have suffered from regional decline that was made worse by the recession. This has contributed to increasing resentment against political and economic elites and even undermined the stability of European democracies. These problems of aggregate and regional stagnation require more public investment in physical infrastructure and human skills and an active management of demand than a focus on the economic supply-side can deliver. Austerity undermined all of this, and by mainstreaming this policy, social democratic parties need to take some blame for this.

Going beyond macroeconomic considerations, Thomas [Piketty](#) ([2014](#), [2015](#)) and many other scholars (e.g. [Saez and Zucman](#), [2016](#); [Milanovic](#), [2016](#); [Stiglitz](#), [2012](#)) have pointed to the second main economic predicament of our time: the tremendous rise in income and wealth inequality. Although the way that austerity was administered differed across countries, it generally also had a negative influence in this regard. In Europe, austerity was first and foremost implemented by reducing government spending, which also undermined the welfare state in Europe. Cuts in benefits, pensions, and other forms of government spending largely hit the poor, while the rich were spared from the costs of austerity. In some countries, social democratic parties increased taxes on the rich (e.g. in France), but in general the wealthy did not take the brunt of the measures. As a result, austerity shifted the burden of adjustment on the shoulders of the weakest members of society and further increased inequality.

Austerity thus contributed to the main economic problems of our time and it can hardly be claimed that it worked as an economic strategy. Even ignoring the costs that austerity had for economic growth and inequality in post-crisis Europe, in most countries it did not even lower the debt burden, and therefore, austerity also failed on

its own terms.¹ It hardly freed up resources for the state to invest in long-run growth and left most European countries vulnerable to the next possible crisis.

Social democratic austerity and the current crisis of the left

Social democratic austerity, however, did not only fail as an economic strategy; it also failed as a political strategy. Although I have not had space to consider it fully, it seems clear that austerity had negative implications for the current electoral crisis of the centre-left. In the last few years, these parties have been decimated in countries like France, Greece, Ireland, or the Netherlands and lost elections in many other countries such Germany, Italy, or Austria. Even in Scandinavia, formerly a stronghold of social democracy, the centre-left has lost support and recently gained less than 30 percent in the 2018 Swedish elections. This raises the difficult question why, if social democratic parties accepted austerity for strategic reasons, it actually hurt them in the end.

To answer this question it first is important to acknowledge that the crisis of social democracy is multi-faceted and cannot be explained by a single factor. In fact, the second dimension of politics as well as the different long-term structural dilemma (discussed in Chapter 2) play a central role in the contemporary crisis of social democracy. Austerity may thus not necessarily a, let alone the most significant, reason for the contemporary crisis of social democracy in the first place.

That said, there is evidence that the acceptance of fiscal orthodoxy was bad politics, independently of the economics. In the post-crisis era, such parties have not found a convincing narrative on austerity to legitimise it among the electorate, unlike the centre-right or, indeed, the post-War Labour government in the UK, which implemented austerity and simultaneously built the British welfare state. Unwilling to support “old” Keynesian policies, contemporary social democratic parties were trapped by their economic ideas and failed to lead the opposition against the current macroeconomic regime (Blyth and Matthijs, 2017), while acknowledging that the political and economic consequences of this regime are wholly unsatisfactory.

Social democrats still tried to portray themselves as the protector of the welfare state in election campaigns (see Chapter 3), but they have not shown what this means in practice. By accepting austerity, they shifted the burden of adjustment to the weakest

¹The main exception here is Germany, which has recently seen a significant fall in government debt. This was only possibly because Germany externalised the problem of demand by running an export-led growth model, as discussed in Chapter 7.

members of society (as discussed above), which undermined their own programme: without a clear idea about how the state should protect citizens from the market, social democrats failed to be a strong force during the crisis and did not live up to their historic promise to make capitalism socially acceptable. It left many people in a vulnerable position and contributed to the feeling that social democracy has become an empty and obsolete term. This brand dilution, in turn, contributed to a decline in support for social democracy parties in recent years.

Moreover, by accepting austerity, social democratic parties effectively turned fiscal consolidation into a valence issue. As argued in this thesis, they attempted to neutralise the topic by imitating the political opponent, and in this sense, social democratic austerity was a strategic policy. In hindsight, however, this strategy back-fired. It was based on a fundamentally flawed understanding of representative democracy or, to use Peter Mair's terms, an excessive amount of "responsiveness" (Mair, 2013). In representative democracy, political competition cannot be limited to valence issues because politics is also more than the technocratic management of the economy. By accepting austerity, social democratic parties failed to offer a clear alternative and foreclosed any political discussion about the distributive consequences of austerity. It contributed to a convergence of mainstream political parties and a hollowing out of democracy.

This was a strategic mistake in the short- and long-run. In the short-run, social democrats tried to reduce the salience of fiscal consolidation as an issue. However, in the context of the economic crisis this strategy was not very effective because the crisis was widely interpreted as a sovereign debt crisis. Rightly or not, social democrats are generally perceived as less competent with regard to cutting spending and raising taxes, and social democratic austerity thus gave the centre-right a strategic advantage: the conservatives were not only able to claim that they supported the right economic policies, but they were also able to claim that they were best at implementing them. In this sense, the centre-left joined a game that it could hardly win: no matter how frugal social democrats promised to be, the centre-right always put the bar a little bit higher. In this way, social democratic mainstreamed austerity, entrenching the notion that it was a necessary evil, without reaping any electoral gains.

In the long-run, austerity also undermined the position of social democratic parties because it created space for populist political forces to emerge on both the left, including the Syriza, Podemos, and Jeremy Corbyn within the British Labour Party, and the far right. Evidence is emerging, which shows that austerity is not a priority for voters (Chapter 5) and that austerity has large political costs for governments that

implement it (Bojar et al., 2018; Hübscher et al., 2018). Put differently, austerity created a large amount of political discontent and the new populist forces in Europe have been able to capitalise on this discontent, while the centre-left has been sidelined. This is in line with existing research that there are long-term costs associated with moving to the centre for the left (e.g. Karreth et al., 2013). Moreover, evidence that the current crisis of social democratic parties is, in fact, not a crisis of the left in general supports this claim: while social democratic parties are struggling, other left-wing parties, including the Greens and the far left, are gaining traction.

These new forces on the political left are unlikely to go away any time soon, as the centre-left is experiencing the deepest electoral slump that the social democratic movement in Europe has experienced since the Second World War. Social democratic austerity was, therefore, a colossal failure in both political and economic terms. It contributed to the main economic problems of our time and locked the centre-left into a deep crisis in Europe. Sidelined by the centre-right and deeply unsettled by the rise of populism, the centre-left has lost both its political and economic compass. As a result, Europe's social democratic parties are losing, while the people are hurting.

Social democratic policies for the 21st century

The economic crisis in Europe, therefore, also contributed to a deep crisis of the centre-left. But while Europe's economies are slowly climbing out of this crisis, the centre-left has a lot more soul-searching to do in order to get out of its own crisis. In particular, it has to think more carefully again about the relationship between the market and the state in the 21st century and how it can use the state to implement policies that rigorously promote social solidarity across Europe. To this end, it will not be enough for the left to "pour old wine in new bottles", i.e. the left can neither simply revert to old style socialism nor accept the power of the market. Instead, the left again has to become an innovative force that sets out a coherent political alternative and changes the basic perimeters about how the economy is governed.

Following Berman (2006), the *raison d'être* of social democracy is to find a compromise between capitalism and democracy. Europe's social democratic parties were good at living up to this task in the post-war period: they had a vision to create and deepen the welfare state and to use the state to counterbalance unfettered market capitalism. Today, however, social democrats are failing at this task and this failure goes back to the 1990s.

In 2000, Perry Anderson already wrote in the *New Left Review* that ‘the only starting point for a realistic today is a lucid registration of historical defeat. Capital has comprehensively beaten back all threats to its rule.’ The pessimism expressed in this quote was at the heart for the Third Way. Third Way social democrats did not challenge the underlying faith in free markets but only moderated it. The rhetoric around the Third Way further consolidated the support for markets, thereby changing public opinion and the dominant discourse about how the economy should be governed to their own disadvantage. This is not to say that Third Way social democrats did not come up with effective policies to improve the livelihoods of many people – they certainly did. However, social democrats failed to articulate a broader vision about the relationship between the market and the state. They turned away from discussions about the nature of capitalism and adopted a more technocratic or managerial outlook, accepting that the left has nothing to offer that is fundamentally different from the right.

In other words, the main problem with contemporary social democrats is that the perpetual market accommodation and support for supply-side economics meant that they were unable to develop new approaches towards governing the economy. Supporting the underlying notion that economic agents are rational and that the market is the most efficient and effective allocative mechanism, they could not question the dominant paradigm of our time. This contributed to a perpetual centrism among social democrats: concerned with building a broad coalition from the left towards the centre, they failed to draw lines and to identify their natural opponents. They did not just lose the argument, but they also failed to articulate a vision of what social democracy is for.

In the context of the 2008 financial crisis, this came to haunt them. As markets were failing, social democrats were unable to develop a coherent response. Although many people expected the crisis to an opportunity for intellectual renewal of the left, this did not materialise. Rather the financial crisis led to a narrow debate surrounding finance, but it did not lead to a more fundamental debate about the role of the state in the economy. This intellectual and electoral weakness of the centre-left comes at a time, when it is needed more than before. The main economic problems of our time, (regional) stagnation and inequality, are further aggravated by large structural changes – including digitalisation, demographic change, and globalisation to only name a few – that are changing the basic perimeters of our economies rapidly.

There is not a lack of ideas that social democratic parties could use to address these problems and to develop a new economic programme. Economists like Thomas

Piketty and Lawrence Summer have not only provided influential diagnoses of our contemporary economic difficulties, but they also suggested many ideas about how to respond to them. To take up many of these suggestion, however, social democratic parties need to move beyond supply-side Keynesianism. In the last few years, monetary policy struggled to create growth and a focus on supply-side policies was unable to reinvigorate Europe's economies. Therefore, it becomes vital for social democrats to develop active fiscal policies. They should espouse public investment in human and physical infrastructure and actively manage economic demand to kick-start Europe's economy again.

This macroeconomic framework needs to be combined with social programmes that support the weakest member of our societies and, in the face of widespread automation, social democratic parties even need to think about decoupling this support from the notion of work (for example by supporting some form of a universal basic income). This would protect individual citizens from the disruptive effects of large-scale transformations and help to address both rising inequality and the persistent secular stagnation. It would help to create a new form of "embedded liberalism" (Ruggie, 1982), where the welfare state empowers individual members of the society and shelters them from disruptive global economic processes.

To pay for this programme, however, social democratic parties would also need to increase the capacity of the state again. They should argue for increases in taxation on the rich – to address inequality – and on corporations – to raise the necessary financial resources. Moreover, they should push for new meaningful state institutions that are connecting with citizens in multiple and more positive ways than before. For example, new institutions for self-government, like participatory budgetary processes, could empower people again in an economic and political sense, and allow individual regions to address, and eventually overcome, their different economic problems.

Implementing such a programme would not be easy. From an economic perspective, many of these policies will inevitably create some inefficiencies and in today's globalised economy there will be leakages and externalities. However, the bigger challenge for social democrats will be to implement such policies politically. As emphasized in Chapter 2, in the short-run politicians often have to work with policy preferences that are essentially fixed. In the medium- to long-run preferences are subject to dynamic change, however, which is endogenously influenced by policy-makers and politicians. In the 1990s, Pierson already argued that politicians could use this to overcome the large support for the welfare state and achieve retrenchment. He

suggested that ‘if retrenchment advocates can re-structure the ways in which trade-offs between taxes, spending, and deficits are presented, evaluated, and decided, they may be able to shift the balance of political power’ (Pierson, 1996, p. 177). Today social democratic parties have to shift the balance again in the opposite direction and mobilise around a new economic programme.

At the heart of this programme should, certainly, be an opposition towards austerity. This thesis argued that social democracy austerity was a strategic policy which social democratic parties used to signal fiscal credibility. They attempted to win voters by imitating the political opponent. Instead, social democracy austerity helped to mainstream fiscal consolidation and shifted the economic discourse in Europe to the right. It contributed to a divided left with disastrous consequences. Moreover, austerity did not only create a deflationary bias in Europe, but it contributed to the main economic difficulties of our time, as outlined above. Consequently, social democratic parties need to move beyond the austerity settlement and develop a new economic programme to explain this position. To use the words of Peter (Gourevitch, 1986, p. 240), ‘the future always required imagination: politicians require imagination to find new ways of linking policy goals to coalitions.’ In the 21st century, social democratic parties will again need imagination to save themselves and, in the process, live up to their historic promise to find a compromise between capitalism and democracy.

