Growth Models Under Austerity

Evelyne Hübscher & Thomas Sattler

Chapter 15 in: Lucio Baccaro, Mark Blyth and Jonas Pontusson (eds.). Forthcoming. *Diminishing Returns: The New Politics of Growth and Stagnation*. Oxford University Press.

Abstract

Fiscal policy is an integral part of a country's growth model. This chapter shows how governments subordinate their fiscal policy to the macroeconomic regime of their country: governments in export-led economies are 2-3 times more likely to pursue fiscal austerity than those in demand-led regimes. These rigid fiscal policies in many countries are not in line with voter attitudes and individual-level macroeconomic beliefs. Contrary to the economic ideas that provide the intellectual foundation of fiscal austerity, voters believe that these policies are detrimental to economic growth, but there is great variation between left and right voters. These ideological differences translate into distinct fiscal policies under left and right governments in balanced growth regimes, but not in unbalanced regimes. These results point to a mismatch between government policy, especially in export-led economies, and voter attitudes. This mismatch potentially contributes to the disillusionment of voters that has been observed in many countries.

Keywords: fiscal policy; austerity; growth model; party politics; voters; partisanship; public opinion

1. Introduction

Fiscal policy is an integral part of a country's growth model (Baccaro and Pontusson 2016; Blyth and Matthijs 2017). An export-led strategy, for instance, requires that governments limit fiscal deficits – i.e. by implementing fiscal austerity – in order to promote cost competitiveness and, hence, to enhance export opportunities for domestic firms. In contrast, governments in demand-led regimes should be less concerned about fiscal deficits because they need fiscal flexibility to manage domestic demand.

This chapter shows that, consistent with the implications of the growth-models perspective, governments subordinate their fiscal policy to the macroeconomic regime of their country. We find that the decision to pursue fiscal austerity varies significantly across countries. This variation is in line with a country's growth model. The amount of fiscal austerity implemented in export-oriented economies before the Great Recession is about 2–3 times greater than the amount of austerity in demand-led economies. Differences in austerity are more strongly related to growth regimes than to other economic or political variables, including fiscal deficits, government partisanship or political constraints.

Our analysis also contrasts this systemic, regime-based view with the popular approach in political economy to explain economic policies from a voter-driven, bottom-up perspective. Contrary to this view, we find that growth models dominate voter preferences: governments tend to favor the fiscal policies that reinforce their country's growth regime even if these policies stand in conflict with the preferences of voters. Specifically, voters are quite critical of austerity, but this skepticism does not prevent governments in export-led countries from systematically implementing spending cuts. In addition, government responsiveness is lowest in growth models that are closest to a specific `ideal type': While on average left voters are much less supportive of austerity than right voters, these diverging preferences only translate into distinct policies under left and right governments in balanced growth regimes, but not in unbalanced regimes, i.e. heavily export- or demand-led, regimes.

Together, these results suggest that a country's overarching macroeconomic strategy is critical to understand fiscal and macroeconomic policymaking. It better explains variations in fiscal austerity than voter preferences, and it limits the ability or willingness of party governments to respond to the fiscal preferences of their supporters in regimes that mirror ideal growth models. This points to a mismatch between government policy, especially in export-led economies, and voter attitudes. This mismatch is likely to contribute to political disillusionment of voters and possibly contributes to political perturbations, such as the rise of populist parties (Hopkin 2020; Hopkin and Blyth 2019) – especially in those countries where austerity is implemented without the postulated positive effects on growth.

2. Fiscal policy and growth regimes

2.1 Popular perspectives on austerity

A common perspective in comparative and international political economy puts popular preferences at the center of the analysis of economic policymaking (e.g., (Beramendi et al. 2015; Lake 2009). In this bottom-up view, voters demand or oppose economic policies, which incentivizes governments to pursue or avoid these policies. Change in economic policy then can occur either through a swing in voter preferences; or through a change in government partisanship when new government parties represent societal groups with interests and beliefs that are different from the supporter of previous government parties. Voters can prevent economic policies by threating to punish government parties in the next election or by vetoing policy change at various stages of the policymaking process (Hallerberg and Basinger 1998; Henisz 2004; Immergut 1992).

Applied to fiscal policy, the above model implies that variation in the pursuit of austerity primarily arises from variation in voter attitudes towards fiscal cuts, change in government partisanship, or differences in political constraints, such as veto players. But evidence that this is the case is limited, for two reasons. First, voter preferences cannot explain variation in fiscal policies across countries with different growth regimes. For a long time, and potentially in line with the voter-driven perspective, the political economy literature suggested that voters dislike fiscal deficits and, hence, support deficit-reducing policies (Alesina et al. 2011; Alesina et al. 1998; Brender and Drazen 2008). More recent findings, however, raise doubts about the enthusiasm of voters towards austerity. Although voters may be critical of deficits and debt (Brender and Drazen 2008), they are even more critical of austerity when they are confronted with concrete propositions to cut spending in specific areas, such as pensions, unemployment insurance or education (Bojar et al. 2018; Bremer and Bürgisser 2018; Hübscher et al. 2020). This opposition is remarkably stable across countries (Hübscher et al. 2020) and over time (Hübscher et al. 2015).[1]

Second, fiscal policies should diverge more strongly across party governments than they actually do if voter preferences were a key driver of these policies. We know from previous research that voters hold different attitudes towards austerity depending on their ideological orientation: left voters are significantly more likely to reject austerity than right voters (Hübscher et al. 2020). But despite this large ideological variation, government partisanship only has a limited effect on austerity policies: left and right governments are about equally likely to implement austerity packages (Hübscher 2016, 2018; Hübscher and Sattler 2017).[2]

[1] Of course, exceptions in peculiar circumstances are possible. For instance, many Eastern European citizens accepted austerity in order to avoid currency devaluations, which would have increased their foreign currency denominated debt (Walter 2015).
[2] There is a tendency towards more austerity by right governments, but this result depends on model specification and is not robust. There is also evidence that austerity packages by left

Others find that left governments are more likely to cut welfare spending, which is in contradiction to the voter-driven perspective (Armingeon et al. 2016).

2.2 Fiscal austerity through a growth-models lens

Given these limitations of the voter-driven approach, growth models offer a fresh political perspective on the determinants of fiscal policy and overall macroeconomic policy. Fiscal policy, i.e. fiscal expansion or restraint, plays a crucial role for a country's macroeconomic regime. Public investment and consumption directly contribute a significant share towards a country's *domestic demand*. Public expenditures also indirectly affect demand via their effect on citizens' consumption behavior, e.g. by increasing or decreasing wages in the public sector or by providing more or less generous social assistance programs. In countries that pursue a consumption- and demand-led model, fiscal flexibility, therefore, is an important instrument to stimulate domestic demand and hence growth.

Public spending policies also have fundamental consequences for *international competitiveness* of domestic firms and their export opportunities. Public deficits induce inward capital flows when international investors buy government bonds. These inflows push countries towards a current account deficit (Chinn and Prasad 2003; Jones 2015, 2016) and, hence, are detrimental to exports. Public sector employment and wages also feature prominently in real-economy models of trade imbalances. Trade surpluses are easier to achieve in systems with wage coordination, in which the sheltered sector, such as the public sector, accepts to limit wage growth in line with the interests of the exposed, trading sector (Johnston 2016; Johnston et al. 2014; Manger and Sattler 2020). In countries that pursue an export-led model, fiscal restraint, therefore, is the preferred fiscal strategy.

