The Social Sources of Austerity

The Politics of Fiscal Consolidations in the UK and France, 1978-2014

by

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Declaration

I hereby declare that this dissertation contains no materials accepted for any other degrees, in any other institutions. The dissertation contains no materials previously written and/or published by any other person, except where appropriate acknowledgement is made in the form of bibliographical reference.

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Abstract

Why do countries implement austerity differently? Why do they follow different fiscal pathways? Why do some fiscal consolidations lead to social conflicts while others do not? This dissertation explains this variation by focusing on three key mechanisms - tax linkages, attrition and the evolution of social coalitions - in two most similar countries, the United Kingdom and France from 1978 to 2014.

I argue that where tax systems promote strong linkages between payments and benefits, social groups prefer tax hikes to spending cuts because they do not want to forgo benefits for which they have already paid. If those tax linkages are weak, social groups are more likely to resist tax hikes because of uncertainty. Second, attrition refers to the degree of infighting between social groups during austerity. It is measured as income inequality. Where social groups are equal, they are more likely to agree on higher taxes because of a fair additional tax burden: if incomes are equal, taxes are equal. Where inequality prevails, wars of attrition undermine consensus for tax hikes. These two mechanisms yield ideal-types embodied by the UK and France. Countries like the UK, where tax linkages are weak and inequality is high, are more likely to cut spending than to increase taxes. Conversely, countries like France, where tax linkages are strong and inequality is low, are more likely to increase taxes than to cut spending. These different configurations help explain the divergence of fiscal pathways during the age of austerity (1978-2014). Third, austerity can reshape social coalitions and influence future policy through these mechanisms. If inequality increases in a country with strong tax linkages, austerity provokes fiscal conflicts because social groups oppose spending cuts and tax hikes. Countries like Greece and Portugal are cases in point. I argue that France is coming closer to this configuration because inequality has been increasing in the last decade. In the UK, weak tax linkages and increased inequality levels since 1978 paved the way for deep expenditure cuts after 2010.

To be sure, many scholars have underlined the importance of social coalitions for the politics of policy-making. But these accounts ignore contextual preferences and the endogenous evolution of social coalitions. Therefore, the main contribution of this dissertation is to show how the interaction between tax linkages and attrition levels yields a useful dynamic typology of the politics of austerity. Further, the dissertation has important theoretical implications. I show that traditional partisan or ideational explanations do not fully explain counter-intuitive fiscal pathways and the contested politics of austerity. I suggest that certain configurations of linkages and attrition favor certain parties and certain forms of fiscal governance. This dissertation also sheds light on the politics of austerity in the United States, the Eurozone and bailout countries. Finally, my argument also has important implications for the study of the Economic and Monetary Union, showing why some countries may find it more difficult to respect the Stability and Growth Pact than others.

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If texts are textiles, doctoral dissertations are a peculiar piece of patchwork. It is hard to tell who advised what. But without doubt the better parts of the present palimpsest were stitched from the thoughtful comments of my staunchly supportive supervisors - my invaluable *Doktorvater*, Achim Kemmerling, and patient committee members Dorothee Bohle and Evelyne Hübscher. The same applies to other scholars whose influence may be more visible in the vineyard than in the bottle: Carsten Q. Schneider, Béla Greskovits, Anil Duman, Bob Hancké, Dermot Hodson and Waltraud Schelkle.

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If I forgot someone, I do apologize sincerely. As the Russian saying goes, "we wanted well, but it turned out as usual".

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Abbreviations

BoE	Bank of England
BSA	British Social Attitudes
CBI	Confederation of British Industry
CIT	Corporate Income Tax
CRDS	Contribution pour le Remboursement de la Dette Sociale
CSG	Contribution Sociale Généralisée
EC	European Commission
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council
EEC	European Economic Community
EMS	European Monetary System
EMU	Economic and Monetary Union
EU	European Union
FN	Front National
HMT	Her Majesty's Treasury
IMF	International Monetary Fund
INSEE	Institut National de la Statistique et des Études Économiques
LOLF	Loi Organique Relative aux Lois de Finances
MoF	Ministry of Finance
NHS	National Health Service (UK)
OECD	Organization for Economic Cooperation and Development
PIT	Personal Income Tax
PS	Parti Socialiste
SNP	Scottish National Party
SSC	Social Security Contributions
SWIID	Standardized World Income Inequality Database
UMP	Union pour la Majorité Présidentielle
VAT	Value Added Tax

1

Introduction: *A tale of two countries*

> "*Actors [are] embedded in concrete, ongoing systems of social relations.*"
>
> Granovetter (1985)

The politics of austerity are best illustrated by the diverging trajectories of similar countries. In 1978, the United Kingdom and France had comparable taxes and spending. Since then austere adjustments took place simultaneously in both countries with right-wing parties in office and similar fiscal institutions. Yet, four decades later, the UK reduced taxes and spending to the lowest levels since WWII, while France raised them to the highest levels among OECD countries. This divergence was amplified by the austerity turn of 2010. With a floating exchange rate, aggressive monetary policy, relatively low levels of taxes, spending and interest rates, Britain could have sparred its citizens the deep spending cuts it carried out. The government encountered relatively limited social contestation and got reelected with a landslide. France, with similar levels of public debt but far higher taxes and spending than the UK, nonetheless increased both. There, social contestation was stronger and the government lost the elections.

This dissertation will tell the fiscal tale of these two countries with the broader aim of exploring the politics of austerity. Seeking to understand the latter is a way to ask "who governs?" (Dahl 1961) and "who adjusts?" (Simmons 1994). Austerity is an acid test that helps to decipher social relations, to unearth and locate power relationships as well as to expose dominant coalitions behind the numbers of a budget. Why do some countries tend to increase taxes while others cut spending during austerity? Why do some countries do it fast, while others get mired in fiscal conflicts and failed adjustments? Why do social groups oppose austerity in some countries but not in others?I answer these questions by showing that across countries different social coalitions yield different fiscal pathways. To understand the social sources of austerity, social coalitions need to be embedded

in a framework that encompasses three types of social relationships: first, between social groups and taxation; second, between social groups themselves; and third, between social groups and the distribution of power over repeated rounds of austerity. The latter introduces a dynamic element to my argument to show that past measures of austerity matter because they redistribute social power and reshape fiscal coalitions.

First, where tax systems promote strong linkages between payments and benefits, social groups prefer tax hikes to spending cuts because they do not want to forgo benefits for which they have already paid. If those linkages are weak, social groups are more likely to resist tax hikes because the returns on higher taxes are uncertain. Second, where social groups are equal, they are more likely to agree on higher taxes because of fair distribution. Where inequality prevails, wars of attrition undermine consensus for tax hikes. As a result, countries with strong tax linkages and low inequality are more likely to increase taxes than to cut spending. Conversely, countries with weak tax linkages and high inequality will do the opposite. Third, through these mechanisms austerity can reshape social coalitions and influence future austerity. For example, if tax linkages gain in strength and interact with higher inequality, fiscal conflict ensues because social groups refuse both tax hikes and spending cuts.

This framework sheds light on the diverging fiscal pathways of the UK and France during the age of austerity (1978-2014). In the UK, the tax system is based on weak tax linkages (mainly personal income taxation) and inequality has increased tremendously since 1978. There is thus a bias for spending cuts and tax resistance, which further increases inequality. In France, strong tax linkages decreased inequality and formed the bed of tax-based austerity which increases labor costs and fragments social coalitions through unemployment increases and inequality.

This simple analytical framework can be applied beyond the British and French cases to bring a fresh perspective on well-trodden ground. To be sure, many scholars have underlined the importance of social coalitions for the politics of policy-making (Frieden 1988; Gourevitch 1986; Pepinsky 2009). But these accounts are incomplete if contextual preferences and the evolution of social coalitions are not taken into account. So far the interaction between the embeddedness of social groups in tax structures and the attrition levels and the dynamic effects of austerity on social coalitions over time have been neglected. My coalitional theory of austerity therefore not only provides an account of the social sources of austerity, but also scrutinizes their impact on unfolding fiscal pathways.

1.1 Axe or tax?

Following the common shocks of the Great Recession and the Sovereign Debt Crises, the coordinated austerity turn of 2010 yielded a striking variation (see figure 1.1). Some countries, like the UK, embarked on a fast and deep adjustment cutting spending more than taxes. Central and Eastern European states are a case in point with Bulgaria, Estonia, Lithuania and Slovakia and, to a lesser extent, Canada, Cyprus and Israel. Others, like France, increased taxes more than spending (Austria, Belgium, Denmark, Finland, Germany, Italy, Japan, Malta, South Korea and Switzerland). Countries in red implemented the biggest fiscal adjustments by increasing taxes and cutting spending. Among them are crisis-hit countries which went through bailouts and assistance

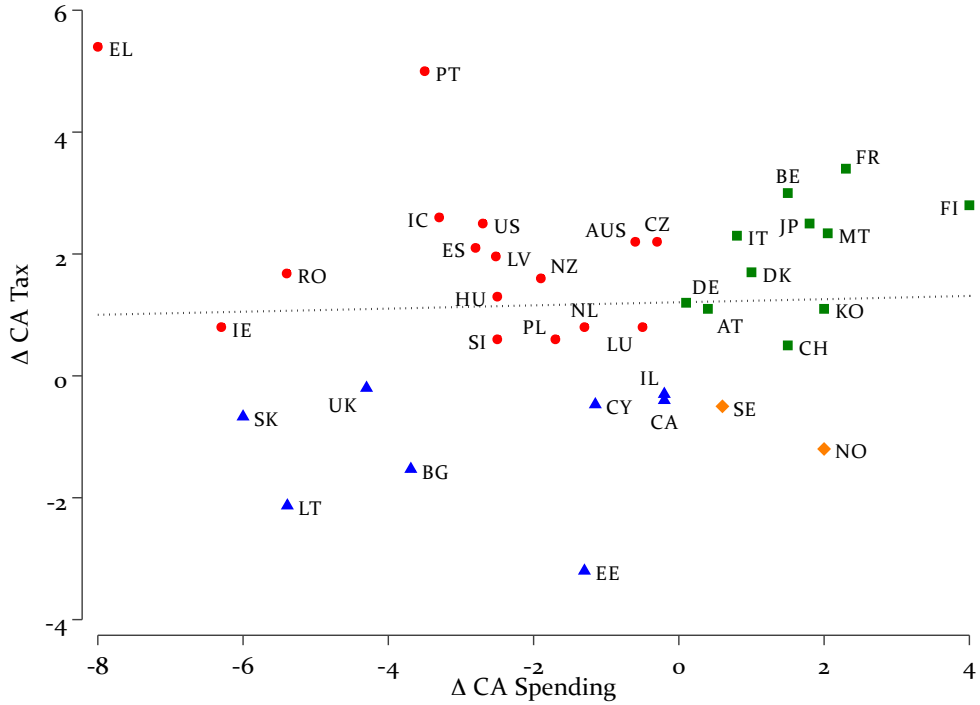

Figure 1.1: Diverging austerity, 2010-14

NB: Cyclically adjusted balances between 2010 and 2014.
Source: OECD Economic Outlook 95.

programs, but even they display significant variance in the austerity they choose. While Greece adjusted on both the tax and spending sides, Portugal mainly increased the former while Ireland mainly cut the latter. Finally timing and social resistance also sets all these countries apart. Some went quite fast (Ireland, Lithuania) while others were bogged down by social conflicts (Portugal, Greece, Italy). In the UK, austerity was seen as the winning policy, while in France the "A" word was taboo. What explains these types of variations in austerity?

Clearly, something is going on here, but perhaps the most interesting fact is that the cross sectional patterns that emerged after the coordinated turn to austerity mirror somehow the long-term fiscal pathways that unfolded since the inception of the age of austerity in 1978. Figure 1.2 suggests that there seems to be a dual outcome to this age of austerity. On the one hand, some countries stuck to revenue increasing strategies to match their ever growing expenditures (France, Italy and Portugal as well as Spain, Finland and Denmark in the 1980s). On the other, countries such as the UK, Sweden, Ireland, Canada and the US rather opted for spending-based fiscal consolidations (which does not exclude tax hikes) and choose to keep tax ratios almost constant or to reduce them over time.

In fact, those patterns are more subtle because some countries switch strategies at one point, while others seems unable to either cut spending and/or increase taxes. Among the "switching" countries, the Netherlands and Ireland are clear examples of fiscal pathways in form of an inversed "u": both countries first increased spending and then taxation. In the mid-1980s however, both

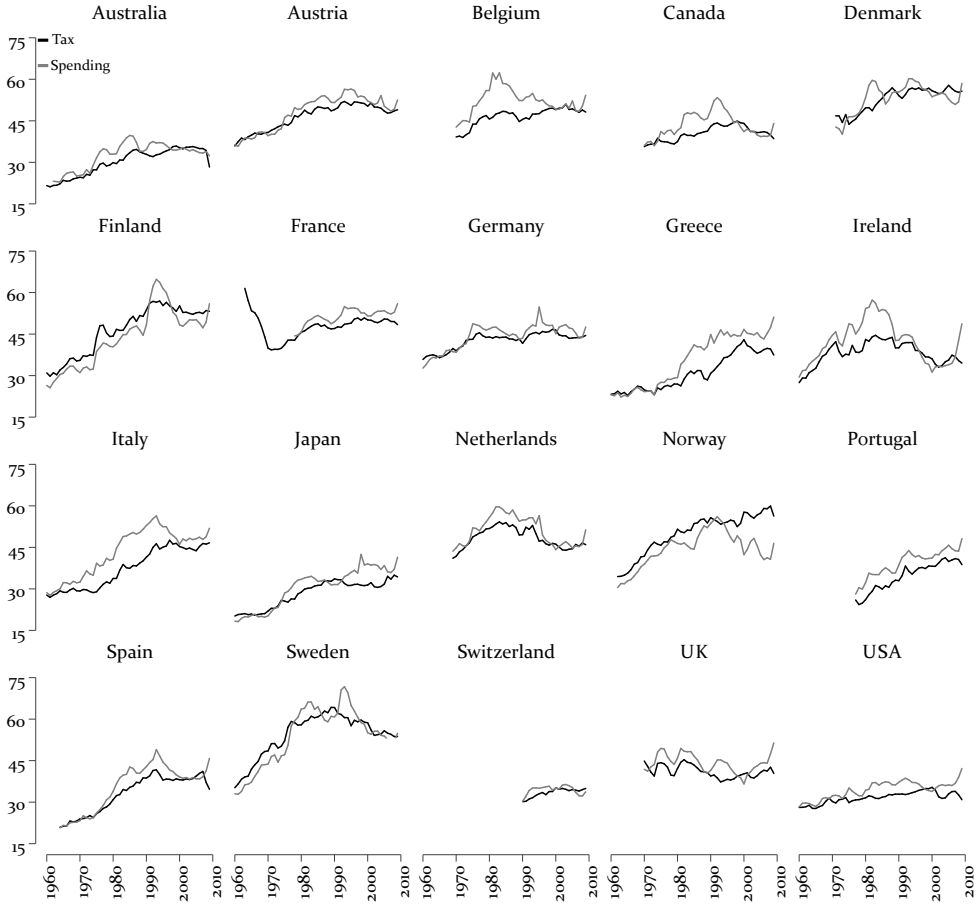

Figure 1.2: Fiscal pathways, 1960-2010

NB: Government receipts are in dark and outlays are in gray.
Source: OECD Economic Outlook 95 & AMECO.

countries reverse course and started decreasing spending and tax levels. Finally, among the countries whose tax and spending levels diverge, we can find highly indebted countries like Belgium, Greece, Portugal and Japan or countries that were formerly very indebted (Canada and Ireland). In these countries, the divergence between taxes and expenditures happened mainly in the 1980s and provoked a significant increase in debt. Some countries, however, managed to correct this problematic trajectory (Belgium, Canada and Ireland) while others strained heavily their public purse (Greece, Italy).

1.2 Social coalitions and austerity

To explain variation in austerity and the divergence of fiscal pathways over time, I propose three interlinked mechanisms that rest on a political sociology of fiscal coalitions (see figure 1.3). First, I argue that different tax linkages produce different fiscal trajectories because social groups relate

differently to the taxes they pay (Bates and Lien 1985; Timmons 2005). Tax linkages are strong when insurance taxes dominate (such as social security contributions): the linkage between what is paid and what is expected in return is strong because benefits have to match "investments". This entails higher social resistance to spending cuts and greater acceptability of tax hikes. Conversely, if tax systems are dominated by non-insurance types of taxation (such as personal income taxes), where the linkages between payments and expected returns are weak, then social groups are more reluctant to pay increased taxes and more likely to accept spending cuts.

Second, I show that if the burden of austerity is likely to be distributed unequally, then social groups will resist tax hikes because they will engage in a war of attrition and governments (Alesina and Drazen 1991) will be left with spending cuts. Whether the burden of adjustment is spread evenly or not depends in turn on the perceived distribution of incomes. The simple mechanism is that equal incomes imply roughly equal taxation and thus low attrition, while unequal incomes imply unequal taxation and thus high attrition. Under the latter scenario, tax resistance is more likely.

In interaction, these two mechanisms predict that in tax systems with strong linkages and low attrition, tax hikes are more likely than spending cuts during austerity. In tax systems with weak linkages and high attrition, tax hikes are less likely than spending cuts. In tax systems with weak linkages and low attrition, tax hikes and spending cuts are equally likely, while in tax systems with strong linkages and high attrition social groups oppose both higher taxes and spending cuts. The latter case of fiscal conflicts yields failed fiscal adjustments.

The third mechanism focuses on the political coalitions constraint (Acemoglu and Robinson 2013; Hellman 1998). It introduces a dynamic dimension to my argument and underlines the effects of past austerity on present fiscal adjustments (see the arrows in figure 1.3). Here I only focus on a few examples that the theoretical chapter will further develop. First, if a political economy has strong tax linkages and previous austerity adjustments increase attrition, past austerity had social coalitions biased towards tax hikes and future fiscal adjustments may be mired in social conflict and fail (the higher red-dashed arrow) because previous social coalitions unravel. This represents the French case which will be analyzed in greater detail later. Conversely, if a political economy with weak tax linkages increases attrition during repeated rounds of austerity, then it will reshape its social coalitions from mixed austerity (tax hikes and spending cuts are equally likely) to social coalitions which are more willing to accept spending cuts than tax hikes. This is exactly what happened in the UK during the Thatcher era: the stop-and-go policies of the 1970s were replaced by a spending cut bias and enabled the policies of Cameron and Osborne three decades later (the lower red-dashed arrow).

This analytical framework illustrates more than the British and French fiscal pathways. The dynamics of social coalitions and austerity can be reversed in theory, but in practice some fiscal pathways are more practicable than others. In general, attrition levels change more readily than tax structures, and this is why the latter is analytically prior to the former. Therefore, changing from weak to strong tax linkages is less probable (dot-dashed green vertical arrows) but it is possible.

The conclusion will sketch out small vignettes to illustrate different cases and pathways to underline the generalizability of my argument. For instance, to illustrate the problem of austerity when high inequality and strong tax linkages interact, I will provide an overview of such cases as Portugal, Italy and Greece, which experience tremendous fiscal difficulties. By contrast, Ireland,

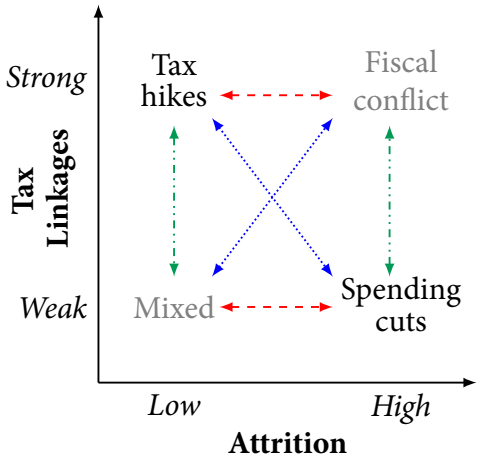

Figure 1.3: The social sources of austerity and fiscal pathways

which has weak tax linkages but has seen attrition decrease sharply since 1990 below French levels, got out much faster from its bailout program by implementing spending cuts and little tax hikes. To further illustrate how attrition can influence the process of fiscal austerity, a small vignette of the American case will show how fiscal conflict erupted after 2010 in Congress.

I do not claim to explain the total variation in fiscal consolidations because too many factors contribute to the final pattern. But I argue that social coalitions can help understand the politics of austerity over time and across countries. To be sure, scholars already used the coalitional approach to shed light on the politics of austerity (Alesina 1988; Barta 2011; Dellepiane-Avellaneda and Hardiman 2009, 2012; Marzinotto 2005, 2009). While I leverage these traditions, I also seek to address their main weaknesses. Where other studies analyzed austerity at one point in time only, I take seriously the contention of Gourevitch (1986), according to which crises and policy solutions are connected over time. Where other studies take fiscal preferences for granted, implying that the same social groups in different polities behave similarly, I show that social groups oppose or approve austerity depending on their relationship with the budget, with other groups and with time. Where studies focus on taxes and spending separately (Mulas-Granados 2006), I seek to link the two because "the mechanism of the mutual interdependence between expenditure and revenue ought to be the primary problem of the science of public finance" (Goldscheid 1958, p. 202).

1.3 Methodology

I build on seminal contributions comparing the UK and France as most similar systems in a longitudinal perspective (Hall 1986; Levi 1989; Schmidt 2001; Stasavage 2003, among others). It is obviously impossible to have perfectly similar systems, but the UK and France come close on many characteristics related to competing explanations (Gisselquist 2014). Following Peter Hall, I ask what sets apart two countries where the right is traditionally dominant, where the electoral system yields strong majorities, where institutions are centralized and where finance ministers are powerful. Despite these similarities, austerity politics differed markedly during the critical

junctures of 1978-1983, 1993-1997 and 2010-2014.

Concerning partisanship, the UK and France have been dominated mostly by right-wing governments (between 1960 and 2015, 64.3% in the UK and 69.6% in France). The UK was mostly affected by the radical policies of Thatcher. In France, similar policies were planned and partially implemented by the right. Raymond Barre was no less a conservative-liberal than his British counterparts.[1] In the 1980s Chirac campaigned on a platform of economic liberalism inspired by his British peers, which by some measures was even more radical. In 1995 Juppé tried to implement sweeping reforms on the expenditure side of the French budget. Likewise, Sarkozy was elected three years prior to David Cameron on a platform of radical reform in 2007, his prime minister claiming that "the State is bankrupt". Thus, from the ideational perspective, both countries were equally prone to adopting the "austerity paradigm" and making sure that state finances were brought back to balance. Yet, while British Tories implemented their program and got reelected, French conservatives consistently failed to do so.

On the level of fiscal institutions, the UK and France are very similar. Their electoral, pluralistic systems entail a winner-takes-all dynamic where the winning party gets all responsibility for government. The upshot of this structure is that, as evidenced by Hallerberg (2004) and Hallerberg et al. (2009), fiscal policy is delegated to a powerful finance minister. Indices constructed by fiscal institutionalists suggest that, compared to other countries, British and French finance ministers rank among the most powerful in terms of delegation of the budget: the British Chancellor's "grade" increased from 0.74 to 0.87 between 1990 and 2004, while the French *Ministre des Finances* decreased from 0.9 to 0.77 in the same period, losing his leadership position of 1990 but retaining an honorable second position in 2004, right behind his British counterpart.

The UK and France are more similar than commonly accepted by the political economy literature, especially by the dominant paradigm of the Varieties of Capitalism which sees the former as a "Liberal Market Economy" and the latter as a close case to the "Coordinated Market Economy". Contrary to this common knowledge, data suggest that trade-unions are stronger in the UK than in France[2] and that the manufacturing sector is stronger or equal in terms of GPD share in the UK than in France (18 vs. 14% until 2000). Conversely, France and the UK have a comparably strong service and financial industry. Both amounted to 28% of GDP in 2012. This industry has been much more represented in the French economy than in the British one from 1990 to 2003. Now, this economic structure where the industry is in decline and the service sector (and especially the financial sector) are gaining strength can suggest a shifting power structure among coalitions. A declining industry means less demand for redistribution as the total exposition to world demand is reduced: the welfare state was indeed build partially to meet the demands of industrial workers. In the service industry, demand for redistribution may be smaller because the industry is more geared towards the domestic market. Another reason may be that collective action in the service industry is much harder to achieve than in the manufacturing industry which has been the traditional base of trade-unions. Finally, financial markets in France changed markedly during the last forty

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[1] Indeed, on September 3, 1979, the center-left *Guardian* published an article asking "[Barre,] A Paradigm for Sir Geoffrey?", who was the conservative Chancellor of the Exchequer at the time. See also Hall (1986); Prasad (2005).

[2] In the UK, union density was at 40% in 1960 and peaked at over 50% in 1982 to come down to around 25% in 2012. In France, union density decreased from 20% in 1960 to 7% in 2012 (see Jelle Visser's ICTWSS database).

years and are much closer to their British counterparts (Hardie and Howarth 2009; O'Sullivan 2007; Prasad 2005). Some scholars have even started talking about the "informal consortium" of the largest banks similar to the City in the UK (Jabko and Massoc 2012). The increased role of the market in the French political economy has also been of tremendous importance in the way the French economic structures embraced globalization through firm-led adaptation to external pressures (Culpepper et al. 2006; Hancké 2002; Levy 1999; Schmidt 2001). All in all, in the last decades, France has steered away from a state-led model of capitalism. It has become much closer to Britain in terms of political economic structures than is commonly perceived.

1.4 Outline

In this dissertation, I aim to explain the puzzling divergence of British and French fiscal pathways and their politics of austerity from 1978 to 2014 with the simplest and most parsimonious argument possible. I argue that social coalitions influence austerity through three mechanisms: linkages, attrition and coalitions formation or fragmentation over time. The following provides a guide to the remainder of this dissertation. The first part, composed of chapters 2 and 3, is more theoretical:

Chapter 2 Theories of austerity	I examine the contested economics of austerity and suggest that since there is no optimal path to fiscal stabilization, politics play an important role during austerity. Then I discuss alternative political hypotheses (ideas, partisanship and institutions). I show that on all those dimensions, the UK and France are similar cases.
Chapter 3 Social sources of austerity	I expose the theoretical framework on the social sources of austerity in two steps, statically and dynamically. First I show how social coalitions are embedded in tax structures and attrition. I demonstrate how these mechanisms interact while presenting cross sectional evidence on the probability of tax hikes and spending cuts. Second, I show that in an endogenous framework, past austerity measures influence the politics of austerity in next rounds of fiscal adjustments if tax linkages are altered and attrition levels change. I show how these changes yield fiscal pathways and can explain change over time.

The second part of the dissertation is empirical: the next three chapters explore each mechanisms in a longitudinal and comparative perspective, looking at the the UK and France. The logic of my argument and of the empirical evidence is the same: tax linkages come analytically first because they are historically rooted and because they have an impact on attrition. I suggest that weak tax linkages tend to increase inequality and thus attrition in some countries is by definition stronger than in others. Once I explored these two mechanisms, I can look into the dynamics of social coalitions over time and analyze the endogenous effect of austerity.

In the last and seventh chapter, I extend my argument to the United States, Italy, Ireland and Portugal and draw the implications of my argument and findings. While the US is mostly similar to the UK because of weak tax linkages and high attrition levels, Italy represents a case towards which

Chapter 4 Linkages and austerity	I investigate the first mechanism, tax linkages. In the UK, the income tax is the main tax linkage, while in France social contributions dominate. These tax linkages structure the attitude of social groups to austerity differently. In the UK the income tax acts as a powerful revenue-generating constraint and forces expenditures to match limited revenues. This is an element of the spending cuts bias in Britain. In France, the logic is different. Strong tax linkages match revenues to rising expenditures. Thus tax linkages are an important mechanism to explain diverging fiscal pathways in the UK and in France.
Chapter 5 Attrition and austerity	I explore the second mechanism, attrition. In the British case, Thatcher's austerity has increased attrition significantly. This has slowly eroded support for higher taxes and moved the UK from a mixed case to a bias for spending cuts. In France, austerity has decreased attrition in the first place between 1978 and 2005, strengthening the consensus for tax hikes. Soaring unemployment and the crisis of 2008 have, however, increased attrition and put a strong constraint on tax increases.
Chapter 6 Coalitions and austerity	I illustrate how British austerity consolidated social coalitions around a bias for spending cuts, which was confirmed with the fiscal consolidation implemented between 2010 and 2014, while in France, austerity fragmented social coalitions and brought France closer to cases where strong tax linkages and increasing attrition preclude an effective fiscal correction. Political turbulences (loss of elections by mainstream parties, rise of fringe parties) and renewed social opposition to higher taxation confirm this hypothesis.

France is slowly evolving with strong tax linkages, increasing attrition and mounting public debt. Ireland and Portugal are used as contrasting cases. I use my framework to shed light on the fast adjustment performed in Ireland and the early exit from the bailout program (weak tax linkages and low attrition facilitated both tax hikes and spending cuts), and the conflicted fiscal adjustment in Portugal (due to strong tax linkages and high attrition).

I then discuss the implications of this dissertation for other literatures and possible avenues for research. The most important ones are probably for the partisan approach to austerity and fiscal governance. I suggest first that right wing parties will find it easier to implement their preferences for austerity (spending and tax cuts) where tax linkages are weak and attrition is high, while left wing parties will be more comfortable in a constellation where tax linkages are strong and attrition is low. Both types of parties will find it hard to implement austerity in the most difficult scenario, when tax linkages are strong and attrition is high. Finally, coming back to the literature on fiscal governance, I discuss whether the delegation type of fiscal governance is not more suited to a configuration conjugating weak tax linkages and high attrition, while the contract form of fiscal governance may be more appropriate to countries with strong tax linkages and low attrition. This may explain why delegation worked better in the UK than in France.

2

Austere politics: *Theories of fiscal consolidation*

> "*There are no solutions, only trade-offs.*"
>
> Thomas Sowell

This chapter first presents the different political-economic theories of fiscal austerity that stem from the contested economics of fiscal consolidations. The aim is to map the policy options that governments face when embarking on austerity and to avoid the analytical trap of equating austerity with spending cuts only. Second, the objective of the chapter is to indicate that what we seem to know about fiscal consolidations from an economic point of view is indeed very much contested in the economics profession itself: the kernel of the debate revolves around the economic fiscal multiplier and, to a lesser extend, around the political fiscal multiplier.

In short, the economic fiscal multiplier refers to how much return there is on fiscal policy depending on which side of the "austerity trade-off" governments choose to target. Does cutting expenditure and taxes increase or decrease the interest rate on debt and/or GDP growth? Under which conditions? In a more nuanced way, what is the redistributive impact of this economic fiscal multiplier? This is an important question because governments will seek to protect their constituencies and will therefore adopt different fiscal strategies for retrenchment.

The political fiscal multiplier refers to the political effects of austerity: do governments stand less or more chance of being re-elected? Both dimensions are important because they influence the behavior of governments. If the economic multiplier is positive and strong (i.e. contracting the budget causes an economic contraction), then incoming governments may want to implement austerity strategically at the beginning of a term rather than at the end to maximize chances of reelection (Hübscher 2015).

The interaction of both fiscal multipliers shows that the political economic map of fiscal adjustment is blurry: it is hard to find an "optimal" path. This triggers a set of political explanations

(part two of this chapter) as to why governments choose particular combinations of the fiscal multipliers, economic and political. For instance, some governments adjust fast and hard, cutting spending, front-loading austerity and targeting the interest rate, while others adopt gradual, slow moving strategies raising taxes little by little and worrying about growth. Finally, some governments fail altogether. The literature review of the political explanations of austerity will shed light on this issue and will leverage the existing and rich literature to sharpen our research question.

2.1 The contested economics of austerity

This section will not establish the economics of fiscal consolidations. Rather, it will seek to show that those economics are highly contested. In so doing, I show how politics finds room for maneuver within contested economic theories of fiscal consolidations, concerning their timing, scope and relation to other policy instruments. The result will be to focus on the political determinants and political consequences of austerity.

2.1.1 The austerity trade-off

There is no optimal path for fiscal consolidation for the simple reason that fiscal policy operates in a certain context. What is important is not the absolute but the relative level of fiscal aggregates to an economy, because fiscal policy is ultimately measured in proportion of the gross domestic product (GDP). In other words, fiscal policy is what a country pays against the backdrop of what it can afford.

Domar (1944) summarized first the sustainability of fiscal policy as a race between a numerator (in short, the interest rate on debt) and a denominator (the GDP).[3] This simple and intuitive idea is a useful heuristic device to parse out the dilemmas of austere politics and contextualize the notion of austerity.

If interest rates spike, then the service on debt gets more costly as debt accumulates. This can be especially problematic for governments having huge debts non-denominated in their currency, i.e. they do not "own" a central bank that could either lower the interest rate or act as a lender of last resort (De Grauwe and Ji 2013). The aim of the government is then to "calm" financial markets and to convince them that their budget is in order. This can be done, for instance, by acting swiftly and cutting expenditures to signal a lower future tax burden and thus higher growth possibly. Although there is no clear link between taxation and GDP growth in theory (e.g. US vs. Denmark), this can be a *perception* of financial markets. Likewise, if GDP falls due to a recession, governments may well do everything they can to reverse the adverse shock and increase expenditures, following with taxes. When both interest rates spike and GDP falls, governments are caught in a tricky situations and social forces will shape the adjustment.

Given this trade-off, it is not surprising that during the austerity turn in 2009-2013 many conflicting voices were heard about the best way to go about fiscal policies. On the one hand,

[3] The appendix to this chapter explains the austerity trade-off in greater detail. It is not the scope of this thesis to deal with the huge economic literature on fiscal sustainability and fiscal adjustments, just to show how disputed the notion is and what are the consequences for the politics of austerity.

given the spikes in interest rates, some governments (UK, Germany), international institutions (EC, ECB) and some economists (the "freshwater" and "ordoliberals") called for front-loaded fiscal consolidations to restore "credibility" and "confidence" in domestic budgets. In other words, government should slash spending as fast as possible to convince debt holders that public finances are "sustainable".

On the other hand, some governments (France, Italy, the US), international institutions (IMF) and some economists (the "saltwater" and the "keynesians") called for back loaded efforts in austerity and for tax increases to match expenditures that were funding increasing numbers of unemployed. The argument was that austerity would have an effect on Domar's denominator and that harsh adjustments would be self-defeating. Governments would better first sustain a frail economy and consolidate slowly but surely once growth picks up.

While Domar's equation maps quite reasonably the fierce debates about the contested economics of austerity, one should notice that the arguments were a bit more complicated. In fact, reducing Domar's numerator - the interest rate - may have beneficial effects for Domar's denominator - GDP - and vice versa. To these subtleties we now turn.

