AUSTERITY AND ELECTIONS

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MOTIVATION: THE PRESS

"Portugal's socialists tipped for re-election after charting path out of austerity"

France24, 6/October/2019

"Greek conservatives score landslide election win as country rejects austerity"

The Telegraph, 8/July/2019

"Voting begins in Finland's anti-austerity election"

Bangkok Post, 14/April/2019

"Argentina: voters reject Mauricio Macri's austerity in primary vote"

DW, 12/August/2019

"Austerity, not the 'failure' of Brexit, is behind the Tories' election wipeout"

The Guardian, 5/May/2019

=> Conventional wisdom that austerity carries electoral costs

MOTIVATION: THE ECONOMIC LITERATURE

*"To the extent that **voters dislike deficits** in general […], it is probably especially difficult to persuade them that they are 'good' in an election year"*

Brender and Drazen (2008, AER)

*"**some parties gain votes for retrenching the welfare state**"*

Giger and Nelson (2011)

*"**leaders have substantial latitude to implement austerity** without being sanctioned"*

Arias and Stasavage (2019)

*This chapter raises doubts about the **conventional wisdom suggesting that austerity always mean an electoral defeat** for the government implementing it*

Alesina, Favero and Giavazzi (2019)

=> Yet, hypothesis that austerity is a government's 'kiss of death' mostly rejected in empirical work

EMPIRICAL CHALLENGES

1. Strategic selection => governments refrain from austerity if perceived to be costly

2. Austerity data => *ex-post* fiscal variables miss 'unsuccessful' consolidation

3. Matching => yearly fiscal data risks assigning austerity to 'wrong' government

4. Electoral cost => 0/1 re-election dummies very rough measure

THIS PAPER

- How does austerity affect electoral outcomes?

  (i) **Action-based, *ex-ante*,** fiscal austerity data

  (ii) **Matching** austerity measures to actual government announcing them

  (iii) New electoral data: change in governing parties' **vote share** & parliament seats

  (iv) **Endogeneity checks** to control for strategic selection

- Emphasis on the **'how'**, and the **'who'** => do effects depend on

  1. Type of austerity: tax hikes or expenditure cuts (how)?
  2. The economic manifesto of parties implementing it (who)?

- Explain results through model of electoral competition with polarized voter constituencies

TAKE-AWAYS

BASELINE RESULTS

- **Large electoral cost if austerity carried out through tax hikes**
- 'Expenditure-based' austerity neutral on average

IMPORTANCE OF MANIFESTO

- Tax hikes costlier if government campaigned on free-market manifesto (deviation)
- Expenditure cuts costly if government did not campaign on free-market manifesto (deviation)
- Expenditure cuts beneficial if manifesto is pro-market (adherence)

<u>BUT WHY DO GOVERMENTS PROMISE SOMETHING AND THEN DEVIATE?</u>

- Repeated electoral competition + polarized constituencies & asymmetric information can explain these results

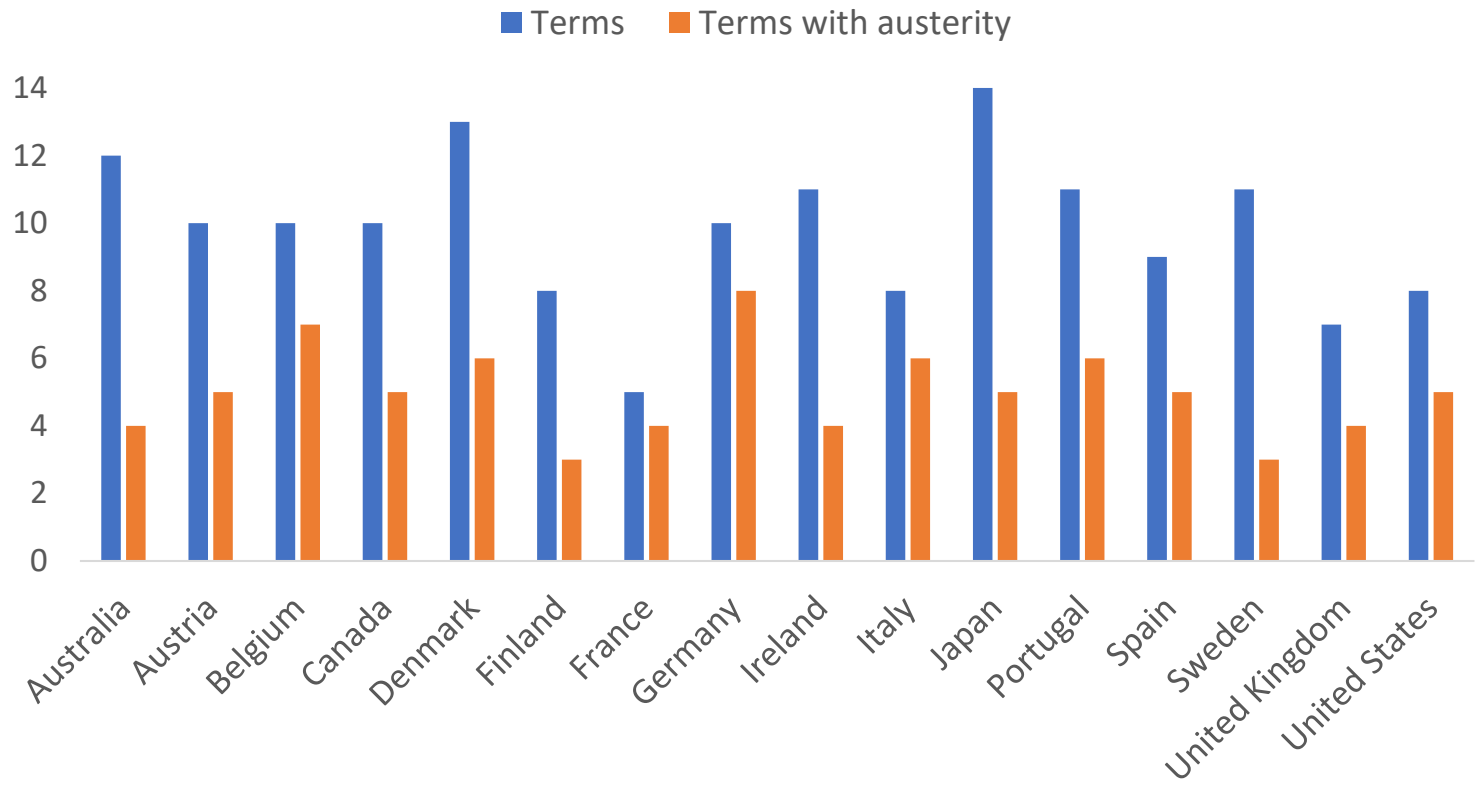
OUTLINE

1. Dataset
2. The electoral cycle of austerity
3. Econometric specifications
4. Baseline results
5. Endogeneity
6. Economic manifesto
7. Theoretical model
8. Conclusions