These diverging fiscal strategies have their ideational origins in different economic literatures that postulate distinct mechanisms linking fiscal policy to economic growth. A large macroeconomics literature highlights the positive impact of fiscal policy on growth via so-called 'fiscal multipliers'. Vice versa, research in this tradition points to the adverse effect of fiscal austerity on growth (Chowdhury and Islam 2012; Guajardo et al. 2014), especially during recessions (Jordà and Taylor 2016). In line with these insights, recent research shows

---

governments are somewhat smaller, but these differences are small compared to differences in attitudes between left and right voters.

that fiscal multipliers and hence the detrimental impact of austerity on European economies were much larger during the past crisis than the ECB assumed (Górnicka et al. 2018). Researchers in this tradition, therefore, have called for a more active fiscal policy in order to stimulate growth (Blanchard 2019; Blanchard and Summers 2017).

The intellectual counter position to the fiscal flexibility view does not explicitly consider the link between fiscal policy and international competitiveness and exports. But it also points to a supply side argument that connects low deficits and fiscal restraint to economic growth via 'expansionary fiscal contractions'. As Blyth (2013) describes in detail (see also, Dellepiane-Avellaneda 2014), an influential view advocates that fiscal austerity in fact does not inhibit growth, but can even induce economic expansion (Alesina et al. 2019; Giavazzi and Pagano 1990).[3] To the extent that fiscal consolidations have negative effects, these are traced to an inadequate strategy to consolidate: in particular, tax-based consolidations are seen as detrimental to growth, while growth is unaffected by spending-based consolidations.

From a growth-models perspective, fiscal and macroeconomic policies should be much less variant over time than the voter-driven perspective suggests. Specifically, fiscal austerity can be expected to change less with government ideology and voter attitudes and should primarily vary across countries that pursue distinct macroeconomic strategies. Largely, the main macroeconomic policies should be 'locked in', either institutionally, ideationally or politically. Institutionally, debt brakes, for instance, can ensure that governments of export-led countries do not deviate from the prescribed low-deficit policies. Ideationally, the public discourse can help to secure wider political support for the preferred policy by disseminating the economic arguments that motivate the country's growth model (Barnes and Hicks 2018; Ferrara et al. 2021). Politically, the influence of the dominant social bloc pushes political parties and governments towards the policy that is in line with the growth model (see esp. chapters 1 and 15 in this volume, and Haffert and Mertens 2019). To the extent that policies vary over time, policy adjustments mostly follow the need of the particular growth regimes and vary less according to political ideology.[4]

[3] In the language of the previous view, this means that the 'fiscal multiplier' is small or even reverse.

[4] Accordingly, macroeconomic outcomes that are central to growth models, notably current accounts, are highly persistent and vary mostly across countries. This cross-country variation in current accounts and trade balances is much more significant than the within-country variation over time (Manger and Sattler 2020).

This does not necessarily mean that ideology and government partisanship do not play any role at all. Instead, partisanship may matter most in countries with more balanced growth regimes, i.e. in which both domestic and external demand equally contribute to economic growth, but it should matter less in countries with more unbalanced growth regimes. In export-led regimes, the dominant social interests are aligned in favor of fiscal austerity, which pushes both left and right governments in that direction. In demand-led regimes, social interests demand fiscal flexibility and oppose austerity, which again should be taken into account by both left and right governments. In mixed regimes, however, governments have greater political room to pursue distinct fiscal policies that vary according to their ideological viewpoints and the attitudes of their supporters.

3. What do voters want? Beliefs about austerity and growth

Following the discussion in the previous section, we begin our empirical analysis with an analysis of voters (cf., Häusermann and Kriesi 2015). Specifically, we study the beliefs that they hold about the link between fiscal policy and economic growth. This allows us to explore to what extent these beliefs are consistent with the ideational narratives that accompanied fiscal consolidation measures taken by governments over the past decades. It also allows us to see how voter attitudes vary, both across countries and across subgroups of voters. We will then compare these attitudes with the actual behavior of governments, which we will analyze in the next section.

We conducted surveys in two countries – Germany and the United Kingdom – because they represent polar extremes in terms of their growth model (see chapters 9 and 10 in this volume and section 4 of this chapter). The survey took the form of a vignette-based online experiment (Mutz 2011), which allows us to examine how respondents evaluate the governments' fiscal strategy and its impact on economic growth. All respondents read about a situation in which their country experiences a situation of low growth and high fiscal deficit.

We then present two different scenarios how the government intends to address this situation. In both scenarios, the government aims at reducing the deficit and increasing growth albeit through fundamentally different mechanisms. Each mechanism corresponds to one of the different economic theories discussed in the previous section. In the first scenario, the government follows a Keynesian approach that highlights 'fiscal multipliers': it proposes to increase public spending in order to stimulate growth, which should then lead to a lower fiscal deficit. In the second scenario, the government follows a non-Keynesian approach that highlights the possibility of 'expansionary fiscal contractions': it proposes to cut public spending in order to reduce the deficit, which should then stimulate economic growth. The control group read about a scenario, in which the government does not change fiscal policy. Respondents are randomly exposed to one out of these three scenarios and the difference in their responses towards the scenarios represent the political effect of one policy solution compared to another.[5] Table 1 shows the exact wording of each scenario.

Table 1: Design of Experiment

Introduction (shown to all respondents)		
The UK [German] economy has experienced slow economic growth for several years. At the same time, the UK [Germany] has experienced a sizeable deficit in the public budget for several years. The UK's prime minister [German Chancellor] then announces in a televised speech how to deal with the situation.		
Group 1 (Control)	**Group 2 (Austerity)**	**Group 3 (Expansion)**
The prime minister says that despite this situation, the government will keep the current level of public spending on government programmes, such as public infrastructure, healthcare, schools and public pensions, unchanged.	The prime minister says that the government will cut public spending on government programmes, such as public infrastructure, healthcare, schools and public pensions, in order to reduce the public deficit. The prime minister says that the resulting reduction of the public deficit will also stimulate economic growth.	The prime minister says that that the government will increase public spending on government programmes, such as public infrastructure, healthcare, schools and public pensions, in order to stimulate economic growth. The prime minister says that the resulting increase in economic growth will also reduce the public deficit.

After having been exposed to one of the above scenarios, the respondents answered a set of questions that are used as outcome variables in our analysis. More specifically, respondents were asked 1) to what extent they approve of the government's policy strategy, and 2) how, according to them, the decision will affect economic growth.[6] This allows us to examine to

[5] The fielding phase of the survey has been administered by *respondi*. For each country we have a total of roughly 1.200 respondents (stratified by age cohorts and gender). The survey has been in the field between August 2 and August 9, 2019.