2.1.2 The idea of expansionary fiscal contractions (EFC)

The idea of "expansionary fiscal contraction" (EFC) or "growth-friendly fiscal consolidation" is a paradoxical one: under certain conditions, austerity can increase output. Thus policy-makers can have their cake and eat it: sound public finances and a thriving economy with satisfied voters.[4] This idea appeared in the beginning of the 1990s, when two Italian economists (Giavazzi and Pagano 1990, 1996; Giavazzi et al. 2000) showed that austerity in Denmark and Ireland showed unexpectedly non-Keynesian effects: austerity did not cause recessions, but growth. The so-called fiscal multiplier (the impact on the economy of fiscal policy) had turned negative. Less, it seemed, was more. This idea was later picked up by other economists (Alesina and Perotti 1995, the first title in a long series of studies with Perotti, Ardagna and others) and spread to European economic institutions (the European Central Bank and the DG ECFIN of the European Commission) in the late 1990s and 2000s (Blyth 2013; Dellepiane-Avellaneda 2015; Needham and Hotson 2014, for the deeper sources of the idea, its diffusion and case studies).

The underlying logic rested on an expectational view of fiscal policy, which worked on both the supply side and the demand side of the economy. By convincing financial markets and voters, a "large, credible and decisive" fiscal adjustment could bring down interest rates and thus stimulate the economy. The effect could be achieved together with and thanks to improved "efficiency" in the labor markets, a favorable external environment, sustainable debt dynamics, and devaluations. The recipe proposed by the EFC is to rely mostly on spending cuts in government wages and transfers and to avoid tax increases, lest austerity be contractionary. In the EFC view, the bigger the spending cuts, the better because they "signal" the government's "commitment" to fiscal rectitude and thus generate positive expectations (e.g. reducing expenditures means lower taxes in the futures and

[4] There are in fact two strands in the EFC thesis: the economic negative fiscal multiplier (decreasing the deficit with increase economic growth) and the political negative fiscal multiplier (decreasing the deficit can secure reelection). The literature is daunting given the fierce ongoing debates, therefore I will present only a primer.d

thus a higher propensity to consume kicks in). There are in fact several "channels" through which the EFC is supposed to works it way through:

- The demand side:
  - Agent's expectations of smaller or no adjustment in the future if the current tax increases and spending cuts are perceived as permanent;
  - Agent's expectations of lower future interest rates through a reduced probability of government default, which ripples through the economy;
  - Agent's financial wealth increases through the appreciation of stocks and bonds due to lower interest rates;

    According to this logic, lower interest rates crowd in private investment through a Ricardian effect (lower taxes in the future) and increase asset prices. Agents increase their expectations of future permanent disposable income and thus augment their consumption and investments
- The supply side (here the EFC thesis seems less precise)
  - Labor market in a neoclassical model

On top of that, research on the relationship between debt thresholds and economic growth stipulated that above 90% of GDP, public debt weights down on growth. This buttressed the case for swift and consequent fiscal consolidations (Reinhart and Rogoff 2010) in January 2010. This research has sparked considerable polemic and mis-understanding, but it was nonetheless used by political elites and fiscal consolidation entrepreneurs to argue for fast deficit cutting.

2.1.3 The Keynesian thesis

Contrary to the EFC approach, the Keynesian thesis posits that the fiscal multiplier is positive. For this reasons, proponents of both camps were at loggerheads during the austerity turn that succeeded the great recession of 2008. The "Keynesians"[5] came back to the foreground in 2012-2013 when a series of governments left office (Sarkozy, Monti, Letta) and several publications cast doubt on the empirical validity and the theoretical consistency of the EFC approach.[6]

The Keynesians also advance that effects of fiscal consolidations are conditional on the initial situation (e.g. whether the economy is at the monetary zero lower bound and whether there is a financial and economic crisis). In general, the larger and more expenditure-oriented a fiscal consolidation is, the more negative its effects will be on output and unemployment (i.e the larger fiscal multipliers are), an this effect increases with the loss of traction by monetary policy. One

[5] I include in this tent concept a large group of economic and political science scholars and policy-makers who may name themselves differently (e.g. neo-Keynesians).

[6] See Guajardo et al. (2011) and Perotti (2011) and Blyth (2013, chapter 6) for a critical approach to the EFC thesis from a political-economic perspective and Herndon et al. (2014) for casting doubt on the thesis claiming that 90% of public debt to GDP slows down economic growth considerably.

of the mechanisms behind this effect is the "paradox of thrift": when an economic crisis hits, the "paradox of thrift" implies that all economic agents save due to uncertainty on future incomes. On the aggregate level this decreases overall output. In that case the State has to step in with a fiscal stimulus (public spending) to restore confidence (private spending). If the State does the opposite, consumers will spend less. In fact, studies of fiscal multipliers during the recession-cum-austerity episode of 2008-2012 showed that the greater the announced austerity the bigger the error forecast to the downside: in other words, GDP decreased by much more than would have been expected (Blanchard and Leigh 2013). Other, non-linear and conditional approaches have given more nuance to the debate by showing that fiscal multipliers increase substantially during recessions as compared to expansions, and that they differ depending on the nature and the strength of the fiscal shock (tax vs. expenditures), the timing of the shock (front or backloaded), and on which country is analyzed (Batini et al. 2012).

Another strand of Keynesian research has emphasized the need to go beyond the debate on fiscal multipliers and to consider the long-term effects of fiscal consolidation. The key concept advanced by those authors is "hysteresis" (Blanchard and Summers 1986; DeLong and Summers 2012), i.e. the fact that temporary unemployment caused by a shock (economic or fiscal) becomes permanent. From the perspective of potential output, which is usually seen as invariable while the business cycle hovers around it, fiscal consolidations can wreak long term damage by lowering economic growth.

Finally, scholars argue that the expansionary effects of fiscal consolidations seem to be overstated due to the nature of the data used. Because the expansionary fiscal contraction camp uses the cyclically-adjusted primary balance (CAPB), it exposes itself to important measurement errors that would include non-policy changes affected by the economic cycle. A case in point is the effect of asset prices that tend to inflate taxation revenues. This leads to the selection of fiscal consolidation episodes that are not linked to debt reduction. They are rather aimed at cooling down an overheating economy (think of Ireland and Finland in the 2000s), thus biasing the results towards expansionary effects of contractionary fiscal policy. To remedy this major shortcoming, a new strand of research has collected data not based on the CAPB, but on genuine policy shocks motivated by debt reduction. Based on qualitative data (implemented government announcements) which are uncorrelated with other economic developments (Leigh et al. 2010; Perotti 2011; Guajardo et al. 2011; Romer and Romer 2010), this literature tends to confirm that fiscal consolidations decrease economic output and increase unemployment as well as inequality and poverty.

The result of this "Keynesian" approach is that, in terms of Domar's fiscal trade-off, one should not target a lower interest rate by seeking credibility gains through tough fiscal adjustment but rather policy-makers should keep the denominator growing and consolidate only when the probability of recession following fiscal consolidation is at the lowest.

2.1.4 The distributive impact of austerity

The distributive impact of austerity, beyond the debate on the fiscal multiplier, can be economic, political or political economic.

On the economic level, studies have found that in general harsh fiscal consolidations on the expenditure side after bailouts imply a massive transfer of money from taxpayers to the financial

sector. If social transfers are trimmed, the most fragile part of the population loses out due to social retrenchment and higher unemployment. On average, it is estimated that fiscal consolidations tend to increase inequality (and are thus detrimental to the lower part of the income distribution) through several channels: higher unemployment, decreasing the share of wages in GDP and retrenchment of social transfers. Depending on the econometric estimation, studies find that fiscal consolidations of 1% of GDP increase, on average, the Gini coefficient by 0.4-0.7 % over the first two years. Now this effect can differ depending on whether the consolidation episode is tax or spending based: the latter seems to increase inequality more than the former. Some 15-20% of the rise in inequality is due to the rise in unemployment (Agnello and Sousa 2012). Duration matters as well: longer consolidation episodes, if spending-based, will have a broader impact in the distribution of income in a society.

In general, policy-makers who want to mitigate the negative impacts of retrenchment increase the progressivity of taxation (e.g. the ratio of direct to indirect taxes), are ringfence social benefits (unemployment, pension and social security benefits) and subsidies, especially if it promotes education and training in the most fragile parts of the working population. This gives alternatives to policy makers: if they care about social cohesion, and want to reduce public expenditures, they can reduce the public wage bill (which affects more middle to upper middle classes) instead of cutting social transfers (which affects more lower income groups). Alternatively, they can raise the progressivity of taxes like the PIT and the CIT and address tax evasion as well as tax loopholes instead of increasing the VAT.

In terms of political economy fiscal consolidations decrease more the wage income share in proportion to GDP, as compared to profits (firms) and rents (capital). This is due to several mechanisms. For one thing, fiscal consolidation packages often include cuts in public sector wages. Depending on the size of this sector in the economy, this can alter the redistribution of the GDP pie in a significant way. For another, since fiscal consolidations involve rises in unemployment, this means that lots of wages otherwise earned are not, and in the best cases they are replaced by benefits. This is especially important for long run effects when short-term unemployment transforms itself into long-term unemployment, thus leaving a permanent scar in the economy and in people's trajectories. Unemployed find it harder and harder to get a job and thus experience the "hysteresis" effect. Finally, if wages fall, profit soar proportionally if GDP continues to grow, thus boosting the standing of firms in a political economy. This will lift financial markets whose buoyant reaction will lift other stocks in which more well-off households invested. In terms of interest groups, one can see who is the biggest loser of fiscal consolidations: wage earners without any assets whose slice of the GDP pie shrinks.[7]

This broad-brush empirical sketch of the distributive impact of fiscal consolidations helps us to draw the contours of various social actors' fragility to fiscal consolidations. Summarizing, households belonging to the lower bottom of the income distribution will be more vulnerable to cuts in social transfers and reduced wages. Households in the middle to upper parts of the income distribution will be more vulnerable to the taxation (taxation on rents, real estate taxes) and the cyclical variation of their wealth (stock market fluctuations). Firms will dislike the reduction

[7] For the empirical work, see Ball et al. (2013); Bastagli et al. (2012); Blanchard and Summers (1986); Mulas-Granados (2006); Woo et al. (2013)

of subsidies and profit taxation. The financial sector will be sensitive to capital taxation. Both will cheer up to reduced wages (in the public and private sector: since both of them are linked with a time lag, the first implies lower future taxes, and the second higher profits) and reduced social transfers (lower costs of production and thus higher competitiveness). Trade unions will be weakened by higher unemployment and lower wages, finding themselves often in a situation where they have to accept consolidation deals.

Finally, fiscal consolidations can have different effects depending on how they interact with other policy instruments. First, political exchange can happen if the exchange rate can be weakened, thereby boosting the export sector and business (Almunia et al. 2009; Hjelm 2002, 2004; Lambertini and Tavares 2005). If this is possible, then businesses and the export sector can accept higher taxes on profits or taxes on labor (Marzinotto 2009). If this is not possible, the stance of businesses may harden, especially if those represent the manufacturing sector that has to export rather than the service sector. As we will see, this is precisely the case of France under rigid monatary regimes since the early 1980s. Second, monetary policy can be a powerful instrument during fiscal consolidations. Usually considered to be independent from fiscal policy in normal times, the recession of 2008-9 and its aftermath have proved that when fiscal consolidations follow financial crises and central banks intervene to inject liquidities in the financial system, this can relieve the government from a certain burden and urgency of fiscal consolidation. In this case, it often happens that to lower interest rates to kickstart the economy when the repo rate hits the zero-lower bound, the central banks buy government debt (like in the US or the UK). This is a very special configuration that makes some fiscal consolidations (like the British one) quite puzzling from a political point of view.

2.1.5 The political fiscal multiplier

In the 1990s and the 2000s, European policy-makers were facing the "Juncker Curse", of the name of the former Prime minister of Luxembourg and later European Commission President. According to this curse, "governments know what to do [e.g. implement "structural reforms"], but they do not know how to do it to be reelected". This common knowledge assumed the political fiscal multiplier to be positive. Increase spending and reduce taxes, polls go up and re-elections ensue. Do the opposite and be ousted out of office.

A new strand of research has been devoted to debunking this common knowledge, showing that if anything, the political fiscal multiplier can be either null or negative. The proponents of this thesis were either the representatives of the EFC thesis (Alesina et al. 1998, 2011), officials from institutions with a vested interest in convincing governments to reform (Buti et al. 2008a,b; Kalbhenn and Stracca 2015) , or political economists focusing on the welfare state (Armingeon and Giger 2008; Giger and Nelson 2010).

This literature seems to suggest that is possible to conduct austerity in whatever form and get away with it, provided that financial markets are liberalized and well-functioning (and thus "bringing forward" the gains of reforms), that the issues of retrenchment are not on the electoral agenda and that parties can diffuse the blame. This means that austerity maybe easier in more fragmented polities as austerity policies need more consensus to be decided in the first place and then have move people to blame in the second place. In centralized polities as in the UK or France, with majoritarian electoral systems and winner-takes-all elections, it is hard to diffuse

blame. It is puzzling therefore that Tories were able to implement austerity and get credit for it as an economically "competent" government while in France the Gaullists are perceived as incompetent precisely because they tried and failed to do the same.

These contrasting cases may explain why other parts of the literature have presented evidence undermining the negative political fiscal multiplier and confirmed the "Juncker Curse". Mulas-Granados (2006) suggests, before 1992, not only that austerity is likely to cost policy-makers their office, but also that expenditure cuts increase this likelihood more than tax hikes. From this perspective is it puzzling to see that, in the case of the UK, not only that Tories were reelected in 1983, 1987 and 1992 after years of spending-led austerity, but that Labour got itself elected in 1997 once it accepted the necessity to keep spending low. Likewise, France exhibits a strange pattern of failed tax-based consolidations. Literally no or few governments were reelected on a platform of fiscal adjustment in France.

More subtle approaches may give a clue of what may be going on here. Going beyond the traditional dependent variable of the probability of reelection, (Hübscher et al. 2015) look more closely at voting intentions as impacted by fiscal plans, while Hübscher and Sattler (2014) investigate the conditional effect of electoral victory margins. The results add a greater understanding to mixed evidence of the literature: the probability of austerity decreases with the margins of victory at the previous elections and impacts significantly voting intentions. This last finding adds some subtle nuance to the literature: after austerity, a voter may be dissatisfied with its party in office and signal this through polls but still vote for this party to avoid getting a worse deal with the opposition gaining office.

My theoretical framework and empirics will prolong this line of inquiry by showing under which conditions right wing parties in the UK and France embark on fiscal consolidations and why they succeed or fail.

To conclude, this section has underlined how disputed and contextual the economics of fiscal consolidations can be in their timing, in their scope and depending on the other policy instruments at hand. For this reason, there is no single optimal path for fiscal consolidations and thus agents with skin in the game can push forward and form coalitions molded on their preferences. To this aspect of the politics of fiscal consolidation we now turn.

2.2 Political perspectives on austerity

Given the contested nature of austerity economics, what determines its shape? Why would some government frontload austerity and cut expenditures while another one will prefer to wait the storm out and consolidate later through tax hikes? Although the literature on this question is large, three main approaches can be singled out. The first one is ideational and deals mainly with the emergence of austerity as a concept that guided policy decisions since 2010. The second one refers to how political parties distribute the burden of fiscal adjustment across political groups and over time. The third one takes institutions as the central variable and suggests that it may well be the

power of the finance minister that decides whether austerity is implemented or not.[8]

Austerity as idea

The first and most recent strand of research concerning fiscal consolidations gained some ground in the aftermath of 2010 (Blyth 2013; Schui 2014; Dellepiane-Avellaneda 2015). The background of the ideational approach is a broader take on how ideas and discourses matter. Labelled as the "fourth institutionalism" (Schmidt 2008), discursive institutionalism focuses on how political actors get their ideas across by taking the context into account. In a way, discursive institutionalism tries to answer the question of the idealists: "why do some ideas become the policies, programs, and philosophies that dominate political reality while others do not" (p. 307). It thus prolongs the question of the viability of an idea, on several levels: administrative, political and policy-wise (Hall 1989). Analytically, this perspective focuses on how the idea of austerity became policy in a short time span (the spring of 2010) as a solution to the vows of crisis-ridden economies. Tracing back the origins of "expansionary fiscal austerity" to Italian-American scholars in Bocconi and Harvard universities who sought to demonstrate econometrically that fiscal consolidations do not hurt growth in the short run and can increase economic output in the longer run. While Blyth (2013) and Dellepiane-Avellaneda (2015) showed that the main influencial episode of idea diffusion was the distribution of Alesina's paper in an ECOFIN Council Meeting in April 2010 (Alesina 2010) just days before the Greek episode happened mainly aimed at refuting this claim by showing that the diffusion of the austere idea of fiscal consolidation was to be found in the bank bailouts that then exerted pressure on national budgets to squeeze out the deficits.

The question is then to know whether financial crisis was a material condition for the EFC thesis to take hold and for the Keynesian approach to fail. In the ideational literature on the austerity turn in 2010 this mechanism is not really spelled out very efficiently: did bank bailouts and the sovereign debt crisis trigger EFC ideas jointly, reinforcing each other? Independently of each other? Did these crises undermine Keynesian ideas of fiscal policy? It seems that there is not strong correlation here. Looking at bank bailouts one may hypothesize that the bigger the bailout the more likely the adoption of EFC ideas. But even if this is proven, are expenditure cuts implemented because countries believe in EFC or simply because bailouts overstretched public expenditures. Additionally we may even confuse spending cuts with fading out bank bailouts. All the same, one can take two extreme cases: Ireland and Denmark committed roughly the same amounts of money to their banking systems, 231.8 and 259.4% of GDP respectively (Woll and Grossman 2014; Woll 2014). In both countries, expenditures increased sharply (in 2010, to 66 and 57% of GDP) but as of 2015, Denmark's expenditure stand at 54.75% of GDP while Irish expenditures are at 36.11% of GDP. Both countries went through a housing boom and have high household debt levels. In the rest of the data presented by Woll and Grossman (2014), the commitments are roughly comparable: France and Spain committed the same amounts and experienced the same losses, but Spain ended cutting expenditures much more than France. Likewise, the UK and the Netherlands were involved to a similar extent with their banking sector (commitments of 41.6 and 52% of GDP and losses of

[8] The following does not pretend to be an exhaustive literature review but a summary of the main salient points to sharpen the research question on the political determinants of austerity.

6.3 and 4.3% of GDP respectively). But their fiscal consolidations diverged (see figure 1.1).

Most importantly, we still see variation in the invocation of the EFC in crisis-hit countries. Dellepiane-Avellaneda (2015) suggests that even in Ireland, the poster child of previous EFC episodes, the EFC thesis was mentioned only reluctantly and was not adopted as the main policy position of any government, even through adjustment happened through spending cuts. The material sources rather lie in the necessity to satisfy coalitions that wanted a low corporate tax.

It thus clear that even ideational approaches seek their own material sources. As a result, ideas of austerity become as much an explanans as an explanandum. This was already clear in the long tradition of political economy. Hirschman (1977) showed that the increase of commerce and industry subverted the notion of interest and challenged the idea that passions should be fought with through reason or beliefs.[9]

The latest trend in ideational studies is a powerful methodological innovation. What can be dubbed the "personal turn" seeks to identify which actors promote which ideas about crucial issues as capital openness or inflation hawkishness or dovishness (Adolph 2013a; Chwieroth 2007, to name but a few). These studies sought to remedy the main aforementioned problem of ideational approaches by showing the causality behind policy ideas but in doing so still rely on interests and actors.

Austerity and partisan politics

A second strand of research on austerity focuses on partisanship, and it can be divided into two threads. One can be dubbed the "simple partisanship hypothesis" and the other the "contextual partisan hypothesis".

The simple partisan hypothesis has been developed mainly in the 1980s-1990s when more data became available to test the political determinants of fiscal policy in a panel data format. Using quantitative methods, a group of scholars[10] sought to determine whether the color of governments rubs off onto fiscal policy. The partisan fiscal literature (mostly Mulas-Granados 2006) departed from the simple trade-off established by Boix (1998) between equality and efficiency in government policy according to which left wing parties care more about equality and right wing parties care more about efficiency.

The upshot of this line of research has been that left wing governments tend to increase taxation in order to protect the level of expenditures, also to mitigate the impact of fiscal policies on inequality. Conversely, right wing governments prefer to cut expenditures to keep taxes low, whatever the cost

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[9] Perhaps art historians argue most clearly that ideas emerge from material sources. Take the example of two border cultures in 17th century Low Countries. While in the Spanish part, Baroque ruled supreme among Flemish painters (e.g. Rubens), in the Netherlands the "realist" Golden Age was the main expression of Dutch painters (e.g. Vermeer). This is partly explained because in the feudal-royal Spanish South foreign rule empowered court culture over middle classes and crystallized a coalition between agricultural and aristocratic interests, which encouraged "heroization" and bucolic iconography, while in the independent Dutch North the urban coalition between crafts and trade focuses on natural and intimate scenes from everyday life.

[10] Boix (1997, 1998, 2000); Cusack (1997, 1999); Franzese (2002); Garrett (1998); Huber et al. (1993); Mulas-Granados (2006); Tavares (2004).

to inequality.[11] Thus, in the context of austerity, left wing governments are expected to increase taxes and keep expenditures constant or increasing, while right wing governments tend to do the opposite. In so doing, governments also influence the level of inequality during fiscal consolidations.

While this approach was popular in the 1990s and the 2000s, the pattern of fiscal consolidations that appeared after 2010 seems not to be correctly predicted and the evidence seems pretty shaky when it comes to the previous four decades. It is puzzling to see that governments from the same parties often implement different consolidation packages, if we compare the 1970s, the 1980s, the 1990s and the 2010s. Many of the governments in place change abruptly their plans and switch to other fiscal consolidation strategies. Here once again, right-wing parties in the UK and France spring to mind. Thatcher's government had to first implement a tax-based adjustment in the face of rising unemployment in the early 1980s, while in France the government of Juppé in 1995 and the government of Fillon in 2010-12 were unable to implement serious reforms on the front of public expenditures. From this follows that the pure partisan approach can hardly work because it does not take into account support (or lack thereof) for economic policies and this influences political parties as well as the competition in which they find themselves.

Given these shortcomings, the "simple partisan hypothesis" gave rise to another thread of research, the "contextual partisan hypothesis", that sought to identify under which conditions government partisanship influences reform contents and when governments engage in the perilous maneuver of reforms abhorred by the median voter (Kitschelt 2001; Ross 2000).

To answer this question, Kitschelt (2001) uses contextual mechanisms to explain conditions under which welfare retrenchment may happen[12] focusing on the interaction of opposing parties rather than on pure political partisan positions. Ross (2000) continues this line of inquiry and remarks that in the "new politics of welfare retrenchment" sometimes the parties that are supposed to protect social expenditures cut them most, implying that austerity episodes on the expenditure side of the ledger can be conducted by left wing parties. This logic was dubbed the "Nixon-goes-to-China" hypothesis whereby a party reforms an owned policy without running the risk of being accused of "selling it out". German Social Democrats under Schröder provide an example of how this logic may backfire (Kemmerling 2009). The bottom line of this approach is that in liberal market economies, left-wing parties are more likely to retrench. This is less likely in polities where more veto points are scattered throughout the political system.

One of the foremost advocates of the partisan thesis has, however, cast some doubt on whether partisanship matters in hard times (Castles 1998). Castles showed empirically that there is no partisan effect during hard times and that we rather see partisan effects during good times only. This finding of an absence of partisan effects was confirmed robustly in a more recent study showing

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[11] Much of this literature was also devoted to the question of whether left wing parties run bigger deficits than the right. The accumulated evidence rather confirms the counter-intuitive suggestion of Persson and Svensson (1989) that it is rather the opposite. Conservatives are more likely to run a lax fiscal policy in order to constrain their future left-wing successors. Another approach has been to ask whether partisanship affects government spending. Boix, Cusack and Garrett demonstrated empirically that it does, although to a different extend. For Boix, the effect fades over time. But for Garrett, it rather increases with globalization due to demand for compensation.

[12] Those are: weakened parties vying for the welfare state in liberal market economies, no acute trade-offs when parties implement policies that are further away from the preferences of the electorate, small level of inertia inside the parties, and parties competing on economic rather than social issues.

that left and right are equally likely to implement spending cuts (even though the latter does more so than the former), especially in the beginning of electoral terms (Hübscher 2015). This leads to the conclusion that partisan effects are not "pure" or direct, but conditional or indirect. One thus needs to pay close attention to the context in which parties operate - in the words of Kitschelt, whether the political system is competitive or not - but also on the timely evolution of underlying politics. The replacement of high growth by permanent austerity could be one factor. Other factors could be demographic changes, the decline of class voting, etc. This thesis will try to show under which conditions partisanship matters or not, whether it is due to underlying variables or evolutions over time.

Austerity and institutions

This contextual approach that gives much weight to factors constraining partisan actions leads us straight into the territory of fiscal institutionalists. This third strand of research was mainly developed as a result of institutionalist analyses of the crisis of capitalism in the 1970s that led to high inflation and high deficits. Institutionalists on the economic side sought to explain why some groups blocked economic adjustment (Olson 1982), how rules could help solve such problems as time inconsistency in monetary policy (Kydland and Prescott 1977) or the common pool resource problem (Ostrom 1990). Concerning fiscal policy, institutionalism was used in two approaches.

Fiscal institutionalists (Hallerberg 2004; Hallerberg et al. 2009) argue that deficits and debt mainly stem from the problem of the common pool resource problem, i.e. when politicians use to their advantage the fact that on the one side revenue collection is centralized and on the other expenditure decisions are decentralized. This gives politicians a strong incentive to use the common tax collection to please individual constituencies with targeted expenditures. While the benefits of such policies are concentrated, the cost is spread out to the whole population. In general, this leads to higher expenditures with which taxation does not catch up because the whole population has to consent. If governments are decentralized, this problem is exacerbated due to lack of coordination and control. Unchecked ministers "overfish" the common pool of collected taxes. The implication of this research is that deficit reduction happens through institutional reforms such as strengthening the budget process, implementing fiscal rules, limiting the number of budget amendments in parliament to curb pork barrel politics, strengthening the role of the minister of finance, and creating fiscal contracts between coalition parties.

The main contention of this approach - that centralization of decision-making processes is the way to reduce debts and deficits - was turned on its head by another institutionalist approach (Pierson 1994, for example). The literature asks whether it is really the case that a strong state with few veto players produce strong retrenchment? Observing states like the UK, Pierson concluded that this is not the case, among other reasons (feedback loops, path dependence) because a strong state concentrates power. This implies that power is centralized and that it is harder to diffuse blame for costly decisions. Historical institutionalists thus claim that austerity is better conducted under the mask of decentralization because it shifts blame for spending cuts and tax hikes to local politicians, because it generates competitive deregulation in social policy and fragments the pro-welfare state interest groups. In other words, centralization makes blame avoidance more difficult because it increases accountability and visibility.

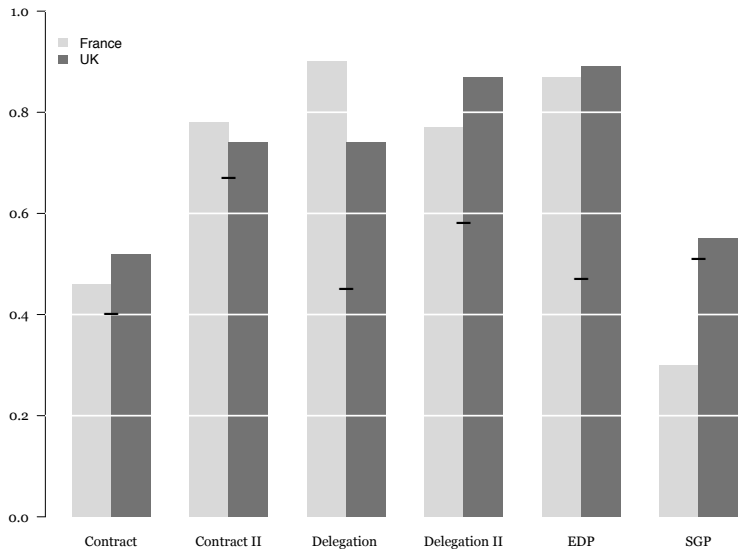


Figure 2.1: Fiscal governance in the UK and France

NB: The figure displays the fiscal governance indices of the UK and France around 1991 and 2004. EDP stands for the time spent in the excessive deficit procedure between 1998 and 2007, and SGP measures the respect of self-imposed fiscal targets under the Stability and Growth Pact. Black lines represent averages. Source: Hallerberg et al. (2009, p. 74) & own calculations.

All in all, institutionalists approaches to fiscal policy provide conflicted hypotheses and evidence. Two countries stand out again for their institutional proximity but their different fiscal paths. The UK and France have very comparably strong fiscal institutions which are always above the average of the sample (see figure 2.1). First, the contract index of fiscal coordination in 1991 was almost equal in both countries (0.46 for France, 0.52 for the UK and 0.4 for the average, the little black bar) and it subsequently increased in 2004 to 0.78 for France and 0.74 for the UK (with the average standing at 0.67). Finance ministers are also almost equally strong on average over the period, with France starting with a more powerful guardian of the purse, who then lost a bit of power, while the UK increased the power of the Chancellor over the years. But it is obvious that in both cases fiscal institutions are equally strong and stronger than average. Yet, both states honored their fiscal targets more in the breach than the observance. As the columns EDP (share of months spend in the excessive deficit procedure of the European Commission between 1998 and 2007) and SGP (share of years where self-defined targets of the preventive arm of the Stability and Growth Pact were respected) suggests, both France and the UK spent much more time than average countries in excess of their fiscal targets, while France, contrary to the UK, respected very few of its own fiscal targets (and below the European average).

Given that the EDP and SGP targets are about reaching a medium term fiscal balance, one can see that equally powerful fiscal institutions lead to different fiscal outcomes. That is not to say that fiscal institutions do not work. They do, and evidence is pretty robust on this account (Hallerberg 2004; Hallerberg et al. 2009; European Commission 2006). But here the puzzle is rather why they do not seem to work in France. The problem, as will be shown later, is that in France

social coalitions diminish the effects of such institutions. Given the fragmented nature of French coalitions and their left skew, finance ministers have a tough time discussing and implementing spending cuts, especially in the realm of the welfare state, even though they have the backing of their Prime minister and of the President. The case study of fiscal retrenchment under Alain Juppé suggests that the tax structure and the level of attrition greatly influence the power of fiscal institutions.

2.3 Conclusion

This chapter first showed that the economics of austerity are highly contested. Second, it aimed at using the rich literature on austerity as a leverage to sharpen the central puzzle and to justify the comparison of the United Kingdom and France. If austerity is explained by ideas, how come some countries adopt it while others consider it a taboo? Surely then, partisan differences should explain why some governments are more prone to use some forms of austerity over others. In broad terms, given the trade-off posited by the partisan literature, left wing parties should backload tax hikes because they care about equality while right wing parties should frontload spending cuts because they care about growth. However, partisan patterns after 2010 do not seems to match this hypothesis perfectly. Democratic America has cut expenditures more than conservative France, and Tory Britain has implemented a fiscal adjustment that would have triggered an acute social conflict in Berlusconian Italy. Surely then, what decides whether a party can implement its preferred shape of austerity is the institutional power that the finance minister enjoys. However, using the most advanced indices of fiscal power, it appears that countries with similar institutional configurations and political parties diverge on their austerity measures and fiscal pathways. As a result, the literature helps a lot to iteratively approach the central research question: given similar conditions, why do the UK and France - our (al)most similar cases - embark on divergent fiscal pathways in the age of austerity?

Appendix to Chapter 2

The austerity trade-off

To understand the austerity trade-off between targeting the interest rate or GDP growth, equation 2.1 is useful because it shows the government budget constraint:

$$\underbrace{(G-T)+rD}_{\text{Deficit}} = \underbrace{\Delta D+\Delta M}_{\text{Financing side}} \tag{2.1}$$

G is the level of public primary expenditure (i.e all government spending less the interest payments on debt), T are taxes, D is government debt and r the interest rate on it. M is the monetary base. The left side of the equation is the deficit; the right side is the financing side (issuance of debt, ΔD, or by letting the monetary base grow, ΔM).

Given low inflation and central bank independence, the financing side is left with ΔD, i.e. the issuance of debt. If there is a deficit, the government must borrow ($\Delta D > 0$). If there is a surplus, government can repay debt ($\Delta D < 0$). The bigger the debt (D), the higher the debt service (rD), the bigger the deficit and the higher the need for new debt. Even if the primary budget $G - T$ is in surplus, the budget can be in deficit and the debt can still grow (see the case of Italy for instance). In order to stop the growth of debt ΔD, there should be a primary surplus large enough to pay for the service of debt (rD) without borrowing (equation 2.2).

$$\Delta D = 0 \quad \text{if} \quad T - G = rD \tag{2.2}$$

These values are ratios to GDP showing the capacity of a country to repay its debt relative to its economic size. What should be consolidated is not the nominal level of debt, but the ratio of debt to GDP. This means that fiscal consolidation is a race between the nominal debt level (the numerator) and real GDP (the denominator). Debt may nominally increase but fall in proportion to GDP if GDP rises faster than debt. Therefore, formalizing in equation 2.3:

$$\frac{\Delta D}{Y} = \frac{G-T}{Y} + \frac{(r-g)D}{Y} \tag{2.3}$$

Where r is the rate of interest on debt and g the growth rate of GDP. If $(r - g) > 0$, then debt increases. If $r - g < 0$, then debt decreases. If the growth rate of GDP is higher that the interest rate ($r < g$) the debt to GDP ratio can be stabilized while running a deficit. Hence, equation 2.4:

$$\frac{\Delta D}{Y} = 0 \quad \text{when} \quad \frac{T-G}{Y} = \frac{(r-g)D}{Y} \tag{2.4}$$

Taking inflation (monetary base, $M0$) into account in equation 2.5:

$$\frac{\Delta D}{Y} + \frac{\Delta(M0/P)}{Y} = \frac{G-T}{Y} + \frac{(r-g)D}{Y} \tag{2.5}$$

The deficit can now be financed by new debt and/or the creation of additional monetary base (either

the central bank buying government bonds by creating money or by higher inflation which is a tax on non-indexed bond holders). The conclusion is that, as seen in equation 2.6, the stabilization of the debt to GDP ratio with additional monetary base requires a smaller primary budgetary surplus $(T - G/Y)$ or even a primary deficit if there is enough inflation. $\Delta D/Y = 0$ when

$$\frac{T-G}{Y} = \frac{(r-g)D}{Y} - \frac{\Delta(Mo/P)}{Y} \tag{2.6}$$

Likewise, if inflation is too low, the primary budgetary surplus has to increase. ■

3

Debt, deficits and democracy: *The social sources of austerity*

> "*If politics is [...] conflict [...], then the budget records the outcome of that struggle.*"
>
> Wildavsky 1979, p. 4

To shed light on the bias in austerity (tax hikes or spending cuts), I develop a comparative historical framework that seeks to embed social coalitions in the context where they operate. This context refers to their linkages with the budget, to the relationship between social groups, and to the evolution of these coalitions over time.

