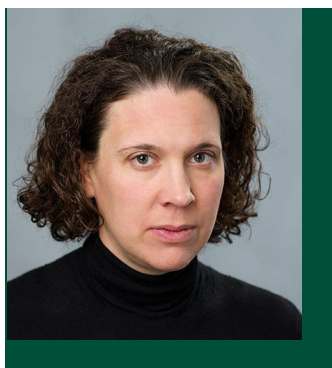
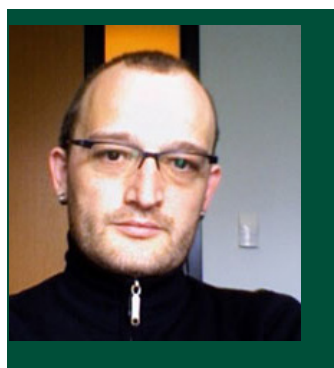


The Political Consequences of Fiscal Austerity

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Fiscal policy, and especially fiscal austerity, has become one of the most politically contentious economic policy issues over the last decade. In the wake of the Global Financial Crisis, many governments harshly reduced fiscal deficits, like in the UK during the Cameron government. Austerity policies became even more common and politically salient with the outbreak of the European Debt Crisis, especially in Portugal, Ireland, Greece and Spain. And although the focus of many governments these days is on fiscal stimulus to mediate the adverse impact of the



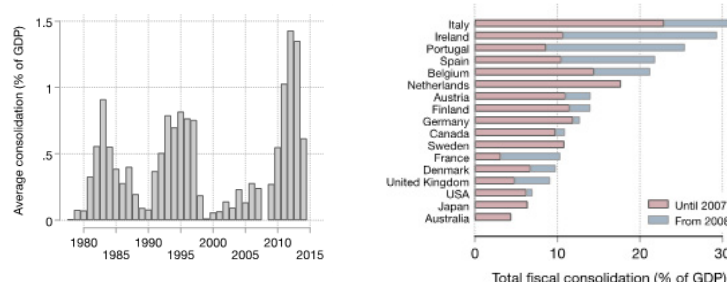
Covid-19 crisis, the question what the political consequences of austerity are is as central as ever. Austerity looms in the background when discussions on how to deal with the sharp rise in public debt since the start of the Covid-19 pandemic will move to the center of the public debate.

Austerity isn't something new

In fact, a look beyond the past decade shows that austerity is not unique to the European Debt Crisis and that it is likely to become a major issue again in the future. As figure 1a shows, austerity policies have occurred in waves and have been common in many countries since the 1980s. From this historical perspective, the European Debt Crisis is just the most recent, large wave that was more serious and concentrated on specific countries than the previous waves. Earlier, large waves can be identified during the 1980s and the 1990s, in the run-up to the Eurozone.

As figure 1b shows, there is not only temporal, but also significant cross-country variation when it comes to the implementation of fiscal austerity packages (see also Hübscher

and Sattler, forthcoming; Hübscher, Sattler and Truchlewski, 2020; Baccini and Sattler, 2020).



(a) Over time

(b) By country

Figure 1: Austerity in industrialized countries, 1978 - 2014; note: data for the Netherlands is only available until 2009.

A few facts are particularly noteworthy. First, the biggest consolidator among the listed countries is Italy, which is sometimes portrayed as particularly fiscally 'profligate'. However, Italy has adjusted fiscal policy considerably more than countries that are widely seen as 'frugal', such as the Netherlands, Finland or Austria. Second, Anglo-Saxon countries have implemented a comparatively small amount of cumulative fiscal adjustment packages. Although the austerity measures in the United Kingdom after the Great Recession have gained strong attention (Fetzer 2019; Barnes and Hicks 2019), they really dwarf compared to the adjustment policies of other, continental European countries.