[6] The exact wording of the questions is the following: "To what extent do you approve the Prime Minister's announcement?", answer categories varied between 1 (strongly disapprove) to 5 (strongly approve); "How do you think this decision will affect the growth of the British [German] economy?", with answer categories varying between "negatively", "neither/nor", and "positively".

what extent respondent's assessment of fiscal policy is consistent with the economic ideas discussed above.

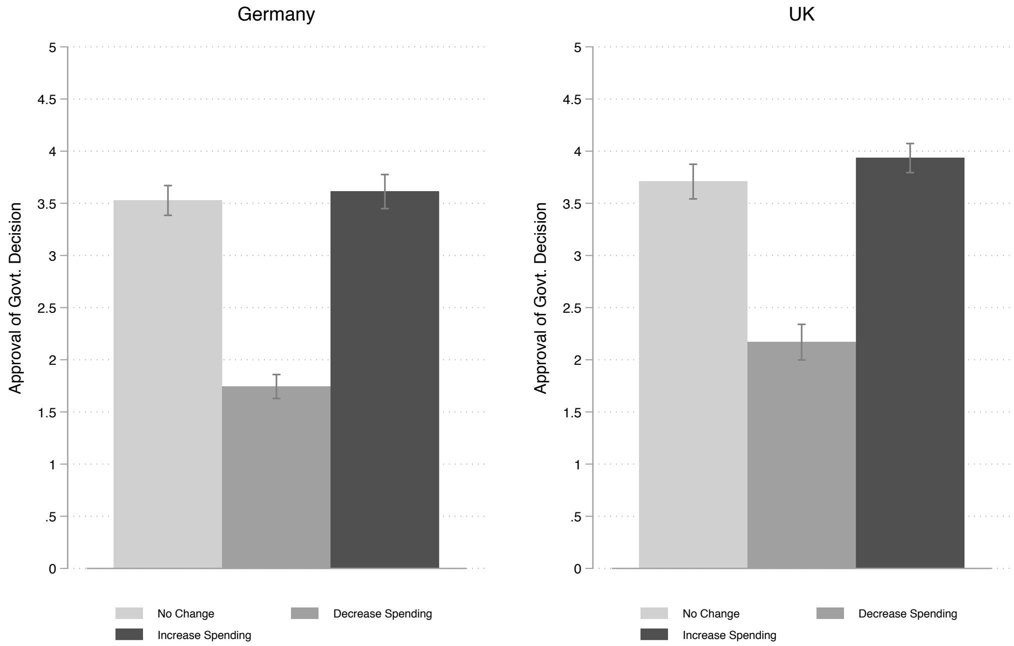

Figure 1: Approval of policy (approval varies between 1 and 5, with higher values indicating higher levels of approval)

Figure 1 shows the mean values of all three treatment groups for the approval of each policy option with 95% confidence intervals. It becomes immediately clear that a decrease in spending is the least preferred option in both countries.[7] A decrease in spending is also significantly less popular than the status quo with popular disagreement being stronger in Germany than in the UK. In both countries, an increase in spending is the most popular policy option. In the UK this policy option enjoys significantly more approval than the status quo, which is not the case in Germany. This finding could be interpreted as evidence that – on average – voters in Germany may be more critical of spending increases than voters in the UK, which is in line with our expectations for an export-led economy. However, these differences are small compared to the general disagreement with fiscal cuts in both countries.

[7] Assessing the impact of our policy treatments on a third outcome variable (whether respondents would vote for the prime minister after a given treatment) reveals the same results, the proportion of respondents who would vote for the incumbent is as low as 10% for Germany and roughly 25% for the UK.

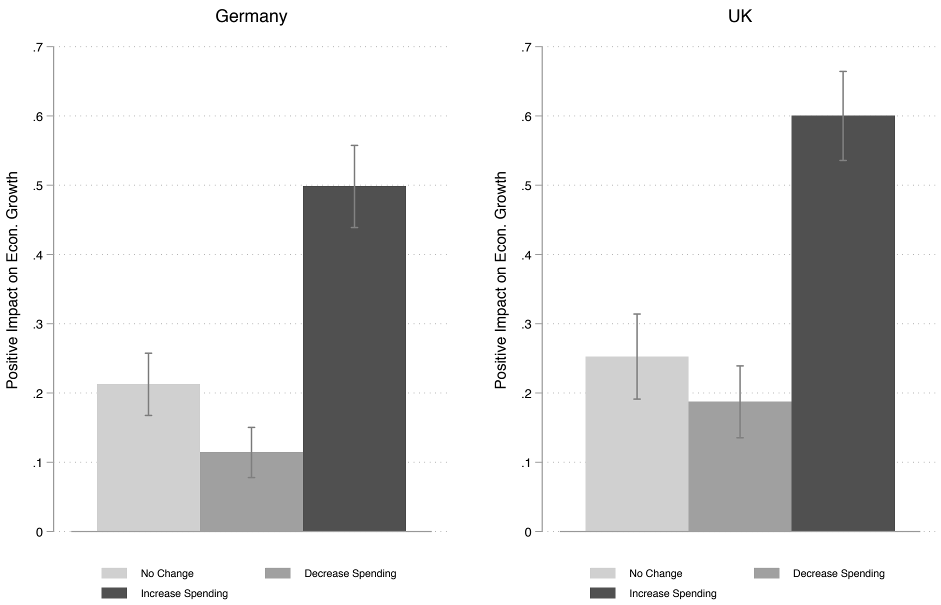

Figure 2: Expected impact of policy on economic growth

We also examine voters' beliefs about the relationship between the different types of fiscal policies and economic growth. Figure 2 shows how respondents expect the economic performance of their country to change as a result of different fiscal policies. We find that an overwhelming majority of respondents believe that an increase in public spending will have a positive effect on economic growth. Specifically, the ratio of respondents who expect an increase in spending to have a positive effect ranges from 50% (in Germany) to 60% (in the UK). In contrast, only a relatively small faction of respondents (10%-20%) think that austerity measures will have a positive effect on the economy. If voter preferences were in line with the dominant growth model, we should find that German voters, on average, expect austerity to have a positive effect on economic growth and an increase in spending to be negatively associated with economic growth.

Finally, we examine how these evaluations differ with respondents' political ideology, notably their self-placement on the left-right axis. Figure 3 shows that in both countries the predicted level of approval for spending increases is high across the whole ideological spectrum, with the UK showing a slightly higher level of support for spending increases (across the ideological spectrum). Furthermore, support for increases in spending at the very left of the ideological spectrum is only slightly different from the level of support at the very right. In contrast, approval of austerity varies greatly in the UK with the left being highly critical of austerity and the right showing a significantly higher level of approval. While the overall pattern in Germany is similar (in particular for approval of increases in spending), the level of support for austerity is approximately the same as in the UK at the left of the political spectrum, but does not increase as much as it does in the UK when moving towards the right of the political spectrum. In fact, the level of approval of austerity at the left is only slightly different from the level of approval at the conservative end as indicated by the 95% confidence intervals.

