In the Red

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Notes

CHAPTER 1

1. Although Japan’s net debt-to-GDP ratio is only about half of the gross, it is still dangerously large, on par with that of Greece or Italy.

2. Reinhart and Rogoff (2010) claimed to have found a limit at 90 percent of the GDP, but their results were later discredited by Herndon et al. (2014).


6. Economists conceptualize this problem as an example of free riding: fiscal stabilization is a public good whose benefits everyone enjoys (although it is arguably more valuable to those that are more affected by the negative side effects of debt accumulation), but it is rational for different groups to be reluctant to pay for it in the hope that other groups will bear the costs instead of them (Drazen 2004).

7. More precisely, in any moment in time, a group has to weigh the expected value of resisting fiscal pain. This expected value comprises of three parts. One is the gain from successful free riding multiplied by the probability of success. The second is the certain cost of having to endure the negative side effects of debt for longer. The third is the loss from having to eventually give in to bearing a large share of the fiscal pain when the size of the necessary stabilization has grown much larger multiplied by the likelihood that this will happen.

8. In this sense, the book makes a similar point as Hausermann (2010) about the multidimensionality of the politics of policy making, but it also emphasizes that this multidimensionality arises from the simultaneous influence of socioeconomic
structure and existing policies and that the interaction of these multiple dimensions leads to shifts in preferences as time passes.

CHAPTER 2

1. While models exploring the sociopolitical dynamic of economic reforms abound—and call attention to a variety of factors that delay or hasten reforms, from information asymmetry to the imminence of crisis (e.g., Fernandez and Rodrik 1991; Alesina and Drazen 1991; Drazen and Grilli 1993; Laban and Sturzenegger 1994; Cukierman and Tommasi 1998)—Alesina and Drazen’s war of attrition model has arguably been the most influential in explaining delay in fiscal stabilization.


4. Obviously, at very high levels of debt, continued fiscal problems also increase the risk of financial and economic disaster. This is an issue that affects society fairly uniformly. It is left out of further discussion here because the question at hand relates exactly to why borrowing is allowed to continue so long that even these risks arise. Therefore, such risks are part of the question, rather than the answer.

5. Obviously, Alesina and Drazen’s (1991) model itself says nothing about social coalitions since it works with the simplifying assumption of two monolithic groups fighting about the choice between two different distributions of fiscal pain. As soon as the analysis is extended to more groups and a range of different stabilization packages, the issue of coalitions and the composition of packages most suitable to the interest of different coalitions becomes relevant.

6. Party systems and electoral rules shape how societal conflicts play out in electoral politics (Haggard and Kaufmann 1992; Pal and Weaver 2003); corporatist arrangements crucially influence how different groups can exercise leverage in policy making outside of the electoral arena (Katzenstein 1985 and 1987); while the autonomy of the state creates room for policy choices that are not simply the result of societal pressures (Skocpol 1985; Weir and Skocpol 1989).


8. Majoritarian institutions minimize the number of vetoes in the governmental sphere (Haggard et al. 2001), while an autonomous state can bypass bickering vested interest groups to successfully impose fiscal pain on society for the sake of the greater good (Della Sala 1997).

9. In political systems, where parties, unions and employers’ organizations encompass large sections of society, conflicts will be settled within these interest-representing organizations (Haggard and Kaufmann 1992; Katzenstein 1985; but cf. Baccaro 2003). In some polities, negotiations and compromise are promoted by institutionalized frameworks of consultation in the governmental and corporatist sphere (Lijphart 1999).

10. Party systems evolve (Mair 2006), corporatist actors rise and fall and their interactions change (Baccaro 2003; Culpepper and Regan 2014), electoral rules are amended (Dunleavy and Margetts 1995), states gain and lose autonomy (Della Sala
policy paradigms are adopted and discarded (McNamara 1998), and new ideas emerge to provide focal points for new compromises (Culpepper 2008).

11. The emergence and later demise of the practice of social pacts in many European countries in the 1990s and 2000s exemplifies how institutions geared to foster compromise can be constructed and dismantled, or simply ignored, depending on the evolution of the socio-economic context (Culpepper 2002; Culpepper and Regan 2014).