These three types of context constitute three causal mechanisms (linkages, attrition, and coalition constraints) that influence the bias of austerity and reshape social coalitions over time. Thus, my argument challenges the common assumption that austerity episodes are independent of each other: in fact austerity episodes can be seen as a series of critical junctures leading to power recalibration among social groups. As a result, austerity can send comparable countries on divergent fiscal pathways.

The weaknesses of previous studies of austerity reside mainly in problematic assumptions. First, the literature assumes that austerity episodes are independent of each other over time, which may be warranted by the methodology used to analyze the determinants and effects of fiscal policy (panel data regression analysis). This results in postulating independence of observations, the absence of serial correlation over time and the absence of perfect collinearity between variables (Alesina and Drazen 1991; Mulas-Granados 2006; Wagschal and Wenzelburger 2008a,b, 2012). Thus, policies are modeled as one-shot events based on inter-temporal independence where the future policy (x_{x+1}) is a function with no linkage to past events (G): $x_{x+1} = G(\blacksquare)$.

This kind of approach is problematic insofar as it sweeps problems of endogeneity and selection bias under the carpet (Kemmerling 2014; Kemmerling and Truchlewski 2015). Because austerity

episodes are implemented over the medium term and matter for future policies, they are repeated games. For example, the trauma of going cap-in-hand to the IMF in 1976 may have influenced Thatcher's policies in the UK in 1979, while the failure of fiscal consolidation under Juppé in France in 1995 certainly forced Sarkozy to treat austerity as a taboo in 2010. Therefore, to analyze austerity it is equally important to understand events (implemented austerity) and non-events (failed austerity).

Second, fiscal shocks - i.e. increased expenditures and lower taxes - are rarely exclusively exogenous. On the one hand, even if fiscal shocks come from an external event (oil price shock, financial crisis, etc...), they are filtered by the domestic political economy of taxes and spending. The variation in deficit increases after the crisis of 2008-9 attests to this. On the other, some fiscal shocks are purely endogenous: taxing labor too much may increase unemployment and thus increase social expenditures. Some fiscal crises may stem from previous decisions (e.g. deregulation of financial markets). This study thus differs from the gourevitchian perspective (Gourevitch 1986), which implies that shocks are exogenous and that they are thus "chemical" agents revealing coalitions in hard times.

Third, social coalitional studies of fiscal policies assume that preferences remain static and are independent from the context in which social groups act (Alesina and Drazen 1991; Barta 2011; Marzinotto 2005). This is problematic because on the one hand, austerity episodes are linked by power recalibration among social groups. Fiscal stabilization involves a political conflict over the distribution of the burden of adjustment. Thus, some groups losing out too often may end up being more active: after austerity episodes increasing inequality too much or increasing taxation too much, voters may prefer to switch policies. On the other hand, actor preferences are not fixed. I argue that, on the contrary, they are context-dependent. As we will see in the British and French cases, a similar structure of the economy suggest a similar structure of economic social groups. But tax linkages and attrition shape differently the preferences of these similar social groups.

In the following, I first explain the social-coalitional mechanisms shaping the politics of austerity, starting from linkages, then attrition and the coalitions constraint. This first part of the chapter thus presents the static version of my argument and offers simple evidence as a first cut. The second part of the chapter builds a ball-and-urn model of austerity to present the dynamic version of my argument and explains how endogeneity is taken into account. The conclusion summaries the hypotheses.

3.1 Three endogenous mechanisms of austerity

This section lays out the static version of my theory. It suggests that, during austerity, the preferences of social groups are mainly shaped by two mechanisms - tax linkages and attrition - and that a third mechanism (coalition constraints) explains whether social groups win or lose the next round of austerity. The interaction of the first two mechanisms - visualized in plot 3.1 - yields four ideal-types of austerity bias: spending cuts, tax hikes, mixed and failed (i.e. social conflict). Figure 3.1 also helps to map the case studies. Before embarking on the latter, however, I also provide simple evidence for my theory, summarized in figure 3.3.

3.1.1 Linkages

The first mechanism concerns tax linkages and it is plotted vertically in figure 3.1. Here I put social coalitions in the context of their relationship - their "linkage" - with the domestic budget towards which they contribute. I argue that the type of linkage that binds social groups with a national budget affects their preference for austerity.

To see this, one needs to adopt the lens of fiscal sociology (Goldscheid 1958; Martin et al. 2009) and to ask how social groups are connected to the budget and which type of tax dominates. A little taxonomy of taxation can be helpful here. There are, in general, two types of taxes (Kemmerling 2009, ch. 2) that create strong and weak linkages to the budget and which have different political effects because they entail different expectations from social groups.

First, strong linkages are taxes that are earmarked for a specific purpose.[13] When taxes are earmarked, taxpayers expect a "return on investment" because they have to bear a "sunk cost". In this case, if social groups are embedded in a tax structure dominated by earmarked taxes, they will expect the return on investment to materialize. Such taxes are common in capitalist democracies, for example funds dedicated to the construction of infrastructure. The single biggest earmarked tax in advanced capitalist democracies are social contributions: social groups pay them expecting to receive welfare in exchange, either in the shape of unemployment benefits, pensions or healthcare, among others.

Second, weak linkages are taxes that are not earmarked and which are paid to fund general purposes. For this reasons, they generate uncertainty because of the lack of transparency of their funding goal. For instance, in most situations, social groups paying income tax or VAT have no perfect knowledge on the utilization of such a tax. It maybe used to fund defense, schooling or government. In this case, there is no precise expectation on the return on investment. Once taxes are paid, they disappear in the black hole of government coffers and reappear in government-funded programs, but the "fiscal illusion" makes it hard to connect a public benefit with a precise tax.

The political implications of these two ideal-types are easy to see: in the case of earmarked taxes, social groups as taxpayers have a higher stake. Because the benefit is perceived as pre-paid, these social groups will also be more likely to oppose spending cuts during austerity. Therefore, if there is a fiscal deficit, austerity is more probably going to take the shape of tax hikes to fund the expected benefits. In the case of non-earmarked taxes, social power is not on the side of social groups but on the side of the budgetary authority "who is, by presumption, divorced from the citizenry in the political community" (Buchanan 1963, p. 458). In this case social groups are not tax-payers and beneficiaries who make a private choice, but voters who decide on an aggregate combination of expenditures presented by the government. This political constellation nourishes uncertainty over the expected benefit and therefore social groups as taxpayers are less willing to pay taxes. In such a scenario, during austerity, social groups are more likely to oppose tax hikes and therefore, facing greater reticence, the budgetary authority is more likely to cut spending instead.

The implication is that during repeated games of austerity, one should take into account the relationship between social groups and taxation, but also the relationship between taxes and

[13] Earmarked taxes can also be designated through the concept of hypothecation.

expenditures. If social groups are strongly tied to the budget by earmarked forms of taxations, then expenditures are closely knitted with taxation and expenditure cuts are much more sensitive because of sunk costs and expected benefits. Thus if repeated austerity strengthens this linkage, social groups expect less and less expenditure cuts, and prefer to accept taxes hikes. At the same time, it can well be that an economic shock or a deeper, slower moving economic process (i.e. loss of competitiveness) forces governments to lower expenditures. In this case governments can impose their spending cuts only with the acquiescence of social groups that pay the earmarked taxes. This is done through "social pacts" if the micro-political institutions enable coordination, or through social conflict if they do not facilitate it (Hancké and Rhodes 2005).

This taxonomy of taxation has implications for the link between austerity and the welfare state. While the Beveridgian welfare state mainly has a tax component, Bismarckian welfare states have a strong insurance component, mainly financed by social contributions, which are a type of earmarked taxes (Kemmerling 2009, p. 23). The implication is that it is easier to conduct spending-based austerity in a Beveridgian welfare state than in a Bismarckian one. A comparison of the UK and France, which come close to these ideal-types, is useful to test this hypothesis.

3.1.2 *Attrition*

The second mechanism, attrition, refers to the contextual distance between social groups during austerity. This mechanism can be operationalized through income inequality. It is the simplest way to measure distance between social groups. This measure also has a theoretical foundation in the literature on "war of attrition" models (Alesina and Drazen 1991) of economic policy reform and economic stabilization (reducing inflation, debt and deficits). This literature is mainly interested in why some governments take more time than others to reform given that such a delay is costly. The answer is that the disagreement over how to share the burden of adjustment is proportional to the heterogeneity (that I measure as inequality) among the population. The greater this heterogeneity is, the more social groups will expect an uneven allocation of costs to stabilize and the more they are likely to enter into conflict (the "war of attrition"). Thus heterogeneity increases the delay in stabilization.

To see this, Alesina and Drazen assume two social groups where the "loser" gets to pay $\alpha > \frac{1}{2}$ of the stabilization burden (taxes and spending cuts) and the "winner" gets to pay a fraction defined as $1 - \alpha$. This fraction measures the fairness of the distribution of the burden of adjustment. If the loser group thinks the burden is unfair, it will delay stabilization. In a society with equal incomes, social groups will not be distant from each other and will perceive the burden of adjustment (taxes) as distributed fairly. Social groups will therefore be more likely to agree on increasing taxes and stabilizing the budget. But in an unequal society, where the difference in incomes increases the distance between social groups, the poorer groups will want to put a bigger share of adjustment on the richer groups and the latter will tend to oppose this move. All groups will see the burden of adjustment as unfair, even at a flat rate. In this scenario, social resistance to tax hikes will be greater.

It is important to underline the key implications of the attrition model. First, this perspective is mainly concerned with taxation, not spending. Now in a fiscal stabilization, policy-makers consider both. But if attrition precludes the first option, i.e. increase taxation, the implication is

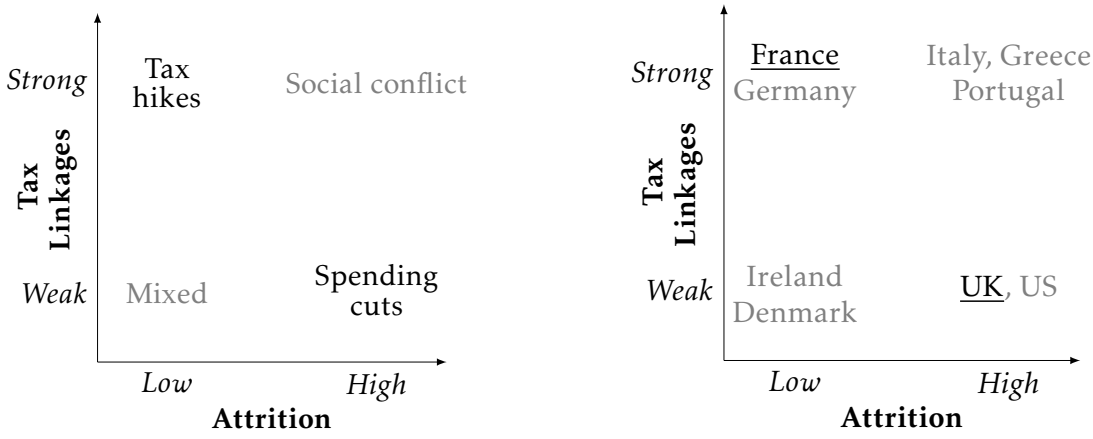
that policy-makers will have to cut spending. Therefore, I put forward the following mechanism and hypothesis: in more unequal societies, austerity is more likely to happen on the expenditure than on the tax side. This hypothesis has a simple effect: if, as the empirical literature suggests (Ball et al. 2013; Woo et al. 2013), spending cuts increase inequality, then in the framework of austerity as repeated games, we may expect austerity episodes that increase inequality to erode the consensus for higher taxes in the next round of adjustment.

Second, the war of attrition model shows that economic stabilization occurs with political consolidation, i.e when group one wins over group two to impose its preferred type of stabilization. The significance of this implication is that as austerity episodes succeed each other, the political power of social groups will be either strengthened or weakened. If austerity succeeds to consolidate the power of one group, then we may expect more of the same model of stabilization in the future. If austerity fails to recalibrate the configuration of social power, future austerity episode are more likely to be messy politically with stop-and-go policies and social conflicts erupting. The conclusion is that either way, one may expect fiscal pathways to develop with two ideal-types: one where inequality and thus attrition increases and leads to lower taxes and expenditures over time, and the other, where inequality and attrition are low, with increased taxation and expenditures.

In interaction, our first two mechanisms - linkages and attrition - yield our theoretical map and potential cases in figure 3.1. On the *y* axis are the linkages, weak and strong. On the *x* axis are the levels of attrition that I divide into low and high for the sake of simplicity. The implications of this interactions are quite simple and yield four ideal types of austerity bias: tax hikes, spending cuts, mixed and failure due to social conflicts. First, where linkages are strong and attrition is low, tax hikes are more likely than spending cuts. This is quite easy to prove because social groups have important sunk costs in earmarked taxation and expected expenditures: they will thus oppose any expenditure cuts. Given that attrition is low, there will be no opposition to tax hikes. The resulting bias is tax hikes. Second, where tax linkages are weak and their expected benefit uncertain, and where attrition runs high, spending cuts are more likely than tax hikes because of social opposition to the latter. The demonstration here is clear. Third, when tax linkages are weak and attrition is low, I expect mixed austerity: tax hikes and spending cuts are equally likely and can be implemented equally. It is up to the dominant social groups to decide how to wield the ax.

Fourth, when tax linkages are strong and attrition is high, I expect to see social conflict and failed attempts at austerity that sometimes result in international bailouts when the situation becomes intractable. Here, strong tax linkages make social groups oppose spending cuts while high attrition levels make them oppose tax hikes. Here social groups may overlap and have contradictory preferences or different social groups may oppose other ones. Whatever the configuration, the result is the same: fiscal consolidation fails, social conflict precludes adjustment and debt increases until default or its threat ensues.

Do these scenarios have any empirical backing? Figure 3.2 maps out our universe of cases according to the two dimensions, tax linkages (measured as the total share of social contributions as proportion of tax revenues minus the proportion of income taxes in revenues) and attrition (income inequality). It is surprising to see that the figure fits quite well with fiscal pathways described in chapter one: in the upper left panel are the countries where taxes and spending mostly increased, while in the lower right panel are countries where taxes and spending where kept constant or reduced. Most important, in the upper right panel are the countries experiencing fiscal problems:



(a) Bias in austerity (b) Examples

Figure 3.1: Visualizing the argument

Greece, Portugal, Italy, Spain and Japan. Other countries, like Poland, introduced controversial reforms (nationalization of pension savings) to avoid fiscal tightening.

To go further, in figure 3.3 I provide a first, simple cut at the empirical evidence that will be explored in greater detail in the following chapters. In this figure, I look at fiscal adjustments after the Great Recession and the coordinated turn to austerity that provoked such a cross-national divergence in austerity politics. The sample consists of 28 countries[14] with the dependent variable measured as the cyclically adjusted taxes and expenditures, and the independent variables consisting of economic growth, deficit, debt and tax linkages that I code as 1 when tax linkages are strong (because social contributions dominate largely in the tax mix) and 0 when tax linkages are weak (because income taxes represent the lion's share of tax revenue as percentage of taxation). To get the expected probabilities of tax hikes and spending cuts, I dichotomize the dependent variable depending on whether tax hikes dominate spending cuts and then estimate a logit model and then draw a vector of simulated model parameters to get the predicted probabilities in order to visualize them (King et al. 2000). It is important to note that in the two plots on the top, the darker shade represents the 67% confidence interval and the lighter shade the 95% confidence interval.

The results seem to confirm first that the probability of tax hikes diminishes with higher attrition levels and that the probability of spending cuts increases with greater attrition levels. In a country like the UK where the Gini coefficient was at 34.2 in 2010 (and thus where attrition is very high), I can say with a 67% degree of confidence that the probability of tax hikes is between 2 and 20% and a 95% degree of confidence that tax hikes do not have a higher probability than 40%. If I split the sample into countries with strong and weak linkages, the UK with its weak linkages, has now below 10% chances of increasing taxes (with a certainty of 67%). Conversely, concerning spending cuts, I can say with 67% certainty that an unequal country like the UK has more than 80% chances

[14] The sample was constrained by the data availability of cyclically adjusted variables and the share of different taxes in total revenues. The countries are: Austria, Belgium, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Iceland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, and the UK.

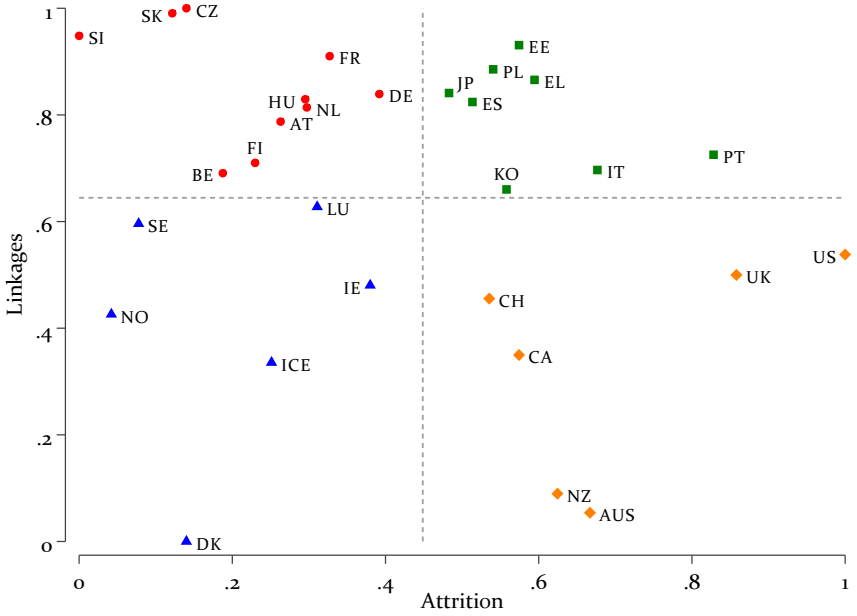


Figure 3.2: Linkages and attrition in the OECD

NB: Dashed gray lines represent the average in the samples. The two variables are normalized. Tax linkages are the total share of social contributions as proportion of tax revenues minus the proportion of income taxes in revenues. The four quadrants correspond to the four ideal-types of figure 3.1.
Source: OECD for the tax linkages and SWIID for attrition measured as income inequality.

of cutting spending, and with 95% of certainty that these chances are above 60%. I can also say that when the UK's weak tax linkages are taken into account, the probability of spending cuts now increases to 90% with a degree of confidence of 67%. Thus more unequal countries with weaker tax linkages are really more likely to cut spending than to increase taxes.

On the opposite side, more equal countries with strong tax linkages are more likely to increase taxes than to cut spending. Consider the French case with a Gini of 28 in 2010. Here I can say that tax hikes have a 50% chance with 95% of certainty and 70% chance with 67% of certainty. Spending cuts have a probability included in the interval 10-50%. But if French strong tax linkages are taken into account, the probability of tax increases is above 70% and the probability of spending cuts falls below 25%, with a 95% confidence interval.

3.1.3 Social coalitions constraint

Having placed social coalitions in the context of their relationship with the tax structure of the state and in the context of their mutual relationships, the third mechanism embeds social coalitions in the context of time. The premise behind this mechanism is simple: in order to implement austerity, governments need their policies to be supported by social coalitions. If austerity is a repeated game, it reshapes social coalitions. But it can do so in different ways: austerity either strengthens existing coalitions, reshapes fiscal coalitions around a new equilibrium or erodes old social blocks without creating new coalitions.

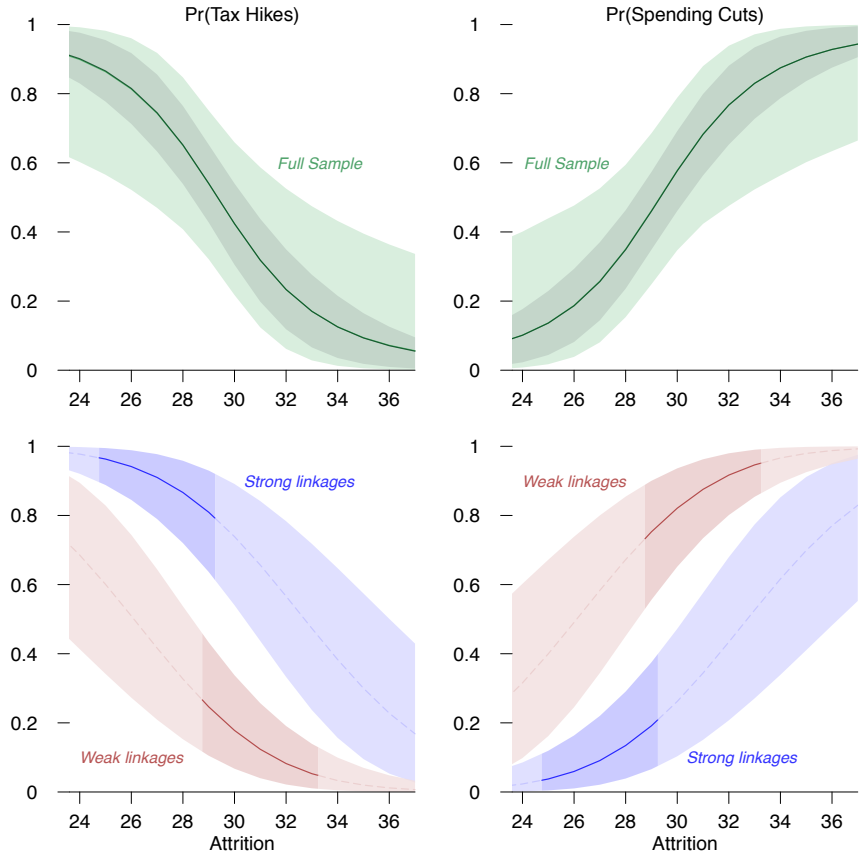


Figure 3.3: Predicted probabilities of austerity

NB: Austerity episodes between 2010 and 2014 measured as cyclically adjusted data. In the lower graphs, solid shaded areas symbolize "ideal types" of country groups according to my argument.
Source: OECD for the fiscal data and SWIID for attrition measured as income inequality.

With the interaction of our first two mechanisms, it is easy to see in which cases previous austerity episodes strengthen or undermine social coalitions. If social coalitions operate in the context of strong tax linkages and low attrition, fiscal consolidations that do not alter the structure of the tax mix and do not impact the level of inequality are likely to cement the status quo and strengthen social coalitions. Conversely, social coalitions preferring spending cuts to tax hikes are strengthened if social coalitions are tied by weak linkages to the domestic budget and inequality is high and increasing.

But in the case of strong tax linkages, if austerity increases inequality it can erode the social consensus that allows for tax hikes. In this scenario, inequality has increased either through austerity, spending cuts in the welfare state, reduction of redistribution through the tax system or an exogenous shock. It can also be the case that high levels of social contributions have weighted on the competitiveness of the export sector and increased unemployment. It is important here to keep in mind the slow-moving effects of fiscal policy in general and austerity in particular.

3.2 Social coalitions and austerity as repeated games

This section lays out the dynamic version of my theory. It looks at what happens once the static mechanisms of the previous section are applied in a dynamic, diachronic framework of austerity as repeated games. To do so, I first elaborate a ball-and-urn model of austerity over time, and then use examples of fiscal pathways to illustrate it.

3.2.1 A ball-and-urn model of endogenous austerity

I propose to analyze fiscal consolidations not as discrete events, but as processes of power struggles that unfold over time. I model austerity as repeated games with path dependence and forks in the fiscal road (Pierson 1994; Streeck and Thelen 2005; Mahoney and Thelen 2010), where the balance of power between social groups is affected by past policies. Austerity can have marginal effects over the distribution of power across social groups and on their preferences regarding tax hikes and spending cuts. If a function $f(a)$ (austerity) is applied again, the importance of small differences increases with each iteration. In comparable institutional and partisan settings, repeated spending based consolidations will play out differently than tax-based consolidations, biasing the distribution of politically feasible future policies.

The question is how to analyze this endogeneity. Suppose a two-period model, x_t and x_{t+1}: in the first period, governments choose policy freely; in the second period, the distribution of political power x_{t+1} is determined by the policies of the first period x_t: $x_{x+1} = G(h_t)$ (Page 2006). As such, the distribution of power in the second period p_2 (x_{t+1}) can be summarized by a function ζ: $x_{t+1} = \zeta(p_2)$ (Acemoglu and Robinson 2013).

To analyze $\zeta(p_2)$, it is useful to think in terms of a ball-and-urn model (Page 2006). Blue (tax-based policies) and red (spending-based policies) balls are selected each time a policy is to be implemented. In a classical political economy framework, the first policy event is drawn randomly (i.e. independently from the past): no new balls are added, so the probability of a spending (S) or tax (T) based austerity stays the same, $\frac{T}{T+S} = \frac{S}{S+T}$. As a result, it is up to governments to choose according to their preferences.

There are several ways to think about how endogeneity shapes the future distribution of social power, preferences and policies, $\zeta(p_2)$. If austerity skews this $\zeta(p_2)$ distribution towards a certain type of social coalition and policy, endogeneity has a reinforcing effect. For each draw of a certain ball, one ball of another color is removed and replaced by a ball in the same color as that selected. If we start with five balls of each color, and draw a red ball (spending-based consolidations), we end up in the next round with six red balls and four blue ones. Thus, the past changes the probability distribution of outcome in $t + 1$. If there is a sequence of red balls drawn, then it really strengthens the hand of social groups that favor red balls.

It may well be that austerity affects the distribution of policies differently, not by strengthening but by undermining the political equilibrium: each round of austerity may be politically and economically self-defeating due to mounting resistance. The distribution of policies is neither skewed nor normal, it is bimodal. In this case, if one draws a blue ball from the box and puts it back, a red ball is added to simulate this effect. The result is that any attempt at adjustment makes future ones even harder. The distribution of $\zeta(p_2)$ can thus take on several shapes: equally distributed

(independence of policies over time), skewed to the left or to the right (spending or tax based policies more likely) or bimodal (implementation of austerity strengthens opposition).

3.2.2 *Endogenous austerity as repeated games*

This section first illustrates the ball-and-urn model with different fiscal pathways in time derived from the interaction of tax linkages and attrition (see figure 3.4). I present these fiscal pathways keeping in mind that tax linkages and attrition levels are kept constant. Second, I look at what happens once we relax the previous assumption and allow for variation in the strength of tax linkages and in attrition levels over time. I suggest that, if these vary, our fiscal pathways hinge on two types of social coalitions that enable or disable the power of the government to implement austerity.

First, using the interaction of linkages and attrition, I suggest that there are four basic, hypothetical and ideal-typical fiscal pathways from the onset of the age of austerity in 1978. These four fiscal pathways illustrate in a dynamic way the four cases from figure 3.1. In each fiscal pathway, a fiscal solvency shock (e.g. economic crisis) happens at roughly the same time, but the four configurations of tax linkages and attrition react differently. Over the long run, the fiscal pathways diverge.

Panel *a* in figure 3.4 illustrates the first case in the upper left corner of figure 3.1, when tax linkages are strong and attrition is low. In this case, social resistance to spending cuts will be more vigorous than opposition to taxes: in fact low attrition means that tax hikes are socially acceptable because all social groups may pay an equal share. This "force" is reinforced by the dynamics of strong tax linkages. Over the long run, with each fiscal shock the ratio of expenditures and taxes to GDP increases. Among the examples in figure 1.2, one can see that Austria, Denmark, Finland, France, Germany, the Netherlands, Norway and Sweden have followed this fiscal pathway to a certain extent.

Panel *b* in figure 3.4 illustrates the second case in the upper right corner of figure 3.1, when tax linkages are strong and attrition is high. Here is the worst case scenario for fiscal policy-makers because social groups resist both spending cuts and tax hikes, which implies that the budget is rarely balanced and debt skyrockets. In figure 1.2, cases in point include Belgium, Greece, Italy and Portugal, mostly in the 1980s and the 1990s: in each case debt could increase by a factor of five. In Greece, gross public debt in 1980 was around 20% of GDP and within thirteen years it went above 100% of GDP. In Belgium, gross public debt went from 46% of GDP in 1978 to 128.1% in 1987. In Italy, public debt was 56.1% in 1980 and increased to 121.2% in 1994. In Portugal, debt increased from 13.5% of GDP in 1974 to 56.5% of GDP in 1986.

Panel *c* in figure 3.4 illustrates the third case in the lower left corner of figure 3.1, when tax linkages are weak and attrition is low. In this case, governments have a freer hand to implement their preferred type of austerity because social groups are equally tolerant of spending cuts and tax hikes. For the sake of simplicity, I call this case "mixed austerity" because there is an equal probability of tax hikes and spending cuts. I expect that over the long term, the fiscal pathway will be horizontal and relatively stable.

Panel *d* in figure 3.4 illustrates the fourth case in the lower right corner of figure 3.1, when tax linkages are weak and attrition is high. In this configuration, the austerity bias is towards cutting spending and keeping taxes low. It is easy to see why this is the case: social groups do not have any

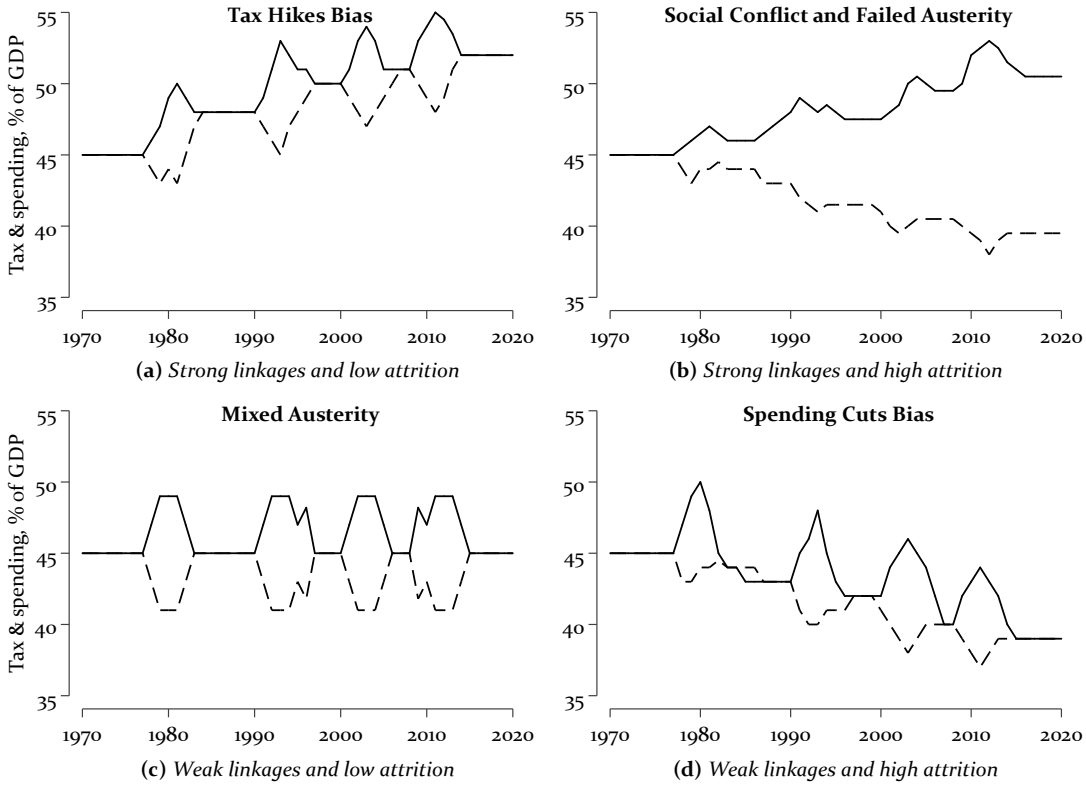


Figure 3.4: Hypothetical fiscal pathways in the age of austerity

NB: Dynamic fiscal pathways based on figure 3.1. Note that in the four graphs, the strength of tax linkages and the level of attrition are maintained constant over the age of austerity. When tax linkages and attrition vary over time, fiscal pathways can bifurcate. Solid lines represent spending and dashed line taxes after each solvency shock and austerity.
Source: own compilation.

strong vested interests in spending because of weak tax linkages. At the same time, high attrition levels make tax increases very conflictual among social groups, and they are therefore likely to be blocked. In figure 1.2, the examples coming close to this ideal-type are Australia, Canada after 1990, Switzerland, the UK and the US. It should be noted that, as suggested in figure 3.5 our two British and French structured case studies somewhat follow scenario *a* and scenario *d*.

So far, we have assumed that tax linkages and attrition levels remain constant over time. As a result, the onset of the age of austerity yields four new equilibria towards which fiscal pathways converge: *a*: tax hikes bias (higher taxes and expenditures), *b*: social conflict and failed austerity (lower taxes and higher expenditures), *c*: mixed (taxation and spending come back to their initial levels after fiscal shocks) and *d*: spending cuts bias (lower taxes and expenditures). In these scenarios, *a*, *c* and *d* reinforce social coalitions and bias even more the austerity bias, while in *b* social coalitions split, squabble, and seek to escape the fiscal squeeze.

In the first case of reinforcing social coalitions, political parties favored by the constellation of tax linkages and attrition levels can implement austerity policies that reinforce the social coalitions

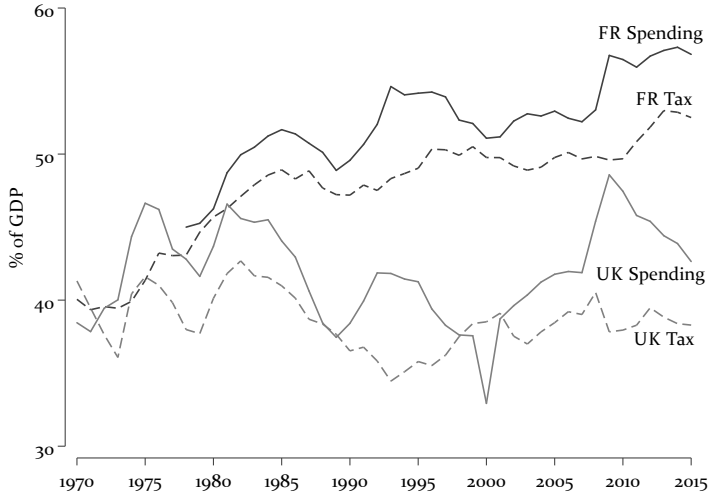


Figure 3.5: British and French fiscal pathways

NB: The British and French fiscal pathways seem to confirm the static mechanisms of figure 3.1 & the dynamic argument of 3.4.
Source: OECD data.

supporting their policies. In the framework of the ball-and-urn model, previous austerity episodes can reshape the preferences of social groups about future policies in $\zeta(p_2)$. In this case, I label these social coalitional dynamics *Zwischenzug*. This German term refers to a chess situation when an unexpected move by one player forces the opponent to respond to that move instead of responding to an expected move. In general, from a game theory perspective, this dynamic changes the situation of the first player from a loss to a win. A government inheriting a fiscal problem may, instead of seeking to satisfy all social groups by adopting incremental tactics, rather implement a forceful austerity packages that seeks to favor certain social groups over others and thus reshape social coalitions.