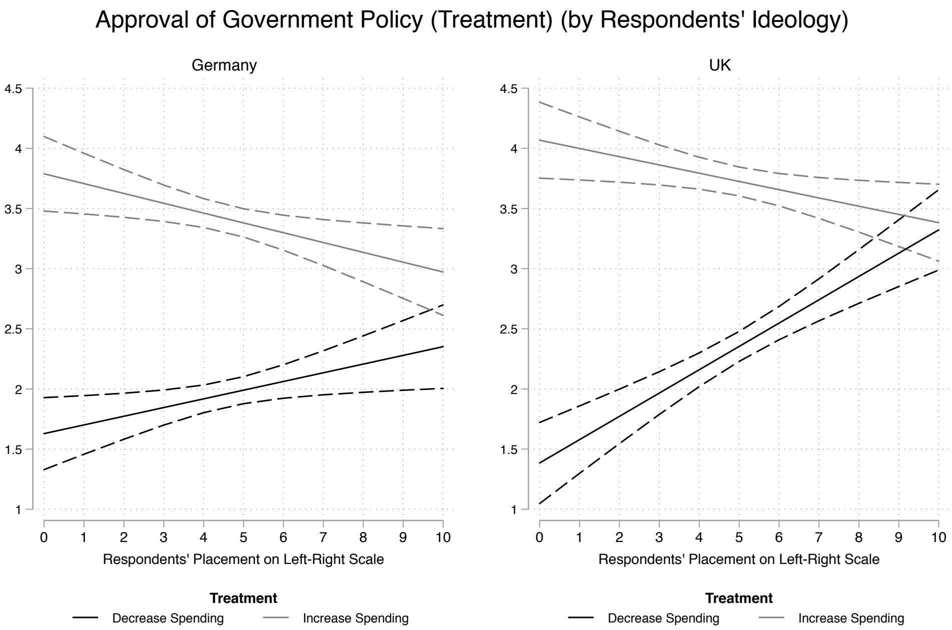

Figure 3: Predicted effect of spending increases (gray) and spending cuts (black) on policy approval as left-right position of voters changes (with 95% confidence interval).

We again perform the same analysis for the expected impact on economic growth in Figure A3. More left voters expect that spending has a positive effect on economic growth than right voters. In the UK, there is a shared belief across the ideological spectrum that an increase in spending will have a positive effect on economic growth, while there is a clear divide across the ideological spectrum when it comes to respondents' evaluation of the impact austerity. While the left expects that cuts have a negative impact on growth, voters on the right expect a more positive effect of austerity on growth.

The evidence on voter attitudes in this section suggests that voters are rather skeptical about the ideational narrative that has shaped the latest series of fiscal consolidation episodes. The beliefs of a majority of voters are not consistent with the economic arguments coined by economists and exponents from international organizations, which were overwhelmingly in favor of austerity policies (until the most recent past). While there is variation in the level of opposition towards austerity across the political spectrum, a majority of respondents find the Keynesian arguments about the connection between fiscal policy and economic growth more convincing. Furthermore, opposition to austerity is similar in countries following a demand-led as well as an export-led growth model.

4. What do governments do? Patterns of growth regimes and austerity

The previous section found that voters, on average, are quite critical of the idea that austerity will be good for economic performance. At the same time, there is a strong difference between left and right voters. In this section, we examine to what extent these diverging views translate into different fiscal policies under different party governments. Or whether fiscal austerity is in fact much more tied to systemic factors, in particular the growth regime of a particular country.

Our analysis uses data from the IMF on fiscal consolidation events in 16 OECD countries between 1978 and 2007 (Devries et al. 2011). This dataset includes all political announcements of fiscal measures that aim at reducing the public deficit as reported in government documents and policy reports. The indicator reflects by how much these measures were supposed to improve the fiscal balance (as % of the GDP). As opposed to commonly used fiscal policy measures that are grounded in actual spending, this indicator does not reflect variation of macro-economic indicators, such as the level of unemployment and economic growth. The indicator used, therefore, allows us to directly uncover political dynamics in fiscal consolidation and has become the standard indicator of fiscal consolidations in recent research (Alesina et al. 2015; Armingeon et al. 2016; Guajardo et al. 2014; Hübscher 2016).

To identify differences in growth regimes, we use an indicator by Baccaro and Neimanns (2021) that captures the contributions of exports and internal demand to aggregate growth of a country. Although we also look at export and demand contributions separately, we generally use the difference between export and demand contributions to growth because both dimensions are theoretically relevant for our purpose. A value around zero means that export and internal demand contributes about equally to growth, i.e. the growth model is balanced. Negative (positive) values mean that internal demand (exports) contribute disproportionately to growth, i.e. the growth model is more unbalanced. This indicator is available from 2000 onwards. Since we want to examine cross-country differences, we use the mean of the indicator for each country between 2000 and 2007.

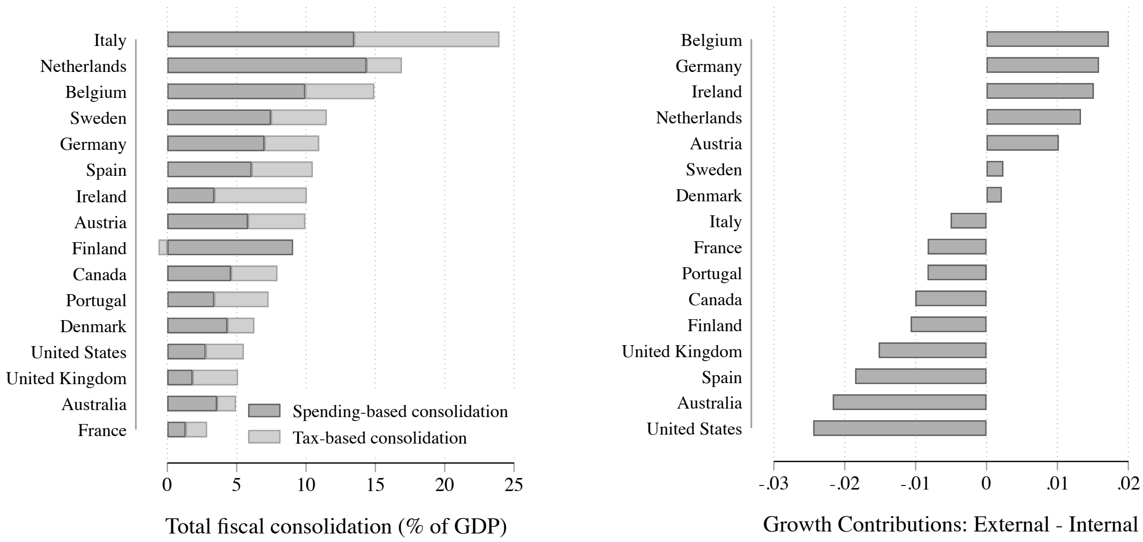

Figure 4: Austerity and growth contributions per country (until 2007)

Figure 4 shows how austerity (left graph) and growth contributions (right graph) are distributed across countries. The figure reveals a number of insightful patterns that are consistent with the growth model perspective. First, the overall size of consolidation implemented in these countries varies significantly. It ranges from a total of 23% of GDP in Italy to just about 3% in France. If we only look at spending-based (as opposed to tax-based) consolidations, the Netherlands with fiscal cutbacks of more than 13% of its GDP is the biggest consolidator. France implemented the smallest spending cuts with a total of about 1% of its GDP. In other words, the cross-country variation in fiscal austerity is considerable. As we will show below, this variation can only partially be explained with core macro-economic fundamentals, such as the state of public finances.