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Appendix A

A.1 Data collection

The data was collected as part of the POLCON project at the European University Institute. Table A1 includes a detailed list of all the elections included in this study. For each election, we selected all newspaper articles that were published within two months before the national election day and reported on the electoral contest as well as national party politics more generally. Editorials and commentaries were excluded and the selection of articles was done by an extensive keyword list including the names and abbreviations of political parties and key politicians from each party. In the case of early elections that did not have a two-month long election campaign, we selected the period from the announcement of the election until election day. We then coded a sample of the selected articles using core sentence analysis (CSA). Following this type of relational content analysis, each grammatical sentence of an article is reduced to its most basic ‘core sentences’ structure, which contains only a subject, an object, and the direction of the relationship between the two. The core sentence approach was developed by Kleinnijenhuis et al. (1997) and Kleinnijenhuis and Pennings (2001) and later extensively used by Kriesi et al. (2008) and Kriesi et al. (2012). This type of quantitative content analysis allows us to study both the salience that parties attribute to certain issues and the positions that they take towards these issues. For this purpose, we quantify the direction between actors and issues by using a scale ranging from -1 to $+1$, with three intermediary positions -0.5 , 0 , and $+0.5$. For example, the grammatical sentence “Party A calls for leaving the Eurozone but supports a haircut on the country’s debt” leads to two coded observations: (Party A -1 Eurozone; Party A $+1$ haircut).

Using this approach, one can obtain two types of sentences: sentences that describe a relationship between two actors (i.e. ‘actor-actor sentences’) and sentences that describe a relationship between an actor and an issue (i.e. actor-issue sentences).

Table A1: Election Campaigns Studied

Country	Type of Election	
	Pre-crisis	Crisis
Austria	2006	2013
France	2007	2012
Germany	2005	2009, 2013
Greece	2007	2009, 2012*, 2015*
Ireland	2007	2011
Italy	2006	2013
Netherlands	2006	2010, 2012
Portugal	2005	2009, 2011, 2015
Spain	2004	2011, 2015
Switzerland	2007	2011, 2015
UK	2005	2010, 2015

*Data from both elections campaigns in that year is included in the dataset and analysed.

Several examples from our data can illustrate this further. For example, the following sentence was reported during the Swiss general election of 2015:

“Susanne Leutenegger Oberholzer (SP) demanded better employment protection for employees above 55.” (Neue Zürcher Zeitung, 24/09/2015: “*Das Bundesamt für Statistik wegputzen*”, own translation)

This example contains one actor-issue sentences and it is coded in the following way: (SP +1 employment protection). A second example comes from the British general election of 2015:

“Ed Miliband has pledged to slap a mansion tax on properties worth £2 million or more if Labour comes to power in the general election next month and the proceeds will be used to fund the NHS.” (The Times, 14/04/2015: *Sales of top London homes down 40 percent*)

This sentences contains two core sentences within one grammatical sentences. It leads to the following two observations: (Labour +1 mansion tax; Labour +1 health care.) Finally, the last example is a quote from Angela Merkel (CDU) that was reported by the Süddeutsche Zeitung during the 2009 election campaign in Germany:

“Importantly, a public, universal and cross-regional minimum wage that the SPD demanded would have cost many jobs.” (Süddeutsche Zeitung, 28/08/2009: *Merkel für Mindestlohn*, own translation)

This sentence contains one actor-actor sentence (with an issue reference) from which we also derive two actor-issue sentences. It is coded in the following way: (CDU –1 SPD; CDU –1 minimum wage; SPD +1 minimum wage).

Table A2: List of Vague Issue Included in the Data

Category	Issue
Welfare	Reduction of unemployment
welfare	Reduction of youth unemployment
Economic liberalism	Support small and medium enterprises
Economic liberalism	Export oriented measures
Economic liberalism	Measures to promote innovation
Economic liberalism	Promotion of national business
Budgetary rigour	Measures to fight economic crisis

These examples show that the coding procedure is, in principle, relatively simple. However, there are also some difficult decisions that one has to make when coding articles. For example, it is often difficult to disentangle whether a sentence includes clear partisan statements that can be used to extract a direction between an actor and an issue or another actor. In general, we always tried to code as many sentences as possible including vague ones. Consequently, our list of issues also includes statements that could be considered valence issues, as defined by (Stokes, 1963). For example, a list of such issues with regard to the economy is shown in Table A2. Generally, most actors agree on these issues and, hence, they do not help to classify parties based on their (relative) positions. Still, I keep all observations on these issues in the dataset in order to study salience. The only observations that are excluded from the analysis in this paper are actor-actor sentences without an issue reference. They neither include information about salience nor positions. Technically, actor-actor sentences with an issue reference are also not included in the analysis. However, during the coding procedure we always automatically coded all actor-issue sentences that derived from actor-actor sentences with an issue-reference (as shown above) and, hence, my analysis still captures the importance of these sentences for salience.

Depending on the country, we either coded a maximum of 20 core sentences for a given article or all core sentences in the first few paragraphs of any given article. In

total, the resulting dataset contains nearly 81,159 core sentences and for each election I have on average 2136 core sentences, ranging from a minimum of 1453 core sentences for the Swiss election in 2012 to a maximum of 3944 core sentences for the Irish election in 2011. The newspapers that were used for the analysis in North-Western Europe are listed in Table A3 and the newspapers that were used in South-Western Europe are listed in Table A4. Note that in Northern Europe the newspapers were selected to represent a balance between tabloid and broadsheet newspapers; in Southern Europe, the newspapers were selected to present a balance between left-right newspapers.

Table A3: Western European Newspapers Used for Content Analysis

Country	Quality Newspaper	Tabloid
Austria	Die Presse	Die Kronenzeitung
France	Le Monde	Le Figaro
Germany	Süddeutsche Zeitung	Bild
Ireland	The Irish Times	The Irish Sun
Netherlands	NRC Handelsblad	Algemeen Dagblad
Switzerland	Neue Züricher Zeitung	Blick
United Kingdom	The Times	The Sun

To create the dataset, we coded the function, party affiliation, and (if available) name of actors, but for the present analysis the actors were grouped according to their party family (operationalised as shown in Appendix A.5). The issues, in turn, were coded inductively, i.e. coders were given a long list of possible issues but they were encouraged to add to this list during the coding procedure. This resulted in more than 200 coded issues per election campaign and, as described in the main text, the issues were then aggregated into three economic categories prior to the analysis. Note that each category that I identified includes several different issues, which are listed in Appendix A.2. These issues, in turn, often contain several sub-issues that were

Table A4: Southern European Newspapers Used for Content Analysis

Country	Left Newspaper	Right Newspaper
Greece	Ta Nea	Kathimerini
Italy	Le Repubblica	Corriere della Serra
Portugal	Público	Diário de Notícias
Spain	El País	El Mundo

coded inductively. For example, the issue ‘budgetary rigour’ contains the following sub-issues: ‘budgetary rigour (in general)’, ‘austerity measures’, ‘fighting deficit’, and retrenchment’. Note that I decided to split issues relating to taxation into two different categories: taxes with an explicit redistributive character (e.g. wealth tax, tax on top-income levels, etc.) were coded as redistribution (i.e. welfare), whereas all other statements about taxation that were more general were coded as budgetary issues.

The major benefit of using an inductive coding procedure is that it allows one to study the full complexity of political competition by coding all statements in the media irrespective of pre-developed categories. Still, there are some disadvantages of studying political competition in this way. First, the major disadvantage is that the data collection is very work intensive because it relies on manual coding. Coder disagreement is potentially also a problem but based on the experience of previous rounds of data collection, we attempted to reduce coder disagreement. For this purpose, we relied on refined coding instruction, trained all coders intensively and continuously monitored their progress. Moreover, each electoral campaign in a given country was coded by at least two coders to reduce individual biases. A third potential problem for our data is that it relies on the media to represent the positions of parties. Given that there is some variation in the way that different newspapers report on political competition this might introduce some biases. As a result, in some instances the representation of parties varies across newspapers, but these variations are generally small and not systematic. Moreover, using other data to check the robustness of our findings shows that by and large our coding procedure leads to positions that are similar to those recorded in other datasets (also see [Helbling and Tresch, 2011](#)).

A.2 List of issues by category

Table A5: List of Issues by Category (adopted from Kriesi et al. 2008)

Category	Issue
Welfare	Welfare (general)
	Redistribution
	Health care
	Retirement
	Unemployment
	Poverty
	Families
	Disability support
	Consumer rights
Economic liberalism	Economic liberalism (general)
	Housing market
	Labour market
	Free trade
	Agriculture
	Finance
	Enterprise
	Competition
	Market regulation
	Keynesianism
	Corporatism
	Promotion of business
Budgetary rigour	Budgetary rigour (general)
	Austerity
	Indirect taxation
	Direct taxation

A.3 Methods

To study the salience that parties attribute to certain issues and the positions that parties take towards these issues, I calculate two key measures from the data. First, salience is measured by the share of core sentences coded for a party on a given issue category compared to all the sentences coded for that party. For example, if there are 10 core sentences for party A and three of these core sentences are about welfare policies, then the salience of welfare for party A is $3/10 = 0.3$. Second, I calculate the left-right position for a party as the average direction of all statements on an issue category, which ranges from -1 to $+1$ where -1 is the left end of the spectrum and $+1$ is the right end of the spectrum. For example, if party A has two positive statements ($+1$) and one negative statement (-1) towards welfare, the average position of party A towards welfare is $1 + 1 + (-1)/3 = 0.33$. Using these simple rules, I get a dataset with the salience and the positions for each party on each category for every election. In Appendix [A.6](#) these numbers are summarised for the pre- and crisis period.

I also use these measures to calculate the salience and left-right position for every party on the aggregate level, i.e. for all economic issues. The salience of all economic issues for a party k is simply the sum of party-specific salience of all the three issue categories:

$$\text{Aggregate Salience}_k = s_{\text{welfare},k} + s_{\text{ecolib},k} + s_{\text{budget},k} \quad (1)$$

where $s_{\text{welfare},k}$ is the number of core sentences for party k about welfare while $s_{\text{ecolib},k}$ and $s_{\text{budget},k}$ are the number of core sentences for party k about liberalism and budgetary rigour, respectively. The aggregate left-right position for any given party k is calculated as the mean of all statements from the three economic categories, weighted by the salience of the individual categories. It is computed as follows:

$$\begin{aligned} \text{Aggregate Left - Right Position}_k = \\ \frac{s_{\text{welfare},k} * \bar{x}_{\text{welfare},k} + s_{\text{ecolib},k} * \bar{x}_{\text{ecolib},k} + s_{\text{budget},k} * \bar{x}_{\text{budget},k}}{s_{\text{welfare},k} + s_{\text{ecolib},k} + s_{\text{budget},k}} \end{aligned} \quad (2)$$

where $\bar{x}_{\text{welfare},k}$ is the average position of party k on welfare while $\bar{x}_{\text{ecolib},k}$ and $\bar{x}_{\text{budget},k}$ are the average positions of party k on economic liberalism and budgetary rigour, respectively. Appendix [A.6](#) shows the average values by party family across all 11 countries for the two periods under study.

I analyse this data by combining descriptive analysis with regression analysis to study how the party-specific salience and positions that social democratic parties attribute to economic issues changed during the Great Recession. For the regression analysis, my unit of the analysis is a given party for each national election campaign in my sample. For example, for the German SPD I have three observations, one for each German election that is included in my dataset. In total, this gives me a dataset with 198 observations across eleven countries. Thus, my data for both the independent and dependent variable X and Y extends over n numbers of cross-sections and t points in time and, hence, the formal regression model can be written in the following form:

$$Y_{it} = \beta_k X_{kit} + u_{it} \quad (3)$$

where $i = 1 \dots N$ refers to the cross-sectional unit, $t = 1 \dots T$ refers to the time points and $k = 1 \dots K$ are the explanatory variables. Note that in my dataset the number of cross-sectional units exceeds the temporal units, i.e. my data is “cross-sectional dominant” (Stimson, 1985). As explained in the main text, the dependent variable for my analysis are (1) the salience that parties attribute to economic issues and (2) the left-right position that parties take on these issues. My key independent variable are party family (operationalised as shown in Appendix A.5) and a dummy variable that equals one when the election occurred after 2008 and zero otherwise. The effect of the crisis on any given party family is then tested through an interaction effect between these two variables. To test the conditionality of the crises effect, I use a three-way interaction term between party family, my dummy variable for the crisis, and different economic indicators. Finally, I also include country fixed effects and other control variables that could potentially explain party positions on economic issues. Additional confounding variables are not included in the regression model shown in the paper due to the small number of observations. However, a variety of other variables (e.g. Eurozone membership, international bail-outs, the presence of populist parties, or differences in the economic system) were also included as control variables and did not turn out to be significant. Note that in order to test the effect of time-invariant variables in my model (like party family) I do not include time-fixed effects. Moreover, I use generalised least square (GLS) regressions because it can be shown that a GLS estimator is more efficient than an ordinary least square (OLS) estimator, when there is a certain degree of correlation between the residuals in a regression model (Greene, 2012, p. 372). As a robustness check, I repeated the analysis using an OLS estimator. The results were virtually identical to the ones shown in the paper.