To see how this works, imagine a right wing government entering office in the context of mixed social coalitions being embedded in weak tax linkages and in low attrition levels. Given that social coalitions accept both tax hikes and spending cuts, the right wing government can do both. But cutting spending harshly and lowering taxes can increase attrition. The literature on the effects of austerity shows indeed that spending based consolidations are more likely to increase inequality than tax based ones (Ball et al. 2013; Mulas-Granados 2006; Woo et al. 2013). In this case, social coalitions will move from scenario *c* (mixed) to scenario *d* (spending cuts bias). This is not necessarily a hypothetical example: this is more or less what happened in the UK when Thatcher came to office. Given that inequality increased broadly since 1970 among OECD countries, one could also expect attrition levels to rise with a certain variation across OECD countries.

Now left wing governments, whose preferences are to increase taxation to protect the welfare state, can choose to influence $\zeta(p_2)$, i.e. future austerity policy, by strengthening tax linkages. Again, this is not necessarily a hypothetical example: France choose to do so in the early 1980s. OECD data also suggest that average social contributions among OECD countries increased substantially

since 1965 as proportion of GDP and as proportion of total tax revenues.

Now, what happens when in scenarios *a* and *d* governments increase attrition levels or change tax linkages from weak to strong. In these two cases, I argue, social coalitions erode and fragment. In the next round of austerity, $\zeta(p_2)$, governments moved social coalitions closer to scenario *b* where social groups tend to oppose both tax hikes and spending cuts. This situation where austerity erodes social coalitions rather than reshaping or strengthening them I call *Zugzwang*. This German term used in chess refers to a situation when any move by a given player worsens his situation. In game theory, this situation happens when a move changes the game from a potential win to a certain loss. Governments find themselves in a tough situation, and they are damned if they cut spending or increase taxes and damned if they do not. In this case, governments break the social coalition constraints and fragment the social coalitions that support their previous policies.

The prediction from the previous mechanisms is that a right-wing party can implement expenditure cuts and increase attrition in a weak tax linkages context and thus shape future coalitions, as much as a left wing party can increase taxes and expenditures in a context of low attrition and strong tax linkages. In this case, the constraint of social coalitions supporting a policy and reinforcing it holds and social coalitions strengthen over time: this is *Zwischenzug*. But if left and right parties want to implement their favorite type of austerity in an adversarial context (weak tax linkages and high attrition for the left and strong tax linkages and low attrition for the right), then social coalitions erode and/or the electorate votes parties out of power. This is the case labeled *Zugzwang*.

One should note that it is more difficult to reshape tax linkages than to increase or decrease inequality. Therefore, right wing parties may seem to have an advantage during austerity: if we start from the weak tax linkages / low attrition equilibrium where both parties stand an equal chance of implementing their preferred type of austerity, right wing parties can increase inequality through their policies (e.g with strategic timing of recession), while left leaning parties will need to find consensus for a tax reform.

Another implication is that, in the context of low attrition / strong tax linkages, governments should be careful. If they seek to protect too much a certain segment of the population (call them insiders) at the expense of another one (call them outsiders), their policies can drive a wedge between social groups and increase levels of attrition. In this case, the situation changes from a *Zwischenzug* to a *Zugzwang* and social conflict ensues. In figure 3.1, this leads to a situation where high attrition and strong tax linkages pitch social groups against each other. In the end they all oppose tax hikes and spending cuts. Here the main cases are Greece, Italy, and Portugal.

Finally, the embeddedness of social coalitions in tax structures and attrition levels may imply not only that some family parties will have an easier or tougher job of implementing austerity as they see it depending on the context, but also that in the long run social coalitions may steer politics in a certain direction. Thus, concerning fiscal policy, in a context of high attrition/weak tax linkages, left wing parties will adopt more right wing fiscal policies. As a result the median voter may move to the right. British Labour is a case in point. In order to regain power in 1997, it had to go through a thorough transformation that brought it closer to the Tories in terms of economic policies. As such, Labour had to accept the necessity of expenditure cuts rather than tax hikes. Conversely, in the context of low attrition and strong tax linkages, the median voter may move left because right wing parties can cut expenditures only at the risk of losing elections with

a greater certainty. This example is well illustrated by the French Gaullists. At each iteration of fiscal austerity they first claimed to cut expenditures. But then in the face of social opposition, they changed tack and increased taxes, before being voted out of power.

3.3 Conclusion

This chapter developed my argument on the social sources of austerity. I singled out three mechanisms that ferret out the deeper factors that influence the politics of austerity: linkages, attrition, and the social coalition constraint. The main empirical implications of these mechanisms can be summed up in the following hypotheses, which will be tested in the remainder of this dissertation:

Hypothesis 1. *The austerity preference of social groups will depend on their linkage with the budget. If social groups pay earmarked taxes, they will resist spending cuts in order to recoup their investment. If, however, social groups pay taxes that are not earmarked, they will more probably oppose tax hikes due to the lack of information about the return on investment.*

Hypothesis 2. *If austerity increases attrition significantly, then in the next round of austerity, $\zeta(p_2)$, the preferences of social groups are skewed against tax hikes and towards spending cuts.*

Hypothesis 3. *If austerity at time t reshapes the budget in favor of certain social groups, then these policies are likely to be followed at time $t+1$. If, however, austerity fragments social coalitions at time t, this fragmentation will preclude politically winning strategies of adjustment at time $t+1$.*

While each of these mechanisms will be tested separately in the three following chapters using a comparative historical framework contrasting the United Kingdom and France, it is important to keep in mind the interactive and endogenous nature of these mechanisms. As figure 3.1 suggests, the effect of inequality on the bias of the distribution of austere policies is conditional on the tax structure. In other words, the effect of one context of social coalitions (the distance between social groups) is dependent on the other context (the embeddedness in weak or strong tax linkages). These mechanisms do not work independently of each other. But because of their different nature and due to the complexity of the process of the politics of austerity, it is hard to test them simultaneously.

What are the implications of these three mechanisms in the long run? Fiscal pathways show how austerity reshapes the relationship between expenditure and taxation in the long run. If austerity increases inequality, then social coalitions form around low taxation, even more so if tax linkages are "weak" or not earmarked. With each economic shock and austerity, those coalitions should put the burden of adjustment on spending cuts. As a result, inequality will increase and thus the distribution of austerity policies in the second round of fiscal consolidation may be strongly affected. Future policies are likely be constrained as a result. This distribution of $\zeta(p_2)$ will result in a downward fiscal pathway. Conversely, if austerity does not lead to increased inequality and/or social groups opposing expenditure cuts have strong linkages with the budget, then the distribution of $\zeta(p_2)$ will tilt towards tax increases.

The next chapter looks closer at tax linkages, the first mechanism influencing social coalitions

during austerity. It takes a longitudinal, historical perspective to show how, first, tax linkages between social groups and the budget developed and, second, how these linkages influenced social groups during austerity in the UK and France.

4

Linkages and austerity: *Tax structures and social conflicts*

> "*I hate paying taxes. But I love the civilization they give me.*"
>
> Oliver Wendell Holmes

While the previous chapter elaborated the broad argument on the social sources of austerity, this chapter looks closer at the first mechanism, tax linkages. The chapter will first discuss what tax linkages are and how they can be operationalized. Second, the chapter will sketch the relationship between tax linkages and attrition so that the reader can understand the connection between this chapter and the next. Third, the chapter will analyze tax linkages in the UK and France in a comparative historical perspective.

My definition of tax linkages is simple. It rests on the type of taxes that dominates the revenue side of the budget, focusing mostly on income taxes and contributory taxes. Building on that definition, I argue that the politics of austerity depend very much on which dominating taxes social groups are embedded in and what those taxes are earmarked for - or not. This is because the type of taxes paid in by the voters entails certain expectations towards the budget and thus towards austerity. Some taxes like the income tax are not clearly earmarked and generate some uncertainty about the benefits - or the return on "investment". Once paid, taxes disappear into the black hole of government coffers and reappear in government programs, but payers have little direct control on the allocation of their monies. For this reason, I call income tax dominated budget revenues as weak linkages. The implication is that taxpayers prefer to see taxes and expenditures reduced rather than keeping expenditures constant or increased. But other taxes can be contributions to various types of pre-defined benefits and as such generate very high levels of certainty about the "return on investment" that taxes represent. For this reason, I label this type of taxes strong linkages. The implication is that when tax linkages are strong, taxes are a sunk cost with a strong expectation of benefits and voters prefer not to see spending cuts affecting items for which they have already paid.

This line of reasoning has strong theoretical foundations in both rational choice political economy and fiscal sociology (Bates and Lien 1985; Levi 1989; North 1981; Martin et al. 2009; Goldscheid 1958; Schumpeter 1991; Wilensky 2002, 1975) and robust empirical support (Aizenman and Jinjarak 2012; Timmons 2005). Yet, the political implications of this literature have never been fully drawn for the politics of austerity and how social groups may or may not influence fiscal adjustments. In general, the literature is more concerned about the effect of political systems on the shape of tax structures (Steinmo 1993). Here I propose to turn this question on its head and look at the effect of tax linkages on politics.

The main contribution of this chapter is thus to show that tax linkages shaped endogenously the politics of austerity in the following way. If a country enters the age of austerity with weak tax linkages, dominated by non-earmarked and high uncertainty taxes (as the income tax), then in all periods of austerity $\zeta(p_n)$ this country has a strong bias towards expenditure and tax cuts. This bias may amplify once tax cuts happen because they constrain heavily the revenue-generating capacity of the state and because it creates a powerful lobby group for further tax cuts and spending cuts. As then next chapter on attrition will show, this effect can be magnified when inequality grows. Conversely, if a country enters the age of austerity with strong tax linkages, dominated by taxes that are earmarked and which have a high degree of certainty and sunk costs (e.g. social security contributions), then governments are faced with strong interest groups with high stakes in the welfare state. Given that austerity happens in times of recessions and high unemployment, then in all periods of austerity $\zeta(p_n)$ such countries have a strong bias towards expenditure and tax hikes. Another implication of tax linkages is that they may also have an impact on attrition levels: income tax-based systems may increase attrition because taxpayers refuse to pay for an unguaranteed benefit, while social-contribution-based system may decrease attrition: if all voter pay for the same expected benefits, they will agree more on taxation.

Table 4.1 operationalizes my definition of tax linkages and breaks it down into several dimensions:

- *Tax dominance:* tax linkages can dominate in absolute terms and/or relative terms. Absolute terms refer to the burden a tax imposes on an economy and can be measured as proportion of the said tax to GDP. Relative terms mean how much a specific tax weights in the total taxation. For instance, among OECD countries, a country can have a comparatively low income tax burden but it may play a big role in the tax structure.

- *Insurance:* The dominant tax linkage can have a weak or strong insurance component. If the insurance component is strong, uncertainty about the return on the payment of the tax is higher and the expectation about the benefit is lower. Thus the tax linkage is weak. If the dominant tax linkage has a strong insurance component, then social groups have a high expectation and certainty on the returns of the tax payment. Thus the tax linkage is strong.

- *Hypothecation:* taxes can be either earmarked (assigned to a specific purpose, like building roads or funding armies) or not. If they are, a solid bridge is established between taxpayers and the budget, between revenues and expenditures and associates certainty with sunk costs. It increases the control of citizens over the budget. It matters whether the tax is earmarked for a narrow purpose (local property taxes can fund local education) or for a broader one

Table 4.1: Tax linkages in the UK and France

Dimensions	**United Kingdom**	**France**
Tax dominance	Income tax	Social security contributions
Insurance	Weak	Strong
Hypothecation	No	Yes
Fiscalization	Yes	Increasing
Centralization	Strong	Medium
Fragmentation of R	Weak	Medium
Link R-X	Weak	Strong
R-generation capacity	Weak	Strong
$\zeta(p_2)$	Spending cuts	Tax increases

NB: "R" stands from revenues and "X" for expenditures. $\zeta(p_2)$ *stands for the austerity bias generated by tax linkages.*
Source: own elaboration.

(insure most of society). One broad earmarked tax has different political implications than a welter of narrow earmarked taxes: in the first case, resistance to expenditure cuts can be bigger.

- *Fiscalization:* it refers to the use of general direct revenues to fund specific programs previously financed by earmarked taxes. In general fiscalization can be seen as the opposite of hypothecation.

- *Centralization and fragmentation:* it is important to consider whether a tax is collected centrally by one actor into one common fund or whether other actors participate in the process and taxes end up in different funds controlled by different actors. This has implications for the powers of the finance minister.

- *Revenue generating capacity:* the revenue generating capacity is function of tax rates and tax base but here attention is also paid to the political resistance that the tax linkage encounters. For instance, in the UK, the yield from the income tax is quite important but resistance constrains the government and thus in times of austerity, it cannot increase it too much. Conversely, in France, social contributions and VAT have also a consequential yield and their increase is less subject to contestation. Thus their revenue generating capacity is greater.

Having further developed the concept of tax linkages, the next section indicates that there may be indeed a trade-off between weak and strong tax linkages, and that these different forms of tax linkages can have different effects on attrition. Given that the UK and France stand out in the OECD, the next section uses historical process-tracing to identify how tax linkage influence social coalitions and the politics of austerity in both countries.

4.1 Taxation, austerity and distributive conflicts

Given that my argument postulates that two mechanisms influence the politics of austerity, I need to see how they interact empirically. In general, I advance that weak tax linkages offer less redistribution than strong systems because of the insurance component of strong tax linkage. But this does not imply that weak linkages do not support the welfare state: it does, as in the case of the UK, but rather following the logic of assistance rather insurance. Reviewing the voluminous literature on taxation and the welfare state is beyond the scope of this section, therefore it will only evoke the few strands of research connected to austerity and some stylized facts.

The contention that weaker tax linkages, based on income taxes, are generally faring worse at redistribution than strong tax linkages based on social security contributions, is generally backed by the economics literature (Woo et al. 2013, for the austerity related literature). A strand of literature has shown that strong linkages and indirect taxation can be positively related to the welfare state as a complement to other forms of taxation like social security contributions (Kato 2003; Beramendi and Rueda 2007).

Thus the structure of a tax system - or the political economy of the tax mix - has important consequences for attrition as measured by inequality. Using a sample of 34 OECD countries[15] figure 4.1 suggest that there may be indeed a trade-off between between different forms of taxation and that these forms of taxation have different implications for attrition in the form of inequality and redistribution.

It should be noted here, before proceeding further, that the tax side of national budget is obviously much more complex than just a dichotomous choice between income tax and social security contributions. I focus on these dimensions because of the argument and because these are, apart from indirect taxation on goods, the biggest tax revenues in our sample. Figure 4.3 shows the average tax structure in the OECD, the UK and France and its evolutions over the period 1965-2013. One can easily notice that indirect taxes (for instance, consumption taxes) play an important role and that they should therefore be included in the tax trade-off (Kato 2003). Given that in several countries indirect taxation is used to buttress the welfare state, this suggestion is more than justified. The problem is that in some cases like the UK or Ireland[16] high indirect taxes were not used to fund higher welfare spending but to cut the income tax and therefore, it is hard to see their impact on inequality and redistribution. Suffice it for now to assume that the dichotomy between the income tax and the social security contribution is a useful, if imperfect, heuristic device to start the analysis on the influence of the tax structure and austerity.

Figure 4.1 contains several layers of information included in the six bivariate plots, summarizing information about long term relationships between average values of the share of the income tax

[15] The sample includes Australia (AU), Austria (AT), Belgium (BE), Canada (CA), Chile (CL), Czech Republic (CZ), Denmark (DK), Estonia (EE), Finland (FI), France (FR), Germany (DE), Greece (EL), Hungary (HU), Iceland (IS), Ireland (IE), Israel (IL), Italy (IT), Japan (JP), Korea (KR), Luxembourg (LU), Mexico (MX), Netherlands (NL), New Zealand (NZ), Norway (NO), Poland (PL), Portugal (PT), Slovak Republic (SK), Slovenia (SL), Spain (SP), Sweden (SE), Switzerland (CH), Turkey (TR), the United Kingdom (UK) and the United States (US).

[16] In some countries for instance the VAT was introduced "exogenously", i.e. due to their entrance into the EU and the obligation to contribute to the EU's own resources and building a single market rather than due to their domestic politics.

(IT) in the revenues of domestic budgets, the average share of social security contributions (SSC) and change in inequality and redistribution over the period 1978-2010.

In short, there are broadly speaking four groups of countries. There are the countries where the tax system is tilted more towards social contributions than towards the income tax. This group comprises mostly mature welfare states like Austria, France, Germany, Greece, Italy, the Netherlands and Spain. A subset of this group consists of formerly socialist countries which inherited large welfare states and which, at the exception of Estonia, form the "embedded neoliberal" and neo-corporatist cluster of CEE countries (Bohle and Greskovits 2012). A second group of countries lumps together states known for their developed welfare states (Belgium, Finland, Luxembourg, Norway and Sweden) and other, less developed welfare states (Canada, Ireland, Japan, Switzerland, UK and the US). A third, heterogeneous, group of countries includes countries like Turkey, Ireland, Israel, Mexico, Korea, Chile and Iceland. While Chile, Korea and Mexico have low taxation levels (around 20-25% of GDP, looking at the IMF WEO data), Turkey, Ireland and Israel have been converging towards 35% and Iceland stays above 40%. The last and fourth group of countries is comprised of the entities heavily dependent on the income tax in their budgets: Australia, New Zealand and, quite surprisingly for such a mature welfare state, Denmark.

Panel (*a*) and (*b*) first focus on the trade-off between IT and SSC as share of total tax revenues in OECD countries budgets. Panel (*a*) shows that as the share of the IT as proportion of total revenues increases, the share of SSC decreases. France stands out as one of the countries where SSC represent the lion's share of French budgetary revenues (roughly 40%), while at the same time having one of the lowest share of income taxes in total revenues (slightly less than 20%). It is the ideal typical country with strong tax linkages. The UK, on the contrary, is among those countries where SSC are low and tax receipts from income taxes are the mainstay of the domestic budget (twice the size of SSC). The UK is nonetheless not the most extreme case of income tax dominance: Australia, Denmark and New Zealand have virtually no SSC and the share of the income tax is above 55%.

Panel (*b*) suggests that the trade-off between weak and strong linkages, between PIT and SSC, is also dynamic: increasing the SSC may imply reducing the PIT over the age of austerity. Here however, the pattern is not what is expected: France increased significantly the share of IT and kept SSC constant. The reason for this, as the remainder will show, is that the funding of the welfare state was spread over to the IT in order to reduce the cost of taxation of labor and reduce its impact on competitiveness: therefore, it seems that tax linkages in France have remained strong, but this is a moot point discussed later. In the UK, the tax mix between IT and SSC has remained stable.

Do these tax mixes have an impact on attrition? Consider first inequality in panels (*c*) and (*d*). It seems that the increase of the share of the income tax in the tax mix (thus weakening tax linkages) slightly adds to inequality. The SSC, on the contrary, seem to have an important impact on bringing inequality down. The plots therefore suggest that tax linkages can have an impact on attrition. The UK is, among the countries with weak tax linkages, the country where inequality increased most, while France is, among the countries with strong tax linkages, the country where inequality has been reduced most. In fact, British inequality increased more than inequality in Central European and Eastern European countries, which had to switch from the egalitarian communist system to the neo-liberal regime of economic transitions.

One channel influencing attrition is the redistributive component of welfare state (here mea-

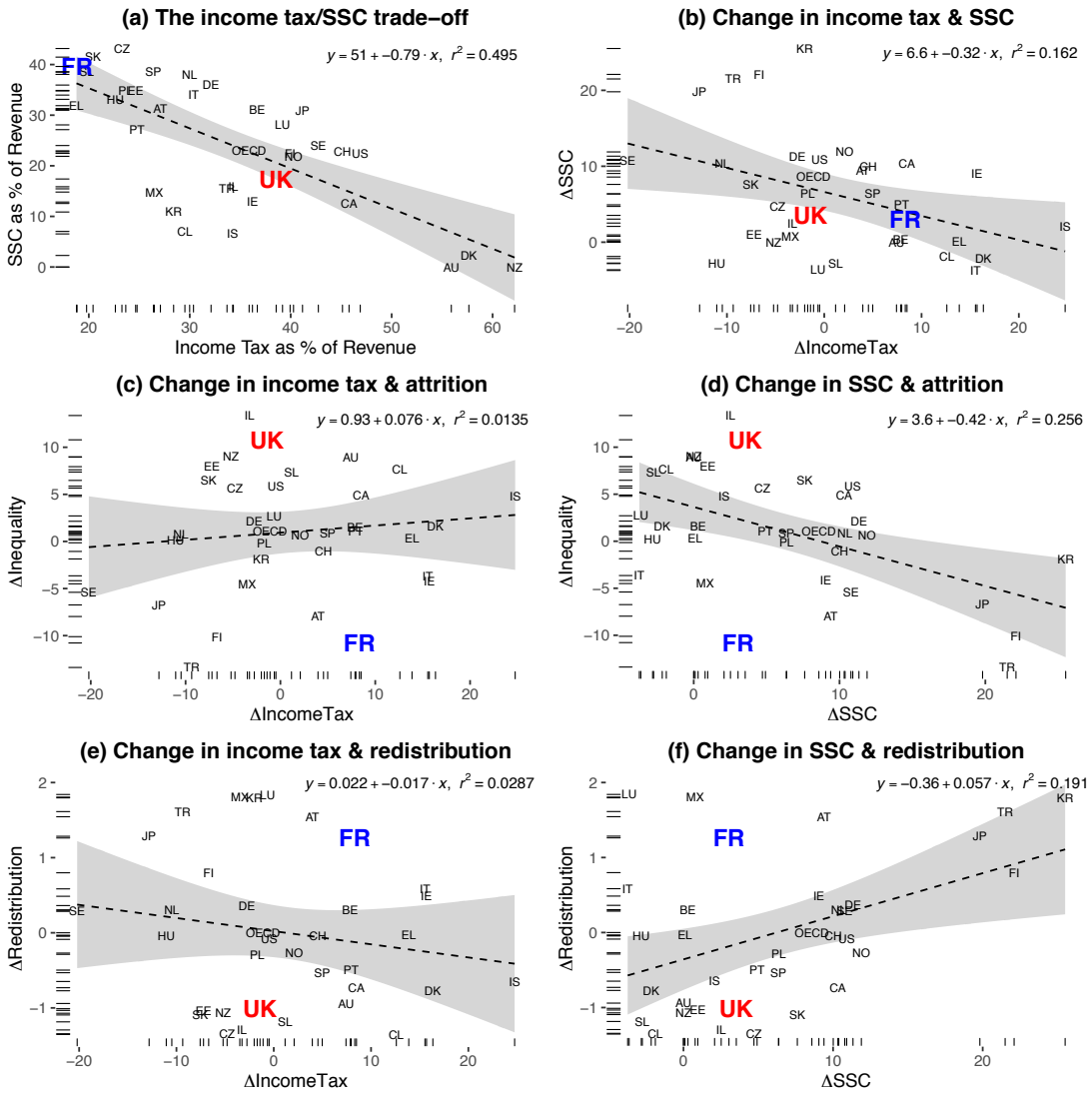


Figure 4.1: Income tax, social contributions and redistribution

NB: Sample of 34 OECD Countries. The vertical bars on the y *and* x *axes are rug plots showing the respective distributions of cases on each variables.*
Source: own elaboration based on Solt (2014) & OECD tax database.

sured as the different between market and net Gini). Given my definition of tax linkages, I expect strong linkages to decrease attrition by increased redistribution and weak linkages to increase attrition through lower redistribution. Panels (*e*) and (*f*) hint at this being the case. In general, it seems that increasing the income tax as a share of budget revenues during the age of austerity decreases redistribution, while increasing the share of SSC increases redistribution. In both panels, one can see that while France has increased mostly its share of IT (and SSC remained high), redistribution has increased significantly. This vindicates the hypothesis that introducing IT in the French tax mix strengthened instead of weakening tax linkages. This is probably the exception that confirms

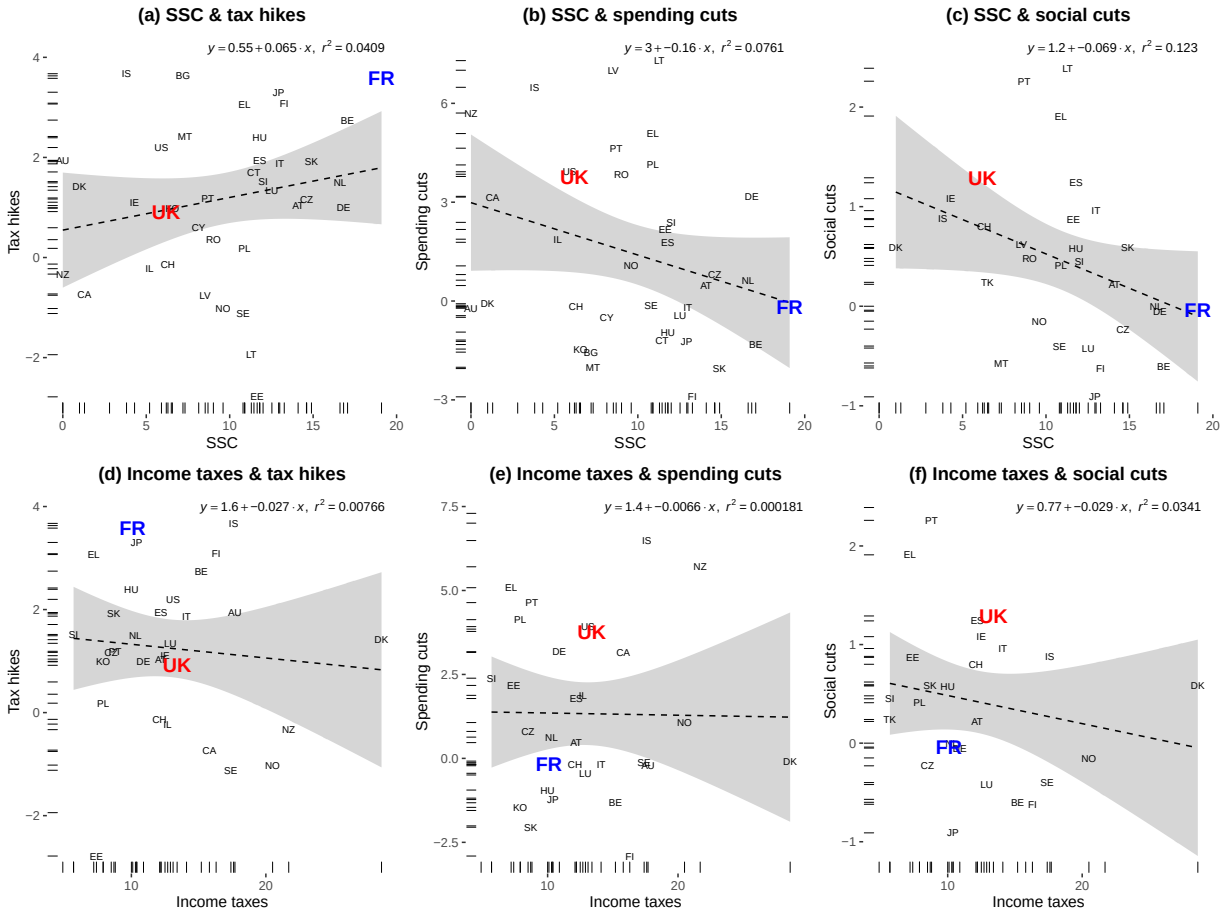


Figure 4.2: Linkages and austerity

NB: Sample of 34 fiscal consolidations in 2010-2013. Tax linkages are in % of GDP (the scatter plots are robust to data in % of taxation) for the year 2010 and tax hikes, spending cuts and social spending are in % of GDP for the years 2010-13.
Source: own elaboration based on OECD tax database, AMECO & IMF WEO data.

my argument (more income taxes mean weaker tax linkages) because the French reforms were, as we will see later, very specific.

The patterns presented in the bivariate plots of figure 4.1 seem to confirm broadly my argument on tax linkages and attrition. Countries with weak tax linkages are more likely to see inequality increase and are therefore more likely to end up in the category of "spending cuts bias" type of austerity, while countries with strong tax linkages are more likely to decrease inequality and to end up in the "tax hikes" bias type of austerity.

Is this confirmed during austerity between 2010 and 2013? To a certain extent, yes. Figure 4.2 suggests that there is indeed a connection between types of tax linkages and the shape of fiscal consolidation after the austerity turn of 2010. This connection lends some external validity to the mechanism of tax linkages, but as figure 4.2 indicates, the mechanism does not always work in the expected direction or with the expected strength.

Panel (*a*) suggests that as the weight of social contribution increases in total taxation as a ratio to GDP, countries tend to increase taxation. Here the UK and France are, like in the other plots showing the potential effect of social security contributions, at the antipodes of each other. The UK has social contributions worth around 5% of GDP while in France SSC weights around 20% of GDP. As a result, after 2010, France has increased its taxes markedly - around 4% of GDP - and the UK did the minimum. When comparing the effect of SSC on tax hikes and spending cuts, the effect is the opposite: while France barely touched its expenditures, the UK cut cumulatively almost 4% of GDP of its headline expenditures, as panel (*b*) suggests. The variation on social expenditures confirms the impact of social security contributions on the reduction social security expenditures. Lower SSC imply higher social expenditure cuts probably due to weaker tax linkages. In France, social expenditures have slightly increased (0.74% of GDP) while in the UK, social cuts amounted to 1.29% of GDP. All in all, the effect of SSC seems to go in the expected direction and suggests that as tax linkages grow stronger, tax hikes are more likely and expenditure cuts are less likely, especially in the realm of social expenditures.

The effect of the income tax linkages also confirms my argument, but to a lesser extent. Panels (*d*), (*e*) and (*f*) show that a higher share of income taxes in the economy lowers tax hikes after 2010, although this effect is statistically weak. Concerning spending cuts, there is no relationship whatsoever between the share of income taxes and the size of spending cuts after 2010. But this does not necessarily contradict my theory: indeed, in quite a few exceptional countries, income taxes are used to fund a mature and legitimate welfare state (e.g. Denmark, Iceland, Norway, Sweden, and France, as we will see in the remainder of this chapter). In these cases, although based on income taxes, tax linkages are quite strong. This is confirmed by panel (*f*) which, quite surprisingly for our argument, shows a negative relationship between the share of income tax in the GDP and the size of social spending cuts. The relationship is partially driven by countries like Belgium, Finland, Sweden, and Denmark, where the welfare state is quite strong.

Once again, the UK and France stand out in these scatterplots. Although the ratio of the personal income tax differs only slightly in terms of proportion to GDP, the effects on austerity are very different. As already mentioned, France barely touched spending and certainly did not cut social spending and increased taxation dramatically while the UK did the opposite.

This section established that there is a possible trade-off between weak and strong tax linkages. On top of this trade-off, weak tax linkages seem more prone to increase attrition than strong tax linkages. The previous section also sought to confirm the preliminary results from the theoretical chapter. I have found that while strong tax linkages have some influence on austerity, weak tax linkages have only a weak influence on austerity. This may be due to the fact that some countries use weak linkages to fund their welfare state. As a result, some countries with a high share of income tax revenues to GDP have higher tax burdens (e.g. Denmark, Norway, Sweden, usually above 50% of GDP) while other have a small tax burden (around 35% of GDP). This section has also established that the UK and France are possible outliers in the analysis of the comparative political economy of tax linkages and that they represent divergent cases. The next section looks closer at these two countries from a historical perspective, inspecting the political sources of tax linkages and exploring the way they shape social coalitions during austerity.

4.2 Linkages in the United Kingdom and France

Comparing the evolution of tax structures in the UK and France in a historical perspective and then tracing their changes during austere times can yield useful clues on the determinants of austerity. Consider figure 4.3 where a set of six radar plots gives a few basic informations about the structure of the British, French and average OECD budget revenues. This should inform us about the likely preferences of social groups in both countries during austerity. The plots are simple: each branch represents one main source of revenue as classified by the OECD revenue database from 1965 to 2013: income refers to all the taxes on income, profits and capital gains; SSC refers to social security contributions as paid by employers, employees and the self-employed; goods stands for indirect taxes on production, sales and consumption (like excises, VAT, etc); other taxes refers to small unclassifiable taxes; property taxes obviously concern immovable property, wealth, inheritance, etc; and finally payroll taxes. The shades represent their evolution in time: the darker the shade, the older the data. The lighter the shade, the more recent the data are. For the sake of robustness of measurement, the left column displays revenues as a proportion of national GDP and the right column displays revenues as a fraction of total revenue, but both paint a similar picture.

The main story one can take away from figure 4.3 is that over the last five decades tax structures seem to have been very stable with the basic shape of the "star plots" changing only at the margin of their branches. From this point of view it is very easy to identify a national profile of tax linkages that may influence the politics of austerity because the evolution of tax structures in the average OECD country, the UK and France is marginal from a macroscopic perspective.

In general (see panels 4.3f and 4.3f), OECD countries seem to have on average a pretty stable structure of taxation with a peculiar shape: its star branches are pretty weak on payroll, property and residual forms of taxation. The two most important forms of taxation are income taxes which represent around 12% of GDP and 35-40% of tax revenues. Interestingly, social security contributions come as the third most important category but their importance has increased dramatically since the 1960s: they have increased from around 4% to almost 10% of GDP, or from 17 to almost 30% of total revenues.

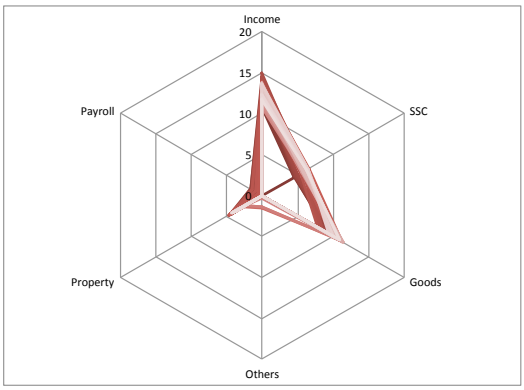
Against this backdrop, the UK and France stand out. Apart from being one of the rare countries with slightly higher property taxes (only Iceland, Japan, Korea, Luxembourg and the US come close behind), the UK has a taxation structure more reliant on income taxes but equally heavy on indirect taxation. While in the OECD in general, countries have moved away from this type of taxation, the UK looks as it is more dependent on it, as suggested by the brighter color inching towards the upper values. Otherwise, the British taxation structure seems to follow the average OECD pattern: moving slowly towards more social contributions and slightly decreasing the share of income taxation.