Second, and crucial for our purpose, the pattern of fiscal consolidations seems to be largely consistent with the growth models view. Among the countries with particularly low levels of austerity are the United States, the UK and Australia, in which, according to the graph on the right in Figure 3, internal demand contributes much more to growth than exports. In contrast, countries, where export contribute most to economic growth, like Germany, Belgium and the Netherlands, dominate the top of the austerity ranking. The differences in fiscal policy between these two groups are sizeable. The total amount of consolidation by the export-led group is about 2-3 times the size of the amount by the demand-led group. A more systematic analysis of the bivariate relationship between growth contributions and austerity confirms this preliminary conclusion (see Appendix A.2). There is a clear correlation between growth contributions and total austerity. Most of this correlation is due to the relationship between export contributions and austerity, but the pattern between demand contributions and austerity also goes in the expected direction.

The question now arises to what extent these differences are related to varying macroeconomic fundamentals, especially fiscal deficits, and political circumstances, in particular government ideology, across countries. When zooming in on how austerity events are spread over time while also plotting information on a country's deficit (see Appendix A.3), we find that austerity is only partially related to fiscal deficits. For instance, the US and the UK refrained from implementing austerity even during periods of prolonged – and at times substantive – deficits. This pattern becomes more pronounced from the mid-1990s leading up to the `Great Recession'.[8] Germany, and other more export-oriented countries, such as the Netherlands, and Belgium, battled fiscal deficits much more pro-actively by implementing austerity measures or managed to run surpluses for a number of consecutive years, which rendered austerity unnecessary.

[8] This coincides with the period that Baccaro and Pontusson (2016) define as turning point, from 1993 up to the Great Recession.

Table 2: Determinants of fiscal austerity

	Baseline / OLS		Full / OLS		Full / Multilevel	
	(1)	(2)	(3)	(4)	(5)	(6)
GrowthContr(i)			5.105***		5.682*	
			(1.955)		(2.962)	
Abs(GrowthContr)(i)				-5.676		-5.539
				(5.141)		(6.270)
Ideology(i,t)	0.021	0.049***	0.029*	0.124***	0.037**	0.126***
	(0.015)	(0.018)	(0.016)	(0.037)	(0.018)	(0.043)
Abs(GrowthContr)(i)*Ideology(i,t)				-7.155***		-7.132**
				(2.039)		(2.948)
Constraints(i,t)	0.203	-0.915*	0.102	0.379	-0.126	0.189
	(0.224)	(0.477)	(0.230)	(0.244)	(0.291)	(0.284)
Deficit(i,t-1)	-0.069***	-0.083***	-0.068***	-0.067***	-0.075***	-0.073***
	(0.010)	(0.011)	(0.010)	(0.010)	(0.008)	(0.008)
Growth(i,t-1)	-0.037***	-0.028*	-0.037***	-0.035**	-0.033**	-0.032**
	(0.014)	(0.015)	(0.014)	(0.014)	(0.014)	(0.014)
Constant	0.311***		0.326***	0.397***	0.325***	0.391***
	(0.026)		(0.028)	(0.077)	(0.040)	(0.084)
Fixed / Random effects	--	FE	--	--	RE	RE
Sd(Cons)	--	--	--	--	0.11	0.09
Sd(Ideo)	--	--	--	--	--	0.04
Corr(Cons, Ideo)	--	--	--	--	--	-0.09
p	0.000	0.000	0.000	0.000	0.000	0.000
R2	0.20	0.41	0.21	0.22	--	--
N	477	477	477	477	477	477

Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1.

To further investigate the role of the broader macro-economic and political environments in these countries, we also estimate a series of annual time-series cross-section models with fiscal austerity as the outcome variable. This allows us to examine the relationship between growth regimes and austerity, net of the variation that arises due to systematically different macroeconomic and political circumstances. Following our theoretical discussion, we include the fiscal balance and economic growth as macroeconomic explanatory variables. In order to assess political determinants of fiscal consolidation, we consider government ideology and institutional constraints.[9] This strategy allows us to isolate the country-specific differences that are not related to variation in macro-economic or political circumstances.

As expected, the results for the first baseline model in Table 2 show that fiscal deficits have a considerable impact on the propensity of a government to implement austerity. Specifically, a one-unit increase in the fiscal balance (1% of GDP) leads to a decrease in consolidation activities of ca. 0.07% of GDP. Political and institutional factors do not have a significant impact on fiscal consolidation. While the sign on the coefficient on government partisanship goes into the expected direction (more conservative governments implement bigger consolidation packages), the coefficients are not robustly statistically significant.

Although the economic variables, especially the fiscal balance, have an important influence on fiscal consolidations, the baseline model with country-fixed effects show that a large part of the variation is country-specific and unrelated to fundamental macro-economic indicators. The explained variance in the specifications that include country dummies is more than twice as big than the explained variance in the specifications without. This confirms our expectation that countries vary in their fiscal strategy in a way that the standard economic and political variables do not capture.

[9] The variables measuring fiscal deficits and growth are taken from the Comparative Institutional Dataset by Armingeon et al.. Government ideology is operationalized as the government parties' position on the ideological left-right axis from the Comparative Manifestos Dataset (Volkens et al. 2013) weighted by its vote share. Lower values on the ideology variable signify a more leftist government. In order to control for institutional constraints we use Henisz's (2004) index of political constraints, which measures to what extent a government is constrained to implement its agenda. A higher level of political constraints implies that the government is meeting a veto point, i.e. in the form of a different majority in the upper chamber.

We, therefore, re-examine to what extent the growth regime of a country can explain the cross-country variation after having factored out the impact of macroeconomic fundamentals. In the model in column (3), we simply add the growth model variable, which has a statistically significant impact on austerity. The model in column (5) accounts for the multi-level nature of our data (Gelman and Hill 2007). It accounts for the fact that growth models are (almost) time-invariant, whereas the control variables, like macroeconomic fundamentals, vary over time. We use a "partial pooling" approach, which fixes the coefficients on the time-varying variables, but allows the intercept to vary with the growth strategy. The intercepts then represent the typical austerity level in a country per year when the control variables are at their means.[10]

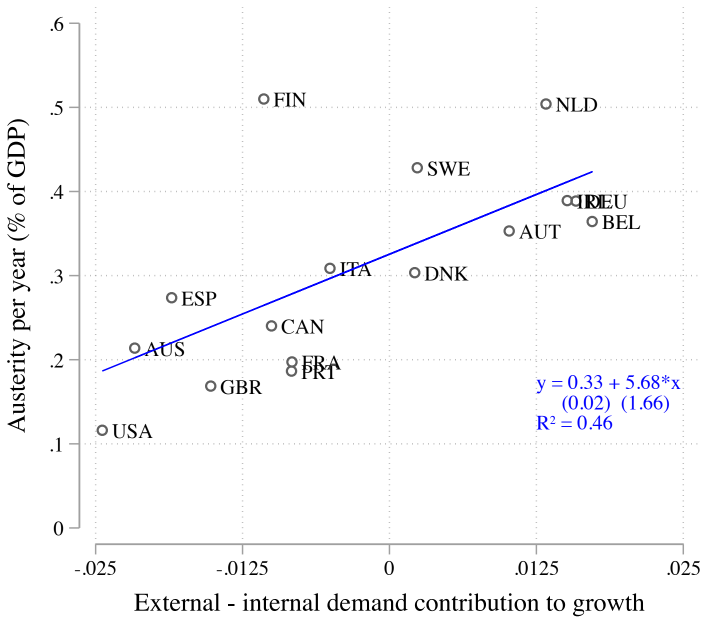

Figure 5: Estimated relationship between growth contributions and austerity (based on model (5) in Table 1)