12. The public choice school suggests that the electorate rewards the ability to consume more today at the expense of tomorrow, either because it suffers from “fiscal illusion” and therefore fails to recognize the costs that extra consumption in the present will have in the future (Buchanan and Wagner 1977) or because it wants to transfer the costs of its present overconsumption to later generations (Cukierman and Meltzer 1989). Political business cycle models contend that incumbent governments want to reinforce their image as competent managers of the economy and of public finances, so they generate deficit-fuelled economic upswings and provide more public goods from the same amount of tax revenues (Nordhaus 1975; Rogoff and Sibert 1988). Finally, electoral spending cycle theories suggest that incumbent political actors want to remind their supporters—and potential supporters—who they should vote for by pleasing them with new targeted spending measures or tax cuts before the elections (Tufte 1978).

13. Alesina et al. (1998) and Brender and Drazen (2008) show that loose fiscal policies tend not to yield the electoral advantage that these theories attribute to them. At the same time, there is evidence that incumbent policy makers still try their luck with such fiscal manipulation sometimes, although not universally (Alt 2007).


16. While studies on the independent effect of fiscal rules and targets returned mixed results, Mark Hallerberg and his colleagues identify constellations of budgetary institutional arrangements and coordination mechanisms that seem to consistently keep public borrowing in check. In one, policy makers delegate decision-making power to a strong finance minister. In the other, they subject the budget to the terms of a contract previously negotiated between representatives of diverse particularistic interests (Hallerberg 2004; Hallerberg, von Hagen, and Strauch 2009). Hallerberg et al. also convincingly show why one or the other type of coordination works better in different types of governments.


18. Hierarchical decision-making, transparency, centralization, commitment to fiscal targets, and credible penalties for defection from pre-agreed objectives have been consistently associated with lower deficits (Alesina and Perotti 1996; Hallerberg and von Hagen 1997; Hallerberg 2004; Hallerberg, von Hagen, and Strauch 2009).

19. Obviously, the lack of success of the Stability and Growth Pact experiment is no reason to indict the theoretical approach. The European fiscal system can be
(and has been) criticized from the perspective of the “fiscal indiscipline” school itself and failure can be blamed on defects in design: the lack of credible penalties for noncompliance, the insufficient flexibility of its rules, and the unsuitability of the coordination mechanisms it provided. (For a review of the extensive critique of the suitability of the rules and enforcement of the Stability and Growth Pact, see Fischer, Jonung, and Larch 2006.) At the same time, the failure of the Stability and Growth Pact experiment does call attention to the lack of sufficient theorizing about why some countries adopt appropriate budgetary institutions when others do not.

20. Alesina and Perotti (1996) and Hallerberg, von Hagen, and Strauch (2009) point out that this is a major shortcoming.

21. Hallerberg et al. (2009, ch5) suggest that countries in which governments house similar ideological differences across time are likelier to be able to develop the right forms of coordination to deal with those differences. Countries in which intragovernmental ideological distance is consistently small will adopt a delegation approach to budgetary coordination. Countries with consistently large intragovernmental ideological distance will adopt fiscal contracts. Where the distance varies across time, however, it is difficult to consolidate either form of governance. Furthermore, the authors hypothesize that fiscal crises spur the adoption of more effective coordination because experience with such crises makes the electorate more fiscally conservative. They seek to test these propositions quantitatively, but they get ambiguous results. Beyond the obvious problems of operationalizing their explanatory variables—e.g., the difficulties involved in consistently measuring ideological distance across countries and time and in identifying “crises” in both the objective and subjective sense—dually noted by the authors themselves, the regression analysis yields no statistically significant results.

22. Earlier theories in this literature explicitly excluded the possibility that borrowing could be politically costly. Note, for example, the concept of “fiscal illusion” (Buchanan and Wagner 1977). Common resource pool models ignore political costs. Hallerberg’s latest work takes a step towards incorporating the political costs of budgetary imbalances into the fiscal indiscipline model by including the fiscal conservatism of the electorate as an incentive for budgetary self-restraint (Hallerberg et al. 2009). However, the concept of fiscal conservatism is arguably too vague to be of real explanatory value.

23. In Fiscal Governance in Europe, Hallerberg and his colleagues acknowledge that under certain institutional setups, budgetary decisions might be influenced from outside of the governmental-parliamentary sphere, for example in the field of social partnership, but they leave it to further research to investigate the exact nature of this influence on fiscal problems (2009, 205–8).