France seems to be an outlier altogether. Its share of income taxation is half of that of the UK on average, with an incrementally growing slice. At the same time, social security contributions form the bulk of French revenues, reaching an all time high of 45.5% in 1993. The analysis below will show that there is a tight and somewhat problematic relationship between the evolution of these two forms of taxation in the second moment of the age of austerity, before the qualification for the Euro in the early 1990s. Suffice it for now to notice that the structure of French taxation

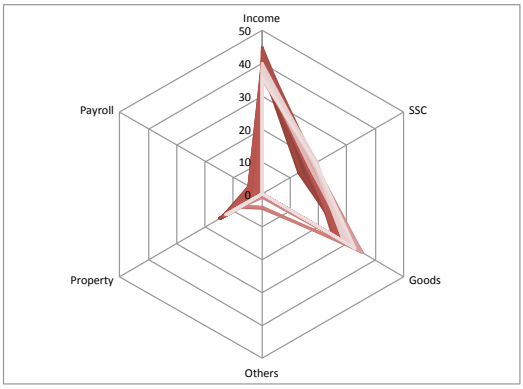
is, as the British one, heavily skewed towards a certain tax. Finally, the French tax structure also used to rely on indirect taxation on consumption. This has been somewhat reduced in the recent decades, but the analysis will show that this change notwithstanding, harsh debates over this type of taxes have peppered French politics, especially since the entrance into the Eurozone.

If the star plots suggest broad variation over five decades, the first decade of austerity (1978-1989) was pretty much eventful, as can be seen in figure 4.6. The 1980s were intense tax reform-wise, with important changes in the maximum and minimum tax rate in income and corporate taxation but also in the number of brackets. One can see that tax systems tended to be simplified during the first decade of austerity. But once again, our case studies stand apart, with important consequences. While in the UK, income taxes form the lion share of tax revenues, their rates have wildly fluctuated in the 1980s. In 1975, the UK ranked highest among advanced capitalist democracies for the top tax rate of the income tax. Fifteen years later, it made the steepest reduction, ranking among the last countries. The same applies, but to a lesser extent to minimal tax rates for the income tax: while the UK topped the ranking in 1975, it found itself in the middle of the pack by 1989 with, again, the steepest change. By contrast, in France, where personal income taxes are more marginal to the budget, maximum and minimum tax rates have stayed put, as did the number of tax brackets.

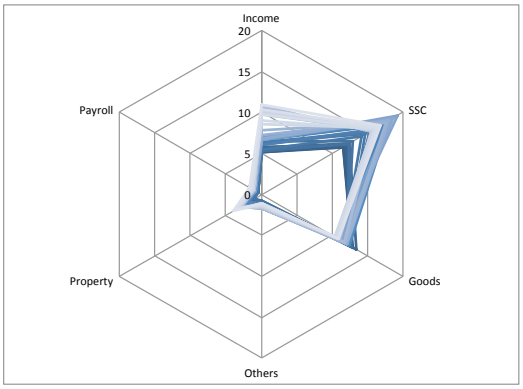
All of this suggests that the onset of the age of austerity has brought significant change for some countries but not for others. To understand why, it is important to analyze the unfolding of successive austerity episodes in a longitudinal perspective and look closer at how fiscal consolidations add up from the point of view of tax linkages. The case studies of the UK and France will seek to answer this question and will be structured in the following manner. First, the sources and structure of taxation on the eve of the first period in the age of austerity (1980s) will be examined. How did historical legacies mold the politics of austerity in the 1980s? Second, what were the changes made in both countries and how did they affect the second and third period of austerity (1990s and 2010s)?



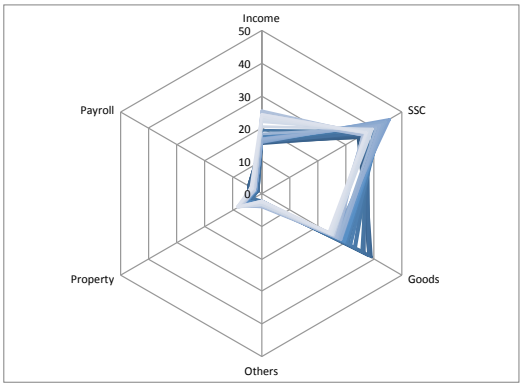
(a) UK, % of GDP



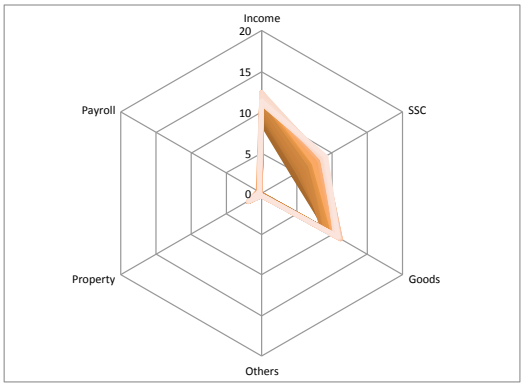
(b) UK, as % of total taxation



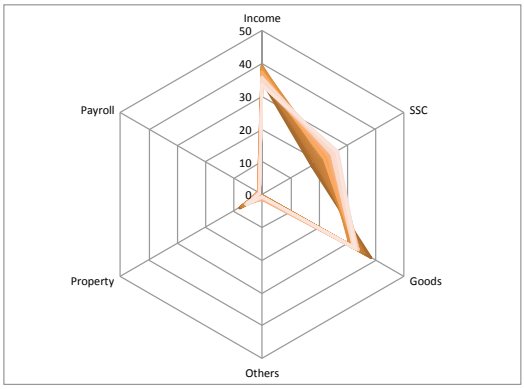
(c) FR, % of GDP



(d) FR, as % of total taxation



(e) OECD average, % of GDP



(f) OECD, as % of total taxation

Figure 4.3: Tax Structures, 1965-2013

NB: Radar plots are used to decompose the revenue side of public budgets and thus to see which social groups are more powerful. While those plots are usually used to differentiate between static categories, I use colors to add a time dimension and thus capture long term changes induced by repeated austerity: the clearer the color, the more recent the data. One can thus trace change from the past (darker) to the most recent evolution (lighter).
Source: own elaboration based on the OECD tax database.

4.2.1 UK linkages: the income tax and refusal of "hypothecation"

British tax linkages have a puzzling evolution. In 1979, when Thatcher came to power, the British tax system was palimpsestic: an incoherent tax system with weak revenue generating capacity heavily dependent on the income taxes and customs (almost 90% of total revenues according to Daunton (2002, p. 16)). This happened despite the fact that politicians in the UK in the 19th century managed to build a somewhat consensual and stable tax system. How did this come about? What were the political consequences for austerity in 1979? Before proceeding further, it should be noted that the following paragraphs have no ambition to retrace the history of British taxation, but rather to tease out key developments in tax linkages that shape the politics of austerity from 1979 to 2015. In order to do so, this section will focus on taxes as linkages between taxpayers and the state. It will appear that the principal tax linkage is the income tax which is mainly characterized by a lack of hypothecation and the frail support offered by indirect taxes which offer no strong linkages between revenues and expenditures.

The sources of tax linkages in the UK

The following historical description shows how the UK was one of the first state to develop an efficient tax system that helped Albion win wars. But at the same time, the UK became heavily reliant on the income tax. The paradox, as we will see, is that this tax structure was and is somewhat based on an anti-spending bias: British citizens are willing to pay income taxes as long as they fund reasonable expenditures that hopefully end (e.g. the Napoleonic Wars). In an ironic twist, Britain developed one of the first powerful tax machines, but for this very reason it comes with a price in the form of a heavy popular constraint.

The sources of contemporary British tax linkages are to be found in the seventeenth century, as in France. Both countries emerged from feudal structures as strongly centralized states in the Renaissance. According to Levi (1989), this increase in the bargaining power of rulers on both sides of the channel should have led to an augmented capacity to extract taxes that became more and more necessary due to the increasing costs of war. Yet the UK was able to extract significant revenues, while France was not. If wars thus forged the social contract whereby states provide the greater common good of defense, what explains the different fiscal pathways chosen by the UK and France?

The paradox is that even though UK rulers where comparatively weaker due to the pressure of the Parliament (North and Weingast 1989), the existence of few powerful rich constituents and the greater dependence on the taxation of movables strengthened compliance with taxation and thus yielded greater revenues. This political and economic linkages of the tax structure came in handy at the end of the 18th century when the Napoleonic wars and mounting public debt forced the British government to look for additional sources of revenues. The new income tax first introduced in 1799 by William Pitt, reintroduced by Addington in 1803 and finally adopted definitively in 1842 redefined the relationship between the state and its citizens. On the one hand, the power of the State increased thanks to a new source of revenue and information on the financial situation of its citizens. But on the other hand, this new situation also put pressure on the government to provide more collective goods (on top of defense, social insurance). As a result, the introduction of this

new tax fortified popular control of government which increased with the number of taxpayers: while they represented a minority in the 19th century, their number rose fast with the diffusion of the franchise and therefore strengthened the grip of taxpayers on budgetary politics.

The principles of this new fiscal contract are fundamental to understand the political effects of its tax linkages. First, political resistance to the income tax and its supposedly temporary status (to pay for the Napoleonic war and then to pay public debt) means that the process of containment of the British state is at the very heart of these tax linkages (Daunton 2002). Second, the early rise of the income tax cemented a path dependency that would later give the UK the most efficient, flexible and approved fiscal system during World War I, compared to other belligerents who did not introduce the income tax early enough. The way taxation was built in the long 19th century fostered trust between social groups and the state because the government sought to promote a sense of fairness (taxes were equally distributed or perceived to be so) and because public spending of the executive was scrupulously monitored.

Third, and perhaps most importantly, the British tax system was based on the refusal of "hypothecation", i.e. taxes are not earmarked for specific purposes but should be paid into one, consolidated fund which precluded transfers between surpluses and deficit funds. The aim was to preclude the growth of maximum expenditures and use surplus to pay national debt.[17] Fourth, British governments carefully avoided to establish particularistic linkages to the budgets by favoring interest groups: as such, tax linkages in the UK as established during this period were more holistic, tying the whole voting body to the tax side of the budget.[18] This is why the connection to the franchise was so strong then (at least until 1867) because it associated an income tax threshold with a property qualification. This principle has been weakened ever since by the second, third and fourth reform acts[19] but it remains as a strong undercurrent in British tax politics.

This Gladstonian[20] fiscal contract began to unravel after WWI with the surge of organized labor which forced a rethink of the tax structure and linkages. Tax-funded (as opposed to contributory) welfare increased, and so did taxation and spending levels under the influence of the Depression, the War and the construction of the Beveridgian welfare state. While from a historical perspective this transition may appear seamless, the politics behind this change in the fiscal contract were conflicted (Lowe 1989; Rhodes 2000). The fragmented welfare state that emerged from the Beveridge report was built on contradictory principles (Ashford 1986) and was never underpinned by cross-class coalitions so characteristic of the Nordic countries because the reforms proposed entailed too

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17 According to Abbas et al. (2010), Britain national debt peaked at 259% of GDP in 1819 and came down to 30% of GDP in 1913. The absolute maximum was reached in 1947 with 270% of GDP.

18 This was done as much as possible given the increasingly corporatist nature of British politics in the fifties and sixties. Compare the British case in opposition, for instance, to the basket case of the United States, where Congress rules supreme in all matters budgetary. During the budget process politicians fight for their constituencies - local or sectoral - poking exemptions and loopholes in the tax system. See Hallerberg (2004, chapter 4) for more precisions on the strength of the British budget process and Hallerberg et al. (2009, p. 74).

19 The last one in 1918 established voting rights for unskilled men, while until then skilled men, who could vote, used to underlined their independence from the welfare state.

20 William Ewart Gladstone was a liberal politician who served four times as Chancellor of the Exchequer (cumulated time of around 13 years) and Prime Minister (also a cumulated time of around 13 years) between 1852 and 1894. Gladstone used to call the income tax as "an engine of gigantic power for great national purposes".

important a cost, too rigid social insurance principles (Hess 1981; Hills et al. 1994; Ingham 1984; Lowe 1994) and unstable sources of revenues (a roller-coaster according to Steinmo 1993) that would have needed a bi-partisan consensus. In fact these post-World War II conflicts stemmed from frequent political alternations in a competitive party setting, the resistance of the Treasury to outside influence and fragmented social coalitions. As a result, stop-and-go policies were the rule to deal with the crises of the current account and the declining Sterling. This picture is definitely at odds with other accounts of British tax linkages that put forth the resilience of the welfare state in front of neoliberal assault of austerity-driven politics (Boix 1998; Hall 1986; Pierson 1994). The late development of a patchy pension system in the UK shows how weak a political basis the British welfare state had. The UK lagged behind the advanced political economies until 1975 when it adopted an earnings based pension system (SERPS: State Earnings-Related Pension Scheme), and even then this reform lasted only until 1986 (Pierson 1994). Taken together, those characteristics of the British social contract suggest that there was hardly any strong coalition behind the welfare state in Britain, despite strong unions.[21]

In fact, if anything, the alternation of short majorities, in historical institutionalist parlance (Streeck and Thelen 2005), "layered" tax linkages with an increasing number of inconsistencies that rendered the tax system incoherent, inflexible and unstable. Thus ended the once well-regarded stable Gladstonian fiscal contract. As some observers put it in the eighties, "the present state of the British tax system is the product of unsystematic and ad hoc measures [...] whose overall effect have been to deprive the system of any consistent rationale or coherent structure": the authors suggested that "no one would design such a system on purpose" (Kay and King 1983, p. 246).

Tax linkages as source of austerity in the UK

Because British tax linkages are structured around the income tax, the other taxes are mainly seen as a way to relieve the burden from this tax and therefore do not represent a structural link between taxpayers and the budget, to the extent that some political players call them "stealth taxes". Contrary to France, as will be shown later, the development of indirect taxation (of which the most prominent example is the VAT) has not a strong *sui generis* (or endogenous) form but can be rather seen as an "external disturbance" (Hood 1985) due to the entrance into the EEC. The roots of the philosophy of indirect taxation in the UK can be traced back to the culture of free trade which, in the 1860s, deemed indirect taxes important only insofar as they produced additional revenues but did not entail protectionism of domestic producers and distort resource allocation. There the tax base of indirect taxes was narrow and often times applied mostly to superfluous or dangerous products, which implied that the payment of indirect taxes was considered as voluntary.[22] But that

[21] At least compared to France and the OECD countries (union density peaked at 51.8 in 1978 but then declined to 25.8 in 2012 according to the OECD database with the number of members shrinking from over 13 million to less than 7 million).

[22] Another argument was that increasing indirect taxes meant putting the burden on working classes (an argument used regularly by Labour and the trade unions) and would therefore increase their pressure for more redistribution. Therefore, to keep spending under control implied not rising indirect taxes. Conservatives were not very war to indirect taxation either because it implied increasing wages at a time when incomes policies tried hard to keep them stable and rein in inflation.

does not mean that revenues for indirect taxation was weak, on the contrary. For instance, 42.5% of government revenues originated from indirect taxes in 1914, reduced to 36% in 1935 and rose again during WWII (Daunton 2002, p. 94, 174, 185). The point is rather that the consensus on this form of taxation was moot which resulted in a frail linkage between taxpayers and services.

Indirect taxation and VAT in particular were not introduced to increase expenditures but rather to cover up revenue shortfall and compensate for cuts in the income tax (Kato 2003). Proof of this can be seen in figure 4.4 which also suggests marginal partisan differences. During the first Thacher fiscal consolidation in 1979-84, measures on taxation of goods and services[23] broke the downward trend that characterized British tax linkages since the 1960s. An opposite movement was initiated: under Conservative rule, income tax cuts were financed by increases in indirect taxation, and so in 1993 their share in budget revenues was practically equal. Under Labour, this trend reversed and the share of the income tax in revenues increased while the share of indirect taxation shrank. The return of Tories to power in 2010 coincided with, again, a turnaround of this practice, confirming the view that in the UK, tax politics - even when changed at the margins - is a "roller coaster" (Steinmo 1993).[24]

The failure of introducing new taxes based on robust consensus left the UK over-reliant on the income tax, compared to other countries. If we add to this the politics of income tax cuts, the revenue generating capacity of British taxes may have been weakened, further fostering the "boom and bust" cycles. A key example of this amplifying mechanism is to be found in the infamous Lawson boom. When in 1988 Chancellor Lawson reduced income tax rates (in figure 4.4 this is clearly visible) and abolished social security taxes paid by employers (paid for by a broadening of the VAT tax base), his budget was dubbed the "giveaway budget" and unleashed the overheating economy by increasing disposable income and confidence. When the "Lawson boom" went bust, Kenneth Clarke, the new Chancellor of the Exchequer, had to face powerful social coalitions against the rise in PIT and CIT (remember that this also came in the wake of the poll tax debacle) and thus turned to increasing the VAT, pushing further the tax structure into regressive territory (VAT on fuels for instance was increased from 8 to 17.5%). But because revenues were low and highly cyclical, expenditures had to be trimmed further and the ax naturally fell on social expenditures (Ahnert et al. 2011). Shifting the burden from direct to indirect taxation was not a result of fashionable ideas among the Tories - like monetary liberalism - but rather the fruit of brainstorming in the 1960s about the problematic structure of British taxation: the aim of the conservatives was to "displace income tax from the pinnacle it had occupied for the last 100 years" and provide for income tax cuts. The underlying issue was that as voters prospered, more of them also happened to be more

[23] VAT rates were simplified and increased: a unique 15% rate replaced a standard and higher rates on luxury goods of respectively 8 and 12.5%. Next, in 1984 the base was broadened to include hot take away food and building alterations. In 1992, the single rate was increased to 17.5 in order to pay for the shortfall in the disastrous poll tax, reduced temporarily to 15% in 2009, increased again to 17.5% in 2010 and finally to 20% in 2011.

[24] Using original data on parliamentary debates, Kemmerling (2016) argues convincingly that in the UK the politics of VAT have followed mainly partisan lines in second half of the 20thcentury: this is confirmed by data from figure 4.4. From 1978 to 1993, the share of the income tax in budget revenues decreased while taxes on goods increased. This patterns was reversed with the return of Labour to power, and again with the victory of Tories in 2010. The consensus for the VAT is thus very weak, and strengthens the reliance on the income tax which is a serious constraint on higher expenditures.

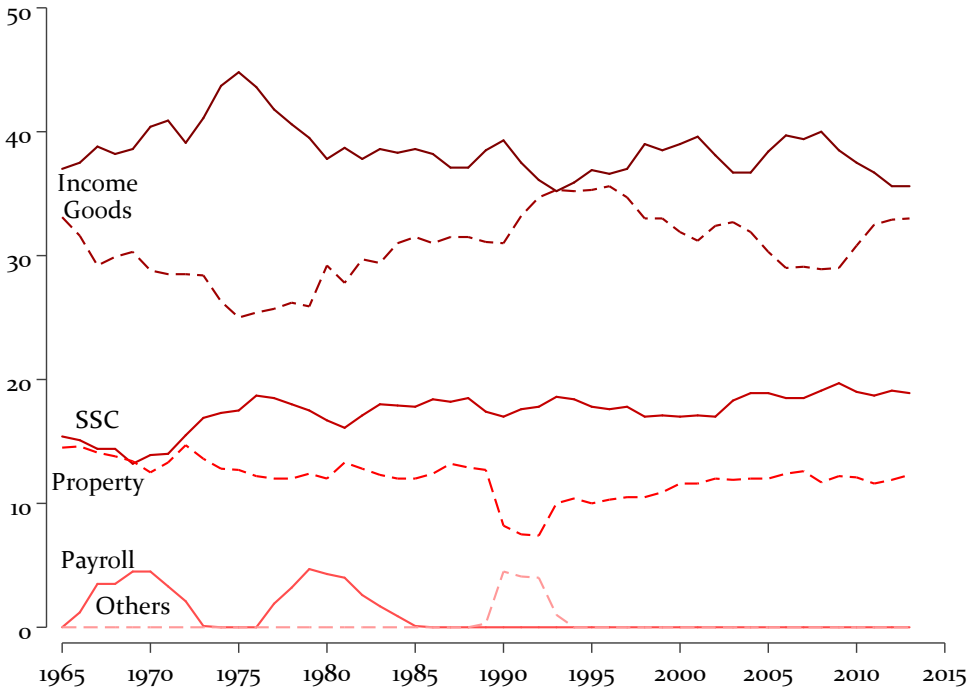

Figure 4.4: British tax linkages, 1965-2013

NB: The lines show the evolution of the share of tax revenues of different forms of taxes in Britain.
Source: own elaboration based on OECD tax database.

likely conservative constituents, and more of them were pushed into higher brackets and paid more: indeed, the number of higher rate tax payers has increased from around 750 000 in 1979 to above 4 million in 2013 (Adam 2014).

Three episodes of vehement opposition show that the consensus is fragile: as such, the British may not seem very keen to accept new taxes. The first and most dramatic example is the poll tax, introduced in 1989, and which led to the downfall of Thatcher. The story is well known: seeking to reduce public expenditure and especially at the local level where power was mainly detained by Labour (especially in Scotland), the poll tax came after years of wrangling grants and expenditure targets that Thatcher wanted to impose on Labour-dominated local councils. When the system of local finance began to crumble, Thatcher decided to move in with the poll tax, a community charge that was aimed at, first, relieving owners (traditional Tory constituents) from some tax burden, and, second, controlling spending at the local level (a major source of the national fiscal deficit) by establishing a linkage between voters and local expenditures - to "create responsible and prudent electors" (Daunton 2002). It should be noted that in the 1980s, out of 40 million electors, only 14 million paid a local levy (Butler et al. 1994, p. 52) with an even smaller proportion in inner cities. As such, Thatcher was facing a classical common pool resource problem (Hallerberg 2004). Thatcher implemented it despite classical strong reservations about a regressive flat tax in the context of rising inequality and conflicts with trade unions and the public sector, first in Scotland in 1989 and then in Wales and England in 1990. Moreover, the flat rate would vary across

towns with respect to the level of expenditures in the locality: the tax was thus truly regressive, falling disproportionately on the poor. The political strategy of Thatcher was to oblige people to see how their local government was overspending and that the electorate would thus pressure their local leaders to cut costs. At the end of 1989, 65% of the public opposed the poll tax (only 23% favored it) and riots broke out. Tories started to accord exemptions and in the end the tax unravelled and this failure had to be compensated by a VAT increase.

The second example refers to the tensions that emerged around the fuel tax at the turn of the millennium. Here, the substitution between the income taxation and indirect taxation has shown clearly its limits. In the autumn of 2000, protesters swept over Britain. They opposed the results of the "escalator" (the above-inflation increase of fuel duties from 1993 to 1999, set at 3% in 1993 and 6% in 1997) which dramatically increased the price of fuel on top of the excise tax and high oil prices. As a result, between 1987 and 2000, the price of fuel increased 60% points above inflation and between 1997 and 2000 the price of fuel increased by 37% while without tax it would have increased only 20% (Smith 2000; Leicester 2005). The government announced a freeze in fuel duties despite the consensus of both Tories (who introduced a the tax) and Labour on the environmental rationale of the tax. These protests and subsequent ones (in 2005 and 2007) thus severely tested the aim of moving away from direct to indirect taxation and underlined, once again, how tense the fiscal debate had become in the UK.

The third and final example of the fragility of tax linkages in the UK is the infamous "pasty tax" of 2012. The delicious and ironically British devil in the detail is in the question of what can be considered hot or cold food: in the philosophy of British VAT "hot" means cooked and consumed in a restaurant and is subject to a 20% VAT, while "cold" refers to what is meant to be eaten at home and is free of VAT. But what about hot food that is to take away and becomes cold in the meantime? The solution of HMT was to decide that "the changes will apply VAT at the standard rate to all food which is at a temperature above the ambient air temperature at the time when it is provided to the customer, with the exception of freshly baked bread. This will clarify the rules in this area and ensure that all hot takeaway food is taxed consistently. Freshly baked bread that is cooling down in racks will remain zero-rated" (HM Revenue & Customs 2012, p. 7). After a month of turbulent and truculent "pastygate", Chancellor Osborne renounced to introduce the new tax.

Most importantly, the failure of the poll, fuel and pasty taxes shows how ossified the British tax system has become, how hard it is to change it and how difficult it is to have a candid discussion about tax linkages. The income tax and the marginal substitutive power of indirect taxation with its narrow base still occupy the pinnacle of British tax linkages and act as a powerful constraint on the revenue generating capacity of British taxation and, by effect, on the capacity raise expenditures. In the end, VAT had, at the end of the Thatcher government, a very weak revenue-generating capacity due to many exemptions, a low rate and due to the fact that it was not comprehensive. VAT was mainly used to compensate for income, social security and corporate tax cuts and tax failures like the poll tax with a view to balance the budget, not to secure an expansion of the welfare state. This goes against the grain of a recent literature on the link between welfare state expansion and the reliance on indirect taxation (Beramendi and Rueda 2007; Kato 2003; Wilensky 2002).

At the same time, social contributions have never been deemed a serious contender to the income tax. Social contributions were considered as an important element of the construction of the welfare state in the UK, which was built partially on them since the National Insurance Act

of 1911. So why did the welfare state become less dependent on contributions over time, contrary to most European welfare states? This is puzzling given that at the time of the construction of the welfare state in Britain both the Treasury and Beveridge supported them. The Treasury saw in contributions a way to limit expenditures and thus to guarantee balanced budgets, and to avoid the mistake made in 1908 with tax-funded pensions (which became contributory in 1925). Beveridge supported them because they implied bringing the middle class in the welfare state and tying the two strongly, while the poor where not anymore dependent on stigmatizing charity but "converted into upright, self-maintaining members of society" (Daunton 2002, 309). For Beveridge, contributions were also a way of justifying benefits through collective action. But this philosophy could only be implemented if it was not "displaced", in historical institutionalist parlance, by means-tested benefits, which it did. As such, the British welfare system was based on two competitive pillars: the contributive pillar linked to benefits, and the tax-funded, targeted pillar where flat-rate contributions were linked to flat-rate benefits. Because of austerity, the latter won, and so it drove a wedge in the support for the welfare state between the poor, the middle classes and the rich, and delinked the tax system from the welfare system. As a result, for instance, the NHS is funded mainly from general central taxation (between 90% in the seventies and 80% in the noughties according to Lowe 2005). Interestingly, it should be noted that Labour was opposed to the extension of contributory welfare because it considered it as regression on the grounds that the contributions were a flat rate, while Tories (e.g. Harold McMillan) were more prone to increase them whenever the costs of the NHS soared.

To be sure, other sources of financing of the welfare state were considered in the UK, but they somewhat always failed. The tax-funded welfare state could be accused of being financed by the active population for the inactive population and thus would always see a spending cut bias. Besides, shifting the burden of taxation would be an opportunity to reduce income taxes, which business actors always underlined. Therefore, on top of indirect taxes and contributions (which would have linked benefits to the working population), governments were thinking about payroll taxes to pick up the bill, while at the same time trying to respect the Treasury's principle of non-hypothecation. As the thinking went, from the 1950s to the 1970s a payroll tax would also force business to think more efficiently about the use of workers and would apply to a wider base and would not suffer from the major flaw of indirect taxation. So why did payroll taxation fail? As figure 4.4 shows, two attempts were made and twice they failed. For starters, the Treasury and successive governments could never decide whether such a payroll tax would serve to fund higher expenditures on the welfare state, to fund income tax cuts to put in place the Tory-dreamt "state of opportunity", or to fund corporate tax cuts as compensation for the payroll tax and to ensure a greater competitiveness of the private sector. Second, the botched introduction, implementation and repeal of a similar tax under Labour government, the SET (selective employment tax) did not really help. Inspired by Nicholas Kaldor and applied by James Callaghan in 1966 when the UK was trying to cope with (another) balance of payment crisis, the tax aimed at redirecting resources from the service to the industrial sector in order to boost exports. But the SET inspired wide opposition inside the government's machinery because it was invented outside the traditional channels and because, as usual in the history of British tax linkages, its base was too narrow. Given this failure, the Conservatives were not keen on pursuing the development of the payroll tax and generalizing it from the service industry to the whole economy and rather aligned behind the implementation

of the VAT, which they did when they came back to power. The main implication of this marginal movements in tax linkages in the 1960 and 1970s was that the failure of the payroll tax led to more expenditure cuts as revenue generation was once again limited (indeed, the VAT would not produce revenues before a few years and also suffered from a narrow tax base).

Overall, British tax linkages had an important impact on the politics of austerity at both $\zeta(p_1)$ and $\zeta(p_2)$. Because Britain's main tax linkage relies heavily on income taxation, the features of this linkage generate a peculiar type of politics that heavily influence austerity. First, it implies that the middle classes bear the brunt of taxation and may therefore vehemently oppose additional forms of taxation. Second, political parties try to find alternative sources of revenues but they often fail to broaden the tax base of these different taxes (the VAT, the payroll tax, the poll tax, the fuel tax, etc.) and thus end up with alternative forms of taxes that have weak revenue-generating capacities that they often use not to fund higher expenditures but to grant income tax cuts to their constituencies. All of this despite long time efforts to "find so large a revenue raiser that one could take the heat off the income tax" (Daunton 2002, p. 308). Importantly, adjustments to the tax system happen mainly on the territory of rates but not in the realm of tax bases. This is a powerful resource constraint for governments. Third, the principle of non-hypothecation (whereby revenues are not earmarked and flow to one account which precludes surplus from one side to cover deficits on another side) acted as an important undermining force weakening the linkages between specific taxes and expenditures that would have legitimized the need for higher taxation to cover higher expenditures. As such, the main linkage is between voters and the income tax and not between interest groups (insured) and benefits (social insurance).

4.2.2 French linkages: hypothecation and insurance

Contrary to the UK, French tax linkages are not based on the income tax but on social contributions. The apparent puzzle is that, despite strong opposition to taxation,[25] France still manages to extract more revenues that Britain: in 2015, tax revenues amounted to a staggering 53.1% of GDP (vs. 35.6% of GDP for the UK). Interestingly, after each recession and attempt at fiscal consolidation since 1978, French taxes increased, thus enabling expenditures to stay high or higher than previously. Thus the main objective of this section will be to seek to explain how this ratchet effect came about (as opposed to the "shrinkage effect" of British taxes and revenues). This ratchet effect is conditioned by tax linkages and the way the French tax consensus crystallized through the construction of specific tax linkages that have the opposite effect of the British ones, namely, enabling a greater fiscal capacity to the French state. As with the British case, the following certainly does not pertain to be a history of French taxation, but rather a stylized attempt to process trace the elaboration of tax linkages, their effects on the first age of austerity in the 1980s and how their change affected fiscal consolidations in the 2010s - mainly by provoking a return of tax resistance.

[25] France has a long history of tax resistance, from the riots of 1381, the Gabelle revolts of 1542 and 1548 and the tax strikes of 1579 and 1597, the Jacquerie des croquants in 16th and the tax rebellions of the 17th centuries, the French Revolution and the revolts against the King in 1829, the wine revolt of 1907, dodging the income tax in 1922, Poujadism in 1955, and most recently to the Bonnets Rouges in 2013.

The sources of tax linkages in France

In this section, I explain the following political twist in French tax politics: strong tax resistance to the income tax was in fact the basis for the creation of alternative forms of taxation that would lay the groundwork for strong tax linkages.

As Carl Shoup once remarked, the problem of understanding why a tax is introduced is really a problem of understanding why other taxes were not introduced. History provides some hints that may explain the development of tax linkages in France. As the feudal age faded away and absolutist power rose, peaking with Louis XIV, the power for revenue extraction seemingly increased in Paris. Contrary to the UK, the French kings were never constrained by a powerful parliament but had rather to deal with an array of General Assemblies. But in reality, even though the King enjoyed greater centralization, he also had to face more resistance over taxation due to high transaction and compliance costs, and could thus - paradoxically - extract less revenue than his British counterpart (Levi 1989). Because France was spread over a bigger and more heterogenous territory with changing shapes as war molded its history, collective action was limited on the part of the taxpayers[26] and so was their influence on tax decisions. This small influence on tax decision spurred greater resistance to the imposed taxes.

The real tax linkages that underpinned and shaped this political structure was that royal finances were based on the credit provided by those who were exempted from taxes: in short, a *quid pro quo* of privileges for credit, where the very privileges that were given by the king in reality limited seriously his fiscal capacity (White 1995). As a result, the political effects of this fiscal contract were that "borrowing tested public confidence in the monarchy and may have paradoxically reinforced democratic habits of political participation internal to corporate groups; taxing led to resentment of privilege and triggered debates about the meaning of citizenship" (Kwass 1998, p. 299). Over time, the growing fiscal constraint led the King to exempt higher social classes from *old* forms of taxation but not from *new* ones, at a time when the resentment against the privileged increased. Here is the historical roots of opposition to taxation by the privileged and the unprivileged, and of the weakness of the income tax linkage in France.

The other political implications of fiscal linkage in absolutist France was that fiscal privileges strengthened feudal inequalities.[27] Tocqueville himself noted that tax linkages did help significantly to create centrifugal forces that led to the demise of the "Ancien Régime" by exacerbating the war of attrition between and within classes (Tocqueville 1985). To see this, one has to understand that the absolutist regime rested on a coalition between the crown and financial élites that extracted revenues from the third estate and redistributed it upwards (Collins 1988). This social contract started to unravel when the Crown imposed two new taxes on the privileged in 1695 to finance new wars, thereby eroding the fiscal linkages of privilege that secured the loyalty of the nobles and making them realize that absolutism had become despotism. Despite these changes, it is striking to

[26] There was no permanent national parliament, although there existed 19 "regional" ones. The Estates-General which were supposed to represent the three main social actors, the clergy, the nobility (both of whom were exempted from taxes through privilege) and the common people, did not convene between 1614 and 1789, i.e. only when prompted by the financial crisis of the government, with the result we know: the French Revolution.

[27] In fact, the three estates that met in 1789 mirrored a feudal social structure divided between the *oratores*, the *bellatores* and the *laboratores*.

see that already in those times, the French structure of revenues crystallized around a specific shape that would emerge a few centuries later (figure 4.5 provides an overview from 1965 to 2013) and that would continue to hold in successive rounds of fiscal conflict: indeed, since the inception of these new taxes, the proportion of direct taxes decreased from 44% in 1726 to 35% in 1788 while the proportion of indirect taxes increased from 50 to 57% (Morineau 1980, p. 314). The distributional impact of these taxes was unequal, however: while it left most of the clergy untouched, it fell mainly on the nobility and thus created a "strange creature, the privileged taxpayer" (Kwass 1998, p. 324) which together with the commoners would resist direct taxation later on. Ironically then, even when commoners initiated the revolution to become rulers of taxation they repeated the patterns of royal taxation.