Figure 5 shows how these country-specific austerity levels that we estimated from model (5) are related to the countries' growth strategies. The empirical relationship is clear: the more important external demand is for growth, the more austerity a country implements (up to a maximum of 0.5% of GDP per year). Vice versa, the more important internal demand is for

[10] This interpretation requires that we center the control variables at their means.

growth, the less austerity a country implements (with a minimum of slightly more than 0.1% of GDP per year).[11]

Finally, we re-examine the role of partisanship through the growth models perspective. As discussed in section 2, partisanship should only matter in countries with more balanced growth models and not in those with unbalanced ones. This requires a revised empirical specification, which we present in columns (4) and (6) of Table 2. In these specifications, we interact the partisanship variable with the absolute value of the difference between external and internal demand contributions. The latter variable reflects to what extent exports or internal demand contribute disproportionately to growth: if the variable is zero, then the growth contributions of exports and internal demand are equal, i.e. the model is balanced; if it is positive, then the growth contribution of either exports or internal demand dominate, i.e. the model is unbalanced.

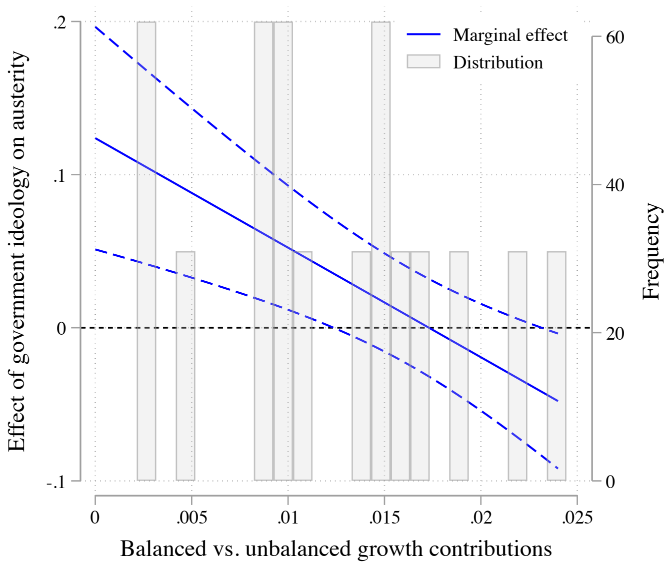

Figure 6: Effect of ideology across different growth models (with 95% confidence intervals)

To simplify the interpretation of the interaction, we compute the marginal effects of government ideology based on model (4) in Table 2 and plot them in Figure 6.[12] The blue

[11] Finland deviates from this pattern due to extensive austerity measures in 1993/1994 in the wake of the EMS crisis and the resulting economic crisis. Apart from this peculiar episode, Finland did not implement any austerity

line represents how the impact of ideology on austerity changes when the growth model becomes more unbalanced. The grey bars represent how countries are distributed along the scale of the moderating variable. As we can infer from the figure, ideology has a very strong and statistically significant impact in balanced growth models. In the most balanced model, a change from a typical center left government to a typical center right government increases the expected austerity level per year by 0.32% of GDP.[13] This effect decreases and becomes statistically insignificant when the growth model becomes more unbalanced.[14]

When we tie these findings back to our analysis of voter preferences in the previous section, we can conclude that the voter-driven perspective seems to work better in balanced models, but not at the unbalanced "extremes" on the continuum of available growth strategies. In the balanced models, party governments implement distinct fiscal policies in line with the diverging demands from their leftist or rightist voter base. In the unbalanced models, dominated by a demand-led or an export-led economy, this link between voter preferences and government ideology is broken.

5. Reconciling micro and macro – or why do governments ignore voters?

The results from the previous two sections raise the question why governments in important cases seemingly ignore voters and implement policies that are at odds with the attitudes of a majority of voters and the government party's own constituencies. Ultimately, nonobservance of voters can be politically risky and create political dissatisfaction and instabilities. This problem is particularly prevalent in export-led countries where the discrepancy between anti-austerity attitudes of the majority of voters and pro-austerity policies by governments is most severe. Voter preferences and government policies are less in disarray in demand-led

[12] The government ideology variable varies from -5 to +5, with higher number indicating more right governments.

[13] We define a typical center left (right) government as one that is one standard deviation, i.e. 1.67 points, below (above) the mean.

[14] In additional analyses, we disentangled the moderating effects of export-led from the effect of demand-led models. In line with our expectation, we find that in demand-led models, the partisanship effect works mostly through the behavior of right governments: right governments increasingly pursue austerity, while left governments continue to avoid austerity, when a heavily demand-led model becomes more balanced. In contrast, the partisanship effect mostly works through the behavior of left governments in export-led models: left governments become less austere, while right governments continue to pursue austerity, when a heavily export-led model becomes more balanced.

economies since governments in these countries tend to pursue austerity less often. But the question why right governments are unresponsive to the preference of right voters for spending cuts also prevails in these regimes.

Our answer highlights the trade-off that government parties face between the costs from alienating a large share of voters (potentially including the median voter) and the costs from alienating the dominant social bloc. When parties in government face competing demands from organized interests and the wider electorate, they need to decide whose demands they will prioritize in their policy decisions based on their assessment of these costs (Barta 2018). The social bloc represents a key political stakeholder that it is well organized and that governments cannot simply ignore. The power of this bloc is grounded in its financial strength and its ability to influence the public discourse and public opinion, which again can have an impact on a wider share of voters (see chapter 1 and the chapters in part 2 of this volume). The power of voters arises from the threat that they will resort to other political parties if they are dissatisfied with the policy of the government party.

For a long time, parties seemed to perceive the costs of alienating voters as the lesser of two evils. In fact, the convergence of the main political parties on a similar economic agenda in many political systems itself helped to contain these costs because it limited the options that were available for alienated voters. Most mainstream parties eventually began to prioritize the interests of the dominant social block and to converge on pro-market policies throughout the post-war period, which led to an overall decline in political competition (Baccaro and Howell 2017; Lynch 2019; Przeworski 2019). A prominent example of this process is the development of 'Third Way' politics, an attempt of the left to overcome their traditional alliances in order to reform the economy while embracing neoliberal ideas (Bremer and McDaniel 2020). This development prepared the ground for the austerity narrative that emphasized the importance of balanced budgets, the importance of a lean state, and the abandonment of counter-cyclical public spending.