DATASET

SAMPLE

- 16 OECD countries; 1978-2014 period



=> 157 terms observed overall, about 50% with some austerity

ELECTORAL DATA

- Start from leader start & end dates + election dates (Alesina et al., 2020)

- For each leader, recover supporting party(ies) & **construct 'party term' variable**
  - 2 or more successive leaders supported by same party(ies) within same legislature => same party term
  - Different leaders supported by different party(ies) within same legislature => different party terms

- For each party term, source:
  - **Vote shares** & parliament seats (Doring & Manow, 2019)
  - **Political ideology** (Doring & Manow, 2019)
  - **Economic manifesto** (Volkens et al., 2021)

FISCAL DATA (ALESINA ET AL., 2018)

- Action-based – *ex-ante* – data on budgetary impact (% of GDP) of over 3500 fiscal consolidation measures
- Only measures motivated by desire to reduce budget deficit
- Measures classified in multi-year plans
- Distinction between tax increases and expenditure cuts

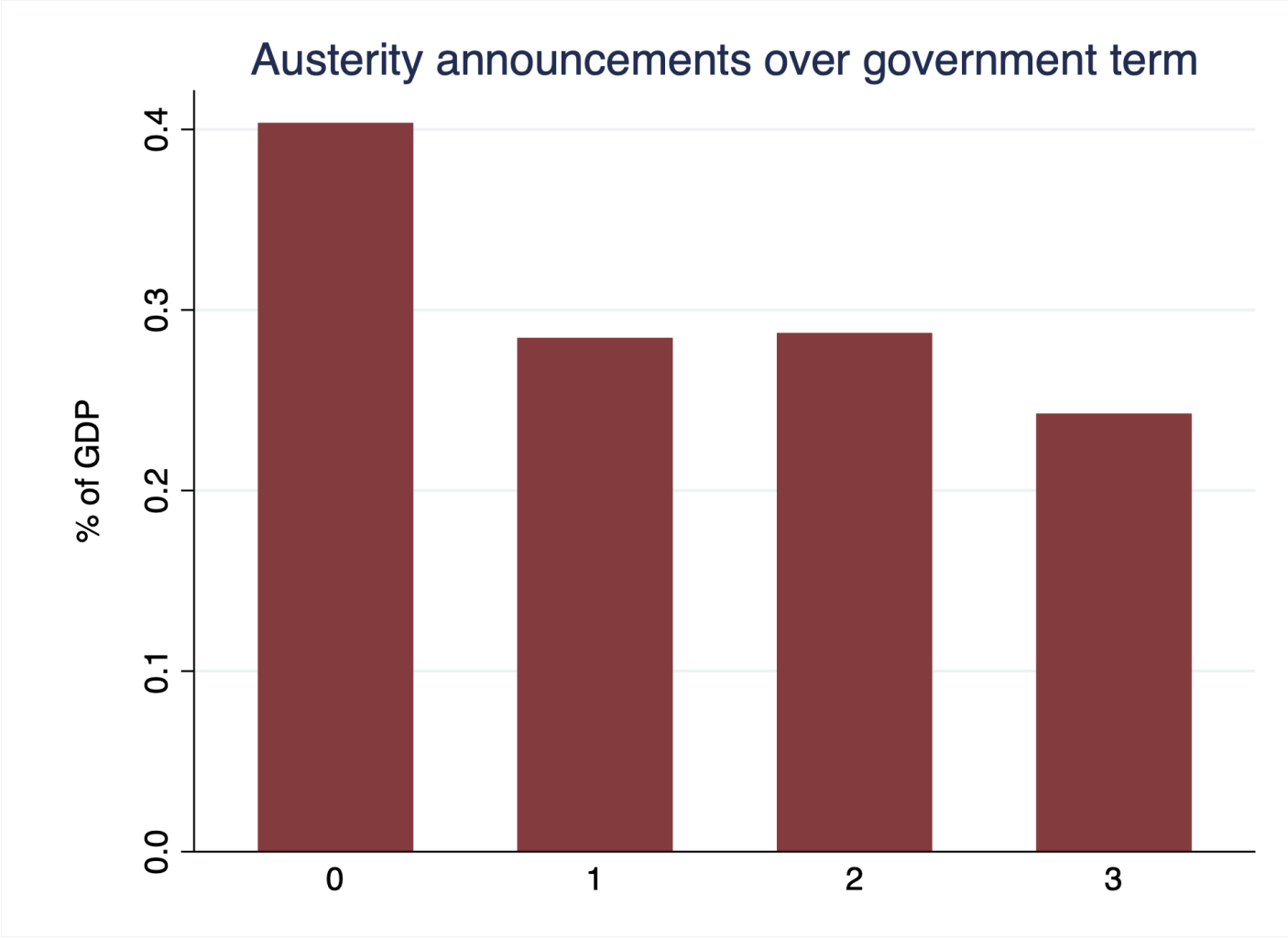
  - Example: Canada 2011

		t	t+1	t+2	t+3	t+4	t+5	announcement