This double resistance to direct taxation of the privileged and the non-privileged explains why the French had little appetite for income taxation later on, and not necessarily due to late industrialization as claimed in the literature (Morgan and Prasad 2009).[28] This also explains why the income tax was introduced very late in France (in 1914) compared to the UK, and only under the financial challenge of war. Even then, the new income tax was not given the proper instruments to assess revenue and collect the tax. This weakness of the income tax would lead to the creation of a sales tax in the 1920s to repay war debt and sustain public finances which would later become the VAT (Piketty 2001).

Interestingly, in both the UK and France, tax linkages established in the end of the 19th and until the mid-1930s remained stable despite tremendous shocks as the Great Depression, the Second World War and the construction of the welfare state. Tax linkages were strongly path dependent: to be sure, taxes increased, but their structure kept the imprint of history. Even though both states were highly centralized, only the UK managed to construct tax linkages around a centralized income tax. Why is that so? This is especially puzzling because French voters have a preference for a strong state.

In the 19th and 20th century, tax resistance continued unabated (Spire 2013), but the construction of fiscal linkages were subsumed under greater tasks that created a very specific context. One the one hand, the creation of a Nation-State sought to homogenize the whole territory, to create a strong national identity and to soothe the scars of fallen imperial projects (both Napoleon and Napoleon III). As such, taxation was used for political modernization. On the other hand, taxation was underpinning the elaboration of a welfare state that would seek to solve the social problems that proved intractable in the inter-war period and led to the demise of the Third Republic (Delalande and Spire 2010). These two fundamental political projects led to a movement of fiscal appeasement whereby taxes would become less coercive and more redistributive. Persistent fiscal resistance led politicians to seek alternatives to income taxation - especially in the wake of the tax upheavals of small businesses in the 1950s.

The first alternative was the use of indirect taxation, the VAT (Kato 2003; Lynch 1998). While France made no serious effort to rework the income tax linkage between 1950 and 1990 (or even since Joseph Caillaux introduced the tax in 1914), it was much more innovative in other forms of

[28] The authors explain that, compared to the US, France did not introduce income taxation until 1914 because of a fear of the centralized French state (which they strangely voted for during the whole Third Republic) and due to late industrialization (which generated high inequality.

taxations. In 1954, the French government, building up on a sales tax introduced during World War I in Germany[29] and on a 1920 turnover tax in France, pioneered the VAT and put it on the legislative agenda. The main aim of the VAT was to correct the principal flaws of the turnover tax: it increased prices, depressed exports and was mainly a tax on production, not on consumption. Consequently, investments were depressed and so introducing the VAT was meant to simultaneously stimulate the economy and private investment, reduce investment expenditures of the state and stifle fraud. First applied to the production sector due to socialist opposition, it was then extended to wholesale trade in 1955 and in 1968 to the retail sector (where there was actually most fraud).

As a result, and as suggested by figure 4.5, the VAT and other indirect taxes on goods and services occupy a prominent place in the French tax mix. This place is diminishing nonetheless since the late 1970s in proportion of revenues (it peaked at 9.2% of GDP in 1969 and decreased to 6.8% in 2013). Figure 4.5 also suggests that the most prominent tax linkages are the social security contributions. The important point from the perspective of linkages is that both taxes on goods and social contributions are hypothecated - although to different degrees.

The origins of hypothecation stem from the construction of the French welfare state after WWII (Konishi and Tristram 2015; Palier 2002) known as the "Sécurité Sociale" or simply "Sécu". Created under the leadership of Pierre Laroque and Ambroise Croizat in 1945, the Sécu' was masterminded by the Resistance Council to create a unified social security system that would reconcile a very divided country. Unfortunately, the numerous corporatisms precluded this and therefore there is a myriad of regimes (general, firm and self-employed, plus around 100 specific regimes) to which one or more insurance funds are affiliated across four insurance branches associated to different risks (old-age, sickness, family and occupational risks). The paradox is that the consensus behind this system spans the whole political spectrum and is well-grounded. The implications of both hypothecation and fragmentation are that the politics of austerity is made significantly more prone to tax increases than spending cuts.

To see this, one has to have a closer look at the mechanics of hypothecation. The whole point of the latter was to wrestle budgetary power over social policy from the state so that the Sécurité Sociale, in the words of its creators, would never be financially constrained. The aim was to satisfy social demands, not to balance books. But it also entailed that the Sécurité Sociale would guarantee its political independence only if it stayed financially sound. Therefore, if expenditures increased, so did the contributions. This is the opposite of British tax linkages where taxes come first and expenditures are then adjusted to the volume of receipts.

The underlying philosophy of this fragmented hypothecation was that of "démocratie sociale" or social democracy, but in the sense that social groups formulate their own social policy to avoid any state paternalism. And indeed, this principle is so strongly ingrained in this tax linkage that the government of Pinay fell in 1952 when it tried to question it and so did the government of Juppé in 1995 when it tried to impose governmental preferences on social policy.

This fragmented hypothecation also entails conflicts between the administration of Sécurité Sociale and various ministries. Finally it should be noted that this fragmented hypothecation underwrites a very specific welfare state that redistributes within social groups and not between them. Therefore, this tax linkage can have an indirect effect on attrition: even though inequality

[29] Called the *Umsatzsteuer*.

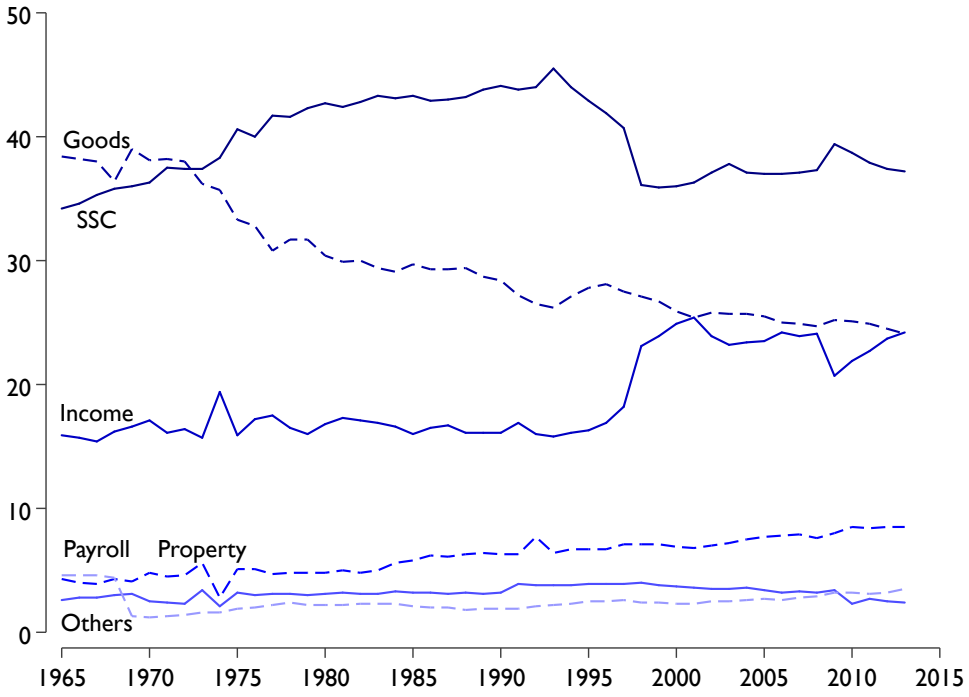

Figure 4.5: French tax linkages, 1965-2013

NB: The lines show the evolution of the share of tax revenues of different forms of taxes in France.
Source: own elaboration based on OECD tax database.

decreased tremendously between 1970 and 2005, this tax linkage does drive a wedge between social groups (insiders and outsiders) and spill-overs onto other policy domains (like labor markets, especially with high unemployment). As a result, attrition has started to rise again in 2005, getting closer to British levels in 2014.

Summarizing the French web of tax linkages, several points should be underlined: first, compared to the UK, the income tax appears to be a very weak tax linkage (its base is narrow, its yield low and it is very much opposed). Second, indirect and social taxes form the strongest tax linkages in terms of budget structure and total revenues, and their underlying principle has important political implications. Hypothecation provides a strong link between revenues and expenditures while fragmentation makes collective action and interaction with the state difficult in hard times. As a consequence, austerity is not conducted top down as in the UK. Rather, each fiscal consolidation puts the state-society relationship to the test.

Tax linkages as source of austerity in France

How did these tax linkages influence the politics of austerity from 1978 to 2015? The paradox is that while most of the OECD countries sought to reduce their tax burdens during the age of austerity, especially in the 1990s, France increased hers. Why? To understand this, let us start with the weakest link, the income tax. From a general point of view, the French income tax has gone

through some both marginal and important changes depending on how one defines the income tax. If seen traditionally through the lens of taxation on income as established by Caillaux in 1914, then the tax remained a weak linkage during the age of austerity, used by government to let off steam out of an overtaxed electorate or to plug the fiscal hole when the going gets tough. Thus this linkage was mainly characterized by tax cuts or marginal increases during hard times: as a result, the narrow base and progressivity of the income tax *stricto sensu* have remained.

A quick overview of this tax linkage will help us understand its evolution, but not using OECD data which shows little sensitivity to the peculiarities of French linkages. First, according to the data from INSEE (the French statistical office) the proportion of income tax in total taxation was divided by two between 1981 and 2014, from 12 to 6%. This reduction is mainly due to the scaling down of tax brackets, the lowering of marginal and average tax rates and the increase in the number of tax loopholes. The difference ones sees with figure 4.5 is quite significant and suggests that one of the main flaws of the OECD tax database is that it includes in its income tax statistics the CSG and the CRDS. As will be explained later, those taxes are earmarked for social security.

Second, the share of households paying the income tax peaked in 1985 (65%). It was 2% in 1916 and 20% in 1955. In the last thirty years, this share has decreased to less than 50%, fueling tensions among the French electorate: it appears that in lean years, not all contribute to the effort of austerity while at the same time the level of the tax burden is extremely high and thus provokes a feeling of injustice. This is somewhat justified given that while the income tax burden on the 90% has increased, it has fallen for the top 1% (André and Guillot 2014).

While from 1945 to 1973 the number of brackets, the average and top tax rates were stable (respectively hovering around 8, 28.% and 60%), things were upset by the first oil shock (brackets increased to 13 and the average tax rate to 30%) and were further changed by the incoming socialist government in 1981: the number of tax brackets increased to 14, the average tax rate to 32.5% and the top tax rate to 65%. Thus, in the first stage of the age of austerity (1980s), the income tax was used to bring more fairness in the tax system and to increase revenue for a constrained budget, going against the neo-liberal grain of its North-Atlantic peers (see figure 4.6). However, soon after, the first "neo-liberal" government of Jacques Chirac started a downward trend uninterrupted even by Socialist governments that brought down the number of brackets back to 5, the average tax rate decreased to 17.9% and the top tax rate to 40% in 2006. Thus in the second stage of austerity, the income tax was not very helpful to consolidate the budget.[30]

In the third age of austerity (2010-2015) marginal changes to income taxation were made and they still encountered strong social resistance. It took some time before the right wing government of Sarkozy backed away from its "bouclier fiscal", thanks to which it limited taxes on the richest constituencies of society. Only the Great Recession, the sovereign debt crisis and the election of a Socialist government in 2012 changed the stability known since then, when brackets increased to 6 with a new bracket of 45% for revenues above €150 000, the average tax rate to 26% and the top tax rate to 45% (Bozio et al. 2012b, 2013). While the 2013 and 2014 budgets sought to realign labor and capital taxes in order to bring more social justice to the budget, it mainly elicited wide social unrest that glued together a heterogeneous social coalition - from the Red Caps of Brittany opposing the environmental tax on trucks, to the Pigeons representing high-tech start ups contesting the

[30] Source: own calculations based on André et al. (2015).

capital gains tax, to renowned actors emigrating as far as the Republic of Mordovia to avoid paying a higher income tax. All of this to oppose a tax increase of €7bn to plug a deficit of €100.4bn in 2012. Given this opposition, the socialist government changed tack and announced income tax cuts for 2016 and 2017.

Thus, in the first two periods of the age of austerity, an already fragile tax linkage was weakened further, and in the third period attempts were made to reverse this trend with limited success. This somehow repeats history: as in the Ancien Ré, the income tax linkage is not only weak, it also generates strong resentment. As a result, since the beginning of the age of austerity in 1978, the burden of the income tax decreased, but the total tax burden increased from 33.6% of GDP in 1965 to 45% of GDP in 2013. Therefore, reforms of the income tax during the age of austerity have set France further apart from its OECD peers.

This shows up in the OECD statistics on the income tax, as mentioned previously. The diverging picture one gets from the OECD and the INSEE is due to the introduction of the CSG[31] and the CRDS[32] which amounts to a fiscalization of social security (i.e. involving general taxes like the income tax to finance social security). This enables us to make the connection between the many tweaks made on the income tax and the social security contributions, which are at the heart of French taxation and influence heavily the politics of austerity. The CSG was introduced in 1991 and the CRDS in 1996. Both are the result of the entrenchment of the deficit of the social security system in the political landscape which became a political hot potato since the early 1980s. The roots of this deficit are both structural and conjunctural: the system was designed to support full employment, not high and semi-permanent high unemployment (since 1978, according to the World Economic Outlook fo the IMF, French unemployment was never beneath 8%), and is therefore very sensitive to the economic cycle and structural transformations (Shaughnessy 1994).

The political implication of introducing the CSG and the CRDS was to make larger swathes of the electorate responsible for the financing of the welfare state (and hopefully opposing its further expansion)[33] and to give more power to the central government (parliamentary control over social budgets was also introduced because of fiscalization) over something that should be governed by social democracy. From this point of view, the failed consolidation of Juppé in 1995-97 can be seen as a struggle between the government and social actors over who has the last say over the social budget. This interpretation, however, can be challenged: on the one hand, the introduction of the CSG and CRDS may sever the link between taxes and expenditures that underpins social contributions because not all those who pay the CSG have rights to social security. Together with the social VAT, such a reform can reduce the power of trade unions in the future and increase the power of the state and government to impose their preferred type of austerity. On the other hand, such tax reforms as the fiscalization of social contribution confirm the legitimacy of social

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[31] CSG stands for a "generalised social contribution", a flat tax paid on all revenues and dedicate the financing of the welfare state

[32] Contribution for repaying the social debt.

[33] The scope of the initially marginal CSG widened greatly over time: both its base and its rate increased tremendously under both left and right wing governments. The rate of the CSG increased from 1.1% in 1991. to 2.4% in 1993, to 7.5% in 1997. Its rate is 8.2% on revenue from wealth and capital since 2005. In 2013, the revenue from the CSG was larger than the revenue of the personal income tax: €90bn vs. €60bn.

expenditures and broaden the pool of voters who have "skin in the game". As a result, opposition to expenditure cuts especially in the realm of the welfare state may increase.

It seems that the difficulty of Sarkozy and Hollande to speak about austerity while in office and their incremental approach to social spending cuts point to a strong opposition towards spending cuts. Thus the introduction of the CSG and the CRDS may not have weakened tax linkages in France. On the contrary: it is widely acknowledged that the CSG finances the welfare[34] state and therefore it increases the certainty over the expected benefits. In fact, in 2014 the CSG funded almost 20% of Social Security for the private sector. Therefore, social actors in both the public and the private sector of the economy have strengthened their linkages to expected benefits in France.

In terms of political economy, it is interesting to have a closer look at the distributive impact of the CSG: in the end it benefited much more employees much more than employers, which may have hardened the stance of the latter towards tax increases, as seen during the tax upheavals of 2013. Indeed, while social contributions for both employers and employees have increased since 1965, they are since 1980 hovering at around 11% of GDP for employers, and increased from 2 to 6% of GDP between 1965 and 1996 for employees. But after the reforms of the CSG and the CRDS, employees are only taxed at around 4% of GDP (6.8% of total taxation in 2013), while the burden remains the same for employers: employers' social contributions represent 25.4% of total taxation in 2014, down from 29.4% in 1977. In the end, these numbers show that both employees and employers have a strong stake in taxation and its expected benefits.

Finally, concerning the VAT, it has played an ambiguous role during the age of austerity. Introduced with the aim to steer up private investment, it ended up yielding important revenues that the budget could not do without. Until 1983, VAT was producing one fifth of French revenues, with spikes at one fourth. Since then the contribution has stayed around 17-15%. VAT was many times considered to plug fiscal holes, as a substitute for increased social contributions that were putting a lot of pressure on labor costs. After the Balladur government refused to increase it in 1993-1995, the Juppé government extended it from 18.6 to 20.6% in 1995 in order to accelerate fiscal consolidation to qualify for the Euro. But in general, governments were reluctant to do so, not least because of the need for European tax coordination. After all, tax coordination has long been a central policy plank of French decision makers on the European forum to preclude any tax competition. As a result, the average VAT tax rate has been declining since its 1970 peak (20%), ending up at 8.6% in 2006 but still yielding an impressive amount (€142.2bn).[35]

This political marginalisation - or its depoliticisation - of the VAT is cyclically challenged by revenue-seeking policy-makers, most recently by Sarkozy on the eve of the 2012 presidential elections. Sarkozy brought the social VAT back to the table of national debates: the idea is to increase the VAT partially, earmark the revenues for social protection and decrease social contributions, thus contributing to regained competitiveness (De Mooij and Keen 2012; Farhi et al. 2014). Given that France has a twin deficit (fiscal and trade) and is rapidly losing export markets shares, the debate grew quite serious. The measure drew heavy flak (Landais et al. 2011), but was finally introduced

[34] It is used to fund healthcare, family benefits, the old-age solidarity fund and to repay social debt.

[35] VAT rates were simplified a great deal in the meantime. The higher rate reached a plateau of 33.3% between 1970 and 1982 and then gradually decreased to 18.6% in 1992 before it disappeared. The intermediary rate was reintroduced only in 2012 after an absence of 40 years.

months before the presidential election of 2012. It was scrapped by the socialist government after it took office. Instead, the socialists proposed a tax credit "for the competitiveness of firms", which also ended up being heavily criticized for its complexity. In the end, Hollande regretted rejecting the social VAT, and therefore the issue is likely to come back to the foreground. France may be tempted to follow in the footsteps of Angela Merkel who has operated such a VAT rise in 2007. From the point of view of linkages, such a measure may have important political implications, not unlike the introduction of the CSG and the CRDS: spreading the financing of the welfare state may increase the linkage between revenues and expenditures, and thus strengthen the logic of hypothecation on which French public finances are based. Ironically, it is the socialist party that refuses to do so, despite its attachment to the welfare state.

To conclude, French tax linkages are characterized by a strong hypothecation and gradual fiscalization. The paradox is that while the French are very much opposed to income taxation, they have also a strong preference for the welfare state. All in all, austerity politics in the 1980s and the 1990s did not alter significantly French tax linkages, but made incremental changes that have fundamental consequences for state-society relationships. Tax linkages have been strengthened, which implies that spending cuts are more difficult to undertake. But this strategy of increasing labor taxation has clearly showed its limits as shown by the need to find new sources of revenues (CSG, CRDS, VAT) and the renaissance of tax contestation. One may well conclude that the French politics of austerity is in a tight spot, especially given that attrition has increased in the last decade. As chapter 6 on coalitions and austerity will show, it does not bode well for the politics of austerity in France because together, these forces are a harbinger of increased fiscal conflicts.

4.3 Conclusion

This chapter sought to dig deeper into the politics of austerity by exploring tax linkages in the UK and France. Tax linkages reflect the distribution of power within a polity, they suggest how interest groups may influence fiscal-policy making in hard times, and how the very organization of tax linkages influences the interests of social actors.

The main findings of the chapter are the following. First, in broader comparative perspective, there is some evidence that tax linkages influence both attrition and the shape of austerity. Weak tax linkages based on the income tax increase attrition and in general lead to smaller tax hikes. Strong tax linkages based on social contributions mitigate inequality, increase tax hikes and lower spending cuts, especially in the realm of social expenditures. Second, in a narrow comparative perspective of the UK and France, tax linkages weak and strong played out differently during austerity. In the UK weak tax linkages based mostly on the income tax act as a powerful constraint on higher expenditure and taxes. The failure to create alternative sources of revenue has locked the UK into a fiscal pathway where austerity is biased towards spending cuts to match the heavily constrained revenue side of the budget. In France, this logic is turned upside down: strong opposition to the income tax has led French policy makers to innovate and expand other forms of taxation. In so doing, French politicians have created strong tax linkages which oblige revenues, old and new, to match increasing expenditures. As a result, the French fiscal pathway during the age of austerity has yielded increasing expenditures and increasing taxation.

The next chapter looks closer at the attrition mechanism and enables us to see what happens when attrition and linkages interact. As will be shown, attrition has a strong effect: it increases the probability of spending cuts and reduces the probability of tax hikes quite significantly. Chapter 6 will pick up the findings on linkages and attrition, and it will apply them to coalition dynamics over time. It will show that weak linkages and increasing attrition in the UK has strengthened the bias for spending cuts during the age of austerity. In France, on the contrary, the initial conditions (strong linkages and low attrition) led to tax increases. But this strategy has found its political limits with increasing attrition since the mid-2000s. French social coalitions after 2010 have started to oppose both tax hikes and spending cuts, which does not bode well for French fiscal politics.

Appendix to Chapter 4

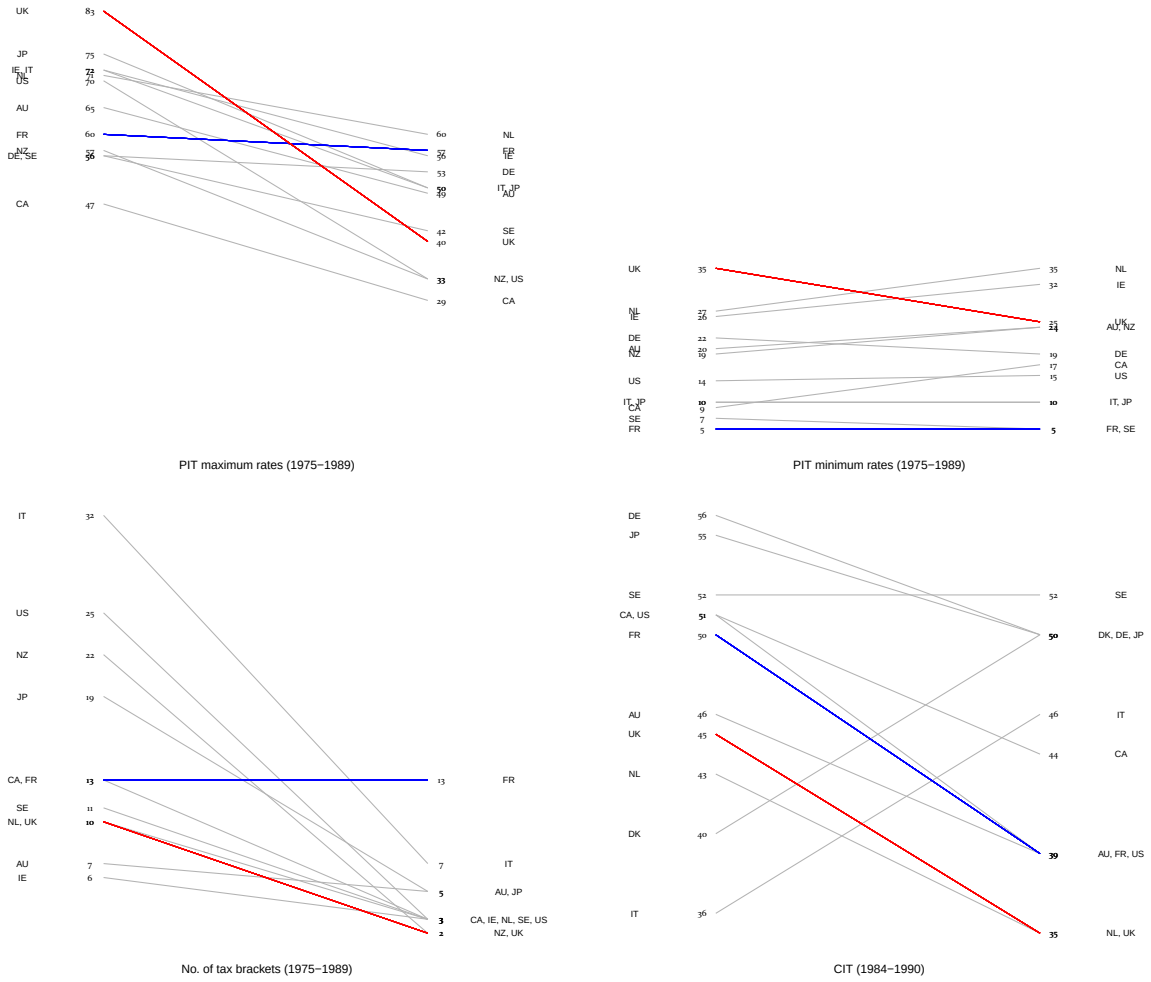


Figure 4.6: Tax reforms in the first decade of austerity

NB: Invented by Tufte (2001) in the early 1980s, table-graphics, aka slopegraphs, are useful to expose data patterns that a table would probably obscure, particularly the hierarchy among groups at different dates with its evolution, rate of change and outliers (both in levels and first difference), all this in a minimalist way.
Source: own elaboration based on Peters (1991).

5

Attrition and austerity: *Adjusting budgets in unequal times*

> "*An imbalance between rich and poor is the oldest and most fatal ailment of all republics.*"
>
> Plutarch

While many studies analyzed the distributional impact of fiscal consolidations on inequality, the opposite link has often been left out of the picture: does inequality influence the distribution of austerity? This chapter therefore looks at the connection between wars of attrition and austerity. In the following, I propose to measure wars of attrition with income inequality. Income inequality is a useful, if imperfect, proxy to estimate attrition, i.e. the distance between social groups. It is thus as way to evaluate the propensity of social groups to agree on types of austerity measures. If the incomes of two groups are equally distributed, the share of the new tax burden during austerity is likely to be equal. Therefore, these social groups will more easily agree on tax hikes. But if the income distribution is unequal, so will be the perceived distribution of the new tax burden. Therefore, social groups will oppose tax hikes and thus the adjustment will happen on the spending side.

In our perspective focused on austerity as repeated games, the implication of this argument is that if previous austerity is mainly spending-cuts based and if it increases attrition through higher levels of inequality, then in the next rounds of austerity, the social consensus for tax hikes will erode. Consequently, a spending-cuts bias will appear in the next rounds of austerity.

As noted in chapters 2 and 3, many studies have demonstrated empirically the impact of austerity on inequality. The academic debate on the economic effects of austerity has centered around the trade-off of growth vs. inequality (Mulas-Granados 2006), echoing other strands of research on partisan politics and the economy (Boix 1998). Pre-crisis evidence suggests that spending-based

fiscal consolidations are "expansionary", i.e. they spur economic growth (Alesina and Ardagna 2009), but at the same time they increase inequality substantially. Tax-based adjustments seem to have the opposite effect: while growth remains subdued, the impact on inequality seems to be mitigated. While the effects of austerity on inequality have been widely accepted and replicated, the effects of austerity on growth have been widely debated and seriously criticized on empirical and methodological grounds (Blanchard and Leigh 2013; Leigh et al. 2010; Perotti 2011, among others).

The poor economic results of the coordinated turn to austerity in 2010 triggered another round of heated debates and spurred empirical work on the effects of fiscal consolidations. Here, dynamic results are important to consider because the effects of austerity are felt long after consolidation packages are implemented. Therefore, instead of looking at static regression coefficients, one rather needs to consider the time dimension of the impact of austerity through dynamic panel estimation. From this point of view, fiscal austerity has a substantive and significant impact on inequality through different channels. First, wages decrease on average by 1.5% four years after austerity, as estimated by Ball et al. (2013), while the effect on profits and rents is not statistically and substantively significant. Another channel for increased attrition can be unemployment, which mechanically depresses the share of wages in an economy. As a result, spending cuts do seem to have a higher impact on inequality than tax hikes. Other studies have replicated the findings of Ball et al. (2013). They showed that the impact of spending cuts on inequality is statistically significant and substantive just after the implementation of cuts, while the effect for tax hikes is smaller and delayed by a few years (Woo et al. 2013).

Econometric evidence thus suggests that spending cuts greatly increase income inequality while tax-based consolidations help to mitigate the impact on the income gap (Agnello and Sousa 2012; Mulas-Granados 2003, 2006). This has important implications for $\zeta(p_2)$. If a country implements a fiscal adjustment that increases inequality significantly, then the next adjustment will be biased towards expenditures cuts. Conversely, if austerity at time t mitigates inequality, the tolerance for tax increases will remain intact at $t+1$ because, as the theory implies, "popular support for [...] redistributive policies decreases with inequality" (Bénabou 2000). Consequently, the higher inequality is, the less consent there is for redistribution and thus the tax level is lower. In his case, fiscal adjustment to a solvency shock is harder: low tax levels and higher debt mean that fiscal gap (difference between debt and taxes to repay it) can shrink dramatically in the case of a shock and since it is more difficult to raise taxes due to inequality, spending cuts bear the brunt of fiscal consolidation.

The remainder of this chapter proposes to investigate the link between attrition, as income inequality, and austerity. In a first step, the chapter tests empirically the external validity of the war of attrition argument on a cross section of fiscal consolidation episodes between 2010 and 2014. The results suggest that inequality increases the chances of spending cuts and decrease the probability of tax hikes. Second, the chapter changes the focus of the analysis to concentrate on our two case studies, the UK and France, in a longitudinal perspective. Time series analysis and process tracing suggest that fiscal consolidations did have a tremendous impact on inequality and that inequality has subsequently impacted austerity. In the UK, austerity has increased attrition mainly in the early 1980s. But support for higher tax and spending has decreased only in the late 1990s. In France, austerity decreased inequality mainly in the mid-1990s. Support for taxes and

spending remained high until unemployment and the Great Recession laid bare the shortcomings of a dual labor market. The latter increased inequality and thus undermined the consensus for tax hikes, which explains social contestation in 2012-2013. All in all, the bottom line of this chapter is that, if previous austerity episodes increase attrition, future tax hikes are more difficult. If they decrease it, tax hikes are more acceptable.

5.1 War of attrition and austerity

Given the likely redistributive effects of austerity at $\zeta(p_1)$ and their impact on austerity, how do these effects affect austerity in the second and third rounds of adjustments $\zeta(p_2)$ in 2010? As a first cut to this question, one can inspect visually bivariate plots of a cross section of countries during the coordinated turn to austerity after 2010.[36] My preferred measure for attrition is, as stated before, income inequality. It suggests how much tension there may be between social groups, and how those would relate to austerity given the expected unequal burden of taxation. Therefore, I use the Gini coefficient of the world income standardized database (Solt 2014) that is based on net inequality (after taxes).

For the sake of robustness, I also use other measures that can capture the degree of attrition in a society. Another way to measure attrition and inequality is to consider the share of market income of the richest 1% (International Monetary Fund 2013). This is an important measure because if the share of market income is high and tax linkages are mainly based on the income tax, then rich social groups have very strong theoretical reasons to oppose tax hikes.[37]

The third measure that I use as a robustness check is political polarization. It is another way to estimate the degree of attrition in a country, but this time on the level of political parties. Here, the difference between the left-right positions of the main party in government and the main party in opposition are used according to the RILE indicator of the MARPOR database (Volkens et al. 2014) in 2010 because this is when the coordinated turn to austerity started. To a certain degree, the position of political parties mirrors attrition in society. The literature has shown that inequality can be the source of political polarization (McCarty et al. 2006; Pontusson and Rueda 2008).[38] The main assumption behind this literature is that if the main political parties are at loggerheads with each other, it may be more difficult to pass tax hikes because those are more likely to be reversed in the next parliament due to weak consensus.

Concerning the dependent variable, the best practice would be to have plan-based measures of fiscal adjustments after 2010 because those reflect the political *intentions* of cabinets. The Devries

[36] The sample includes 41 countries: Australia, Austria, Belgium, Bulgaria, Canada, Chile, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Malta, Mexico, the Netherlands, Norway, New Zealand, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States when data is available.

[37] The following results are also robust to the share of market income of the top 10% but for lack of space, I do not display them.

[38] My own scatter plots from the database I built using classic measures of Gini (Solt 2014) and polarization (Volkens et al. 2014) suggest that this inequality-polarization link is very weak. The correlogram in figure 5.9 confirms this.

et al. (2011) dataset on austerity plans for 1978-2009 has been updated by Alesina et al. (2015), but it only added ten country observations for the period 2010-2013, which is not enough for a minimally robust cross sectional analysis. Therefore, we need to use another set of measures of fiscal consolidation and turn away from action-based data to output-based data for the dependent variable, looking at cyclically adjusted expenditures and revenues as well as social expenditures. Here the data come mainly from the World Economic Outlook of the International Monetary Fund in 2014 and the OECD for social expenditures. We should use these data with one caveat in mind though: they are likely to be revised due to the deep impact of the crisis on potential growth which makes the estimation of the cycle more difficult.[39]

Visual evidence from fiscal consolidations after 2010 suggests that the attrition mechanism may have some influence on budgetary adjustments (see figure 5.1). Panels (*a*), (*b*) and (*c*) seem to suggest that, visually, inequality is the most consistent and robust on all the three dependent variables (tax hikes, spending cuts and social spending cuts). As expected, the higher inequality, the lower tax hikes appear to be after 2010. Surprisingly, some countries with higher levels of inequality which have been hard hit by the financial crisis even reduced taxation during austerity. Those countries (the three Baltic States) seem to drive the correlation but the robust regression estimation (see below) will show that it is not the case. Concerning spending cuts, the effect of inequality seems to be even more consistent, whether it influences spending cuts or social spending only (third scatter plot in the first line of figure 5.1).

Looking at the share of market income of the top 1% seems to confirm the results of the Gini coefficient. This is not surprising given that the two measures may seem correlated.[40] Once again, where the share of market income of the top 1% is higher, tax hikes tend to be lower, expenditure cuts are higher and cuts in social spending are more pronounced. It should be noted that one can clearly see the effects of tax linkages here: countries with comparable Ginis and share of market income of the top 1% like the UK and Italy, or Portugal and Latvia, display radically different types of austerity: countries with weak tax linkages (as the UK and Latvia) cut social spending much more and as result total spending is affected as well. Countries with strong tax linkages (Italy or Portugal) are way off the regression line: they increase social and total spending instead of cutting them.