Voters are more critical of austerity than often claimed

A key question now is how voters react to these policies. The political literature, for a long time, has focused on the impact of austerity on aggregate political outcomes, such as government collapse, electoral vote shares or aggregate vote intentions for government parties. A prominent view in this strand of the literature is that voters are averse to fiscal deficits and that austerity does not lead to government collapse (Alesina et al. 1998; Arias and Stasavage 2019). Others argue that voters object to spending cuts and that austerity leads to a decline in vote intentions (Hübscher, Kemmerling and Sattler 2015; Talving 2017; Bojar et al. 2020).

Recently, a wave of research focused on

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individual-level rather than aggregate political responses to re-examine these contradictory findings. These studies overcome some challenges that are difficult to address in the macro analyses. For instance, governments are highly strategic when implementing unpopular reforms. Thus, only those governments implement austerity who can politically afford it will also implement it (Hübscher and Sattler 2017; Hübscher 2018). Studies that focus on aggregate electoral outcomes or government stability, therefore, may underestimate the electoral risk associated with fiscal adjustments.

To address this challenge, Hübscher et al. (2019) conduct a series of surveys in five European countries (Germany, Italy, UK, Spain and Portugal). The surveys included an experimental part in which respondents were exposed to one out of three possible scenarios depicting simplified descriptions of actual fiscal policies: a) decrease spending on public and social services, b) increase income taxation, or c) keep spending and taxes unchanged. All three scenarios are anchored in a context of fiscal pressure and the presence of a sizable budget deficit over a number of consecutive years. Figure 2 shows the key results, which imply that voters – on average – are highly critical of austerity and that governments minimize political losses by avoiding fiscal adjustment measures. It also shows that deficit-reduction via tax increases is less unpopular than via spending cuts.

Naturally, the composition of austerity packages matters as well when citizens decide to what extent they support austerity measures. Hübscher et al. (2019), therefore, complement the vignette experiment with a conjoint experiment that provides a more detailed picture of individual-level preferences over different types of austerity measures. In the

conjoint part, respondents were asked to compare and to rate two different austerity packages each consisting of the same spending related policy items and one taxation issue. Spending cuts on the five policy dimensions (healthcare, pensions, education, unemployment benefits, public infrastructure) could be either small or large, whereas tax increases could vary between an ‘increase across the board’ or an ‘increase for the wealthy only’. By and large, the results from our conjoint confirm that austerity is negatively evaluated by a majority of the electorate. Political support drops particularly strongly if the government proposes to apply cuts to public pensions, healthcare and to a lesser extent education. Cuts applied to spending on public infrastructure, but also tax increases across the board do not significantly harm governments’ electoral prospects.

Although this study shows that voters are critical towards spending cuts, it does not capture how the decision of voters is contingent on the position of the other political parties in the system. In a follow-up analysis, Hübscher et al (2019), therefore, conduct an experiment that presents respondents with fiscal policy proposals of the key mainstream parties in a political system. To give an example, respondents in the UK were randomly exposed to three possible scenarios: a) both Tories and Labour avoid fiscal adjustment; b) Tories propose fiscal adjustment, but Labour does not; c) both Tories and Labour propose fiscal adjustment. Figure 3 shows the results from our pilot study in the UK. (The full results for four European countries and a series of additional analyses is available at https://www.researchgate.net/publication/339989405_Does_Austerity_Cause_Polarization.)

The results show that support for Labour significantly increases in a scenario in which only the Conservative party proposes to adjust fiscal policy, but Labour does not, compared to a scenario in which both parties either propose to leave fiscal policy unchanged. When both parties propose to adjust fiscal policy, however, both parties lose support and voters turn towards ‘third parties’ or abstain from voting. In additional analyses, we show that non-mainstream parties, such as UKIP in the UK, Die Linke and AfD in Germany, Podemos and Ciudadanos in Spain and the Bloco de Esquerda in Portugal, are among the winners if both mainstream center parties converge on a pro-austerity platform. Austerity policies, therefore, contributed to the increase in political polarization of European party systems in the past decades. These findings resonate with