27. Countries that were OECD members for the entire period under consideration.
28. At the same time, the individual country case studies do discuss the trends that can be discerned in 2015.

29. Despite accumulating debt for a long time at low pace (Austria, France, Germany, and Spain), for a moderate time at a moderate pace (the Netherlands, Portugal, and the United States), or at very high rates for short periods (Denmark, Finland, and Sweden), these countries mostly remained under 70 percent of GDP.

30. For concrete analysis of policy structures, see the relevant case studies in chapters 3, 4, 5, and 6.

31. For exact details of the within-country comparisons, see Table 3.1 in chapter 3.

32. For exact details of the most similar case design, see Table 4.1 in chapter 4.

33. For exact details of the most different case design, see Table 5.1 in chapter 5.

34. Qualitative analyses of planned and actual policy measures are favored over quantitative databases, like the one generated by Devries et al. (2011). Devries and his colleagues code formal legislation and budgetary appropriations to capture governmental attempts to deal with a country’s fiscal imbalances as a numerical indicator that measures the planned impact of the legislated acts as a percentage of GDP. While it is a useful starting point for gauging policy makers’ intentions, this source cannot capture deviations from original government policy that result from political resistance to reform or pick up on changes in policy that arise from the enforcement of previously ill-enforced legislation, like when the government manages to raise revenue by cracking down on tax evasion. Such deviations from official policy and non-legislated changes are often key to understanding fiscal performance.

CHAPTER 3

1. Some of these reforms were aimed at ensuring better planning, others at enforcing discipline on the members of parliament (Ferrera and Gualmini 2004, p64; Padovano and Venturi 2001).

2. Although regular unemployment benefits have historically been trivially small and short in duration in Italy, workers laid off in the restructuring process were entitled to generous income-replacement benefits for up to three years from the so-called the Cassa Integrazione Guadagni (CIG) and the Cassa Integrazione Guadagni Straordinaria (CIGS) (Bertola and Garibaldi 2003).

3. Early retirement was introduced for redundant workers in 1981, in an effort to dissipate the growing tension over the large number of redundancies (Ferrera and Gualmini 2004).

4. For example, marginal adjustments to pensions included limits on the collection of multiple benefits and defined income ceilings for the entitlement to social pensions (Ferrera and Gualmini 2004, 94).

5. The Amato reform of 1992 significantly tightened eligibility criteria and decreased the benefit levels, but it exempted older cohorts already in retirement or likely to retire within the next decade and was only to come fully in effect by 2032, due to its very long phase-in (Ferrera and Gualmini 2004, 114). The Ciampi reform of 1993 encouraged the development of a second pension pillar and placed penalties on early retirement but left regular pensions fully intact. The Dini reform
of 1995 mandated the phasing in of new, contribution-based formulae for the calculation of pensions and created further disincentives for early retirement. The Prodi reform of 1997 tightened the availability of seniority pensions in the public sector (Ferrera and Gualmini 2004).

6. In 1992 and 1995, corporate tax rates were increased by 1 percentage point and social security contributions by more than 5 percentage points (Bernasconi et al. 2005).

7. The targeted tax exemptions that so severely weakened the revenue-generating capacity of corporate taxes in the 1980s had been phased out in the late 1980s due to the ban on state aid within the Single Market, but many general tax reliefs lingered on into the 1990s. Of these, the tax deductibility of a major local tax (ILOR) from the general corporate tax (IRPEG) was ended in 1993 (Bernasconi et al. 2005).

8. In 1992 and 1993, new taxes on real estate and corporate net worth were introduced. In 1997, a new regional tax (IRAP) on added value replaced many smaller taxes and dues making the fulfillment of tax obligations much more transparent and reducing the opportunities for manipulation of the reported tax base.

9. The move to a defined contribution system begun in 1995 was sped up, the retirement age for women was raised, and the indexation to inflation of higher pensions above was ended (Culpepper 2014).

10. By the early 1990s, old-age pensions accounted for more than an eighth of the GDP and more than a fourth of total expenditure; the deficit of the pension funds accounted for half of the total deficit.