A.4 List of key variables used in the regression analysis

Table A6: List of Dependent Variable

	Variable	Coding	Source
1	Salience	Salience of economic categories by party family and elec- POLCON project tion (operationalised as described in A.1)	
2	Left-right position	Left-right position towards economic categories by party POLCON project family and election (operationalised as described in A.1)	

Table A7: List of Independent Variables

	Variable	Coding	Source
1	Party Family	1 = Far Right, 2 = Conservative (baseline), 3 = Liberal Based on Chapel Hill Expert Survey Party, 4 = Moderate Left, 5 = Far Left, 6 = Green party, (Bakker et al., 2015) 7 = All other parties	
2	Crisis Election	1 = Election after 2008, 0 = Election before 2008	
3	Unemployment (t-1)	Unemployment in the year prior to the election	Eurostat & Swiss Federal Statistical Office
4	Inflation	Inflation in the year prior to the election	Eurostat
5	Gov Def (t-1)	Government deficit in the year prior to the election	Eurostat
6	Gov Debt (t-1)	Government debt in the year prior to the election	Eurostat & Swiss Federal Statistical Office
7	Prime Minister (t-1)	1 = Party lead the incumbent government, 0 = Party did not lead the incumbent government	
8	Government (t-1)	1 = Party participated in incumbent government, 0 = Party did not participate in incumbent government	
9	[Party Family] x Crisis Election	Interaction between party family and crisis election	

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	Variable	Coding	Source
10	[Party Family] x Unemployment (t-1)	Interaction between party family and unemployment	
11	Crisis election x Unemployment (t-1)	Interaction between crisis election and unemployment	
12	[Party Family] x Crisis x Unemployment (t-1)	Three-way interaction between party family, crisis election, and unemployment	

A.5 List of parties by country and party family

Table A8: List of Party Families

Country	Party	Abbreviation	Party Family
Austria	Freedom Party of Austria	FPÖ	Far Right
	Alliance for the Future of Austria	BZÖ	Far Right
	Austria People's Party	ÖVP	Moderate Right
	Liberal Forum	LiF	Liberal
	NEOS – The New Austria	NEOS	Liberal
	Social Democratic Party of Austria	SPÖ	Moderate Left
	The Greens - The Green Alternative		Green
	Hans-Peter Martin's List		Other
	Team Stronach		Other
France	Front National	FN	Far Right
	Union for a Popular Movement	UMP	Moderate Right
	Union for French Democracy	UDF	Liberal
	Union of Democrats and Independents	UDI	Liberal
	Socialist Party	PS	Moderate Left
	Radical Party of the Left	PRG	Far Left
	French Communist Party	PCF	Far Left
	Europe Ecology – The Greens	ECO	Green
Germany	Christian Democratic Union / Christian Social Union of Bavaria	CDU/CSU	Moderate Right
	Free Democratic Party	FDP	Liberal
	Social Democratic Party of Germany	SPD	Moderate Left
	The Left		Far Left
	Alliance '90/The Greens		Green
Greece	The Popular Association - Golden Dawn	Golden Dawn	Far Right
	Independent Greeks	ANEL	Far Right
	Popular Orthodox Rally	LAOS	Far Right
	Panhellenic Citizen Chariot		Far Right
	New Democracy	ND	Moderate Right
	Union of Centrists		Liberal
	Drassi		Liberal
	Democratic Alliance		Liberal

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Country	Party	Abbreviation	Party Family
	Recreate Greece		Liberal
	Panhellenic Socialist Movement	PASOK	Moderate Left
	To Potami		Moderate Left
	Democratic Left	DIMAR	Moderate Left
	Social Agreement for Greece in Europe		Moderate Left
	Coalition of the Radical Left	SYRIZA	Far Left
	Communist Party	KKE	Far Left
	Movement of Democratic Socialists	To Kinima	Far Left
	Greek Anticapitalist Left		Far Left
	Popular Unity	LE	Far Left
	DIMAR		Green
Ireland	Fianna Fáil	FF	Moderate Right
	Fine Gael	FG	Moderate Right
	Libertas Ireland		Moderate Right
	Progressive Democrats	PD	Liberal
	Labour Party	Labour	Moderate Left
	Workers' Party		Far Left
	Anti-Austerity Alliance–People Before Profit	AAA-PBP	Far Left
	Socialist Party		Far Left
	United Left Alliance		Far Left
	Green Party		Green
	Fís Nua		Green
	Sinn Féin	SF	Other
	Christian Solidarity Party		Other
	Fathers Rights-Responsibility Party		Other
Italy	National Alliance	AN	Far Right
	Fratelli d'Italia		Far Right
	Forza Italia / The People of Freedom	FI / PdL	Moderate Right
	Union of the Centre	UDC+	Moderate Right
	Future and Freedom	FLI	Moderate Right
	Civic Choice	SC	Liberal
	Italy of Values	IDV	Liberal
	Democrats of the Left / Democratic Party	DS/PD	Moderate Left
	Left Ecology Freedom-Italian Left	SEL	Moderate Left

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Country	Party	Abbreviation	Party Family
	Party of Italian Communists	PdCI	Far Left
	Rifondazione		Far Left
	Rivoluzione Civile		Far Left
	Communist Refoundation Party	PRC	Far Left
	Five Star Movement	M5S	Other
	Lega Nord	LN	Other
	Fare		Other
	Italian Renewal	RI	Other
Netherlands	Party for Freedom	PVV	Far Right
	Christian Democratic Appeal	CDA	Moderate Right
	People's Party for Freedom and Democracy	VVD	Liberal
	Democrats 66	D66	Liberal
	Labour Party	PvdA	Moderate Right
	Socialist Party	SP	Far Left
	GreenLeft	GL	Green
Portugal	Social Democratic Party	PSD	Moderate Right
	People's Party for Freedom and Democracy	CDS	Moderate Right
	New Democracy Party	PND	Moderate Right
	People's Monarchist Party	PPM	Moderate Right
	Hope for Portugal Movement	MEP	Liberal
	Socialist Party	PS	Moderate Left
	Nós, Cidadãos!	Nos	Moderate Left
	Portuguese Communist Party	PCP	Far Left
	Left Bloc	BE+	Far Left
	Portuguese Workers' Communist Party	PCTP	Far Left
	Portuguese Labour Party	PTP	Far Left
Spain	People's Party	PP	Mod Right
	Union, Progress and Democracy	UPyD	Liberal
	Spanish Socialist Workers' Party	PSOE	Mod Left
	United We Can / Unidos Podemos	Podemos	Far Left
	Ciudadanos		Liberal
	United Left	IU	Far Left
	Republican Left of Catalonia - Catalonia Yes	ERC	Other

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Country	Party	Abbreviation	Party Family
	Democratic Convergence of Catalonia / Convergence and Union	CDC/CiU	Other
	Popular Unity Candidacy	CUP	Other
	Basque Nationalist Party	PNV	Other
	Together for Yes	JxS	Other
	Galician Nationalist Bloc	BNG	Other
	Commitment Coalition	CC	Other
	Amaiur		Other
	Asturias Forum	Foro	Other
Switzerland	Swiss Nationalist Party	PNOS	Far Right
	Swiss People's Party	SVP	Far Right
	Christian Democratic People's Party	CVP	Moderate Right
	Conservative Democratic Party	BDP	Moderate Right
	Ring of Independents	LDU	Liberal
	Free Democratic Party	FDP	Liberal
	Social Democratic Party	SPS	Moderate Left
	Swiss Party of Labour	AL	Far Left
	Green Party		Green
	Green Liberal Party	GLIB	Green
UK	UK Independence Party	UKIP	Far Right
	Conservative and Unionist Party		Moderate Right
	Liberal Democrats	LibDem	Liberal
	Labour Party		Moderate Left
	Green Party of England and Wales		Green
	Scottish National Party	SNP	Other

A.6 Nominal changes of parties in response to the crisis

A.6.1 Nominal changes of social democratic parties in salience and left-right position by issue categories

Table A9: Nominal changes of social democratic parties in salience and left-right positions on welfare

Country	Salience			Left-Right Position		
	Pre-Crisis	Crisis	Change	Pre-Crisis	Crisis	Change
Austria	0.36	0.34	-0.02	-0.52	-0.55	-0.03
France	0.22	0.28	0.06	-0.27	-0.95	-0.68
Germany	0.22	0.28	0.06	-0.42	-0.73	-0.31
Greece	0.15	0.08	-0.07	-0.31	-0.50	-0.19
Ireland	0.24	0.12	-0.13	-0.86	-0.44	0.41
Italy	0.05	0.20	0.15	-0.45	-0.00	0.45
Netherlands	0.27	0.22	-0.05	-0.58	-0.03	0.55
Portugal	0.06	0.10	0.04	0.57	-0.45	-1.01
Spain	0.14	0.14	0.00	-0.71	-0.67	0.04
Switzerland	0.19	0.28	0.09	-0.71	-0.81	-0.10
UK	0.27	0.28	0.01	-0.66	-0.64	0.02

Note: The three tables above show averages for the pre-crisis and crisis positions of social democratic parties towards the three different economic categories.

Table A10: Nominal changes of social democratic parties in salience and left-right positions on economic liberalism

Country	Salience			Left-Right Position		
	Pre-Crisis	Crisis	Change	Pre-Crisis	Crisis	Change
Austria	0.05	0.20	0.15	-0.40	-0.79	-0.39
France	0.20	0.15	-0.05	-0.43	-0.76	-0.33
Germany	0.05	0.13	0.08	-0.36	-0.92	-0.56
Greece	0.14	0.17	0.04	0.18	-0.13	-0.31
Ireland	0.18	0.30	0.12	-0.38	-0.39	-0.01
Italy	0.10	0.21	0.11	0.37	-0.57	-0.94
Netherlands	0.09	0.08	-0.01	-0.23	-0.80	-0.57
Portugal	0.20	0.23	0.03	0.51	-0.29	-0.80
Spain	0.09	0.15	0.06	0.03	-0.45	-0.48
Switzerland	0.10	0.20	0.11	0.25	-0.55	-0.81
UK	0.13	0.15	0.02	0.17	-0.34	-0.51

Table A11: Nominal changes of social democratic parties in salience and left-right positions on budgetary rigour

Country	Salience			Left-Right Position		
	Pre-Crisis	Crisis	Change	Pre-Crisis	Crisis	Change
Austria	0.03	0.05	0.02	0.70	0.61	-0.09
France	0.03	0.06	0.03	0.78	-0.18	-0.95
Germany	0.07	0.03	-0.03	0.56	0.00	-0.56
Greece	0.03	0.04	0.01	0.57	0.29	-0.28
Ireland	0.05	0.10	0.04	0.00	0.36	0.36
Italy	0.09	0.04	-0.05	-0.08	0.17	0.25
Netherlands	0.02	0.09	0.07	-0.33	0.96	1.30
Portugal	0.15	0.16	0.00	0.30	-0.08	-0.39
Spain	0.01	0.12	0.11	0.20	0.10	-0.10
Switzerland	0.05	0.00	-0.05	0.12	0.50	0.38
UK	0.03	0.14	0.11	0.06	0.05	-0.01

A.6.2 Aggregate nominal changes by party families

Table A12: Aggregate nominal changes of different party families

Party Family	Salience			Left-Right Position		
	Pre-Crisis	Crisis	Change	Pre-Crisis	Crisis	Change
Far Left	0.36	0.40	0.04	-0.63	-0.72	-0.09
Mod Left	0.37	0.46	0.09	-0.24	-0.41	-0.17
Mod Right	0.37	0.43	0.06	-0.13	0.07	0.20
Far Right	0.24	0.27	0.03	-0.09	-0.05	0.03

Note: The table shows average values for each party family across all eleven countries included in this study. For each party family a pre-crisis-average and a crisis-average are calculated for both the salience that parties attribute to all economic issues and the left-right position that they adopt towards these issues.