Polarization seems to have the same, albeit weaker effect, which is not surprising given than many other factors can be at play (e.g. the electoral system). As expected, the higher political polarization, the lower tax consolidation is. More polarized countries even decrease taxes, and here the most iconic cases are not only the Baltics (Lithuania and Estonia) but also, quite surprisingly, Norway and Sweden. While in the case of the former it maybe due to measurement error (the three Baltics countries registered staggering drops in GDP in 2008-09 but recovered quickly in the subsequent years), in the latter case this maybe due to a drop in oil prices for Norway and the presence of right-wing liberal government in Sweden. Concerning spending and social cuts, the effect is less pronounced but still the indicators point towards the theoretical direction of attrition.

Regression analysis can help refine these empirical findings, although some caveats should be kept in mind. The sample size is not large enough to provide an efficient estimation and provides

[39] See table 5.5 in the appendix for summary statistics.

[40] In the appendix, figure 5.9 suggests nonetheless that this correlation is weak.

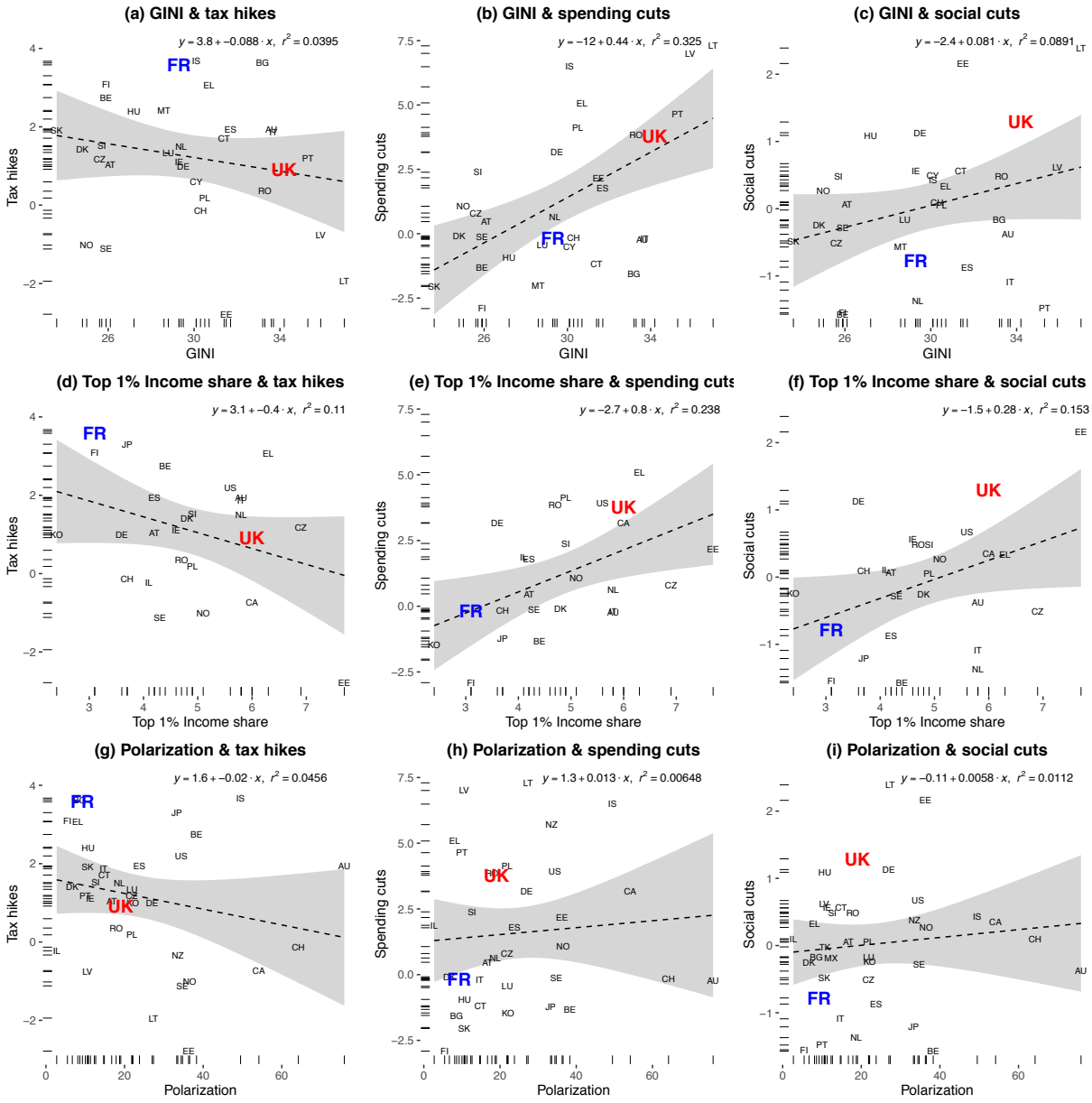


Figure 5.1: Inequality and austerity: Gini, Top 1% income share and polarization

NB: Sample of 41 fiscal consolidations in 2010-2014. Income inequality is measured as the Gini coefficient. Political polarization uses the "Rile" indicator of the Manifesto database for the last election before 2010. Source: own elaboration based on Solt (2014), Volkens et al. (2014), OECD, International Monetary Fund (2013) & IMF World Economic Outlook data.

little statistical power, especially given the fact that we need to control for a vector of economic variables influencing the politics of austerity (debt, deficits and growth). The estimation strategy is simple: I use normal OLS for the cross section regression analysis (table 5.3) as well as a robust M-estimator with robust standard errors to mitigate the presence of outliers like Greece and Ireland

(table 5.4). The results confirm to a certain extent the effect of attrition on austerity as suggested in the bivariate plots. In regression analysis on the determinants of fiscal consolidations, the deck of cards is stacked against any variable that is not economic and directly connected to austerity: as noted by Mulas-Granados (2006), debt, deficits and growth are the most powerful predictors of the timing, duration and composition of fiscal adjustments, to the extend that some authors wonder whether politics matter at all during austerity (Hübscher 2015). In my regressions, only debt is substantively and significantly important in a consistent manner, but only for tax hikes. The bottom line is that the higher debt is, the higher tax hikes. GDP growth is consistently negatively correlated with tax hikes, spending cuts and social cuts, but the results are not significant. Given the small sample size and the presence of outliers like Greece, I also run robust regressions. The main result is that Gini stands up as a robust result for the tax side of austerity while the statistical significance of other proxies for austerity fades away. Finally, I run an OVTEST for omitted variables which does not signal any issues.

The question is how to interpret these results. Here, I will mainly focus on displaying visually the results based on the regression results (see table 5.4). I run simulations in order to get expected values and first differences from expected values as recommended by the standard practice (King et al. 2000).[41] In order to get the expected values, I first create a continuous object of hypothetical x's with a number of scenarios. I choose mean values for all covariates. Then I increase the variable of interest by half a standard deviation in each scenario and I simulate the values of y. I then plot the results (King et al. 2000). I do this for both the normal OLS estimation and the robust M-estimator. This approach is useful because it helps to delineate the uncertainty around the regression results.

Table 5.1 summarizes numerically the simulations that yield expected values of attrition and their influence on austerity, together with confidence intervals (in brackets). The table suggests that with average attrition (inequality at 29.67), one can expect a balanced austerity with tax hikes at 1.2% of GDP and spending cuts amounting to 1.37% of GDP. If, in our hypothetical scenario, we decrease attrition by one standard deviation, then tax hikes increase to 2.13% of GDP and spending cuts drop to almost nothing.

For our case studies, simulations give different expected values. For the UK, with income inequality being at 34.2, tax hikes should be almost non-existent while spending cuts should amount to 2.98%. In my sample I observed that the UK had almost no tax hikes but 3.78% of spending cuts. In France, given the attrition level, the simulations yield an expected tax hike of 1.30% of GDP and spending cuts of 1.25%. In fact, I observe 3.3% of tax hikes and an increase in spending. Clearly, the UK has a bias towards spending cuts, and France a bias for tax hikes. Panels (*c*) and (*d*) show the whole range of values: it seems clear that as inequality increases, expected tax hikes decrease and spending cuts increase.

While we were previously interested in expected values, figure 5.2 helps us visualize the simulation for counterfactual scenarios for first differences (i.e. the difference between two expected values), this time keeping all other covariates at their means and increasing the variable of interest by half a standard deviation in panels (*a*) and (*b*). This visualization is the most efficient as it enables us to compare these simulations from two different types of estimations (OLS and robust-M

[41] King et al. (2000) recommend to use *Zelig* (Imai et al. 2007) an R statistical software but to better visualize those simulations I will use *Simcf* (Adolph 2013b).

Table 5.1: Counterfactual simulations of attrition and austerity

	$\tilde{X}_{-1sd}$	$\tilde{X}_{\bar{y}}$	$\tilde{X}_{+1sd}$	UK	FR
Attrition	26.06	29.67	33.28	34.2	29.3
Tax hikes	2.13 [±0.36]	1.20 [±0.23]	0.27 [±0.35]	0.03 [±0.42]	1.30 [±0.24]
Spending cuts	0.12 [±0.65]	1.37 [±0.42]	2.64 [±0.66]	2.98 [±0.70]	1.25 [±0.40]

NB: Made thanks to Zelig (Imai et al. 2007, 2008). 95% confidence intervals are in brackets.
Source: based on table 5.4.

estimation) and gauge their robustness at the same time. It is very simple to read: compared to the baseline scenario, if we increase one of the covariates by half a standard deviation and keep the others at their means, what happens to tax hikes and spending cuts?

In terms of first differences, increasing inequality by half a standard deviation implies that the expected tax hikes will drop by 0.5% of GDP compared to the baseline, average scenario. Conversely, if we increase attrition by half a standard deviation, expected spending cuts will increase by almost 0.7% of GDP compared to the baseline scenario. This effect is robust for the robust M-estimator, as the tightness of the dot points suggests. If the linear and robust estimation would differ (i.e. the gray zone would be large) we would have evidence for a lack of robustness. Panels (*c*) and (*d*) show the whole range of values for the impact of inequality on austerity.

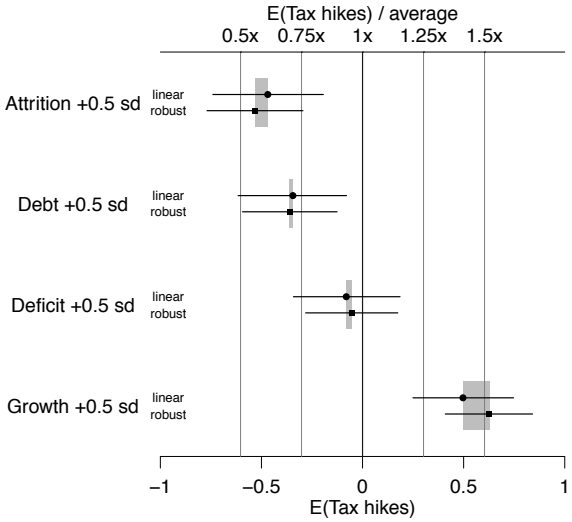
It is possible to see how the marginal predicted probability of tax hikes and spending cuts varies with particular covariates while holding the others at their means, using the logit model of chapter 3 (see figure 3.3). Figure 5.3 does this in a simple way: the left column looks at predicted probabilities for tax hikes and the left column looks at the predicted probability of spending cuts. The rows are for the economic covariates.

Concerning public debt, attrition has the highest impact (i.e. low probability of tax hikes and high probability of spending cuts) at low levels of public debt. For instance, when attrition is around 31, the probability of increasing taxes is less than 20% but it increases to between 40 and 60% when debt increases to 120% of GDP. Likewise, the probability of spending cuts diminishes as debt increases. The result is that increasing levels of debt somehow mitigates the results of the war of attrition, which is pronounced spending cuts and less tax hikes. Higher deficits have the same effects. Concerning economic growth however, the effect of attrition on the marginal probability of tax hikes and spending cuts seems pretty stable.

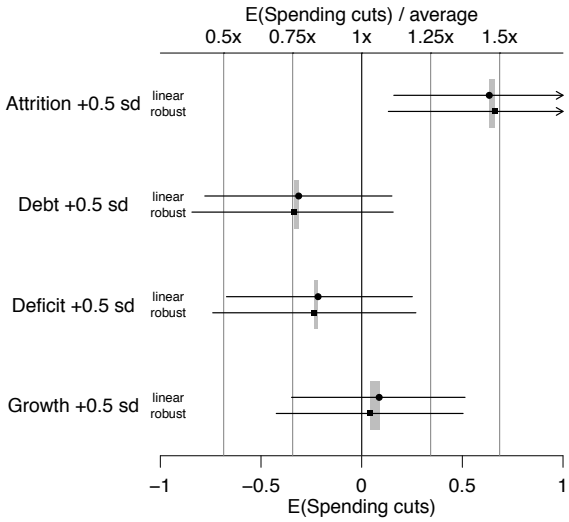
Taken together, these visual inspections of the regression analysis suggest that attrition does influence austerity differently, depending on the level of debt, deficits and growth. We now turn to our case studies to see how attrition was influenced by austerity and how it influenced austerity in the next rounds of fiscal adjustments.

5.2 Attrition in the United Kingdom and France

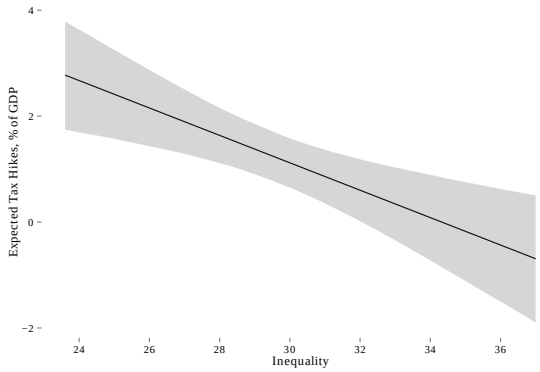
The main aim of this section is to see whether previous austerity episodes exacerbated or not the war of attrition in the UK and France in $\zeta(1)$ in a longitudinal perspective, and how this played



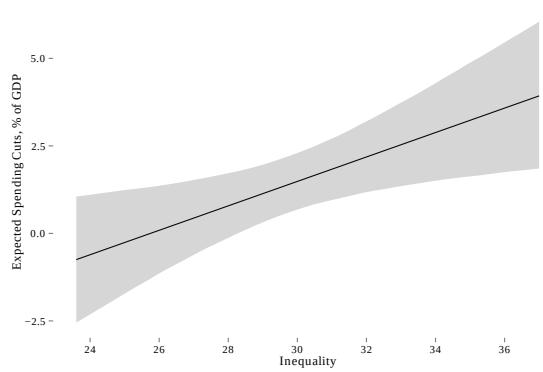
(a) Simulation of tax hikes (FD)



(b) Simulation of spending cuts (FD)



(c) Attrition and tax hikes (PV)



(d) Attrition and spending cuts (PV)

Figure 5.2: Counterfactual simulations, austerity 2010-2014

NB: simulations based on R software (Adolph 2013b; Imai et al. 2007, 2008). PV stands for predicted values and FD stands for first differences (change in predicted values when counter-factual scenario is implemented).
Source: own elaboration based on table 5.3 and with more details in table 5.1.

out in the post-2010 fiscal consolidations, i.e. $\zeta(2)$. To answer these questions, this section uses time-series analysis in our two case studies, the UK and France, to process trace the level and determinants of attrition.[42]

Given that we focus on attrition, I will mainly use income inequality again as a measure of attrition, which fortunately exist for the UK and France over a long time span (Solt 2014). If inequality rose or decreased in either countries, then one may also expect preferences for taxation

[42] For more details on the methodology used in this section, see the section Structural Breaks Methodology in the appendix to this chapter.

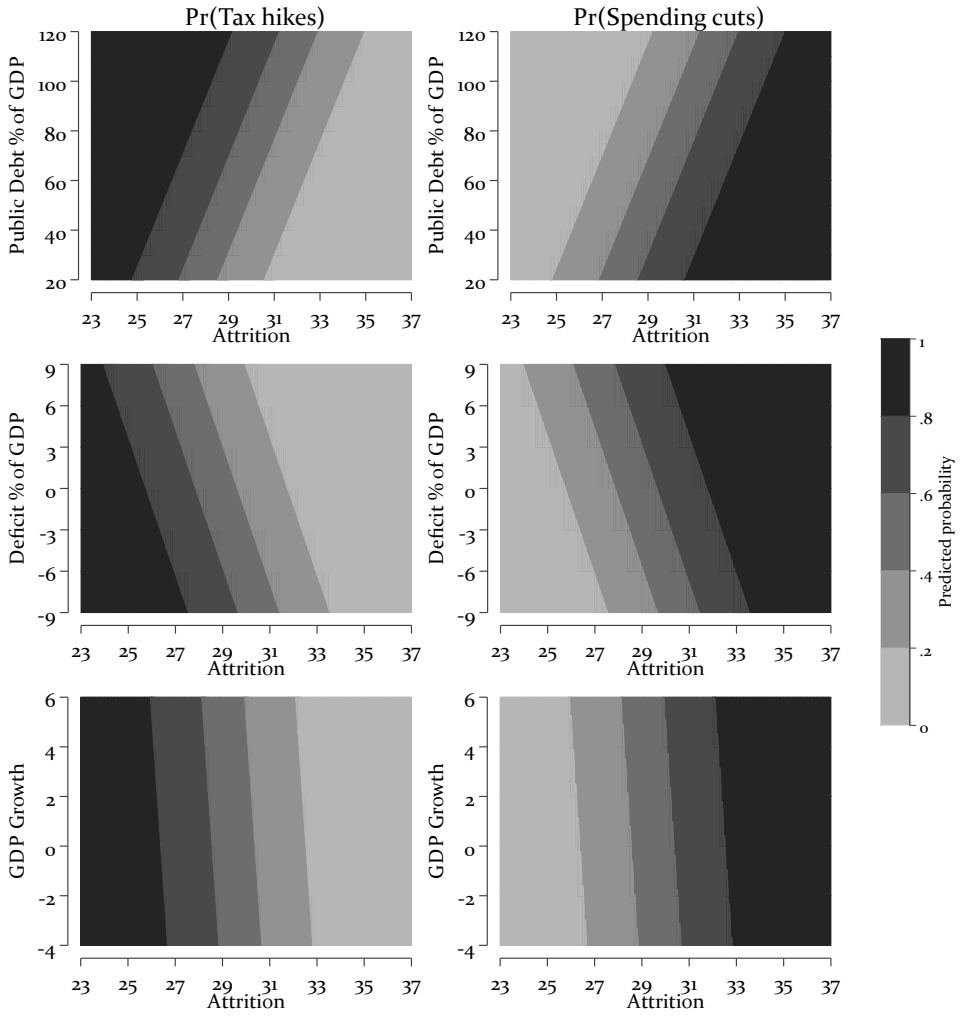


Figure 5.3: Contour plots, austerity 2010-2014

NB: The contour plots display the predictive margins of tax hikes and spending cuts given the interaction of two continuous variables, while the others are kept at their means.
Source: own elaboration.

and redistribution to change between the beginning of the age of austerity and its current iteration. In each case study, after estimating the change in inequality and whether it is statistically significant, we will ask whether preferences for redistribution changed.

Again, for the sake of robustness, I use a second measure of attrition to see how episodes of austerity affect inequality. Here, I choose the relative measure of redistribution (Solt 2014)[43] as a proxy to see whether austerity decreases or increases redistribution and thus inequality (lower redistribution means higher inequality). In the following, austerity is measured as yearly action-

[43] Defined as the difference between market and net income Gini indices, divided by the market income and multiplied by one hundred: $\frac{Gini_{mkt}-Gini_{net}}{Gini_{mkt}} \times 100$.

based episodes from the aforementioned Devries dataset. Austerity episodes are plotted as shaded areas of different colors: red for spending-based episodes and blue for tax based ones.

5.2.1 Wars of attrition in the UK

The UK has long had a reputation for being an unequal country where top incomes dominate a class-based political economy. While there is a grain of truth in this representation, the situation evolved dramatically in the last century, and very much so since the early fiscal consolidations of PM Margaret Thatcher. One way of looking at how attrition is present in the UK and how it makes social groups distant from each other is to look at the share of top incomes (Atkinson et al. 2011). Following the war of attrition model, the more top incomes increase as a share of total income, the more taxable they are, especially if, like in the UK, the structure of taxation rests on the income tax (see chapter 4). Thus, the more likely the social groups behind the top incomes are to resist during austerity periods. From this point of view, fiscal consolidations increasing the share of top incomes in a political economy should hypothetically make tax backlash more likely in the future.

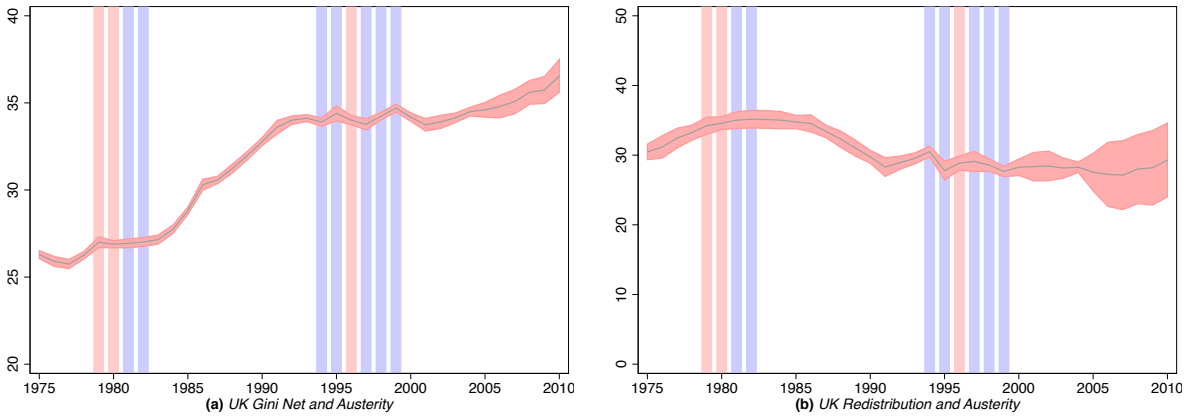
Compared to Sweden and the United States (two polar opposites of inequality), the UK seems to be in the middle.[44] While before World War I, the income share of the top 10% hovered around 45%, it decreased to around 35% in both Sweden and the UK until the Second World War and then below 30% until the second half of the 1970s. Then Sweden's top income shares plunged to a bottom of 22% in 1990 and climbed back to 28% in 2011. In Britain, top income shares bifurcated towards higher altitudes in the meantime, peaking an upward trend at 42% in 2007. In the US, by contrast, top income shares floated between 40 and 45% in the interwar period and then stayed above 30%, before skyrocketing to over 47% in 2011. All in all, for a long period of time the "class-based" UK was much closer to social-democratic Sweden than the economically liberal United States, but then converged on the US with the inception of the Tories in government.

Not surprisingly, inequality figures tell the same story, but with a certain time lag. Graph 5.4a paints an interesting picture using the Gini measures from the SWIID database (Solt 2014). According to panels (*a*) and (*b*) the UK was less unequal than France until the mid-1980s. Since then, the UK and France swapped their positions. A quick look at the SWIID Database shows that between the 1960s and the mid-1970s, the UK had an income distribution which was on a par with egalitarian Sweden. Then the story continues to confirm the top incomes database: Sweden moved to a more equally distributed income distribution while the UK forked towards a more unequal one.

What happened? While inequality may have many sources, figure 5.4a suggests that austerity, as measured using the action-based method of Devries et al. (2011), increased inequality significantly in the UK but only around 1980. Does the redistributive measure confirm this change (figure 5.4b)? Yes, but only with a time lag of a few years. The reduction in inequality (between the market and the net income) amounted to around 35% at the turn of the 1970s and the 1980s and then was reduced to below 30% towards the end of the 1980s. It should be noted that, comparatively, until the second half of the 1980s, the UK was redistributing more than either France or the United States.

All of this suggests that before Thatcher's austerity episodes between 1978 and 1983, one would

[44] In addition to the data of Atkinson et al. (2011), I use the World Top Incomes Database [last accessed 25 June 2015].



(a) Inequality and Austerity **(b)** Redistribution and Austerity

Figure 5.4: Inequality, redistribution and austerity in the UK

NB: The measures of the net Gini show the post-tax, post-transfer inequality (as opposed to market Gini) with the mean as the gray line and the 95% confidence intervals in light red for the UK and light blue for France. The Gini is an estimate with lower and upper bounds calculated with standard errors and comes from the SWIID database. This database uses an index of inequality in equivalized (square root scale) household disposable income, based on the Luxembourg Income Study data as the standard. Likewise, the estimated redistribution captures the percentage reduction in gross income inequality between market and net inequality. Finally, the colored bars represent austerity packages as defined by the action-based dataset: red shows planned expenditure cuts, blue tax increases, and green shows fiscal stimulus.
Source: own elaboration based on Devries et al. (2011) & Solt (2014).

expect attrition levels to be pretty low - comparatively - in the UK. But was this change structural and statistically significant? To answer this question one may need to use basic tools from time series econometrics to check for structural breaks. Figure 5.5 presents CUSUM and CUSUMSQ tests to investigate whether this is the case. If so, then a shock should first leave the horizontal line and then inch out of the shaded 95% confidence interval. The moment the line starts to leave the horizontal (or the oblique line for the CUSUMSQ test) indicate the outset of a shock, while breaching the 95% confidence interval means that the shock is substantively and statistically significant. The difference between the two tests is that the CUSUMSQ graph is more sensitive to point out the start of a break but less useful for identifying the precise date.

In panel (*a*) of figure 5.5 we see that the cumulative impact of austerity on inequality increased significantly after Thatcher's policies but also that it is on the border of statistical significance, as confirmed by panel (*b*). The CUSUM test shows a modest start of the impact after 1980 and then a significant start around 1985. It should be noted that, for robustness checks, if the time frame of the times series is changed (starting not in 1975 but in 1962, as allowed by the data availability of Solt (2014)'s database), the CUSUM test reveals that the change in 1980 becomes significant. The CUSUMSQ test in panel (*b*) confirms that the outset of the shock happened right after the arrival of Thatcher in office and the policies of Thatcher have an almost statistically significant impact on inequality around 1985 and were statistically significant in 1995. Therefore, if we also take into account the fiscal consolidation implemented under John Major (Ahnert et al. 2011), one can see

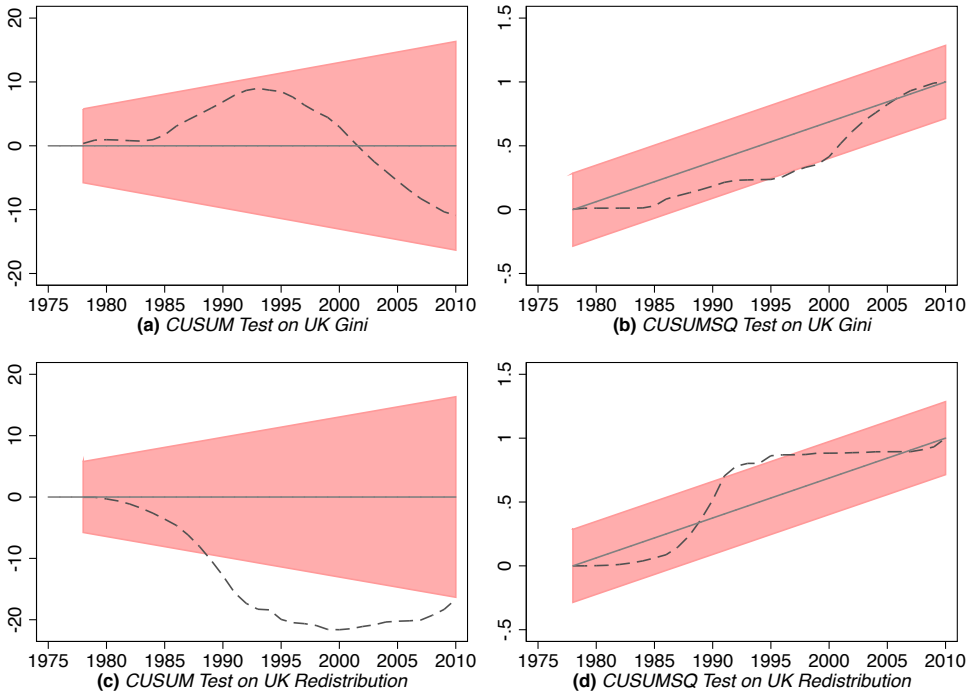


Figure 5.5: UK structural break tests

NB: The CUSUM test graphs are useful to identify when a structural break may have started, which is often where the CUSUM series starts to move away from the horizontal axis. The CUSUMSQ test is more sensitive to whether structural breaks may have occured and is thus more robust, but it is also less useful in identifying the date of the break.
Source: own elaboration based on data from Solt (2014).

that Tory policies in $\zeta(1)$ [1979-1983] and $\zeta(2)$ [1993 onwards] have indeed increased inequality and attrition levels in the British society. Again, as a parenthesis, if we change the time frame for the sake of robustness and start in 1962, the CUSUMSQ test becomes significant after 1980, suggesting that indeed it was Thatcher's austerity that changed the trend in inequality.

For the sake of robustness, as explained in the appendix (see section Structural Breaks Methodology), one can look at recursive parameters estimates. Figure 5.8 gives us a visual estimate that seems to confirm the results of the CUSUM and CUSUMSQ tests: in panel (*a*), it is clear that inequality increased significantly just after 1979 and became stable on a new level after 1985. From this point of view, Thatcher's austerity policy looks to have had a bigger impact on inequality and attrition than John Major's adjustment in the beginning of the 1990s.

The results are more robust and more significant if we have a closer look at the second measure of attrition, redistribution. Panels (c) and (d) of figure 5.5 suggest that the impact of these austerity episodes on redistribution was significant, and that therefore Thatcher's austerity did affect the distribution of income. Because the time series of redistribution start in 1975, it is difficult to change the time frame and see whether those results hold with an earlier start date. But for the sake of robustness, one can look at the results of recursive parameter estimates on redistribution. Panel

(b) of 5.8 evinces the evidence that conservative policies had a significant impact on redistribution but with an important time lag: indeed, it appears that the structural shock of conservative policies dented redistribution mainly after 1985, with a sharp downward trend until 1990 and then a somewhat less abrupt slope after the beginning of the 1990s. These results confirm that the impact of austerity is indeed a slow-moving process which validates our approach of looking for probable breaks rather than testing *ex ante* for precise dates.

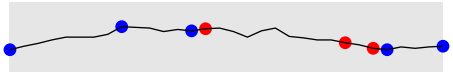
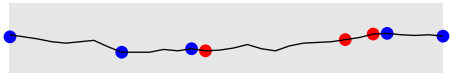
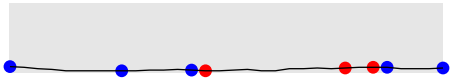
Anecdotal data indicate that austerity increased inequality through several channels. First, tax reforms in the 1980s decreased the progressivity of the tax system (Giles and Johnson 1994): tax rates for higher incomes decreased from 83 to 62%, while the standard rate of PIT was reduced from 33 to 30%. In the meantime the rate of VAT went up from 8 to 15%. In 1984, the increase of the VAT tax was used to abolish social security taxes paid by employers. All in all, the average tax rate fell from 52 to 42.5% for persons earning 5 times the average salary, but it increased from 14 to 16% for people leaving with half of the average earnings (Hall 1986, p. 127). On the expenditure side, the real value of transfers was drastically reduced: in Thatcher's first government, old-age pensions and child benefits for unemployed couples fell by 20%, unemployment benefits were decoupled from previous earnings and subjected to a tax (Atkinson and Micklewright 1989). Panel (c) indicates that fiscal consolidation curbed redistribution, as measured by the percentage change of Gini after taxes and redistribution, which dropped from around 35 to less than 30 in 1990 and remained at this level since then.

Austerity was more slow to dent the welfare state (Pierson 1994) and change the preferences for redistribution than to increase inequality. In the conclusion to this dissertation, figure 7.2 will suggest that preferences for spending cuts in the UK were quite stable between 1985 and 2006: the Brits were only slightly pronounced in favor of expenditure cuts (slightly more than 40% supported them, around 20% had no preference and less than 40% opposed them). This finding confirms what the literature reports: from 1995 to 2005 around 60% of the population supported increased taxes and spending and this was very much true of all the income levels (Alt et al. 2009).

Finer data suggest that the tide of social preferences is turning slowly but surely against redistribution. Here one thinks of the surveys on British Social Attitudes and in particular their time series running from 1983 to 2014. Below we use simple sparklines (Tufte 2006) to illustrate the evolution of the trend of social attitudes during this period in which the UK saw three Tory Prime Ministers (see the blue dots) and two Labour Prime Ministers (see the red dots). Sparklines are particularly useful to get a sense of the data and provide context for the following description of attrition in the UK.

The first and most important time series concern social support for increased taxes and spending for health, education and social benefits. One can see over the thirty-plus year period there was a wide fluctuation but also that, counter-intuitively, preferences changed in the opposite direction of elected governments. Table 5.2 shows the trends referring to preferences on increasing, decreasing or keeping taxes and spending constant. Under the Thatcher government, between 1983 and 1990, preferences for increasing taxes and spending doubled from their initial value in 1983 (32%  65%). One may wonder whether this was due to the fact that in the 1980s unemployment rose quite fast, therefore escalating economic insecurity. Unemployment indeed peaked at a little less then 12% in 1984 but then fell to 7.1% in 1990. Additionally, those were also the boom years (British GDP

Table 5.2: Preferences for taxes and spending in the UK, 1983-2014

Tax and spending:	*Preferences in %*
...increase	
...keep constant	
...decrease	

NB: Blue dots: Tory. Red dots: Labour. Grey rectangle shows *y* values from 0 to 100.
Source: British Social Attitudes.

grew on average 4.145% between 1983 and 1988), and therefore the effect of economic insecurity should be mitigated. Under the John Major government, from 1991 to 1997, those preferences plateaued and kicked off a permanent downward trend (65% 59%), which is puzzling given the fact that in those years the UK went through a strong economic shock (unemployment peaked at 10.5% again in 1993 and GDP fell by 2.5%). This downward trend accelerated during the Labour boom from 1997 to 2010 (62% 34%) seeing support for increased taxes and spending being divided by two and coming back to the levels seen under Thatcher. After 2010, despite the double onslaught of tough economic conditions and the non-negligible fiscal adjustment of the Tory-Liberal coalition, those preferences stayed quite remarkably stable (32% 37%) until 2014.