Direct Taxes		0.18	0.43	0.4	0.05	-0.05	-0.01	
March 2011 Budget pp. 240-241, June 2011 Budget pp. 8, 262-264								
	Anti-Avoidance Rule	0.08	0.03	0	0	0	0	March-2011
	Individual Pension Plans	0.01	0	0	0	0	0	March-2011
	Tax on Split Income - Capital Gains	0.01	0	0	0	0	0	March-2011
	Donations of Publicly Listed Flow-Through Shares	0.03	0.01	0	0	0	0	March-2011
	Stop-loss Rule on the Redemption of a Share	0.06	0.03	-0.01	0	0	0	March-2011
	Partnerships - Deferral of Corporate Tax	0	0.35	0.4	0.05	-0.05	-0.01	March-2011
Government Consumption and Investments		0.15	0.86	1.24	1.79	0.5	0	
March 2011 Budget pp. 240-241, June 2011 Budget pp. 8, 262-264								
	Targeted Strategic and Operating Review Savings	0	0.75	1	1.75	0.5	0	June-2011
	Review savings	0.15	0.11	0.24	0.04	0	0	June-2011
Total		0.33	1.28	1.64	1.84	0.44	-0.01	

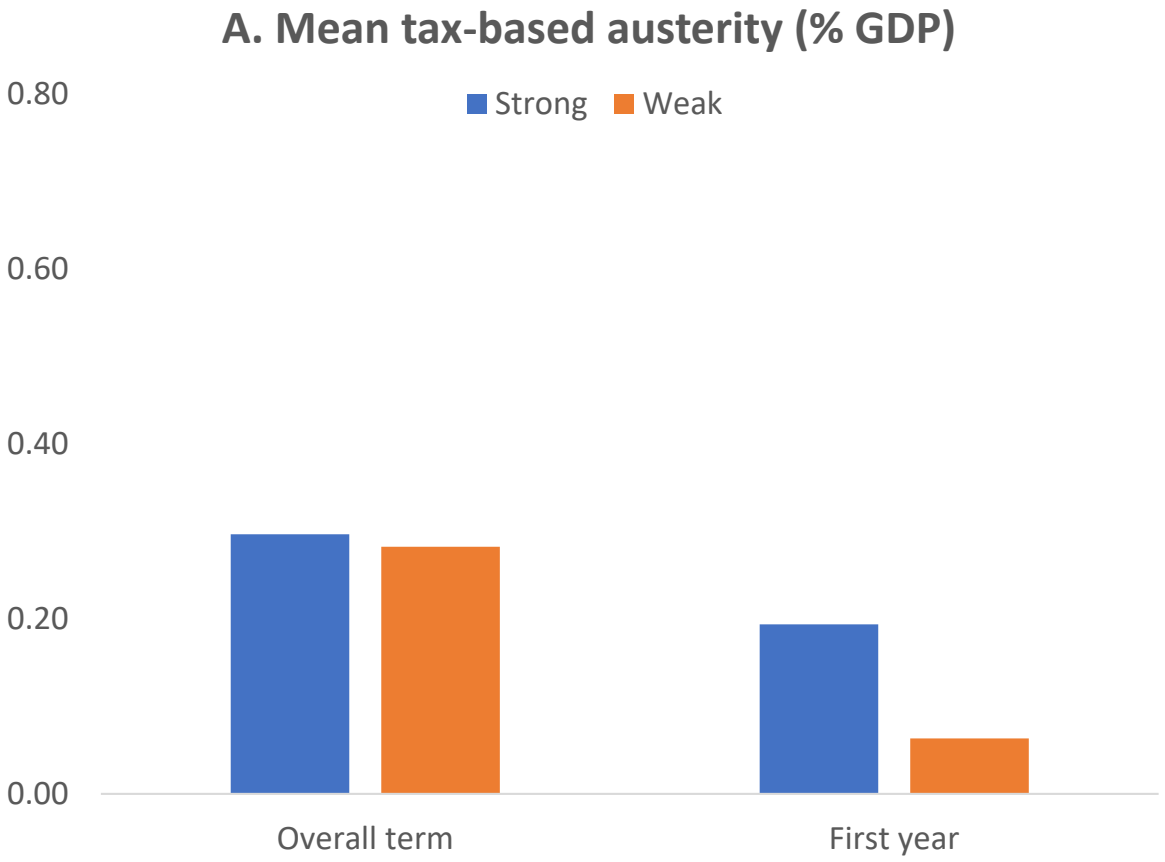
- Recover month of announcements and match plan to party term
- For each announcement, distinguish between tax-based (Tb) & expenditure-based (Eb) plans
- Cumulate all plans announced within term, keeping Tb/Eb distinction