A.7 Observed shifts in salience and left-right position by social democratic parties

A.7.1 Observed shifts in salience by issue category

Figure A1: Observed shifts in salience by issue category for the moderate left in different countries

	Welfare	Economic Liberalism	Budgetary Rigour
+	France, Germany, Italy, Portugal, Switzerland	Austria, Germany, Greece, Ireland, Italy, Portugal, Spain, Switzerland	Austria, France, Ireland, Netherlands, Spain, UK
≈	Austria, Spain, UK	Netherlands, UK	Greece, Portugal
–	Greece, Ireland, Netherlands	France	Germany, Italy, Switzerland

Note: Changes in salience are coded in the following way: + = Increase in issue salience; ≈ = approximately the same level of salience (between -0.02 and 0.02); – = decrease in salience.

A.7.2 Observed shifts in left-right positions by issue category

Figure A2: Issue positions of the moderate left on welfare before and after the crisis in different countries

		After the Crisis		
		Pro	Ambivalent	Contra
Before the Crisis	Pro	Austria, France, Germany, Greece, Ireland, Spain, Switzerland, UK	Italy, Netherlands	
	Ambivalent			
	Contra	Portugal		

Note: Issue positions are coded in the following way: -1 to -0.26 = pro welfare; -0.25 to 0.25 = ambivalent; 0.26 to 1 = contra welfare.

Figure A3: Issue positions of the moderate left on economic liberalism before and after the crisis in different countries

		After the Crisis		
		Pro	Ambivalent	Contra
Before the Crisis	Pro			Italy, Portugal
	Ambivalent		Greece	Netherlands, Spain, Switzerland, UK
	Contra			Austria, France, Germany, Ireland

Note: Issue positions are coded in the following way: -1 to -0.26 = contra economic liberalism; -0.25 to 0.25 = ambivalent; 0.26 to 1 = pro to economic liberalism.

Figure A4: Issue positions of the moderate Left on budgetary rigour before and after the crisis in different countries

		After the Crisis		
		Pro	Ambivalent	Contra
Before the Crisis	Pro	Greece, Austria	Germany, France, Portugal	
	Ambivalent	Ireland, Switzerland	Italy, Spain, UK	
	Contra	Netherlands		

Note: Issue positions are coded in the following way: -1 to -0.26 = contra budgetary rigour; -0.25 to 0.25 = ambivalent; 0.26 to 1 = pro budgetary rigour.

A.8 Additional results (three-way interactions)

Table A13: GLS regression - salience of economic issues by different party families

	Dependent Variable		
	Welfare	Eco Lib	Budget
	(1)	(2)	(3)
Far Right	-0.04 (0.13)	-0.23 (0.14)	-0.01 (0.12)
Liberal	-0.01 (0.11)	0.02 (0.12)	-0.09 (0.10)
Moderate Left	0.04 (0.10)	-0.004 (0.10)	-0.01 (0.09)
Far Left	0.31** (0.12)	-0.04 (0.13)	-0.03 (0.11)
Green	-0.13 (0.11)	-0.10 (0.12)	-0.03 (0.10)
Other	0.08 (0.12)	-0.12 (0.12)	0.02 (0.11)
Crisis Election	0.02 (0.08)	0.09 (0.08)	-0.01 (0.07)
Unemployment (t-1)	-0.01 (0.01)	0.005 (0.01)	0.01 (0.01)
Inflation (t-1)	-0.01 (0.01)	0.02 (0.01)	0.01 (0.01)
GDP Growth (t-1)	-0.001 (0.003)	0.01* (0.003)	-0.0001 (0.003)
Gov Deficit (t-1)	0.002 (0.001)	-0.005*** (0.002)	-0.002 (0.001)
Gov Debt (t-1)	-0.001 (0.001)	-0.001 (0.001)	0.0003 (0.001)
Government (t-1)	-0.03 (0.02)	0.02 (0.02)	-0.01 (0.02)
Prime Minister (t-1)	0.02 (0.03)	-0.02 (0.03)	-0.01 (0.02)
Far Right x Crisis Election	-0.09 (0.14)	0.13 (0.15)	-0.03 (0.13)
Liberal x Crisis Election	0.07 (0.12)	-0.004 (0.13)	0.12 (0.11)
Moderate Left x Crisis Election	0.04 (0.11)	0.01 (0.11)	0.005 (0.10)
Far Left x Crisis Election	-0.24* (0.13)	0.06 (0.14)	-0.03 (0.12)
Green x Crisis Election	-0.002 (0.12)	0.01 (0.13)	-0.002 (0.11)
Other x Crisis Election	-0.23* (0.13)	0.08 (0.14)	0.02 (0.12)
Moderate Left x Unemployment (t-1)	-0.002 (0.01)	0.001 (0.01)	-0.01 (0.01)
Crisis Election x Unemployment (t-1)	0.001 (0.01)	0.0001 (0.01)	-0.01 (0.01)
Mod Left x Crisis x Unempl (t-1)	-0.002 (0.01)	-0.003 (0.01)	0.01 (0.01)
Constant	0.31*** (0.09)	-0.0001 (0.10)	0.04 (0.08)
Observations	198	198	198
Log Likelihood	97.34	90.99	112.33
Akaike Inf. Crit.	-104.68	-91.98	-134.65
Bayesian Inf. Crit.	31.98	44.68	2.01

*p<0.1; **p<0.05; ***p<0.01
Reference party: Moderate Right
Reference country: United Kingdom

Note: Country fixed effects are included in the models but not shown. Similarly, three-way interaction terms for other party families are included in model 2 but not shown.

Table A14: GLS regression - Left-right positions of different party families

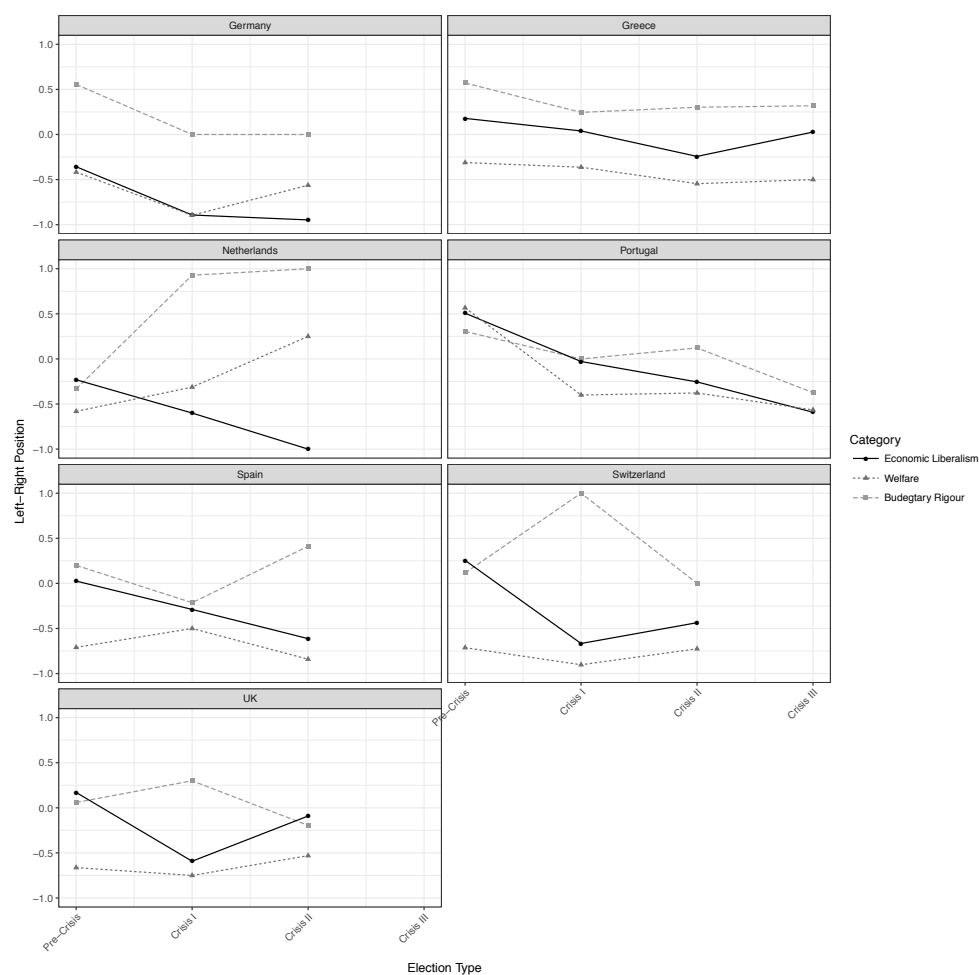
	Dependent Variable		
	Welfare	Eco Lib	Budget
	(1)	(2)	(3)
Far Right	0.36 (0.74)	-1.02 (0.89)	1.02 (1.02)
Liberal	0.38 (0.62)	-0.25 (0.74)	0.19 (0.86)
Moderate Left	0.11 (0.55)	0.01 (0.66)	-0.57 (0.76)
Far Left	-0.59 (0.68)	-1.05 (0.82)	-1.50 (0.94)
Green	-0.38 (0.62)	0.55 (0.74)	-0.89 (0.86)
Other	0.07 (0.65)	0.25 (0.78)	-1.06 (0.90)
Crisis Election	0.94** (0.44)	-0.11 (0.53)	0.31 (0.61)
Unemployment (t-1)	0.13** (0.06)	-0.02 (0.07)	-0.02 (0.09)
Inflation (t-1)	0.04 (0.06)	-0.07 (0.07)	-0.09 (0.08)
GDP Growth (t-1)	0.01 (0.02)	0.02 (0.02)	-0.03 (0.02)
Gov Deficit (t-1)	0.002 (0.01)	-0.01 (0.01)	0.02* (0.01)
Gov Debt (t-1)	-0.01* (0.003)	-0.003 (0.004)	0.001 (0.005)
Government (t-1)	0.06 (0.12)	0.08 (0.14)	0.17 (0.16)
Prime Minister (t-1)	-0.01 (0.14)	0.08 (0.17)	0.03 (0.19)
Far Right x Crisis Election	0.12 (0.78)	0.74 (0.93)	-1.10 (1.08)
Liberal x Crisis Election	-0.19 (0.67)	0.71 (0.80)	-0.01 (0.92)
Moderate Left x Crisis Election	-0.53 (0.59)	-0.59 (0.71)	0.48 (0.82)
Far Left x Crisis Election	-0.04 (0.72)	0.47 (0.87)	1.19 (1.00)
Green x Crisis Election	-0.60 (0.66)	-0.61 (0.80)	0.83 (0.92)
Other x Crisis Election	-0.23 (0.73)	-0.04 (0.88)	0.41 (1.02)
Moderate Left x Unemployment (t-1)	-0.005 (0.07)	0.01 (0.09)	0.08 (0.10)
Crisis Election x Unemployment (t-1)	-0.08 (0.06)	0.02 (0.07)	0.004 (0.08)
Mod Left x Crisis x Unempl (t-1)	0.01 (0.07)	-0.003 (0.09)	-0.11 (0.10)
Constant	-1.16** (0.50)	0.29 (0.61)	0.62 (0.70)
Observations	198	198	198
Log Likelihood	-165.52	-193.98	-215.79
Akaike Inf. Crit.	421.03	477.96	521.58
Bayesian Inf. Crit.	557.69	614.62	658.25

*p<0.1; **p<0.05; ***p<0.01
Reference party: Moderate Right
Reference country: United Kingdom

Note: Country fixed effects are included in the models but not shown. Similarly, three-way interaction terms for other party families are included in model 2 but not shown.

A.9 Positions of social democratic parties over time

Figure A5: Average positions of social democratic parties by country and election type



Note: Countries that only had one election from 2009 to 2015 are not shown in the graph. The two elections in Greece in 2012 and in 2015, respectively, are treated as one observation.