11. Although the electoral law was modified in 2005, this did not have a transformational effect on electoral competition or the party system comparable to the changes of the early 1990s.

12. See, for example, La Palombara 1987 for a vivid description of the failed Visentini attempt to reform tax collection.

13. In an effort to secure lower inflation, the central bank was relieved from the obligation to act as an automatic last resort buyer of government debt in 1981, but the fast growth of debt still prompted policy makers to monetize part of the deficit (Epstein and Schor 1989).


CHAPTER 4

1. Unless otherwise indicated, fiscal data cited in this section are drawn from the database of the National Bank of Belgium (www.nbb.be/belgostat).

2. These financing gap figures are not the official consolidated deficit figures for the different social security funds because the central government covers the financing gap of the social security sector through yearly subsidies. Therefore, the official budget for the social security always balances. Instead, these figures reflect the balance of social security contributions and social benefits paid (source: www.nbb.be/belgostat).

3. Two reforms to the pension system were put into place later—the creation of the Silver Fund in 2001 and the Vandenbroucke law of 2003—but neither affected the balance of outlays and revenues. The Vandenbroucke law set up the legal
framework for a voluntary company-financed second pillar of pension provision, whereas the law on the Silver Fund mandated the setting aside of certain existing funds in anticipation of the effects of population aging (In the end, the Silver Fund was never built up).

4. Parties of different linguistic affiliation competed in largely isolated electoral spheres since the constitutional reform of 1980 designated Flanders and Wallonia as exclusive electoral territories for Flemish and Francophone parties, respectively, leaving the Brussels-capital region as the only shared electoral turf. This caused the “sister parties” on each side of the linguistic divide to drift slightly apart as they adjusted to electoral pressures in their own competitive arenas, but they entered the government together because of the need to ensure the linguistic parity among ministers of the national government that the constitution prescribes (Fitzmaurice 1996).

5. All of these parties changed their names several times during the past decades. Therefore, I am going to refer to them by their ideological label and regional affiliation.

6. The interest organizations representing the standen—the Christian workers movement, the union of the middle classes, and the agricultural association—had the right to select candidates on the party’s electoral lists. Up to the 1990s, 90 percent of the candidates were nominated by the standen. The remaining 10 percent was usually filled by the narrow leadership of the party and former/present ministers (De Winter 1996; Claeyts 1996).

7. The word “pact” had only been used once before in 1944 when the foundations of the Belgian welfare state were laid down. By referring back to this earlier, highly important agreement, the government was symbolically emphasizing the gravity of the moment (Kuipers 2005, 96).

8. This is best reflected in the state reforms of the 1970s and 1980s, which divided up the country into three linguistic communities (Flemish, francophone, and German) and three regions (Flanders, Wallonia, and Brussels), creating a curious, two-layer federalized structure (Deschouwer 2009, 48–53).

9. The 1988 Special Law and the 1989 Finance Act devolved many important functions—e.g., economic affairs, transport and communication infrastructure, and education—from the federal level to the regions and communities and allocated 40 percent of VAT and personal income tax receipts to finance them (OECD 2007; Hooghe 1991). The 1999 St. Eloi agreement corrected the allocation rates of VAT and personal income taxes so that Flanders would get more of the income taxes—reflecting its higher tax-generating capacities—in return for higher VAT receipts going to the Walloon side. The 2001 Lambermont agreement, on the other hand, increased the proportion of revenues over which the regions and communities have total autonomy and allowed the regions to set rates and grant exemptions for a range of taxes (IMF 2003).

10. The cleavage that had originally led to the rise of these two parties—different preferences about the degree of political, cultural, and economic independence from the UK—had long faded in relevance by the 1980s (Mair 1992; Laver and Marsh 1992).

11. Fine Gael officially announced—in the so-called Tallaght strategy—that it would support the minority Fianna Fail government in passing any measure that
helps fiscal consolidation (Marsh and Mitchell 1999, Teague and Donaghey 2009).

12. Although some affiliated unions opposed the pact, peak associations strongly pushed for accepting it, and it was eventually adopted (Baccaro 2003).

CHAPTER 5

1. In the four decades preceding the debt crisis, Greece had a majoritarian electoral system (apart from a short interlude of proportionality around the turn of the 1980s and 1990s), which produced two strong, centralized parties held together by strict party discipline. These took turns in forming stable unitary governments, which were unconstrained by corporatist practices, since unions were weak, divided, and uncoordinated outside of the public sector (Kalyvas 1997; Nicolacopoulos 2005).