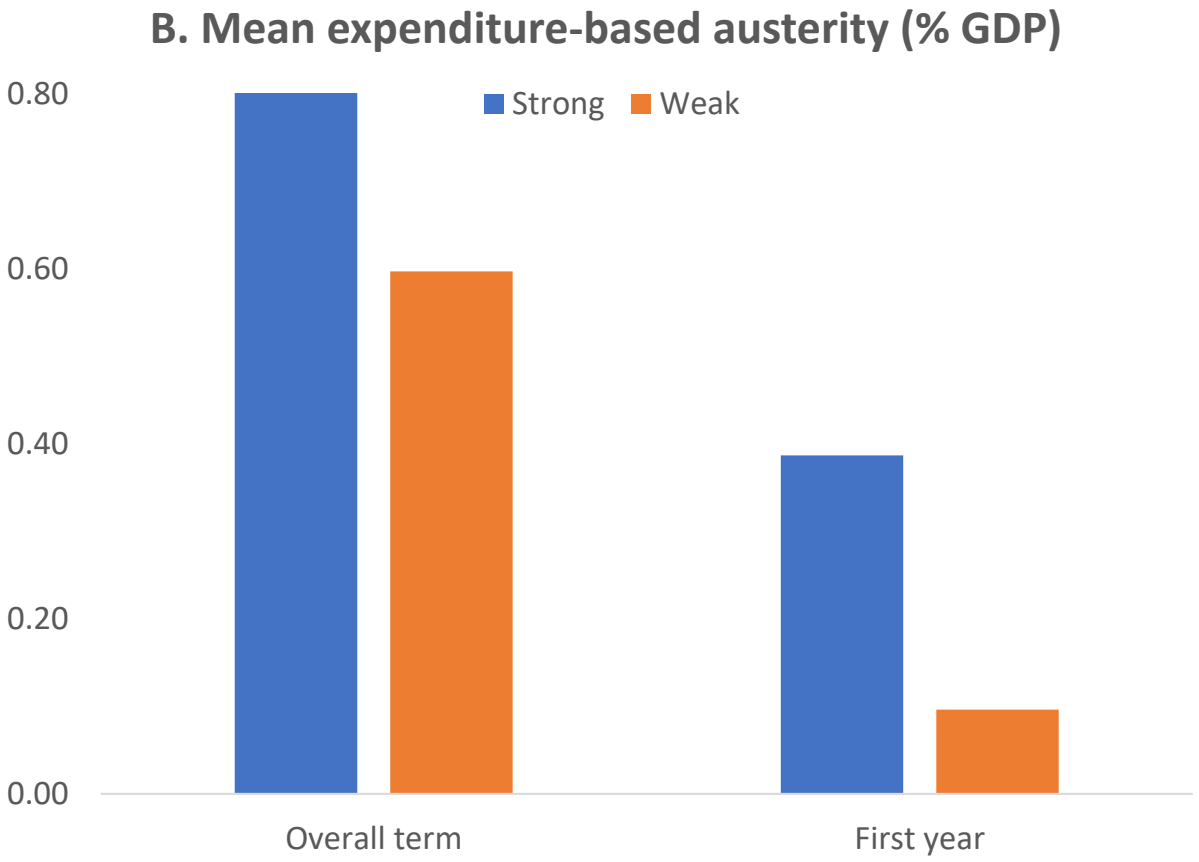
THE ELECTORAL CYCLE OF AUSTERITY

AUSTERITY DECLINES OVER GOVERNMENT TERM



MORE AUSTERITY AFTER SWEEPING VICTORIES





ECONOMETRIC SPECIFICATION

BASELINE ANALYSIS

$$\Delta VOTE_{i,e} = \alpha + \mu_{ij} + \beta Tb_{i,e} + \delta Eb_{i,e} + \rho Y_{i,e} + \gamma Z_{i,e} + \varepsilon_{i,e}$$

$\Delta VOTE_{i,e}$ => vote share change of incumbent party(ies) in country *i* at election *e* (%)

μ_{ij} => leader's party fixed effects

$TAX_{i,e}/EXP_{i,e}$ => tax-/expenditure-based austerity during term (% of GDP)

$Y_{i,e}$ => GDP growth in electoral year

$Z_{i,e}$ => additional covariates (macroeconomic, structural & political)

BASELINE RESULTS

VOTE SHARE

	(1) Party % vote	(2) Party % vote	(3) Party % vote	(4) Coalition % vote	(5) Coalition % vote	(6) Coalition % vote
Tax	-7.2***	-8.3***	-7.3***	-6.4***	-6.8***	-5.9***
	(1.6)	(1.4)	(1.3)	(1.3)	(1.3)	(1.2)
Expenditure	-0.0	0.9	0.4	-0.8	-0.6	-1.1
	(1.4)	(1.6)	(1.5)	(0.8)	(0.7)	(0.8)
Growth			2.7***			2.6***
			(0.9)			(0.9)
Observations	157	157	156	149	149	148
R-squared	0.08	0.12	0.20	0.09	0.14	0.23
Party FE	NO	YES	YES	NO	YES	YES

=> **1% of GDP tax-based consolidation associated to 7% vote share decline**

=> **Expenditure-based consolidations neutral on average**

PARLIAMENT SEATS

	(1) Party % seats	(2) Party % seats	(3) Party % seats	(4) Coalition % seats	(5) Coalition % seats	(6) Coalition % seats
Tax	-9.7***	-10.9***	-9.5***	-8.8***	-9.5***	-8.2***
	(2.3)	(1.5)	(1.6)	(2.1)	(1.5)	(1.6)
Expenditure	0.6	1.1	0.4	-0.3	-0.3	-1.0
	(1.5)	(1.7)	(1.7)	(0.9)	(0.9)	(1.0)
Growth			3.7***			3.3***
			(1.1)			(1.2)
Observations	143	143	142	136	136	135
R-squared	0.10	0.15	0.26	0.11	0.18	0.29
Party FE	NO	YES	YES	NO	YES	YES

=> Electoral cost of Tb translating in 10% decline in seats share (about 5 p.p. decline)

ROBUSTNESS CHECKS

⇒ Different methods to construct austerity variables (implemented vs announced, threshold to define Eb/Tb plans) ✓

⇒ Inclusion of political/electoral controls (term length, turnout, vote share)✓

⇒ Inclusion of macroeconomic controls (D, i and b, level and change) ✓

⇒ Inclusion of structural reforms as controls (banking, labor, KA, PMR) ✓

⇒ Sample stability (EU vs non-EU; excluding ES, PT & IE) ✓

⇒ Exclusion of one party at a time ✓

⇒ Exclusion of one country at a time ✓

ENDOGENEITY

THREE MAIN ENDOGENOUS CHOICES

1. Whether: refrain from carrying out austerity if perceived to be costly

2. When: do not implement austerity close to an election

3. What kind: rely on tax hikes or expenditure depending on electoral base

LARGER COEFFICIENTS FOR 1ST YEAR AUSTERITY

	(1) All years	(2) 1st year	(3) 3rd year	(4) 1st & 3rd year
Tax all years	-6.8***			
	(1.5)			
Expenditure all years	-0.7			
	(1.1)			
Tax 1st year		-10.1***		-10.8***
		(3.6)		(4.0)
Expenditure 1st year		-1.4		-1.5
		(1.8)		(1.9)
Tax 3rd year			-6.3**	-6.3**
			(2.3)	(2.6)
Expenditure 3rd year			-2.4	-5.0
			(4.2)	(5.5)
Growth	2.1**	2.1**	1.9**	1.7*
	(0.8)	(0.8)	(0.9)	(1.0)
Observations	119	119	119	119
R-squared	0.16	0.10	0.10	0.18

=> Govt might refrain doing Tb late in term for fear of being punished (true cost late in term not observed)