Appendix B

B.1 List of variables

Table A15: List of dependent variables from the Eurobarometer

Variable	Wording	Coding
1 Weak debt aversion	Statement: “Measures to reduce the public deficit and debt in (OUR COUNTRY) cannot be delayed.” Answers : 1 = “totally agree”; 2 = “totally agree” or “tend to agree”; 0 = “totally disagree”, 3 = “tend to disagree”; 4 = “totally disagree”	Binary variable measuring debt aversion: 1 = “totally agree”; 0 = “tend to agree”, “totally disagree” or “tend to disagree”
2 Strong debt aversion	Same as above	Binary variable measure debt aversion: 1 = “totally agree”; 0 = “tend to agree”, “totally disagree” or “tend to disagree”

Table A16: List of country-level variables

Variable	Coding	Source
1 Growth (t-1)	GDP growth in the quarter in the previous quarter	Eurostat
2 Unemployment (t-1)	Unemployment rate in the quarter in the previous quarter	Eurostat
3 Debt (t-1)	Government debt as a percentage of GDP in the previous quarter	Eurostat
4 Deficit (t-1)	Government deficit as a percentage of GDP in the previous quarter	Eurostat

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	Variable	Coding	Source
5	Region	Factor variable measuring the region that a country belongs to: North = North-western Europe (Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Luxembourg, Netherlands, Sweden, UK); South = Southern Europe (Cyprus, Greece, Italy, Malta, Portugal, Spain); East = Central and Eastern Europe = (Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia.)	
6	Status	Factor variable measuring the structural position vis-a-vis the Eurozone during the Great Recession: Creditor = creditor country (Austria, Belgium, Denmark, Estonia, Finland, France, Germany, Luxembourg, Netherlands, Malta, Slovakia, Slovenia); Debtor = debtor country that relied on a bailout from other European countries or was in stark financial difficulties (Cyprus, Greece, Ireland, Italy, Portugal, Spain); Non-EA = country outside the Eurozone for most of the European sovereign debt crisis (Bulgaria, Croatia, Czech Republic, Denmark, Hungary, Latvia, Lithuania, Poland, Romania, Sweden, UK)	

Table A17: List of independent variables from the Eurobarometer

	Variable	Wording	Coding
1	Education	“How old were you when you stopped full-time education?” Answers: 1-99 = age; 97 = “no full-time education”; 98 = “still studying”	Respondents who are still studying are assigned their actual age and afterwards responses are coded into categorical variable: 1-15 = primary education; 16-19 = secondary education; 20-39 = tertiary education; above 40 = missing
2	Occupation	What is your current occupation? Answers: 18 re- sponse categories in three different areas (non-active, self-employed, employed)	Responses were coded into five categories following Häusermann and Gingrich (2015): 1 = Employer; 2 = middle-class, 3 = skilled working class; 4 = unskilled working class; 5 = other
3	Unemployed	What is your current occupation? Answer: 3 = “Unemployed, temporarily not working”	Recoded into binary variable: 1 = unemployed, 0 = otherwise
4	Retired	What is your current occupation? Answer: 4 = “Retired or unable to work through illness”	Recoded into binary variable: 1 = retired, 0 = otherwise

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	Variable	Wording	Coding
5	Financial difficulties	During the last twelve months, would you say you had difficulties to pay your bills at the end of the month...? An- Often; 2 = Sometimes; 3 = Never swers: 1 = "Most of the time"; 2 = "From time to time"; 3 == "Almost never/never"	Used as a categorical variable with simplified names: 1 =
6	Age	How old are you?	Coded from 15 = "15 years" to 99 = "98 years"
7	Married	Derived from the variable "marital status": "Could you give me the letter which corresponds best to your own current situation?"	Answers are recoded into a dummy variable where 1 = "married" and 0 = "not married".
8	Children	Derived from the variable "marital status" (see above)	Answers are coded into a dummy variable where 1 = "children" and 0 = "no children"
9	Female	Derived from variable "gender"	Answers are recoded into a dummy variable where 1 = "female" and 0 = "male"

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Variable	Wording	Coding
10	Positive evaluation of “How would you judge the current situation in each of the Answers are recoded into a dummy variable where 1 = economy following? The situation of the (NATIONALITY) econ- “good” and 1 = “bad” omy” Answers: 1 = “very good”; 2 = “rather good”; 3 == “rather bad”; 4 == “very bad”; 5 = “don’t know”	
11	Left-right placement “In political matters people talk of “the left” and “the Coded into a categorical variable: 1 = left (corresponding right”. How would you place your views on this scale?” to codes 1 to 4); 2 = centre = (corresponding to codes 5 to 10) Answers categories from 1 to 10, where 1 is left and 10 is 6); 3 = right (corresponding to codes 7 to 10) right	
12	House ownership Derived from two answer possibilities to the question Recoded into a single categorical variable: 0 = no house; 1 “Which of the following goods do you have?” Answers: = house (with mortgage); 2 = house (fully paid) “An apartment / a house which you are paying for” and “an apartment / a house which you have finished paying for”	

B.2 Summary statistics

Table A18: Summary Statistics

Statistic	N	Mean	St. Dev.	Min	Max
Strong debt aversion	185,367	0.390	0.488	0	1
Weak debt aversion	185,367	0.801	0.399	0	1
Education	379,363	2.147	0.727	0	3
Occupation	388,231	3.644	1.510	1	5
Unemployed	388,231	0.091	0.287	0	1
Financial difficulties	381,881	2.459	0.709	1	3
Evaluation of the economy	381,173	1.320	0.466	1	2
Age	388,231	49.498	18.197	15	99
Age	388,231	0.302	0.459	0	1
Children	382,517	0.401	0.490	0	1
Sex	388,231	0.543	0.498	0	1
Marrital status	387,832	0.525	0.499	0	1
Growth (t-1)	388,231	1.589	3.190	−11.000	27.600
Unemployment (t-1)	388,231	10.225	4.899	4.000	27.900
Debt (t-1)	388,231	69.065	35.159	6.100	179.500
Budget balance (t-1)	388,231	−3.530	3.643	−32.100	1.600

B.3 Results from fixed effects model

Table A19: Fixed effects model: Macro-level support for fiscal consolidation

	Debt aversion	
	Strong	Weak
	(1)	(2)
Growth (t-1)	-0.004** (0.001)	-0.002 (0.001)
Unemployment (t-1)	0.002 (0.002)	0.01*** (0.002)
Debt (t-1)	0.0001 (0.001)	-0.003*** (0.0005)
Budget balance (t-1)	-0.005** (0.002)	-0.005*** (0.001)
Observations	390	390
R ²	0.08	0.24
Adjusted R ²	0.001	0.17
F Statistic (df = 4; 358)	7.81***	27.82***
<i>Note:</i> *p<0.05; **p<0.01; ***p<0.001		

B.4 Results from logit regression models with all waves

Table A20: Logit regression: Individual-level determinants of (strong) debt aversion

	Strong debt aversion			
	(1)	(2)	(3)	(4)
Education (Ref.: No education)				
. Primary	0.23*** (0.06)	0.23*** (0.07)	0.18* (0.09)	0.17 (0.10)
. Secondary	0.37*** (0.06)	0.36*** (0.07)	0.33*** (0.09)	0.32** (0.10)
. Tertiary	0.45*** (0.06)	0.44*** (0.07)	0.41*** (0.09)	0.38*** (0.10)
Occupation (Ref.: Upper class)				
. Middle class	-0.10*** (0.02)	-0.09*** (0.02)	-0.08** (0.03)	-0.07* (0.03)
. Skilled worker	-0.15*** (0.03)	-0.14*** (0.03)	-0.13*** (0.04)	-0.12** (0.04)
. Unskilled worker	-0.12*** (0.03)	-0.09* (0.04)	-0.06 (0.05)	-0.01 (0.06)
. Other	-0.13*** (0.02)	-0.11*** (0.03)	-0.14*** (0.03)	-0.10** (0.04)
Unemployed	-0.01 (0.02)	-0.02 (0.02)	0.04 (0.03)	0.03 (0.04)
Financial difficulties (Ref.: Often)				
. Sometimes	-0.10*** (0.02)	-0.12*** (0.02)	-0.08** (0.03)	-0.10** (0.03)
. Rarely	0.11*** (0.02)	0.07*** (0.02)	0.13*** (0.03)	0.10*** (0.03)
Positive evaluation of economy	-0.14*** (0.01)	-0.14*** (0.01)	-0.12*** (0.02)	-0.10*** (0.02)
Age	0.003*** (0.0004)	0.002*** (0.0005)	0.003*** (0.001)	0.001 (0.001)
Retired	0.08*** (0.02)	0.09*** (0.02)	0.11*** (0.03)	0.11** (0.04)
Children	-0.01 (0.01)	-0.003 (0.01)	-0.02 (0.02)	-0.01 (0.02)
Female	-0.12*** (0.01)	-0.12*** (0.01)	-0.13*** (0.01)	-0.13*** (0.02)
Married	0.05*** (0.01)	0.04** (0.01)	0.05* (0.02)	0.04* (0.02)
Left-right placement (Ref.: Left)				
. Centre			0.14*** (0.02)	0.14*** (0.02)
. Right			0.33*** (0.02)	0.33*** (0.02)
Home ownership (Ref.: No house)				
. With mortgage		0.13*** (0.02)		0.09*** (0.02)
. Fully paid		0.18*** (0.02)		0.14*** (0.02)
Constant	-1.33*** (0.08)	-1.17*** (0.08)	-1.28*** (0.11)	-1.05*** (0.12)
Country fixed effects	Yes	Yes	Yes	
Wave fixed effects	Yes	Yes	Yes	
Observations	173,522	152,168	93,245	73,800
Log Likelihood	-112,491.40	-98,788.02	-59,630.71	-47,169.15
Akaike Inf. Crit.	225,096.90	197,690.00	119,369.40	94,446.29

Note:

*p<0.05; **p<0.01; ***p<0.001

Table A21: Logit regression: Individual-level determinants of (weak) debt aversion

	Weak debt aversion			
	(1)	(2)	(3)	(4)
Education (Ref.: No education)				
. Primary	0.16* (0.07)	0.11 (0.07)	0.31*** (0.09)	0.23* (0.10)
. Secondary	0.32*** (0.07)	0.27*** (0.07)	0.45*** (0.09)	0.39*** (0.10)
. Tertiary	0.37*** (0.07)	0.32*** (0.07)	0.50*** (0.09)	0.44*** (0.10)
Occupation (Ref.: Upper class)				
. Middle class	−0.02 (0.03)	0.01 (0.03)	0.02 (0.03)	0.05 (0.04)
. Skilled worker	−0.03 (0.03)	0.004 (0.03)	−0.01 (0.04)	0.02 (0.05)
. Unskilled worker	−0.06 (0.04)	−0.04 (0.04)	0.002 (0.06)	0.03 (0.06)
. Other	−0.0005 (0.03)	0.01 (0.03)	0.02 (0.04)	0.03 (0.05)
Unemployed	−0.14*** (0.03)	−0.13*** (0.03)	−0.12** (0.04)	−0.12** (0.04)
Financial difficulties (Ref.: Often)				
. Sometimes	0.19*** (0.02)	0.17*** (0.02)	0.19*** (0.03)	0.17*** (0.03)
. Rarely	0.40*** (0.02)	0.33*** (0.02)	0.41*** (0.03)	0.34*** (0.03)
Positive evaluation of economy	0.12*** (0.02)	0.14*** (0.02)	0.13*** (0.02)	0.16*** (0.02)
Age	−0.001* (0.001)	−0.003*** (0.001)	−0.001* (0.001)	−0.004*** (0.001)
Retired	0.003 (0.03)	0.01 (0.03)	0.02 (0.04)	0.03 (0.04)
Children	0.01 (0.01)	0.001 (0.02)	0.02 (0.02)	0.02 (0.02)
Female	−0.03* (0.01)	−0.04** (0.01)	−0.03 (0.02)	−0.05** (0.02)
Married	0.12*** (0.01)	0.10*** (0.01)	0.11*** (0.02)	0.11*** (0.02)
Left-right placement (Ref.: Left)				
. Centre			0.26*** (0.02)	0.26*** (0.02)
. Right			0.38*** (0.02)	0.38*** (0.02)
Home ownership (Ref.: No house)				
. With mortgage		0.16*** (0.02)		0.11*** (0.03)
. Fully paid		0.24*** (0.02)		0.21*** (0.03)
Constant	0.99*** (0.09)	1.01*** (0.09)	0.87*** (0.12)	0.96*** (0.13)
Country fixed effects	Yes	Yes	Yes	
Wave fixed effects	Yes	Yes	Yes	
Observations	173,522	152,168	93,245	73,800
Log Likelihood	−82,016.61	−72,875.49	−45,872.83	−37,739.51
Akaike Inf. Crit.	164,147.20	145,865.00	91,853.66	75,587.02