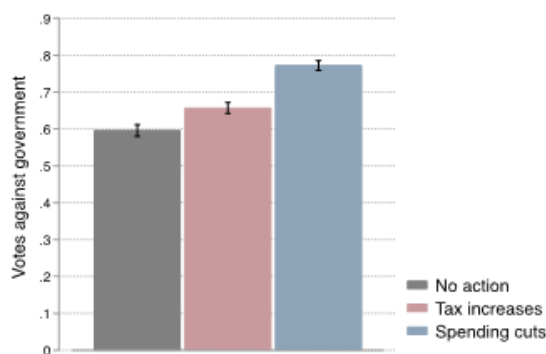


Figure 2: Voter reactions to fiscal adjustments; graph indicates the share of respondents who indicate to vote against the government.

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Fetzer (2019) on the impact of austerity on votes for anti-establishment parties in Britain.

Voter heterogeneity: ideology or material interests?

Although these average effects are important and directly speak to the macro

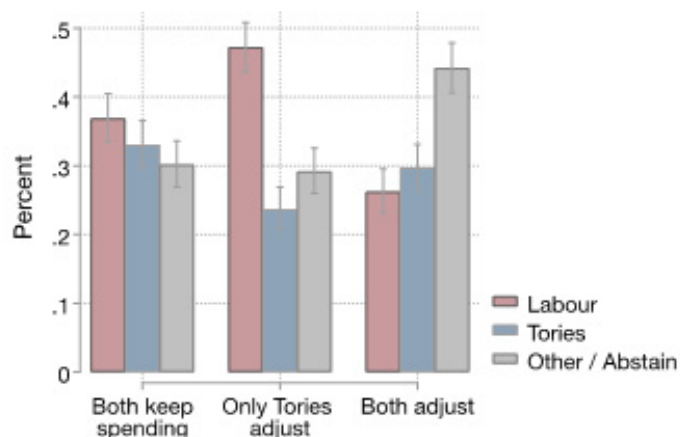


Figure 3: Voter reactions depending on mainstream party positions; graph indicates the share of respondents who indicate to vote for a particular party / to abstain.

analyses conducted earlier, they miss important variation among voters. Recent debates in political economy have centered on the question whether material interests or ideology better explain variation in attitudes towards economic policies. Hübscher et al. (2020) also examine this question using educational and occupational measures to capture material interests and left-right self-placement of respondents to capture ideology. The results suggest that left-right self-placement best explains variation in voter attitudes towards austerity. Figure 4 shows the predicted effects of voting against the government based on pooled data from all five countries that they analyze. The results show that left-leaning respondents are less likely to vote against governments after an increase in taxes than after spending cuts. For right-leaning voters, we see the reverse picture.

That said, ideological patterns are less coherent across countries than they may look at first glance. There is considerable cross-country variation on how ideology affects deficit aversion and the support for fiscal cuts. Hübscher et al. (2021), for instance, find that in Germany supporters of different parties share quite similar views about the appropriate size of

austerity. This stands in stark contrast to voters in Spain and the UK where supporters of parties that belong to different political blocs disagree fundamentally about the appropriate size of austerity and the composition of an austerity package. These cross-country patterns in voter attitudes towards fiscal trade-offs coincide with the variation in past fiscal policy trajectories, notably their fiscal deficits and their inclination to implement fiscal austerity packages, of these countries.

Finally, recent, more in-depth research also shows that material interests play a more significant role for voters than the results above and the the political economy literature more generally suggests. In a recent analysis, Baccini and Sattler (2020) examine to what extent austerity policies push economically vulnerable voters towards populist parties. Their analysis examines vote shares for populist parties in electoral districts across Western Europe and measures the economic vulnerability of the district as share of low-skilled workers, workers in routine jobs and worker in the manufacturing sector in this district. The results show that austerity strongly increases the populist vote in districts with a high share, but less in districts with a low share of economically vulnerable voters. This is the case because austerity leads to a hollowing-out of social security schemes and other policies that help economically vulnerable voters to cope with the key economic transformations of our time, such as globalization and automation.