This mainstream party convergence initiated a process of dealignment between voters and established parties, but this development was slow-moving and not seen as a problem that parties need to address urgently. In particular the growing distance between political parties and their constituents, or the cartelization of political parties (Katz and Mair 1995, 2009), resulted in an alienation of voters from their parties and a further push of parties towards organized interests and the state. As a consequence, a slow but steady decline in votes and an increase in swing voters rendered the supporter base of mainstream parties less stable over the years.[15] Both trends can be interpreted as a latent withdrawal of voter support from the dominant political-economic model by parts of the electorate. Nonetheless, political parties actively pursued this mutual process of dealignment in order to uphold the macro-economic policies prescribed by the growth model. For a long time, this development was not perceived as problematic because in most countries the established parties shared government responsibility and were the only ones who had a realistic chance to participate in government, which limited political competition from other parties.

Only the financial crisis and the following Great Recession generated new political dynamics that put this political-economic equilibrium to a test. The Great Recession disrupted the complacent policy community and also served as a trigger for disenchanted citizens to mobilize against their government and for new parties to be established. The majority of these newly established parties and movements took a decidedly anti-austerity and/or anti-establishment stance and managed to stir up the party landscape in a number of countries.[16] Other parties, which already existed for a longer time, gained more prominence again in the wake of the financial crisis and were able to present themselves as viable alternatives to mainstream parties.[17]

6. Conclusions

We draw three main conclusions from this analysis. First, austerity policies vary greatly across countries and in line with a country's growth model. Countries that pursue export-led models are much more likely to implement austerity than those that are more demand-led, even if we account for macroeconomic and political circumstances. Second, fiscal policies

[15] Average turnout at general elections in Western democracies declined from roughly 82.5% in 1980 to just about slightly more than 70% in 2016 (see Hübscher et al. 2019). This figure includes countries in which turnout hardly changed, such as Belgium, to countries, in which turnout declined dramatically. I.e. Austria experienced a decline in turnout from 92% in 1979 to 75.6% in 2019. In Germany, turnout dropped from roughly 90% in 1980 to 70.8% in 2009 and increased to slightly over 76% in 2016. The recovery in turnout was largely due to citizens who were politically inactive and voted AfD in 2016.

[16] Among the more prominent parties/movements founded after the financial crisis are *Podemos*, *Syriza*, *M5S*, and la *France Insoumise*.

[17] Examples of parties in this category are *Die Linke* or *Lega*.

vary along ideological preferences of government parties only in balanced, but not in unbalanced growth models. Together, these results suggest that governments subordinate fiscal policy to the greater macroeconomic strategy, which is specific to their country and which is unrelated to objective macroeconomic factors. Moreover, this fiscal strategy seems to be part of a broader political consensus among political elites that cuts across political parties on the left and the right in many countries.

The mismatch between government policy and voters' fiscal policy views that our analysis uncovers has important political implications. In the short and medium term, governments may be able to sell austerity to their electorates by highlighting the potential positive effects of deficit reduction (Barnes and Hicks 2018). The political discourse plays an important role: voters are more likely to support austerity if they are consistently exposed to arguments highlighting the benefits of these policies (Ferrara et al. 2021). In the long term, however, these policies need to have the alleged, desired effect and generate economic growth in order to secure political support from voters. If this is not the case, like in Italy, for example, it is likely that political backlash follows. Germany, the country whose economic success heavily relies on export, also experiences significant changes of its political landscape. The combined vote share the two mainstream center-left and center-right have lost between 1990 and 2016 amounts to roughly 23% (SPD: -13% / CDU: -10%). A significant share of people previously voting for either of these parties now support challenger parties, such as *Die Linke*, the *Green Party* or the *AfD*, all of which call for changes (though different in nature) of the dominant macro-economic policies.

There is an increasing amount of evidence that this is in fact the case in a broad range of countries. In Britain, for instance, the rising popularity of UKIP has been linked to the austerity policies of the past decade (Fetzer 2019). More broadly, austerity has detrimental effects on party systems and increases political polarization when mainstream parties converge on a policy of fiscal restraint (Hübscher et al. 2019). The transformation of party systems and the rise of populism in many countries, therefore, can be directly traced to the spread of neoliberal economic policies and the adverse economic effects of macroeconomic regimes on many voters (Hopkin 2020; Hopkin and Blyth 2019). With the spread of austerity to consumption-led and mixed economies during and after the Great Recession, public discontent with economic policymaking is likely to rise further. These ongoing developments are likely to complicate the formation of stable government coalitions needed to produce sustainable policy outputs.

7. Bibliography

Alesina, A., Carloni, D., and Lecce, G. (2011) 'The Electoral Consequences of Large Fiscal Adjustments', *NBER Working Paper No. 17655*: 1-19.

Alesina, A., Favero, C., and Giavazzi, F. (2015) 'The Output Effect of Fiscal Consolidation Plans', *Journal of International Economics* 56: S19-S42.

Alesina, A., Favero, C., and Giavazzi, F. (2019) *Austerity: When It Works and When It Doesn't*: Princeton University Press.

Alesina, A., Perotti, R., and Tavares, J. (1998) 'The Political Economy of Fiscal Adjustments', *Brookings Papers of Economic Activity* 1998(1): 197-248.

Armingeon, K., Guthmann, K., and Weisstanner, D. (2016) 'Choosing the Path of Austerity: How Parties and Policy Coalitions Influence Welfare State Retrenchment in Periods of Fiscal Consolidation', *West European Politics* 39(4): 628-47.

Baccaro, L., and Howell, C. (2017) *Trajectories of Neoliberal Transformations: European Industrial Relations since the 1970s*: Cambridge University Press.

Baccaro, L., and Neimann, E. (2021) 'Determinants of Wage (Dis-)Satisfaction: Trade Exposure, Export-Led Growth, and the Irrelevance of Bargaining Structure', Manuscript, MPIfG

Baccaro, L., and Pontusson, J. (2016) 'Rethinking Comparative Political Economy', *Politics & Society* 44(2): 175-207.

Barnes, L., and Hicks, T. (2018) 'Making Austerity Popular: The Media and Mass Attitudes Towards Fiscal Policy', *American Journal of Political Science* 62(2): 340-54.

Barta, Z. (2018) *In the Red: The Politics of Public Debt Accumulation in Developed Countries*: MIT Press.

Beramendi, P., Häusermann, S., Kitschelt, H., and Kriesi, H., eds (2015) *The Politics of Advanced Capitalism*: Cambridge University Press.

Blanchard, O. (2019) 'Public Debt and Low Interest Rates', Presidential Lecture to the American Economic Association, January

Blanchard, O., and Summers, L. (2017) 'Rethinking Stablization Policy: Back to the Future', PIIE Working Paper, October

Blyth, M. (2013) *Austerity: The History of a Dangerous Idea*: Oxford University Press.

Blyth, M., and Matthijs, M. (2017) 'Black Swans, Lame Ducks, and the Mystery of Ipe's Missing Macroeconomy', *Review of International Political Economy* 24(2): 203-31.

Bojar, A., Björn, B., Kriesi, H., and Wang, C. (2018) 'The Effect of Austerity Packages on Government Popularity During the Great Recession', *British Journal of Political Science* (Online First).