Note:

*p<0.05; **p<0.01; ***p<0.001

B.5 Results from ordinal logistic regression analysis

Table A22: Ordinal logistic regression: Individual-level determinants of debt aversion

	Debt aversion			
	(1)	(2)	(3)	(4)
Education (Ref.: No education)				
. Primary	0.07 (0.06)	0.03 (0.06)	0.12 (0.08)	0.05 (0.09)
. Secondary	0.15* (0.06)	0.10 (0.06)	0.21* (0.08)	0.13 (0.09)
. Tertiary	0.19** (0.06)	0.13* (0.06)	0.25** (0.08)	0.15 (0.09)
Occupation (Ref.: Upper class)				
. Middle-class	−0.09*** (0.02)	−0.08*** (0.02)	−0.06* (0.03)	−0.03 (0.03)
. Skilled worker	−0.09*** (0.02)	−0.07** (0.03)	−0.07* (0.03)	−0.05 (0.04)
. Unskilled worker	−0.06 (0.03)	−0.02 (0.03)	0.02 (0.05)	0.09 (0.05)
. Other	−0.06** (0.02)	−0.04 (0.02)	−0.06 (0.03)	−0.02 (0.04)
Unemployed	−0.06** (0.02)	−0.06** (0.02)	−0.02 (0.03)	−0.02 (0.04)
Financial difficulties (Ref.: Often)				
. Sometimes	−0.0004 (0.02)	−0.02 (0.02)	0.03 (0.02)	−0.001 (0.03)
. Rarely	0.20*** (0.02)	0.15*** (0.02)	0.24*** (0.02)	0.18*** (0.03)
Positive evaluation of economy	−0.08*** (0.01)	−0.07*** (0.01)	−0.05*** (0.02)	−0.03 (0.02)
Age	0.002*** (0.0004)	0.001 (0.0004)	0.002*** (0.001)	0.0005 (0.001)
Retired	0.05* (0.02)	0.06** (0.02)	0.08* (0.03)	0.08* (0.03)
Children	−0.01 (0.01)	−0.01 (0.01)	−0.01 (0.02)	−0.004 (0.02)
Female	−0.04*** (0.01)	−0.04*** (0.01)	−0.04* (0.01)	−0.04* (0.01)
Married	0.04*** (0.01)	0.03* (0.01)	0.04** (0.01)	0.03 (0.02)
Home ownership (Ref.: No house)				
. With mortgage		0.13*** (0.02)		0.10*** (0.02)
. Fully paid		0.19*** (0.01)		0.16*** (0.02)
Left-right placement (Ref.: Left)				
. Centre			0.21*** (0.02)	0.22*** (0.02)
. Right			0.35*** (0.02)	0.35*** (0.02)
Country fixed effects	Yes	Yes	Yes	Yes
Wave fixed effects	Yes	Yes	Yes	Yes
Observations	165,642	144,288	88,719	69,274

Note:

*p<0.05; **p<0.01; ***p<0.001

Appendix C

C.1 Summary statistics

Table A23: Summary Statistics

Statistic	N	Mean	St. Dev.	Min	Max
Fiscal consolidation (control)	1,200	7.201	2.326	0	10
Fiscal consolidation (lower spending)	1,204	5.625	2.583	0	10
Fiscal consolidation (higher taxes)	1,203	4.571	2.615	0	10
Fiscal consolidation (higher taxes/lower spending)	1,193	4.746	2.635	0	10
Age	4,800	46.670	15.851	18	88
Female	4,797	0.512	0.500	0	1
Married	4,800	0.480	0.500	0	1
Children	4,800	0.434	0.496	0	1
Education_c	4,785	2.249	0.674	1	3
Income	4,595	5.177	2.805	1	10
Unemployed	4,768	0.072	0.259	0	1
Retired	4,768	0.181	0.385	0	1
Occupation	4,701	2.677	1.437	1	6
Political interest	4,800	5.928	2.686	0	10
Political trust	4,800	3.453	2.686	0	10
Support for social insurance	4,800	8.315	1.914	0	10
Support for social investment	4,800	8.143	1.988	0	10
Support for redistribution	4,800	7.645	2.371	0	10
Home ownership (house)	4,107	1.282	0.928	0	2
Asset ownership (assets)	4,066	1.311	0.913	0	2

C.2 List of all questions used in the split-sample experiment

Table A24: Design of the split experiment

Split 1 (Control)	Split 2 (Treatment 1)	Split 3 (Treatment 2)	Split 4 (Treatment 3)
The government should increase spending on pensions.	The government should increase spending on old-age pensions, even if that implies higher taxes.	The government should increase spending on old-age pensions, even if that implies higher government debt.	The government should increase spending on pensions, even if that implies lower spending on education.
The government should increase spending on education.	The government should increase spending on education, even if that implies higher government debt.	The government should increase spending on education, even if that implies lower spending on pensions.	The government should increase spending on education, even if that implies higher taxes.
The government should decrease income tax on all citizens.	The government should decrease income tax on all citizens, even if that implies lower government spending.	The government should decrease income tax on all citizens, even if that implies higher VAT.	The government should decrease income tax on all citizens, even if that implies higher government debt.
The government should decrease the tax on high incomes.	The government should decrease the tax on high incomes, even if that implies higher VAT.	The government should decrease the tax on high incomes, even if that implies higher government debt.	The government should decrease the tax on high incomes, even if that implies lower government spending.
The government should decrease value added tax (VAT).	The government should decrease VAT, even if that implies higher income tax for all citizens.	The government should decrease VAT, even if that implies lower government spending.	The government should decrease VAT, even if that implies higher government debt.
The government should reduce the level of government debt.	The government should reduce the level of government debt, even if that lower government spending.	The government should reduce the level of government debt, even if that implies higher taxes.	The government should reduce the level of government debt, even if that implies lower government spending or higher taxes.

C.3 Distribution of responses to the split-sample questions, by country

Figure A6: Distribution of support for fiscal consolidation by treatment in Germany

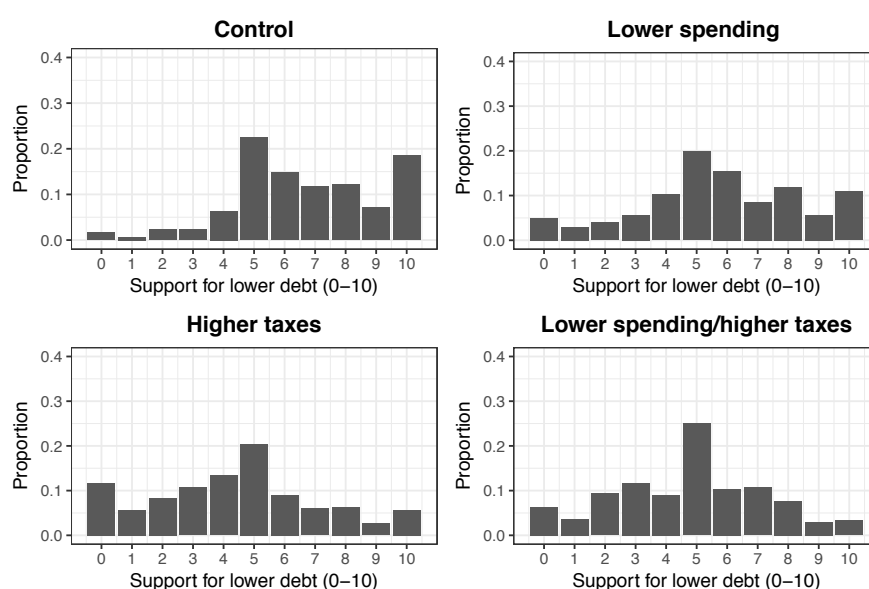


Figure A7: Distribution of support for fiscal consolidation by treatment in Italy

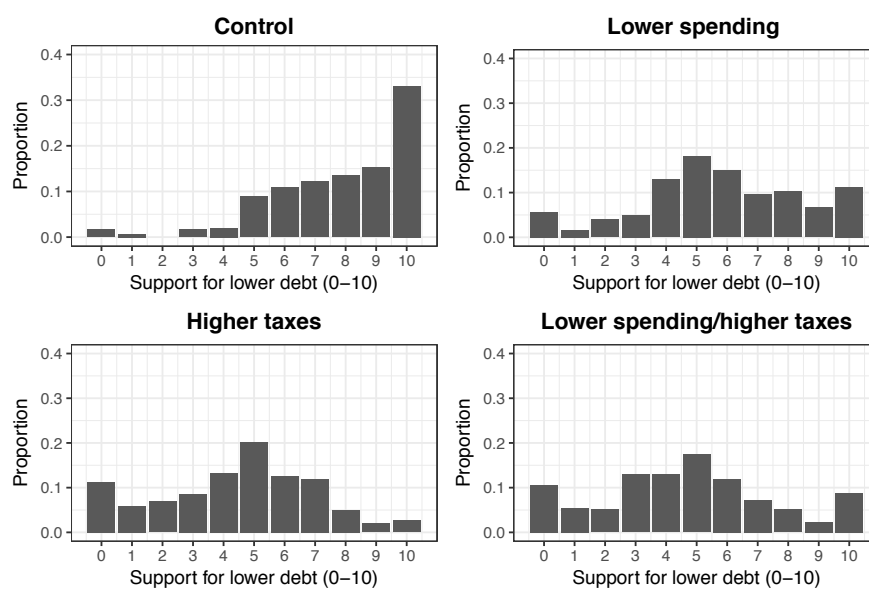
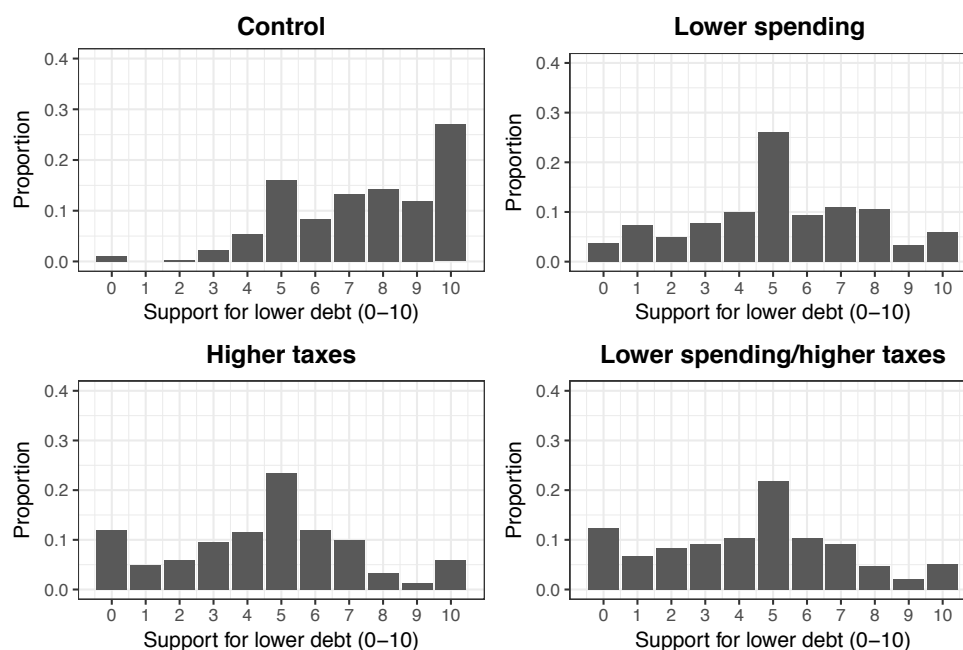
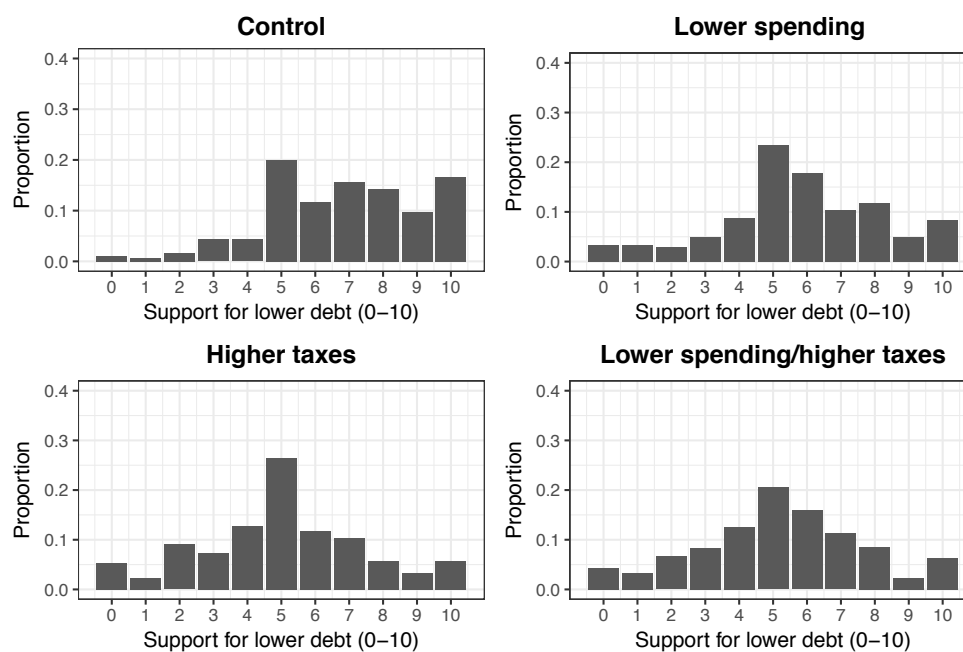
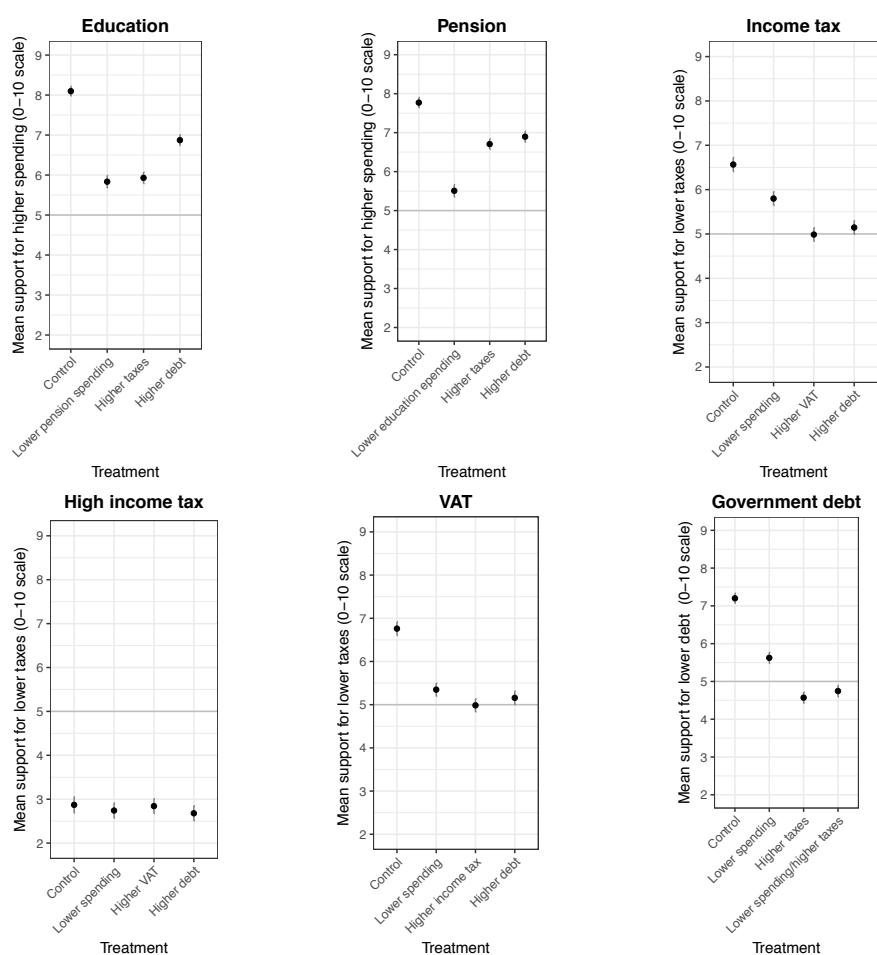