Open questions

Taken together, these studies suggest that austerity has important political consequences even if austerity policies do not necessarily lead to outright government collapse. These policies produce dissatisfaction among important parts of the population, which

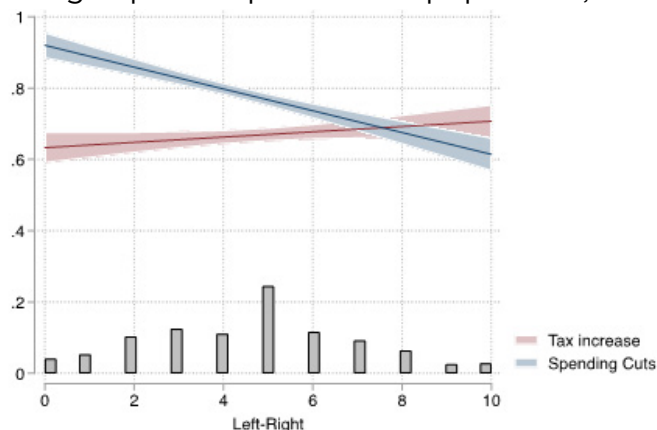


Figure 4: Predicted Effects of Vote against Government, by Ideology

In a similarly designed experiment, Bansak et al. (2021) also find that the support for austerity packages decreases significantly if cuts are applied to spending on pension and education.

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ultimately contributes to party system change, including greater support for non-mainstream parties and political polarization.

Despite these new insights, there still are multiple, open questions. First, a key question is how voters think about the alternatives to austerity, i.e. what will happen if the government does not adjust fiscal policy. Hübscher et al. (2020) highlight the need for austerity by informing respondents that the countries had been running a large fiscal deficit for multiple years, which makes it costlier to finance government programs. The experimental design, therefore, includes the 'status quo' as one out of three options. Bansak et al. (2021) present an increase in public spending as the only alternative to austerity and do not mention the possibility of keeping spending stable. In practice, however, governments that face fiscal pressure may try to preserve spending and are not likely to be able to increase spending. Excluding the option to not adjust fiscal policy, thus, omits an important policy choice. Future research should better anchor respondent's expectations about the 'do nothing' option by specifying potential consequences of no fiscal adjustment, e.g. an increase in interest on public debt when the government borrows on capital markets or a higher level of inflation when the government prints money to finance public expenditures.

Second, there is an emerging literature that distinguishes externally imposed fiscal adjustments from adjustments that the government implemented without external interventions. Such interventions, by the IMF or the EU, not only affect fiscal outcomes, but also remove fiscal policymaking from the democratic political process and increase dissatisfaction with democracy (Alonso and Ruiz Rufinho 2020). Yet, in a recent survey in four European crisis countries, Hübscher et al. (2021) also show that voters expect that IMF interventions increase the credibility of adjustment policies and hence help to resolve the crisis. How the democratic accountability mechanism and the credibility mechanism counterbalance each other varies across countries and with the prior experiences that these countries had with the IMF.

Finally, the new literature on the political consequences of austerity is very Euro-centric. Yet, austerity has been common in other regions, notably in South and Central American countries. As Ardanaz et al. (2020) show, fiscal adjustments in Latin America look very different from adjustments implemented in Europe. While adjustments in Europe usually entail significant spending cuts, the picture in Latin American

countries is reversed with two thirds of the adjustment effort falling on tax increases, in particular the increase of non-progressive taxes such as VAT. This disproportionately affects the less wealthy segments of society and makes tax increases particularly unpopular among Latin American electorates. Further research about the political implications of austerity and the optimal design of austerity in Latin America or other regions could yield valuable insights into the politics of austerity more globally.

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