LARGER COEFFICIENTS FOR WEAKER GOVTS

	(1) Baseline	(2) Strong govts all years	(3) Weak govts all years	(4) Strong govts 1st year	(5) Weak govts 1st year
Tax all years	-7.3***	-5.5	-8.1***		
	(1.3)	(3.8)	(1.6)		
Tax 1st year				-5.2	-17.6***
				(4.5)	(6.2)
Expenditure all years	0.4	0.3	0.6		
	(1.5)	(1.9)	(1.1)		
Expenditure 1st year				0.9	5.3
				(3.9)	(3.4)
Growth	2.7***	5.3**	2.1*	5.0**	2.9***
	(0.9)	(2.3)	(1.1)	(2.3)	(0.9)
Observations	156	76	77	76	77
R-squared	0.20	0.28	0.36	0.26	0.28
Party FE	YES	YES	YES	YES	YES

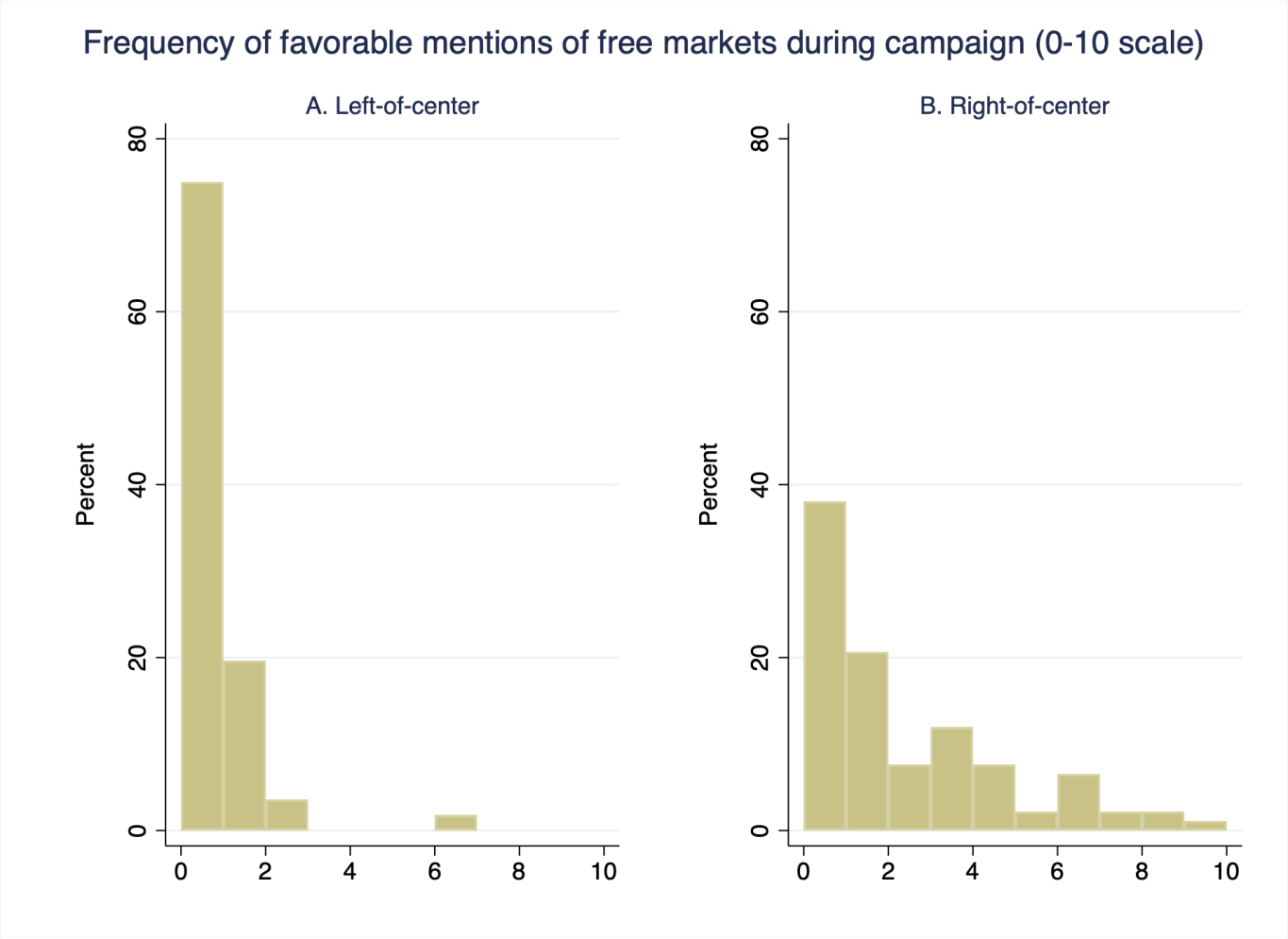
=> Weak govt do less austerity (see descriptive stats) but are punished more when they do (suggest true average cost of Tb austerity might be even larger)

CONTROLLING FOR *CHOICE* OF DOING AUSTERITY

	(1)	(2)	(3)
	Baseline	Austerity dummy	Austerity type dummies
Tax	-7.3***	-7.2***	-4.4**
	(1.3)	(1.4)	(2.1)
Expenditure	0.2	0.3	-0.9
	(1.5)	(1.6)	(2.0)
Dummy austerity		-0.9	
		(3.2)	
Dummy tax-based			-7.6*
			(4.1)
Dummy expenditure-based			4.3
			(3.8)
Growth	2.8***	2.8***	3.0***
	(0.9)	(0.9)	(0.9)
Observations	156	156	156
R-squared	0.20	0.20	0.23
Party FE	YES	YES	YES

THE WHO: ECONOMIC MANIFESTO

MANIFESTO IS NOT A SUBSTITUTE FOR IDEOLOGY



Correlation between political ideology and free-market manifesto	
All parties	0.43
Left-of-center	0.28
Right-of-center	0.19

⇒ To the right-of-center, more right-wing parties do not always campaign more on free-market platform

⇒ Large variation in extent that right-wing parties campaign on free-market platform (even within same party over time!)