Figure A8: Distribution of support for fiscal consolidation by treatment in Spain**Figure A9:** Distribution of support for fiscal consolidation by treatment in the UK

C.4 Mean support for all policies with and without trade-offs, pooled

Figure A10: Mean support for six different items with and without trade-offs, pooled



C.5 OLS regression analysis for split-sample experiment including wealth

Table A25: OLS regression: Preferences towards government debt

	Support for lower debt			
	Control	Lower spending	Higher taxes	Ambiguous
	(1)	(2)	(3)	(4)
Age	-0.01 (0.01)	0.003 (0.01)	-0.01 (0.01)	0.001 (0.01)
Female	-0.16 (0.16)	-0.43* (0.18)	-0.34 (0.18)	-0.63*** (0.18)
Married	-0.07 (0.18)	0.20 (0.21)	-0.10 (0.21)	0.19 (0.20)
Children	0.29 (0.18)	0.40* (0.20)	-0.33 (0.20)	0.12 (0.20)
Education (ref.: Primary) . Secondary	-0.62* (0.26)	-0.17 (0.28)	-0.07 (0.28)	0.02 (0.28)
. Tertiary	-0.81** (0.28)	-0.54 (0.31)	-0.13 (0.31)	-0.08 (0.32)
Income	0.07 (0.03)	0.02 (0.04)	-0.04 (0.04)	-0.01 (0.04)
Unemployed	0.71* (0.33)	0.32 (0.40)	-0.003 (0.38)	-0.24 (0.41)
Retired	0.54* (0.26)	-0.13 (0.29)	0.26 (0.28)	-0.23 (0.28)
Occupation (ref.: Manager) . Middle class	0.23 (0.23)	0.04 (0.25)	0.37 (0.26)	0.19 (0.26)
. Skilled working class	0.38 (0.29)	-0.14 (0.34)	0.002 (0.32)	-0.05 (0.34)
. Unskilled working class	0.71 (0.41)	0.24 (0.44)	0.07 (0.41)	0.21 (0.45)
. Other occupation	0.11 (0.38)	-0.13 (0.40)	-0.33 (0.44)	0.88* (0.43)
. Inactive	0.01 (0.40)	-0.05 (0.40)	0.50 (0.45)	0.66 (0.42)
Partisanship (ref.: Conservative) . Far left	-0.71* (0.29)	-0.82* (0.32)	-0.15 (0.32)	-0.64 (0.33)
. Social democrats	-0.79** (0.24)	-0.74** (0.26)	-0.54* (0.27)	-0.48 (0.27)
. Liberals	-0.30 (0.52)	-1.10* (0.55)	0.31 (0.58)	-0.41 (0.49)
. Greens	-0.48 (0.33)	-0.61 (0.35)	0.09 (0.34)	-0.33 (0.35)
. Far right	-0.34 (0.34)	-0.17 (0.40)	-0.30 (0.41)	-0.07 (0.42)
. Other party	-0.04 (0.41)	-0.53 (0.41)	-0.29 (0.50)	-0.93* (0.45)
. Abstention	-0.31 (0.30)	-0.33 (0.33)	-0.39 (0.34)	-0.23 (0.33)
Pol. interest	-0.09* (0.03)	-0.03 (0.04)	0.02 (0.04)	0.01 (0.04)
Trust in gov.	0.04 (0.03)	0.10** (0.04)	0.18*** (0.04)	0.17*** (0.04)
Support for soc. insurance	0.17** (0.05)	-0.12* (0.06)	-0.06 (0.06)	-0.05 (0.06)
Support for soc. investment	0.14** (0.05)	0.12* (0.05)	0.07 (0.06)	-0.004 (0.06)
Support for redistribution	0.04 (0.04)	-0.004 (0.04)	-0.05 (0.05)	-0.02 (0.04)
Home ownership (ref: no house) . Debtor	0.52 (0.36)	-0.49 (0.43)	-0.10 (0.49)	-0.14 (0.41)
. Creditor	0.26 (0.20)	-0.16 (0.24)	-0.14 (0.23)	-0.11 (0.23)
Asset ownership (ref: no assets), . Debtor	-0.78* (0.35)	0.29 (0.38)	0.80 (0.45)	0.35 (0.38)
. Creditor	0.27 (0.20)	0.19 (0.24)	0.43 (0.23)	0.25 (0.23)
Country (ref.: Germany) . Spain	0.63** (0.24)	-0.49 (0.27)	0.42 (0.28)	-0.19 (0.28)
. Italy	1.00*** (0.24)	0.23 (0.28)	0.58* (0.28)	0.35 (0.29)
. UK	0.18 (0.24)	0.23 (0.27)	1.02*** (0.27)	0.38 (0.26)
Constant	4.46*** (0.70)	6.07*** (0.75)	4.32*** (0.69)	4.93*** (0.74)
Country fixed effects	Yes	Yes	Yes	Yes
Observations	895	934	893	899
R ²	0.14	0.08	0.10	0.09
Adjusted R ²	0.10	0.04	0.06	0.06
Residual Std. Error	2.25	2.58	2.54	2.57
F Statistic	4.16***	2.26***	2.84***	2.74***

Note:

* p<0.05; ** p<0.01; *** p<0.001

C.6 Instructions for the conjoint survey experiment

The full instructions for the conjoint tasks are shown below. First, respondents were presented the following introduction to the experiment.

Please take your time and read the information below very carefully. It contains the instructions for the next part of the survey.

Every year the British government collects taxes and spends money in a variety of different areas. A large share of taxes are paid by citizens like you and they are used to pay for government spending on education or pensions. We are interested in what you think about how your government should change its budget.

We will now show you several proposals for possible changes to the government's budget. We will always show you two possible proposals in comparison. For each comparison we would like to know which of the two proposals you prefer. You may like both proposals or neither. In any case, please choose the proposal that you like the most. In total, we will show you five comparisons.

The possible proposals only include changes with regard to a few selected types of government spending and taxation. Please assume that spending in all other areas as well as all other taxes do not change.

People have different opinions about this issue and there are no right or wrong answers. Please always take your time when reading the proposals.

This introduction was followed by a screen with two proposals for a budgetary change, as shown below in Figure A11. In this way, respondents are asked five times to choose (i) between two packages ("choice" variable) and (ii) to indicate how likely they are to support each of the proposals ("ranking" variable).

Figure A11: Screenshot of a Conjoint Task Presented to Respondents

Please carefully review the options detailed below, then please answer the questions.

Which of these proposals do you prefer?

	Proposal 1	Proposal 2
Income tax (for all citizens)	Decrease	No change
Tax on high incomes	Increase	No change
Value added tax (VAT)	Decrease	Increase
Government debt	Increase	Decrease
Old-age pensions	Decrease spending	Decrease spending
Education	Increase spending	Increase spending

Proposal 1

Proposal 2

How would you rate proposal 1 on a scale from 0 to 10, where 0 indicates that the government should definitely not adopt the proposal and 10 indicates that the government should definitely adopt it?

0 - Definitely not adopt	1	2	3	4	5	6	7	8	9	10 - Definitely adopt
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How would you rate proposal 2?