Bremer, B., and Bürgisser, R. (2018) 'Are Voters Austerians? Evidence from Survey Experiments on Budgetary Trade-Offs and Priorities', Paper presented at the Annual Meeting of the Conference for Europeanists (CES), Chicago, April 5-8

Bremer, B., and McDaniel, S. (2020) 'The Ideational Foundations of Social Democratic Austerity in the Context of the Great Recession', *Socio-Economic Review* 18(2): 439–46.

Brender, A., and Drazen, A. (2008) 'How Do Budget Deficits and Economic Growth Affect Reelection Prospects? Evidence from a Large Panel of Countries', *American Economic Review* 98(5): 2203-20.

Chinn, M. D., and Prasad, E. S. (2003) 'Medium-Term Determinants of Current Accounts in Industrial and Developing Countries: An Empirical Exploration', *Journal of International Economics* 59(1): 47–76.

Chowdhury, A., and Islam, I. (2012) 'The Debate on Expansionary Fiscal Consolidation: How Robust Is the Evidence?', *The Economic and Labour Relations Review* 23(3): 13-38.
Dellepiane-Avellaneda, S. (2014) 'The Political Power of Economic Ideas: The Case of ‘Expansionary Fiscal Contractions’', *British Journal of Political Science* 17(3): 391-418.
Devries, P., Guajardo, J., Leigh, D., and Pescatori, A. (2011) 'A New Action-Based Dataset of Fiscal Consolidation', IMF Working Paper 11/128 (June).
Ferrara, F. M., Haas, J., Peterson, A., and Sattler, T. (2021) 'Exports Vs. Investment: How Political Discourse Shapes Support for External Imbalances', *Socio-Economic Review* (Online First).
Fetzer, T. (2019) 'Did Austerity Cause Brexit?', *American Economic Review* 109(11): 3849-86.
Gelman, A., and Hill, J. (2007) *Data Analysis Using Regression and Multileve/Hierarchical Models*: Cambridge University Press.
Giavazzi, F., and Pagano, M. (1990) 'Can Severe Fiscal Contractions Be Expansionary? Tales of Two Small European Countries', In *Nber Macroeconomics Annual*, O. Blanchard and S. Fischer (ed.), Boston: MIT Press.
Guajardo, J., Leigh, D., and Pescatori, A. (2014) 'Expansionary Austerity: New International Evidence', *Journal of the European Economic Association* 12(4): 949-68.
Górnicka, L., Kamps, C., Köster, G., and Leiner-Killinger, N. (2018) 'Learning About Fiscal Multipliers During the European Sovereign Debt Crisis: Evidence from a Quasi-Natural Experiment', *ECB Working Paper* 2154.
Haffert, L., and Mertens, D. (2019) 'Between Distribution and Allocation: Growth Models, Sectoral Coalitions and the Politics of Taxation Revisited ', *Socio-Economic Review* (Online First).
Hallerberg, M., and Basinger, S. (1998) 'Internationalization and Changes in Tax Policy in Oecd Countries -- the Importance of Domestic Veto Players', *Comparative Political Studies* 31(3): 321-52.
Häusermann, S., and Kriesi, H. (2015) 'What Do Voters Want? Dimensions and Configurations in Individual-Level Preferences and Party Choice ', In *The Politics of Advanced Capitalism*, P. Beramendi, S. Häusermann, H. Kitschelt and H. Kriesi: Cambridge University Press.
Henisz, W. J. (2004) 'Political Institutions and Policy Volatility', *Economics \& Politics* 16(1): 1-27.
Hopkin, J. (2020) *Anti-System Politics: The Crisis of Market Capitalism in Rich Democracies*: Oxford University Press.
Hopkin, J., and Blyth, M. (2019) 'The Global Economics of European Populism: Growth Regimes and Party System Change in Europe', *Government and Opposition* 5(2): 193-225.
Hübscher, E. (2016) 'The Politics of Fiscal Consolidation Revisited', *Journal of Public Policy* 36(4): 573-601.
——— (2018) *The Clientelistic Turn in Welfare State Policy-Making: Party Politics in Times of Austerity*: ECPR Press.
Hübscher, E., Kemmerling, A., and Sattler, T. (2015) 'Austerity for the Win? The Effect of Fiscal Consolidation on Political Support for the Government', Paper presented at the Annual Meeting of the European Political Science Association, Vienna, June 25-27
Hübscher, E., and Sattler, T. (2017) 'Fiscal Consolidation under Electoral Risk', *European Journal of Political Research* 56(1): 151-68.

Hübscher, E., Sattler, T., and Wagner, M. (2019) 'Does Austerity Cause Polarization?', Paper presented at the Annual Meeting of the American Political Science Association, Washington D.C., August 29-September 1

——— (2020) 'Voter Responses to Fiscal Austerity', *British Journal of Political Science* (Online First).

Immergut, E. M. (1992) *Health Politics: Interests and Institutions in Western Europe*: Cambridge University Press.

Johnston, A. (2016) *From Convergence to Crisis: Labor Markets and the Instability of the Euro*: Cornell University Press.

Johnston, A., Hancké, B., and Pant, S. (2014) 'Comparative Institutional Advantage in the European Sovereign Debt Crisis', *Comparative Political Studies* 47(13): 1771-800.

Jones, E. (2015) 'Getting the Story Right: How You Should Choose between Different Interpretations of the European Crisis (and Why You Should Care)', *Journal of European Integration* 37(7): 817-32.

——— (2016) 'Macroeconomic Imbalances and Sovereign Debt Markets', In *Europe, Canada and the Comprehensive Economic and Trade Agreement*, K. Hübner: Taylor & Francis.

Jordà, O., and Taylor, A. M. (2016) 'The Time for Austerity: Estimating the Average Treatment Effect of Fiscal Policy', *The Economic Journal* 126(590): 219-55.

Katz, R. S., and Mair, P. (1995) 'Changing Models of Party Organization and Party Democracy: The Emergence of the Cartel Party', *Party Politics* 1(1): 5-28.

——— (2009) 'The Cartel Party Thesis: A Restatement', *Perspectives on Politics* 7(4): 753-66.

Lake, D. (2009) 'Open Economy Politics: A Critical Review', *Review of international Organizations* 4(3): 219-44.

Lynch, J. (2019) 'Populism, Partisan Convergence, and Mobilization in Western Europe', *Polity* 51(4).

Manger, M. S., and Sattler, T. (2020) 'The Origins of Persistent Current Account Imbalances in the Post-Bretton Woods Era', *Comparative Political Studies* 53(3-4): 631-64.

Mutz, D. (2011) *Population-Based Survey Experiments*: Princeton University Press.

Przeworski, A. (2019) *Crises of Democracy*: Cambridge University Press.

Volkens, A., Lehmann, P., Merz, N., Regel, S., and Werner, A. (2013) 'The Manifesto Data Collection. Manifesto Project (Mrg/Cmp/Marpor)', \urlhttps://manifesto-project.wzb.eu/ (July).

Walter, S. (2015) 'Crisis Politics in Europe: Why Austerity Is Easier to Implement in Some Countries Than in Others ', *Comparative Political Studies* 49(7): 841-73.