DOES ECONOMIC MANIFESTO MATTER?

	(1) No manifesto	(2) Interaction	(3) Dummy
Tax	-7.3***	-4.4***	
	(1.3)	(1.4)	
Tax * free-market manifesto		-2.6*	
		(1.4)	
Tax * (1- dummy free-market manifesto)			-5.1***
			(1.1)
Tax * dummy free-market manifesto			-21.9***
			(7.3)
Expenditure	0.2	-2.5**	
	(1.5)	(1.2)	
Expenditure * free-market manifesto		1.6***	
		(0.3)	
Expenditure * (1- dummy free-market manifesto)			-1.5
			(1.1)
Expenditure * dummy free-market manifesto			7.6**
			(3.2)
Free-market manifesto		-0.3	-0.1
		(0.7)	(0.7)
Growth	2.8***	2.4***	2.4***
	(0.9)	(0.8)	(0.8)
Observations	156	147	147
R-squared	0.20	0.33	0.31
Tax * dummy free = Exp * (1 - dummy free)			0.01
Party FE	YES	YES	YES

- **Governments punished for deviating from manifesto**
  - ⇒ Tb austerity costlier if campaigned on small govt platform
  - ⇒ Eb austerity costly if not campaigned on small govt platform
- **Eb austerity beneficial if campaigned of small govt platform**

=> But why govts do deviate?

A MODEL OF ELECTORAL COMPETITION WITH POLARIZED VOTER CONSTITUENCIES

KEY INGREDIENTS

- Politicians campaign on level of public expenditures
- Polarized voters go to the polls only if mobilized by group mobilizer
- Asymmetric information between politicians and mobilizers
- Elections are repeated infinitely
- Losing politician is replaced by another one with same preferences

SET-UP

- Two politicians with discount factor β and preferences on expenditure γ_t:

$$u_A(\gamma_t) = \begin{cases} -(\gamma_t - \gamma_A)^2 + \mathrm{R} & if\ A\ wins \\ -(\gamma_t - \gamma_A)^2 & if\ A\ loses \end{cases} \qquad u_B(\gamma_t) = \begin{cases} -(\gamma_t - \gamma_\mathrm{B})^2 + R & if\ B\ wins \\ -(\gamma_t - \gamma_\mathrm{B})^2 & if\ B\ loses \end{cases}$$

where $\gamma_A < \gamma_B$; *R* is rent from being in office

- Continuum of voters who get mobilized

  => mobilizers *I* & *J* have quadratic loss function with optima γ_I & γ_J with $\gamma_I < \gamma_A < \gamma_B < \gamma_J$ and discount factor $\delta = \beta$

- Mobilizer *I* can mobilize a mass of voters e_I that prefer promised expenditure γ_A^* over γ_B^*, by paying cost ce_I
- Probability that politician *A* wins is: $F(e_I, e_J) = \frac{e_I}{e_I + e_J}$
- Expected utility of mobilizer *m = I, J* is: $u_m = -\frac{e_I}{e_I+e_J}(\gamma_t^A - \gamma_m)^2 - \frac{e_J}{e_I+e_J}(\gamma_t^B - \gamma_m)^2 - ce_m$

ONE-SHOT GAME ($\beta = 0$)

- Politicians will always implement their favored policies γ_A & γ_B

- Mobilizers expect that (preferences are common knowledge)
  $\Rightarrow$ Mobilize voters based on them

- Suppose symmetric preferences: $\gamma_I = 0$ & $\gamma_J = 1$ and $\gamma_A = 1 - \gamma_B = \frac{1}{4}$

  $\Rightarrow$ We should observe politicians *A* & *B* elected with equal frequency

  $\Rightarrow$ *A* moderately cuts expenditure; *B* moderately raises it

REPEATED GAME ($\beta > 0$)

- Extreme case: both politicians promise mobilizers' bliss points ($\gamma_A^* = 1 - \gamma_B^* = 0$)

  $\Rightarrow$ Politicians A & B again elected with equal frequency

- Once elected, politicians trade off current benefit of implementing favored policy against foregoing future rents from staying in power => don't deviate if:

$$R\frac{\beta F^*}{1-\beta F^*} > u_X(\gamma^X) - u_X(\gamma^{X,*}) = (\gamma^{X,*} - \gamma^X)^2 \qquad X = A, B$$

where F^* is reelection probability in equilibrium

$\Rightarrow$ Mobilizer punishes politician who deviates by letting opponent win if δ high enough

- There can be equilibria where right (left) politicians promise and implement larger (smaller) expenditure cuts than their desired levels

  => **Trigger strategies (punishment) resemble what observed in the data** (but should not be observed)

EQUILIBRIUM WITH UNOBSORVED SHOCKS

- Fraction α of politicians draws, each period, $\beta_t^i \sim_{i.i.d} G[0,1]$
  - Assume politician *X* draws $\beta_t^i = 0$: she deviates at time *t* but might abide in future periods *t+k* (reliable politician but country hit by shock making austerity unavoidable)
- Fraction $(1-\alpha)$ draws $\beta_0^i \sim G[0,1]$ such that $\beta_t^i = \beta_{t-1}^i$
  - Assume politician has $\beta_0^i = 0$: she deviates forever (unreliable politician)
- Mobilizers don't know which type is the politician
  - Possible equilibrium strategy: punish politician that deviates (high chance she is 2nd type)

=> If α not too large, <u>equilibrium promised policies and trigger strategies are as before</u>, **but politicians do deviate and get punished when they do so** (as observed in the data)

MODEL AND THE DATA: A CROSS-CHECK

Voters should punish deviations from *economic* ideology, even conditional on general *political* ideology => test