0 - Definitely not adopt	1	2	3	4	5	6	7	8	9	10 - Definitely adopt
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C.7 Additional tests for heterogeneous effects in the conjoint survey experiment

Figure A12: AMCEs from conjoint survey experiment by party family

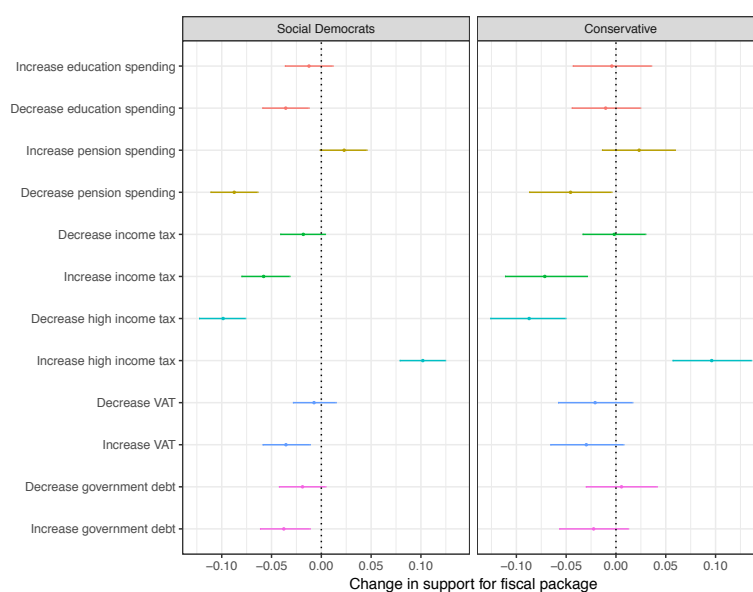


Figure A13: AMCEs from conjoint survey experiment by left-right placement

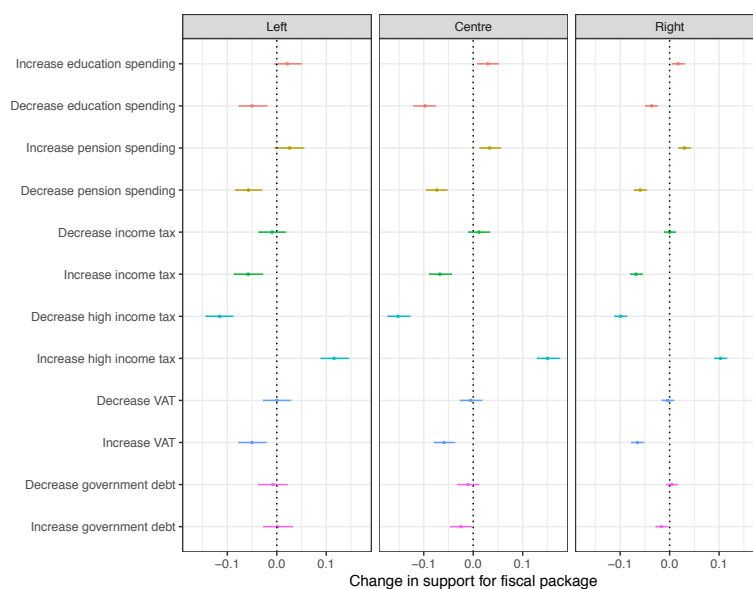
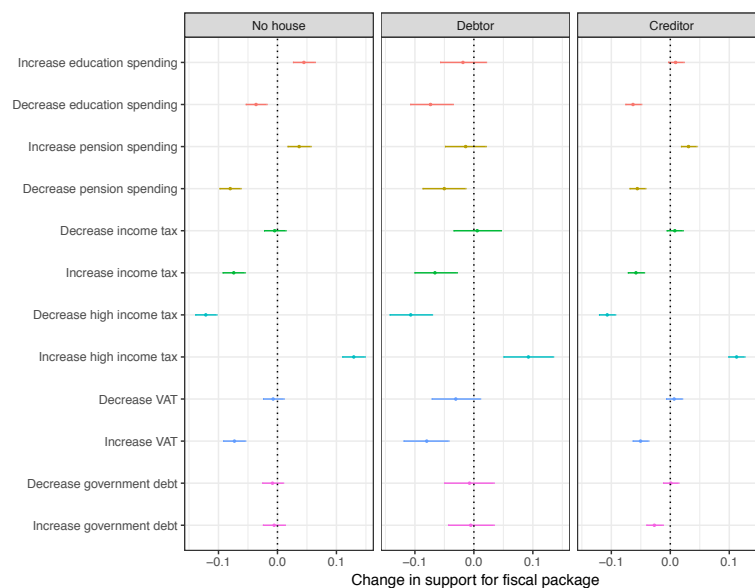
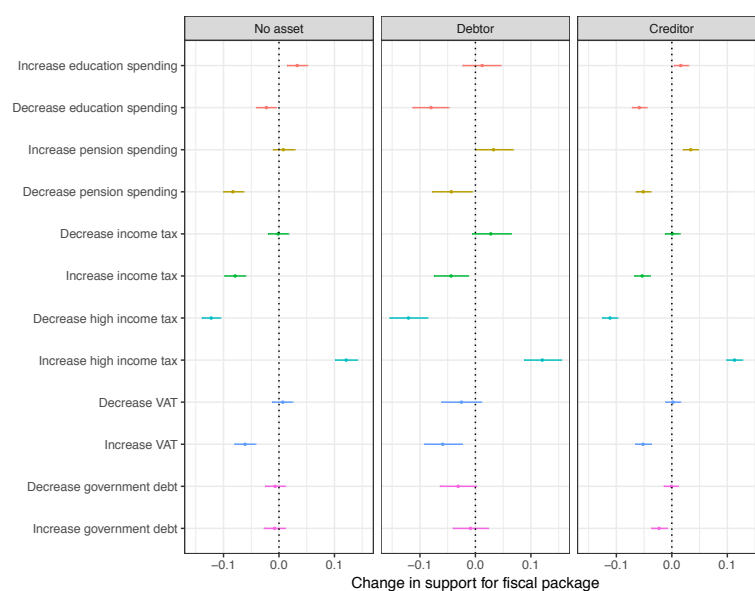


Figure A14: AMCEs from conjoint survey experiment by wealth (house)**Figure A15:** AMCEs from conjoint survey experiment by wealth (assets)

C.8 Robustness tests for the conjoint survey experiment

I used a series of tests to confirm that the results are robust. These robustness tests were designed to check that the common assumptions involved in conjoint analysis are satisfied and to probe potential concerns about the validity of my results. On the one hand, I conducted the diagnostic tests suggested by [Hainmueller et al. \(2014\)](#). First, conjoint analyses relies on the assumption that there are no carryover effects between the different rounds of conjoint tasks. To test whether this assumption holds, I estimated AMCEs separately for each of the five rounds of conjoint tasks. Second, I checked whether there are profile order effects, i.e. whether the AMCEs depend on whether the attribute occurs in the first or second profile in a given task. To this end, I estimated AMCEs separately for all the observations where attribute levels occurred in the first and the second profile respectively. Third, I checked whether there are attribute-order effects, i.e. whether the AMCE of an attribute depends on the order in which it appears in the conjoint table. I estimated row-specific AMCEs, testing whether the estimates are significantly different from each other. Fourth, the analysis depends on the fact that profiles are randomly created. Although the design guarantees that this assumption holds, I still checked whether the randomisation actually produced experimental groups that are well balanced in our sample. Therefore, I compared the profiles rated by different groups of respondents in the sample and conducted multivariate balance checks by regressing the characteristics of respondents on indicator variables for all profile attributes used in our design. Finally, note that I already addressed the concern about atypical profiles raised by [Hainmueller et al. \(2014\)](#) in the research design. Specifically, I included a large number of restrictions to prevent profiles that are unrealistic and would not occur in the real world.

On the other hand, I also used further robustness tests, which are important due to the design of the survey. First, I checked whether respondents lost concentration throughout the survey by estimating all results based on the first two (out of five) conjoint comparisons only. Moreover, I included round or task fixed effects to take account of the fact that respondents might make different choices in later stages of the conjoint experiment, for example due to fatigue or lack of concentration. Second, I assessed the relative time that respondents took to complete the conjoint tasks and I excluded those respondents that speed through the conjoint tasks, comparing the results with the overall sample. Third, the conjoint survey experiment described above was embedded in a survey, which included two different set of conjoint tasks. The order in which these conjoint experiments occurs in the survey was randomised. Still, I checked whether respondents are influenced in their evaluations of the conjoint

profiles if they have already completed a different set of conjoint tasks beforehand. For this purpose, I split the sample and analysed the results separately depending on whether the conjoint experiment occurred before or after the other conjoint experiment in the survey. Fourth, there is also a possibility that the screen size might affect the way respondents evaluate the conjoint tasks. I therefore also separately analysed responses from mobile versus non-mobile respondents and checked to what extent they differ. Finally, I also repeat the analysis without the weights created with entropy balancing to check whether the results are dependent on the weights. All of these robustness checks yielded similar results to the ones shown here.

Appendix D

D.1 List of all British Interviews

I selected my interview partners by combining a ‘purposive sampling method with a ‘chain’ or ‘snowballing’ sampling method. I first tried to identify the key politicians and policy-makers that influenced the response of Labour to the Great Recession. Second, I encouraged my initial respondents to suggest other people, who are relevant to answer my research question (Biernacki and Waldord, 1981; Farquarharson, 2005). In this way, I tried to identify influential players, who were not obvious *ex ante*. Based on this reasoning, I conducted interviews with the following 20 policy-makers between September 2016 and April 2017:

- Anonymous, Former Labour MP and Minister, London,
- Thomas Baldwin, former adviser to Ed Miliband, London
- Ed Balls, former Shadow Chancellor of the Exchequer, London
- Torsten Bell, senior strategic advisor to Ed Miliband, London
- Dan Corry, former Head of the Number 10 Policy Unit, London
- Jon Cruddas MP, Labour Party MP and co-chair of Labour Party’s Policy Review, London
- Alistair Darling, former Chancellor of the Exchequer, London
- John Denham, former Labour MP, Government Minister, Shadow Business Secretary and Parliamentary Private Secretary to Ed Miliband, Winchester
- Patrick Diamond, senior adviser to Tony Blair and Gordon Brown, London
- Peter Hain, Labour peer and former Labour MP and government minister, London

- Neil Kinnock, Lord, former Leader of the Labour Party, London
- Roger Liddle, Lord, former special adviser to Tony Blair, London
- Anthony Painter, Labour activist and author of 'In the Black Labour' (phone interview)
- Nick Pearce, former director of the Institute for Public Policy Research, London
- Rachel Reeves, senior member of Labour Party Shadow Cabinet under Ed Miliband, London
- Rober Skidelski, member of the House of Lords and economic historian, London
- Marc Stears, strategic advisor to Ed Miliband, London
- Nick Thomas-Symonds MP, Labour MP for Torfaen and Historian, London
- Kieren Walters, former Head of Broadcasting for the Labour Party, London
- Simon Wren-Lewis, Professor of Economics at Blavatnik School of Governance, University of Oxford (e-mail exchange)

Appendix E

E.1 List of all German Interviews

I selected my interview partners by combining a ‘purposive sampling method with a ‘chain’ or ‘snowballing’ sampling method. I first tried to identify the key politicians and policy-makers that influenced the response of the SPD to the Great Recession. Second, I encouraged my initial respondents to suggest other people, who are relevant to answer my research question (Biernacki and Waldord, 1981; Farquarharson, 2005). In this way, I tried to identify influential players, who were not obvious *ex ante*. Based on this reasoning, I conducted interviews with the 21 policy-makers between August 2016 and March 2018:

- Anonymous, Adviser to the SPD parliamentary group in the Bundestag, Berlin
- Lothar Binding, MP and spokesperson for financial affairs of the SPD parliamentary faction, Berlin
- Michael Dauderstädt, former head of the Economic and Social Policy department of the Friedrich-Ebert-Stiftung, Berlin
- Sebastian Dullien, Professor of Macroeconomics at the HTW Berlin University and economic advisor to the SPD, Berlin
- Henrik Enderlein, Professor of Political Economy at the Hertie School of Governance and economic advisor to the SPD, Florence
- Andrä Gärber, head of the Economic and Social Policy department of the Friedrich-Ebert-Stiftung, Berlin
- Heiko Geue, former head of Political Staff at the Federal Ministry of Finance, Berlin

- Björn Hacker, Professor at the HTW Berlin University of Applied Sciences and former analyst at the Friedrich Ebert- Stiftung, Berlin
- Dierk Hirschel, Chief Economist at ver.di United Services Trade Union and member of the Commission for Fundamental Values of the SPD, Berlin
- Gustav Horn, Academic Director of the Macroeconomic Policy Institute (IMK), Berlin
- Johannes Kahrs, MP and budgetary spokesperson of the SPD parliamentary group, Berlin
- Christian Kellermann, former adviser to the SPD's executive board and head of the economic policy unit of the SPD, Berlin
- Joachim Poß, Former MP and deputy chairman of the SPD parliamentary group responsible for economic affairs, Berlin
- Carsten Schneider, MP and First Secretary of the SPD parliamentary group, former Deputy Chairman of the SPD parliamentary group responsible for economic affairs, Berlin
- Gesine Schwan, head of the Commission for Fundamental Values of the SPD, Berlin
- Philipp Steinberg, Director-General for Economic Affairs at the Federal Ministry of Economic Affairs and Energy and former senior adviser to SPD Chairman Sigmar Gabriel, Berlin
- Gerald Steininger, senior adviser on financial affairs of the SPD parliamentary group, Berlin
- Ralf Stegner, deputy leader of the SPD, Berlin
- Thorsten Schäfer-Gümbel, deputy leader of the SPD, Wiesbaden
- Kerstin Villalobos, senior adviser on European politics of the SPD parliamentary group, Berlin
- Wolfgang Thierse, former President of the Bundestag and deputy chairman of the SPD, Berlin