2. The Japanese electoral regime—the system of single nontransferable votes—in place until 1994 encouraged centrifugal tendencies in interest representation (Cox and McCubbins 2001). The new electoral system mixes elements of majoritarianism and proportionality. The party system was long characterized by “predominant-pluralism,” with the dominance of the Liberal Democratic Party being counterbalanced by several opposition parties. Single-party majority governments increasingly gave way to minority or coalition governments from the late 1980s. Furthermore, the Liberal Democratic Party itself has traditionally been highly factionalized with a large number of distinct and well-organized groups of politicians vying for positions of power (Wright 2002). Trade unions, albeit organized at the enterprise-level, gained increasing influence in policy making from the 1980s (Kume 1998).

3. Any analysis of Greek fiscal policy undertaken after 2010 is hamstrung by the lack of reliable data for the past decades. The well-known scandals involving deliberate falsification and poor accounting discredited Greek statistics to such an extent that none of the usual sources (IMF, OECD, Ameco, etc.) provide data for more than a few years back. The following analysis attempts to circumvent this problem by using older data sources (Ameco data accessed in 2008, printed issues of older OECD reports, and older scholarly journal articles) despite the questionable reliability of the figures. It also incorporates information derived from past OECD country reports about the reforms that were undertaken in the period under consideration and that influenced fiscal outcomes. This provides information about the broad trends in fiscal policy in the period but obviously cannot inspire confidence in the exact figures. Therefore, to the extent possible, the analysis avoids operating with numbers and tries to describe trends.

4. According to the OECD (2001), 45 percent of all employed are officially registered as self-employed.

5. As the OECD’s 1996 analysis of the Greek pension system points out, all occupational pensions favor early retirement. At the same time, low contribution requirements (fifteen years) and short reference periods (last five years of employment) generate very strong incentives for private sector employees and their employers to evade contributions altogether for most of their careers, underreport income on which they pay contributions for fifteen years, and only pay contributions based on their de facto salaries for the last five years in employment. Similarly,
the self-employed have an incentive to put themselves in the lowest contribution category because decreasing replacement rates do not make paying higher contributions worthwhile.

6. In the early 1980s, farmers still made up 40 percent of the active labor force, but their share declined to under 25 percent by the 1990s.

7. In fact, the most important changes of the health reform of 1982 and the pension reform of 1985 were purely cosmetic, as they related to the cross-subsidization of various healthcare and pension funds, rather than to creating new revenues or restraining expenditure (Suzuki 2000; Estevez-Abe 2008).

8. Although the share of the rural population shrank rapidly from the Second World War, it was more than 60 percent in 1950, and it still amounted to 35 percent in 1960 (Suzuki 2000). The total share of the population linked to low-productivity sectors is even higher. Steinmo (2010) estimates that the high-efficiency sector still only employs around 20 percent of the workforce. With a public employment rate of around 10 percent, this leaves more than 70 percent of the workforce in the low-productivity sector.

9. Although the Liberal Democratic Party was only formed in 1955—by uniting the former Liberal Party and the Japan Democratic Party—the conservative forces that came to constitute the LDP have been actively organizing rural interest groups and receiving increasing electoral support from them from the end of the allied occupation in 1951.

10. As explained above, this move was also supported by businesses in the high-productivity sector due to the increasing cost pressures of in-house welfare benefits in the wake of the increase in the market power of labor.

CHAPTER 6

1. Later, a similar attempt to elicit fiscal sacrifices in the name of the shared interest in national prosperity in Belgium in the early 1990s fell flat even more obviously. Although Christian Democrats likened their proposal for a Global Pact to the Social Pact of 1944 that had made possible postwar reconstruction and plenty, labor failed to see the parallel and refused to make concessions.

2. Even though the “independence” of these technocrats from “politics as usual” could itself be seen as a political construct to lend credibility to the impartiality and universal desirability of their reforms, the fiasco of their first pension reform proposal demonstrates that the claim of “technocratic rationality” did not secure unconditional support, even from groups that otherwise rallied behind the technocratic government.