	(1) No ideology (baseline)	(2) Ideology interaction	(3) Ideology dummies	(4) Ideology and manifesto
Tax	-7.3***	0.4		
	(1.3)	(3.2)		
Tax * right-wing ideology		-1.6**		
		(0.6)		
Tax * dummy left-of-center			-4.4	-4.5**
			(3.3)	(2.0)
Tax * dummy left-of-center * free market manifesto				3.0
				(3.2)
Tax * dummy right-of-center			-9.0***	-5.7***
			(1.5)	(1.3)
Tax * dummy right-of-center * free market manifesto				-2.3
				(1.5)
Expenditure	0.2	-5.2**		
	(1.5)	(2.2)		
Expenditure * right-wing ideology		1.2*		
		(0.6)		
Expenditure * dummy left-of-center			-3.2***	-6.6***
			(1.1)	(2.1)
Expenditure * dummy left-of-center * free market manifesto				3.6**
				(1.6)
Expenditure * dummy right-of-center			1.9	-0.8
			(2.0)	(1.1)
Expenditure * dummy right-of-center * free market manifesto				1.4***
				(0.3)
Dummy left-of-center * free market manifesto				-8.0***
				(2.6)
Dummy right-of-center * free market manifesto				0.3
				(0.6)
Growth	2.8***	2.7***	2.7***	2.7***
	(0.9)	(0.9)	(0.9)	(0.8)
Observations	156	156	156	147
R-squared	0.20	0.26	0.24	0.37
Party FE	YES	YES	YES	YES

⇒ **Deviation from economic manifesto driving electoral effect of Eb austerity over and above general ideology**

CONCLUSION

- Revisit conventional wisdom that austerity is government's kiss of death
- Tax-based austerity almost always costly, expenditure-based neutral on average (localized benefits vs diffused costs)
- Endogeneity all over the place => but our estimates may be lower bound of true cost of Tb
- Expenditure-based austerity beneficial for parties that campaigned on free-market manifesto, costly for those that did not
- Repeated electoral competition with polarized voter constituencies and asymmetric information can explain these results

ANNEX

DATASET: ELECTORAL DATA

=> When same coalition/party supports 2 or more successive leaders within same legislature treat them as belonging to same ‘party term’ => example:

country	leader name	party	start date	end date	election
UK	Thatcher	Conservative	Jun/1983	Jun/1987	Jun/1987
UK	Thatcher	Conservative	Jun/1987	Nov/1990	
UK	Major	Conservative	Nov/1990	Apr/1992	Apr/1992

- Thatcher and Major supported by Conservative Party in Jun/1987-Apr/1992 legislature;

=> Conservative Party term: Jun/1987 to Apr/1992

=> When different leaders supported by different party/coalition within same legislature treat them as belonging to different ‘party terms’ => example:

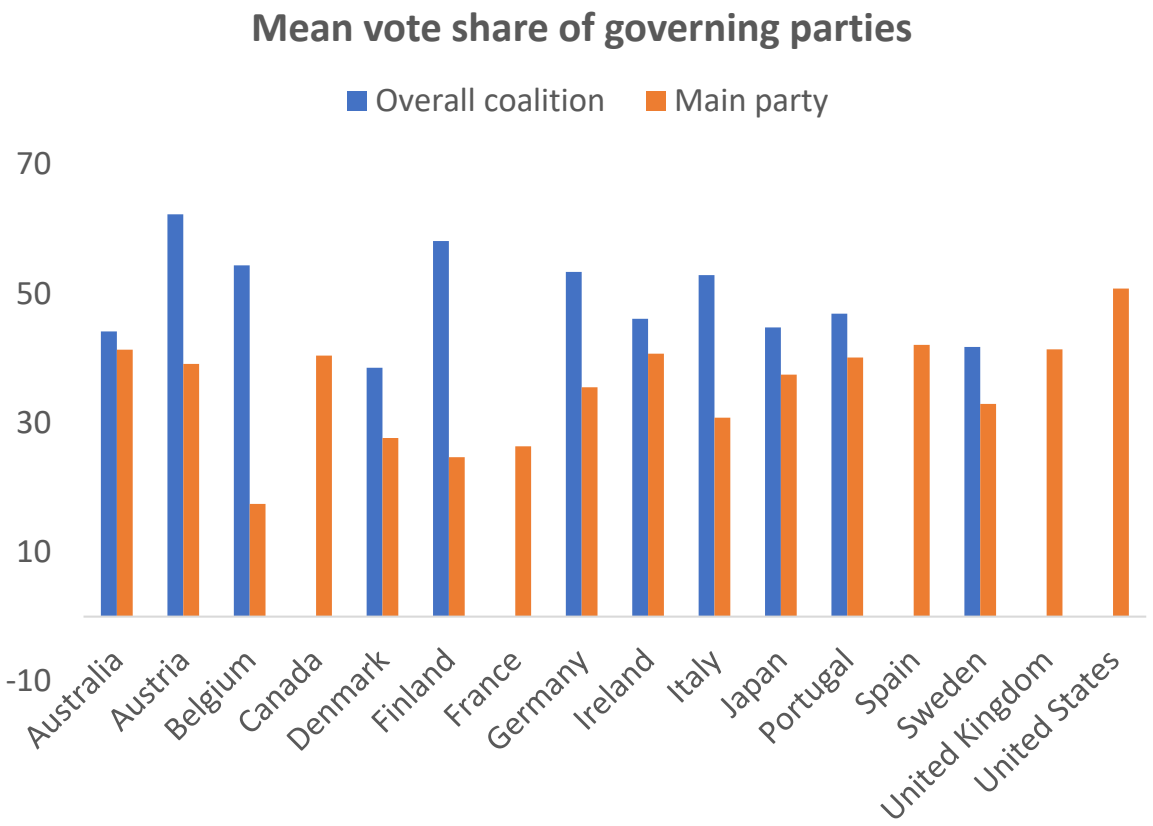
country	leader name	parties	start date	end date	election
Denmark	Schlüter	KF-V-RV	May/1988	Dec/1990	Dec/1990
Denmark	Schlüter	KF-V	Dec/1990	Jan/1993	
Denmark	Rasmussen	Sd-CD-RV-KrF	Jan/1993	Sep/1994	Sep/1994

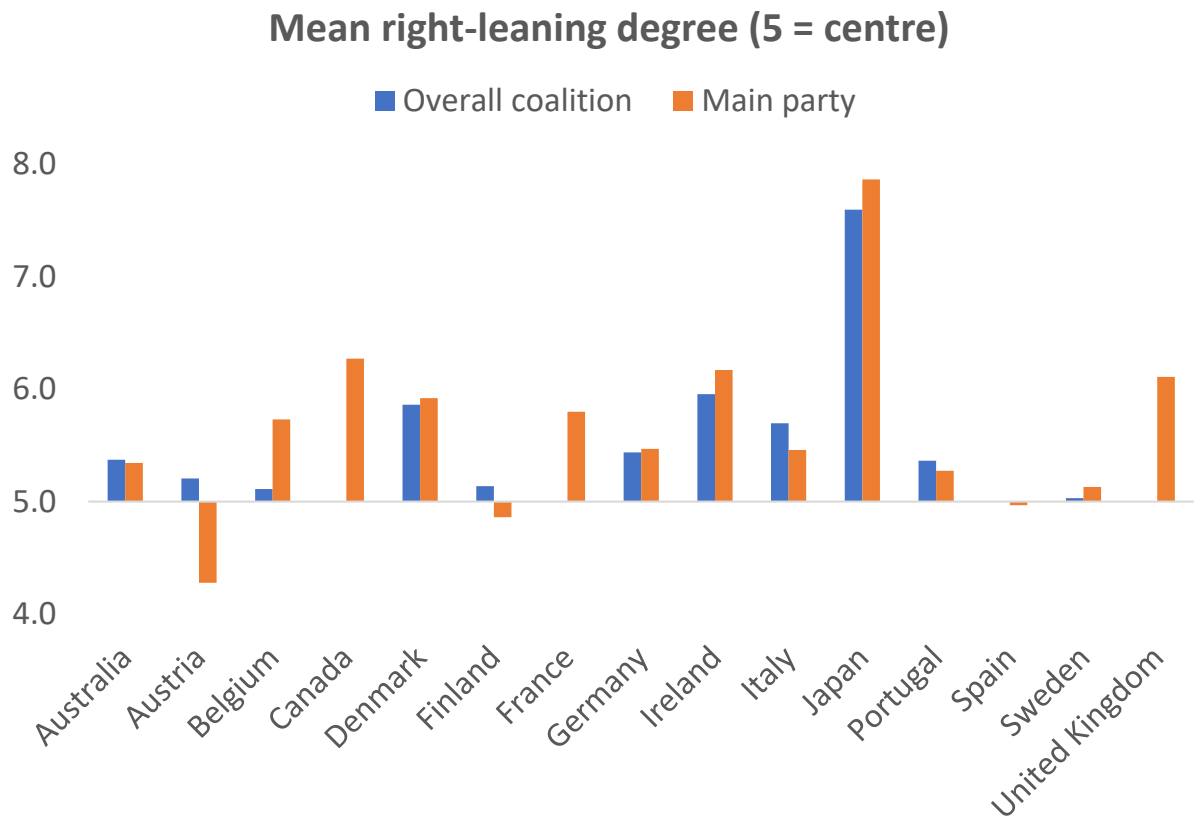
- Schlüter and Rasmussen supported by different parties in Dec/1990 to Sep/1994 legislature;

=> KV-V term: Dec/1990 to Jan/1993

=> Sd-CD-RV-KrF term: Jan/1993 to Sep/1994

DESCRIPTIVE STATS: ELECTORAL VARIABLES





=> Some countries heavily relying on coalition governments

=> More right-wing governments on average

=> **Generally uniform coalitions**

DOES THE RESPONSE OF THE ECONOMY MATTER?

	(1) No control (baseline)	(2) Debt level	(3) Budget balance	(4) 10-year level	(5) 10-year change	(6) All	(7) Output gap	(8) Unempl. rate
Tax	-7.3***	-7.0***	-7.2***	-8.3***	-8.0***	-7.7***	-8.1***	-8.4***
	(1.3)	(1.4)	(1.4)	(1.9)	(1.7)	(1.8)	(1.4)	(1.8)
Expenditure	0.2	0.2	-0.2	0.6	0.4	0.5	1.0	1.6
	(1.5)	(1.6)	(1.4)	(1.6)	(1.6)	(1.5)	(1.7)	(1.7)
Growth at election	2.8***	2.9***	2.7***	3.3***	3.2***	3.6***		
	(0.9)	(0.9)	(0.8)	(1.1)	(0.9)	(1.1)		
Debt level at start term		0.1**				0.1**		
		(0.0)				(0.0)		
Fiscal balance at start term			-0.7			-0.4		
			(0.5)			(0.7)		
10-year real yield at start term				-0.5		-1.0		
				(1.1)		(1.1)		
10-year real yield change during term					-0.3	-1.4		
					(1.6)	(1.3)		
Output gap at election							0.4	
							(0.5)	
Unemployment rate at election								-1.1**
								(0.5)
Observations	156	156	156	150	150	150	157	154
R-squared	0.20	0.21	0.21	0.21	0.20	0.23	0.12	0.15
Party FE	YES	YES	YES	YES	YES	YES	YES	YES

DO MACROECONOMIC CONDITIONS MATTER?

	(1) Any state no ideology (baseline)	(2) High/low states no ideology	(3) High/low states Ideology
Tax	-7.3***		
	(1.3)		
Tax - high GDP		-6.9	-0.1
		(5.7)	(6.3)
Tax - high GDP*Right			-16.7**
			(8.1)
Tax - low GDP		-6.9***	-7.2***
		(1.4)	(1.7)
Tax - low GDP*Right			-0.9
			(2.7)
Expenditure	0.4		
	(1.5)		
Expenditure - high GDP		4.0	4.7*
		(6.6)	(2.3)
Expenditure - high GDP*Right			8.7***
			(2.1)
Expenditure - low GDP		-2.8	-4.7
		(4.1)	(2.9)
Expenditure - low GDP*Right			0.9
			(3.3)
Growth	2.7***	2.5***	2.3**
	(0.9)	(0.9)	(1.0)
Observations	156	156	148
R-squared	0.20	0.21	0.33
Party FE	YES	YES	YES

⇒ **Tax-based costlier when implemented in low states**

⇒ **expenditure-based beneficial for right-leaning governments during booms**