The evolution of preferences for keeping taxes and spending constant mirrors the evolutions of preferences for increasing taxes and spending. What is interesting is that both series cross each other around 2006 after the respective downward and upward trend started around 1995, i.e. after the second Tory fiscal consolidation. The real drop in support for increased taxes and spending came after 2002 and until 2010. Simultaneously, support for keeping taxes and spending constant picked up. One can thus say that this was the time when a coalition formed around precisely this type of relationship between taxes and expenditures that existed before the crisis, and persisted despite what the British polity weathered in terms of economic crisis and fiscal consolidation since 2010.

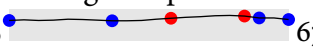
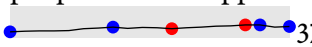
Given this new consensus on low taxes/low expenditures, in the wake of a fiscal shock where expenditures would grow and taxes plummet, the government would find it easier to cut spending than to increase taxes. All in all, one can conclude that while in the 1980s the British supported more taxes and spending, since the turn of the Millennium they seem to have forged a coalition around low taxes and low public spending that the drastic fiscal retrenchment and recession seem not to have affected.

Importantly, while between 1983 and 2010 British Social Attitudes fitted quite well a "thermostat" model of public policy (Curtice 2010; Soroka and Wlezien 2005), this relationship seems to have broken after 2010 (at least at the time of writing in 2015). A thermostat model simply mirrors its own metaphor: with unchanged preferences for a certain temperature, if the room get cooler, one may wish to heat it up. If it is too warm, one may wish to switch on the air conditioned. Applied to public spending, the thermostat model stipulates that voters react to policy-makers choices by

signaling if they want more or less of the same: when spending increases, preferences for spending decreases and vice versa. The inverse relationship comes from the fact that policy-makers overshoot voters preferences: if they provide too much spending beyond what voters want, the relationship is reversed and now voters prefer less spending.

From this point of view, Thatcher's austerity and cuts were in line with the voters until 1985, when preferences for spending and taxes increases crossed those of keeping them constant. When Labour started spending more after 1997, public opinion reversed and wanted less spending and more conservatism in terms of redistribution. But after 2010, the thermostat relationship between preferences and spending broke down: spending cuts should have strengthened preferences for spending, but they did only marginally, much less so than after Thatcher's austerity (at least until 2015). This is surprising given that Cameron's fiscal consolidation came in the wake of the biggest crisis since 1929.

Evidence for attrition in the British society is even more visible in social attitudes towards social benefits (Taylor-Gooby and Taylor 2015). Not only did preferences for more spending and taxes for health, education and welfare fall, but attitudes towards benefits changed as well. Consensus in favor of welfare benefits tumbled from 61% in 1989 to 27% in 2009 and remains stable ever since.[45] But while this consensus unraveled at the seams among all political parties (Labour agreed with compulsory job guarantees and the benefit cap), it did not happen equally between partisan supporters: the gap between Labour and Tories increased significantly since 2010 thereby deepening attrition on the level of partisan politics.

Conversely, support for different benefit schemes did not evolve in the same manner. On one side, support is widespread or strong for benefits that a majority of the population may enjoy at one point or which may insure against permanent risks. Thus pensions have most of the support among British voters (64%  67%) with a peak of 80% in 2005. But since then it decreased significantly since crisis and austerity kicked in. But one should be careful though, because an aging population may skew the results in favor of pension spending: pensioners are indeed one of the biggest social groups in the UK. The second most supported category are benefits for the disabled, which always hover beneath a 2/3 majority (58%  60%). The third most supported category of benefits is for children, although not by a majority of British people. While support was low in the 1980s (around 20%), it doubled on the eve of the crisis (20%  37%) before plunging by 5% points until 2014.

On the other side, support for temporary safety nets or fragile parts of the society is much weaker and reflects well the attritional aspect of refusing to redistribute more. Key here are the preferences regarding the unemployed (32%  13%) which have never been high for starters and plummeted from around 30% in the 1980s to below 10% on the period just before the crisis. Importantly, it should be underlined that while over time preferences about unemployment benefits exhibited a strong countercyclical trend (support for unemployment benefits increased during recessions), this was not as strong in the aftermath of the Great Recession of 2008-09. Finally, support for single parents has been low throughout the period, hanging beneath one fifth of British voters (21%  17%).

[45] Interestingly, this downward trend remained robust to the 1991-1992 recession and John Major's fiscal consolidation.

All in all, despite the economic shock of the recession and austerity, regardless of increasing poverty in the working-age population, less than a third of British voter supports more welfare, a proportion that barely changed since 2008 and which is half of what it was in 1989.

Other pieces of evidence seem to confirm the crystallization of this low-level social-coalitional equilibrium that provided permissive conditions for Cameron's adjustment. First, anecdotal episodes of tax revolt indicate that the consensus on low taxation was strong even before social surveys show the tide turning. A good case in point is the dramatic episode of the poll tax that cost Thatcher her position. When proposing the poll tax in 1989, Thatcher had a double aim in mind (Butler et al. 1994): first to alleviate the burden on the main and growing constituency of the conservative party, i.e. owners, and second to control spending at the local level, which was one of the main drivers of the national deficit and which was mostly controlled by Labour. No. 10 thus proposed to impose a flat tax that would not be based on property but on people living in the locality. Moreover, the flat rate would vary across towns with respect with the level of expenditures in the locality: the tax was thus truly regressive, falling disproportionately on the poor. At the end of 1989, 65% of the public opposed it and riots broke out, even though British Social Attitude Surveys cited above indicate that in the 1980s and early 1990s the Brits still supported increased taxation and expenditure.

Second, more unsettling still is the voting pattern of the British electorate which seems to imply a more critical approach to the welfare state: with openly austere programs, Tories won each general elections from 1979 to 1997 with increasing majorities in the 1980s. As Hallerberg notes, austerity did not undermine support for the government, since in 1982 42% of voters supported Tories, while Labour stood at barely 30% (Hallerberg 2004, pp. 71-72). In 1983, Tories won by a landslide (majority of 144, not seen since the election of Labour in 1945). While the Falklands War may have played an important exogenous factor, the fact that economic growth had resumed may also explain why Tories strengthened their hand in the House of Commons. Thirty years later the Tories still won despite recession and austerity. In 2015, British voters reinstalled the Tories at 10 Downing Street and the Tories gained 24 seats in the House of Commons. There was no more need for establish a coalition to govern.

5.2.2 Wars of attrition in France

France is usually seen as a very equal country due to its oversized welfare state. According to the SOCX database of the OECD, French gross public social expenditures topped 31.9% of GDP in 2014, ahead of very redistributive countries like Denmark (30.1%) and Sweden (27.2%) and more than 10 percentage points above the OECD average. But this was not always the case: in the early 1980s, France was spending less than Germany on social protection (around 20% of GDP).

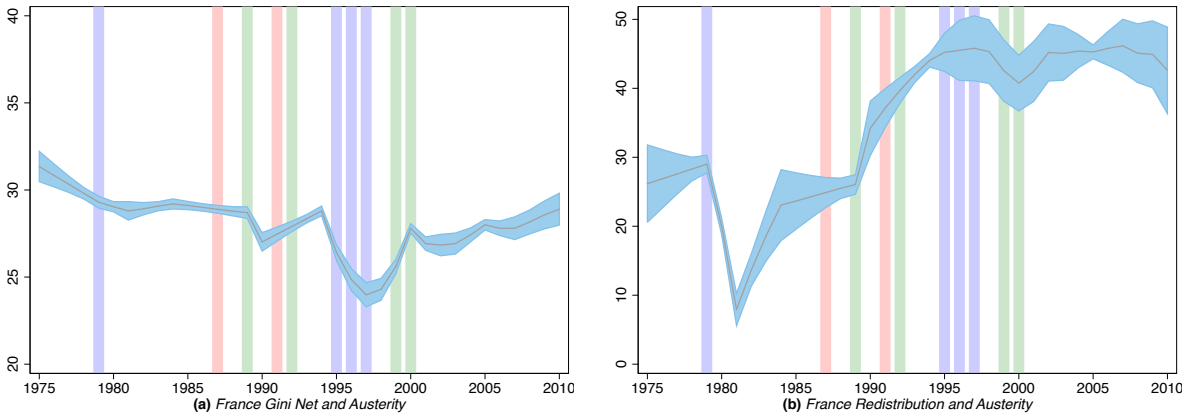
Therefore, France was not always as equal as it is perceived today. Indeed, before 1980 France was as unequal as the United States (and even more so in the 1970s) according to SWIID data (Solt 2014), and was certainly more unequal than the UK until 1986. In fact, until this date, France was as unequal a country as the UK after 1990, when financialization gradually impregnated the British society. After the 1980s however, the opposite happened: while it was certainly not as equal as Sweden in terms of income distribution, France did approach a Gini of 25 and was less unequal a country than Germany in the 2000s.

Data on top income shares confirm this picture of an unequal France during the pinnacle of its economic modernization, the so-called "Trente Glorieuses" (i.e. Glorious Thirty, from 1945 to 1975), and even before. During the 1918-1939 interbellum, the top 10% income share went head to head with the American top 10% income share (between 42 and 45%), in the age of the Roaring Twenties and overtook it for a short period of time in the Threadbare Thirties. Both time series are well above the sample of the other countries (Germany, Sweden and the UK in the same period). In the Nifty Fifties and the Swinging Sixties, the data suggest that the top 10% income share were the highest in France among our sample of advanced countries (around 35% over the period). It is only around 1979 that the top income shares started to decline in absolute terms (reduced to around 32%) and in relative terms (the top 10% income share skyrocketed in the US to 47% in 2010 and 42% in the UK, while it reached 40% in Germany).

The data therefore suggest an interesting story: while during the age of austerity (1978-2015) most countries became much more unequal and thereby vindicate large N research on the impact of austerity on income distribution, France on the other side became much more equal, at least until the mid 2000s. This is puzzling given that France had a majority of right wing governments in place since the beginning of this period, often at the same time as in the US and the UK, and that France has a majoritarian system and fewer effective number of parties which according to the literature should lead to less, not more, redistribution (Iversen and Soskice 2006). It is all the more puzzling that contrary to what high social spending leads us to believe, the French welfare state is usually considered as very inegalitarian, redistributing mainly from the middle class to itself by aiming at security not equality: risk is redistributed within classes rather than between them. (Cameron 1991; Levy 2001).

Using the Devries et al. (2011) dataset, one can locate temporally the episodes of austerity and see how they impact inequality (see figure 5.6a). Before going further, one should note an important caveat of the dataset: it does not show the "tournant de la rigueur" (the austerity u-turn) that happened under Mitterrand in March 1983 after his attempt at reflation through stimulus and nationalization met with capital flight and resulted in three devaluations of the French Franc. The reason for this is that the dataset focuses exclusively on fiscal consolidations that were triggered by the state of public finances. In 1983, one could argue that the main issue was one of credibility towards financial markets and the deficit of the current account (which reached 2% of GDP in 1982).

But one would beg to differ for two reasons at least. First, the "tournant de la rigueur" was initiated also and mostly for fiscal reasons that are too often omitted. Indeed, Mitterrand had to renege on a comparatively limited policy against the backdrop of low public indebtedness. Despite this fact, the French Treasury struggled to refinance itself and had to turn to the Central Bank of Saudi Arabia for help in order to avoid a British-style request to the IMF for a bailout. This whole humiliating episode is deeply rooted in the way debt and deficits were financed: instead of using deep and liquid international financial markets as became the rule since the mid-1980s, the French state leaned on non-negotiable monetary resources from the central bank and on the management of national savings. This was fine as long as deficits were few and far between. When they started accumulating, inflationary pressures rose and in the context of managed exchange rates (EMS), this created political and economic problems. Hence the policy U-turn of 1983 was not only motivated by concerns about the current account (Devries et al. 2011, p. 34, fn. 34) but also



(a) Inequality and Austerity **(b)** Redistribution and Austerity

Figure 5.6: Inequality, Redistribution and Austerity in France

NB: The measures of the net Gini show the post-tax, post-transfer inequality (as opposed to market Gini) with the mean as the gray line and the 95% confidence intervals in light red for the UK and light blue for France. The Gini is an estimate with lower and upper bounds calculated with standard errors and comes from the SWIID database. This database uses an index of inequality in equivalized (square root scale) household disposable income, based on the Luxembourg Income Study data as the standard. Likewise, the estimated redistribution captures the percentage reduction in gross income inequality between market and net inequality. Finally, the colored bars represent austerity packages as defined by the action-based dataset: red shows planned expenditure cuts, blue tax increases, and green shows fiscal stimulus.
Source: own elaboration based on Devries et al. (2011) & Solt (2014).

stemmed from deeply constrained financing structures (Feiertag 2001; Quennouëlle-Corre 2000).

Second, fiscal memories of this traumatic episode would shape French fiscal policy and its financial structure for decades to come, as did the British IMF bailout of 1976 on the other side of the Channel. Because of this change of tack, many a socialist supporter felt betrayed and thus changed his loyalty to other parties (most notably the Front National) starting in the 1986 elections (Grunberg 2006; Haegel 2005). This episode would replay in 1995 for the center right and amplify this duality of fiscal policy as both totem (necessary adjustment, especially to remain in the circle of "serious" EU countries) and taboo (fear of electoral reactions). This line of endogeneity is analyzed further in chapter 6.

Therefore, when investigating the link between fiscal consolidations and inequality in France, one should not only take into account the episodes mentioned in Devries et al. (2011) but also those that have a more complex logic and cast a long shadow on fiscal politics in the next rounds of adjustments.

How then, exactly, did austerity impact inequality in France? Figure 5.6a shows that most of French fiscal consolidations are tax-based, the two most important ones having been engaged by right wing governments in 1978 (Raymond Barre) and in 1995 (Alain Juppé). In each case, the impact on inequality was contrary to initial expectations, be them theoretical or empirical: inequality decreased either marginally (under Barre) or significantly (under Juppé). To be sure, in both periods economic growth was far from being interstellar, but these were not recessions either,

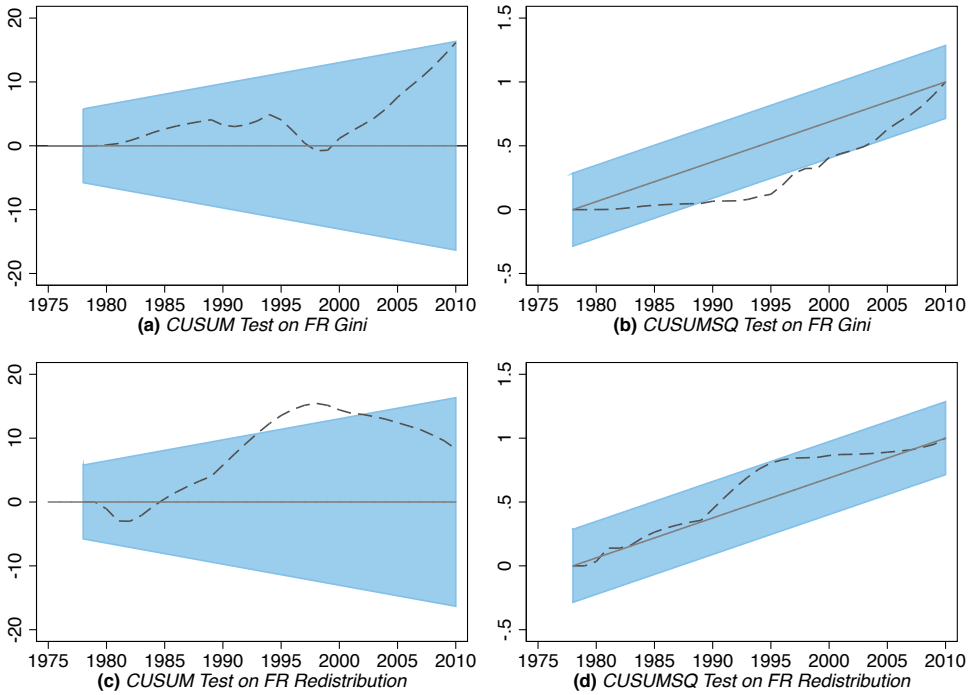


Figure 5.7: Structural break tests, the UK and France

NB: The CUSUM test graphs are useful to identify when a structural break may have started, which is often where the CUSUM series starts to move away from the horizontal axis. The CUSUMSQ test is more sensitive to whether structural breaks may have occured and is thus more robust, but it is also less useful in identifying the date of the break.
Source: own elaboration based on data from Solt (2014).

and therefore the economy should not have impacted inequality significantly. Even spending based episodes of fiscal adjustments had a marginal impact on inequality: the 1987 austerity package of Chirac which cut government payroll and health care spending, and the 1991-1992 austerity package of the left-wing government which mainly cut capital expenditures. Interestingly and quite rarely, fiscal consolidations were mostly followed by fiscal stimuli which were in fact savings measures that expired in a year or two after they were introduced (in 1989, 1992, 1999 and 2000).

What about redistribution? Paradoxically, fiscal consolidations in France seem to have increased it. Looking at graph 5.6b, one can see that if redistribution was on average around 25% before 1980, it jumped to 45% with the fiscal consolidations of the 1990s. This is quite counter-intuitive since fiscal consolidations more often than not target the welfare state and are thus expected to lower redistribution and increase inequality (Clayton and Pontusson 1998; Giger and Nelson 2010). This French result becomes much less counter-intuitive if one takes into account that all major fiscal adjustments in France aimed at correcting the accounts of the Social Security Budget by raising taxes or increasing contribution rates and time rather than cutting expenditures in a fundamental way.

So is this impact of austerity on inequality and redistribution statistically significant in France?

As in the British case, we proceed with simple CUSUM and CUSUMSQ tests, supplemented by recursive parameters estimates for the sake of robustness. Figure 5.7 shows the results of these tests. As for the UK, the CUSUM test fails to confirm statistical significance for the impact of austerity on inequality on the sample period but there seem to be a confirmation of the structural break towards the end of the period. The CUSUMSQ tests seem more promising suggesting that an important shock to the trend happened around 1995 with a 95% certainty. Overall, the test indicate that the most important episode of austerity in terms of inequality (or its reduction) happened at the outset of the right-wing Juppé government.

The recursive parameter estimates in the Structural Breaks Methodology section (see panel (*c*) of figure 5.8) seem to confirm the empirical picture that emerges from the CUSUM and CUSUMSQ tests. Inequality seems to have diminished significantly since the outset of the period with the strongest shocks arising around the fiscal adjustment of 1995. All in all, it appears that fiscal consolidations in France reduced attrition[46] as far as it is measured in terms in inequality: although it increased since 1997, inequality remained stable at around 27 in terms of Gini coefficient until 2010, thus preparing the ground for increased taxation in the new round of fiscal consolidations.

The impact of austerity on redistribution is equally robust statistically speaking. The CUSUM and CUSUMSQ tests, almost statistically significant at the 95% level, suggest that indeed 1995 was a turning point in the history of fiscal policy and redistribution in France: redistribution has significantly increased during the consolidation leading to the instauration of the Economic and Monetary Union. This may signal a political bargain on the eve of monetary unification: tighter monetary conditions (no possibility to devaluate the Franc during an economic shock), greater competition, but also greater redistribution to compensate. The CUSUM and CUSUMSQ tests suggest that the outset of this compensation is to be found in the early 1990s, which the recursive parameter estimates seem to confirm (see panel (*d*) of figure 5.8): there is indeed a positive shock to redistribution around 1990 that peaks with the fiscal consolidation of Juppé and then continues on an upward trend. All in all, those tests provide quite robust - if simple - evidence that fiscal consolidations in France not only had a mild effect on inequality but also increase redistribution.

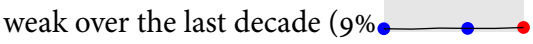
Anecdotal evidence helps to put some empirical flesh on the bare bones of these time series. That austerity increased equality in France does not mean that it was conducted without hiccups, quite the contrary: low attrition levels do not imply lack of political friction. For one thing, France exhibits a strange policy cycle once austerity is initiated. Initially, all right wing governments had serious plans to change the paradigm of the system and liberalize the welfare state by cutting expenditure and rolling back the State. French liberals and conservatives were trying to implement, in the words of Raymond Barre, "a profound transformation of structures and of behavior" (Hall 1986, pp. 188) through fiscal consolidation. Juppé in 1995 and Sarkozy in 2010 intended the same. But at each time fiscal consolidation was enacted in France, a policy cycle unfolded (1978-1986; 1995-2002 and 2010-15): opposition to expenditure cuts rose and cost the right its position in office, the left won the next elections, relaxed policies, then embarked on austerity under the pressure of European partners, and this gave rise to extremist parties. Therefore, in France, fiscal consolidations on the expenditure side fail, and erode the political order. As a result social security

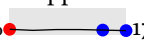
[46] Obviously, low attrition does not imply low political friction: social conflicts erupted during each episode of austerity, the most prominent one happening in the fall of 1995 in France.

contributions increase and cuts to social spending are limited, therefore limiting the effects of austerity on inequality. Attrition is thus kept at low levels and consensus on taxation precludes spending cuts.

This pattern of tax-based consolidation and almost untouched expenditures repeated itself more dramatically in 1995 when the Juppé government decided to embark on a fiscal consolidation that would qualify France for the Euro. The situation was difficult since the deficit for 1995 was 5.5% and it should have reached 3% by 1997 (Hallerberg 2004, p. 108). One would expect such a government to start by cutting social expenditures. This was clearly the intention of Juppé, who was supported by the liberal wing of the conservative RPR, most notably by Alain Madelin, a neo-liberal who became minister of Economics and Finance. Unfortunately, France reversed to the well known patterns already existing in the interwar period and at the end of the 1970s. Why is that so?

Two things happened. First conservatives and liberals could not agree on how to conduct the fiscal consolidation, the latter wanting deep and fast expenditure cuts in social policies and pension reforms while the former preferred increasing social security contributions (like the Barre government) in order to balance the social security budget, as well as an increase in the VAT and an increase of 0.5% in the income tax. Second, this dispute in the ranks of the right wing coalition was exacerbated by the mounting dissatisfaction and latter open opposition of the trade unions who brought the country to a halt in the fall of 1995 with massive strikes. Trade unions deemed the Juppé plan too harsh, but they mostly opposed a consolidation package that did not consult them on matters that concerned them most: the management of welfare state funds.

Given the resistance to spending cuts in France, how strong is the consensus on the welfare state? As a first cut to see whether attrition has increased in France, one can look at the European Social Survey. Unfortunately, this pan-European survey is quite recent and does not cover the 1980s and the 1990s. The six rounds of survey took place every 2 years since 2002 and cover up to 2012. One of the questions related to the welfare state "should the government reduce difference in income levels?". In France there is pretty strong evidence that, over time, support for redistribution was pretty high (82%  74%), but still declined by 8 percentage points over a decade with most of the decline happening after austerity started, reversing previous gains during the recession. Conversely, opposition to redistribution remained quite weak over the last decade (9%  13%) even though it picked up at the end, when austerity policies started to be implemented in earnest.[47] The slow and recent erosion of French support for redistribution may be surprising, but it could be explained by increasing attrition. The SWIID database of Solt indicates that inequality has increased significantly in France since the 2000s: while in 2002, the post-tax, post-transfer Gini was around 27, in 2012 it increased to around 31. Given that the income share of the top 10%, 5% and 0.1% has remained stable in this period (32, 8 and 2% respectively), the sources of increasing inequality may well be found in increasing poverty due to higher levels of unemployment and the recession of 2008. But the latter is not the only reason for increasing inequality: indeed, in the decade leading up to the crisis, many scholars pointed out the fear of middle classes of becoming as poor as working classes (Chauvel 2006). The *perception* that inequality has increased has also

[47] Compare this with the UK where support for redistribution (61%  61%) is consistently weaker and opposition to redistribution (22%  17%) consistently stronger.

become entrenched among French. According to an IFOP poll from 2015, 80% of respondents from left and right alike agreed that inequality has increased significantly in the last decade, mainly due to globalization according to the interviewees (Chasles-Parot and Fourquet 2015). The same poll also points at the increasing attrition between different layers of society: according to 44% of the interviewees, the richest do not pay enough taxes, while the richest people in the sample think that they pay too much taxes. The social breakdown on the opinions on equality and taxation is quite instructive here of the undergoing attrition in French society. While middle-upper class voters from mainstream parties (center-right, center and center-left) think that equality is mainly about equality of opportunity (all citizens should have the same chances to succeed), working class voters supporting extreme parties (the very left-wing party of Jean-Luc Mélanchon and the Front National of Marine Le Pen) think that equality should be implemented through redistributive policies and higher taxes and social expenditures.

This result is a stark contrast with situation from a decade earlier: in the ISSP survey published in 2006 (ISSP Research Group 2008), 77.69% of interviewees responded that the government should probably or definitely decrease inequalities through redistribution.[48] The proportion of people responding that the government definitely should do so was the highest among the advanced OECD and European countries (51.56%). In fact, until the mid-2000s inequality and redistribution were the least divisive issue among citizens, most people agreeing that the income distribution should be equalized through taxes (Piketty 1999). So how can we explain the drop in support for redistribution and increased attrition at the end of our sample period, 2005-2013? Empirical studies suggest that, in France, social demotion and risk aversion is the major drivers of preferences for higher redistribution: given that, in France, lower classes, public sector workers and union members are more prone to support redistribution (Guillaud 2013), in times of austerity these preferences clash with the support for spending cuts and lower taxes because unemployment and fear of social demotion increases for the lower classes (Guillaud and Sauger 2013; Brouard and Le Hay 2012; Bozio et al. 2012a)

It seems that this recent attrition increase may well end up the French "tax peace" that lasted from 1974 to 2010. The increased impatience towards taxation triggered the so-called "grogne fiscale" (fiscal discontent) after 2010. In the last thirty years, French people seemed to accept the *quid pro quo* of higher taxes and higher social protection (Delalande and Spire 2010; Delalande 2011). But this was not always the case: French society has been reluctant to pay higher taxes until the mid-1970s and was even prone to oppose taxation. In the mid-fifties for instance, a wide movement called "poujadisme" named after a populist politician, Pierre Poujade, emerged as a powerful contestation movement of the independent workers (artisans, small workshops and small businesses). This reversal of fortune and the "taxation appeasement" that lasted from the end of the 1960s to 2012 may find its roots in the way taxes are levied (the CSG and the VAT are relatively invisible for they are imposed at the source of income and widespread) and the type of taxes that are levied. Since the personal income tax has remained quite marginal, opposition to taxation has remained weak. It is only in 2011 that it was increased and soon after, many public scandals followed. Big fortunes and renowned actors threatened to emigrate to neighboring countries and less close ones. Social groups tolerate less and less the weight of the welfarist social contract and

[48] This was actually the dominating opinion among the French since 1945 (Schnapper et al. 1986).

the high taxes it entails. Tax revolt is looming large with several social groups already voicing their opposition. Among them, the SMEs concentrated in highly innovating IT industries, called "les pigeons", and big businesses, represented by the MEDEF, started complaining about increased taxation on capital gains and the 75% income tax band in the fall of 2012. One year later, they were joined by the "bonnets rouges" (red caps), who mobilized against the so-called "éco-taxe" on heavy trucks and coalesced around them farmers, fishermen, shopkeepers, traders and workers in Brittany. This wave of violent tax protests and a downgrade by Standard and Poor's painted the Socialist government into a corner from which it tried to escape by announcing a parametric tax reform in November 2013. At the time of writing (July 2015) this has so far stayed a dead letter.

To sum up, increasing attrition points to a French paradox: on one side, there is a strong support for spending and tax cuts[49] but on the other side supporters from Left and Right parties think that the State does not intervene enough in the economy (Balme 2006). In the following chapter I will explain how this peculiar situation came about, but suffice it to say than in our framework, this is the case when a country with strong tax linkages and low attrition moves from this position to a position where strong tax linkages clash with high attrition levels.

5.3 Conclusion

This chapter has sought to gauge the usefulness of the war of attrition mechanism in understanding how past fiscal consolidations affect future ones in a repeated games framework. The main takeaway of this chapter is that attrition does matter, but in ways not expected by the initial attrition model and most importantly in a dynamic, time dependent way.

Breaking this argument into several steps and levels of analysis, the chapter first reviewed the evidence on the impact of austerity on inequality. It appears that spending-based austerity does have substantive and statistically significant impact on inequality. Tax-based fiscal consolidations, on the other side, have a less robust effect: some scholars showed that they tend to maintain or decrease levels of inequality (Mulas-Granados 2006) while others suggest the increase in inequality is less dramatic than after spending-based consolidations (Ball et al. 2013). Second, the chapter gather evidence suggesting that countries with more attrition tend to consolidate more on the spending side of the budget than on the tax side. Third, the chapter adopted a longitudinal view of two case studies, the UK and France, from 1978 to 2015, to unpack the causality of endogenous austerity mechanisms using different levels of evidence (survey data on preferences for redistribution, how social coalitions shaped fiscal consolidations, etc...).

The case studies revealed that in the UK, new social coalitions were shaped by the austerity after 1979. A new political consensus crystallized slowly around 2000-2005 that shaped the political forces behind austerity after 2010. As it appears from survey data, this new consensus took time to form but in the end it was the driving force behind Osborne's fiscal adjustment. In France, on the contrary, fiscal consolidations repeatedly ran in the sand of social opposition and repeated tax-based adjustments cemented the belief that expenditure cuts are a taboo. In the French case,

[49] Balme (2006) cites a poll from 2003 where 79% of respondents support spending cuts and 86% found taxes "excessive and unbearable".

it is important to see that tax-based consolidations can be self undermining in terms of political coalitions. While there seemed to be a broad consensus behind taxation in the 1980s and 1990s, this consensus has been strongly put to the test by the recession and path dependent fiscal policies after the austerity turn in 2010.

All in all, when austerity is implemented in $\zeta(p_1)$, evidence seems to point to a change in $\zeta(p_2)$: in the UK, $\zeta(p_2)$ became biased towards expenditure cuts and low taxes while in France it is the opposite. This can be seen in the "fiscal space" between fiscal plans and fiscal outcomes in both countries.[50] Concerning fiscal plans, over the period 1978-2009, consolidations are much bigger in the British case (totally 5.08% of GDP vs. 2.87 in France), but the lion share of it happens on the tax side (3.28 vs. 1.55 for France) while expenditures cuts are less important, being almost identical between the UK and France (1.82 vs. 1.32). A closer look at fiscal outcomes (cyclically adjusted measures) suggests that, between 1979 and 2009, in France taxation served to consolidate by 10.54% while in the UK this amounted to 3.52% of GDP, while expenditures amounted respectively to 0.98% and 11.68%. There is thus a stark difference between fiscal plans and outcomes in both countries, with a strong bias towards taxation in France and a strong bias towards expenditure cuts in the UK. This is confirmed for the period 2010-2014. The total sum of planned fiscal consolidation was 8.8% of GDP for the UK with 2.2% of GDP for taxes and 6.6% of GDP for expenditure cuts. The French, with their fiscal adjustment of 5.3% of GDP are also tilted towards expenditure cuts (3.5), but only to a smaller extent (taxes amount to 2.3% of GDP over the period). The outcomes confirm the expenditure bias of the UK and the taxation bias of France.

As a result of these biases, voters tend to reward fiscal consolidation in the UK but to punish it in France. This result resonates with recent research on the political effects of austerity (Hübscher et al. 2015) which challenges common wisdom among economists according to which fiscal consolidations and structural reforms carry only a minimal price tag for policy-makers (Alesina et al. 1998, 2011; Buti et al. 2008a; Armingeon and Giger 2008; Giger and Nelson 2010) or according to which voters sanction policy-makers implementing expenditure-based austerity but not after the 1990s because voters are more used to this fiscal strategy or simply because "there is no alternative" (Mulas-Granados 2006). Indeed, austerity carries a certain political cost or benefit, but this also depends on previous episodes of fiscal consolidations and how those reshaped social coalitions through attrition, as showed in this chapter.

[50] For fiscal plans between 1978 and 2009, I use the Devries et al. (2011) database. I use the same method to compile data for the 2010-2014 fiscal plans, mainly based on the 2010 Coalition Agreement in the case of the UK and the Stability and Convergence Programmes submitted to the European Commission for France. For fiscal outcomes, I use data from the European Commission's AMECO Database.

Appendix to Chapter 5

Structural breaks methodology

The main methodological issue in section 5.2 is to detect structural change or structural breaks in the Gini and relative redistribution time series and to see whether those changes are attributable to episodes of austerity and their lagged effects. We use the CUSUM and CUSUMSQ tests from a generalized fluctuation framework as a simple heuristic device to check this hypothesis and probe whether the structural breaks are statistically significant. The CUSUM and CUSUMSQ tests are based on the cumulative sums of recursive residuals (Brown et al. 1975): while the CUSUM test plots the time-sequence of the cumulative sum of residuals divided by the standard error of regression, the CUSUMSQ test compiles the time-sequence of the cumulative sum of squared residuals and rescaling by the partial sum of the residual sum of squares in order to have a last value equal to one. Visually, the main difference is that whereas the CUSUM is better at spotting the probable date of a break, the CUSUMSQ does a better job at pointing out a possible start of a break. Given that the causality of austerity episodes is cumulative, these two pieces of information are very useful.

It should be noted here that there are different types of structural break tests, with different strengths and weaknesses. As opposed to the generalized fluctuation framework used here, there exist tests based on F statistics (like the Chow test). Both classes of test serve a different purpose: while the former tests (CUSUM and recursive parameters estimates) are better to identify a probable date, the latter (Chow tests) are better to test a structural break on a particular date identified *a priori*.

An important difference between the generalized fluctuation framework and the F tests is that in the latter an alternative hypothesis is specificied, which implies that the class of F tests aim at testing against a single shift hypothesis (like an economic shock). Given that austerity episodes are repetitive and scattered throughout decades, our dataset structure makes the F tests difficult to perform. In general, Chow tests are implemented by splitting a time series into two subsamples around an *a priori* specified date and performing the regression on each subsample and then testing for significant difference between the two F statistics. If one has to model several breaks, the subsamples rapidly shrink and thus make it hard to perform regression analysis.

The generalized fluctuation framework, on the other hand, has no specific alternative hypothesis and is thus better adapted to varying patterns of structural changes. It is therefore a better solution for our research strategy because of multiple austerity episodes and multiple possible structural breaks.

Counter-intuitively, one would prefer to identify a probable date rather than testing an *a priori* date because the effects of austerity are not fully felt immediately. Austerity's effects take time to unfold and bias $\zeta(2)$ because austerity's causality can be seen as cumulative and slow-moving. Additionally, austerity episodes are different in their size and scope in the economic and political realm, and it is thus difficult to say *ex ante* which will have the bigger impact on $\zeta(2)$. More technically, Zeileis (2000) argues that CUSUM tests are more efficient to detect structural breaks at the outset and end of a time series. Given that we are interested in early austerity episodes and their influence on later episodes especially in the 2010s, this method seems to fit better.

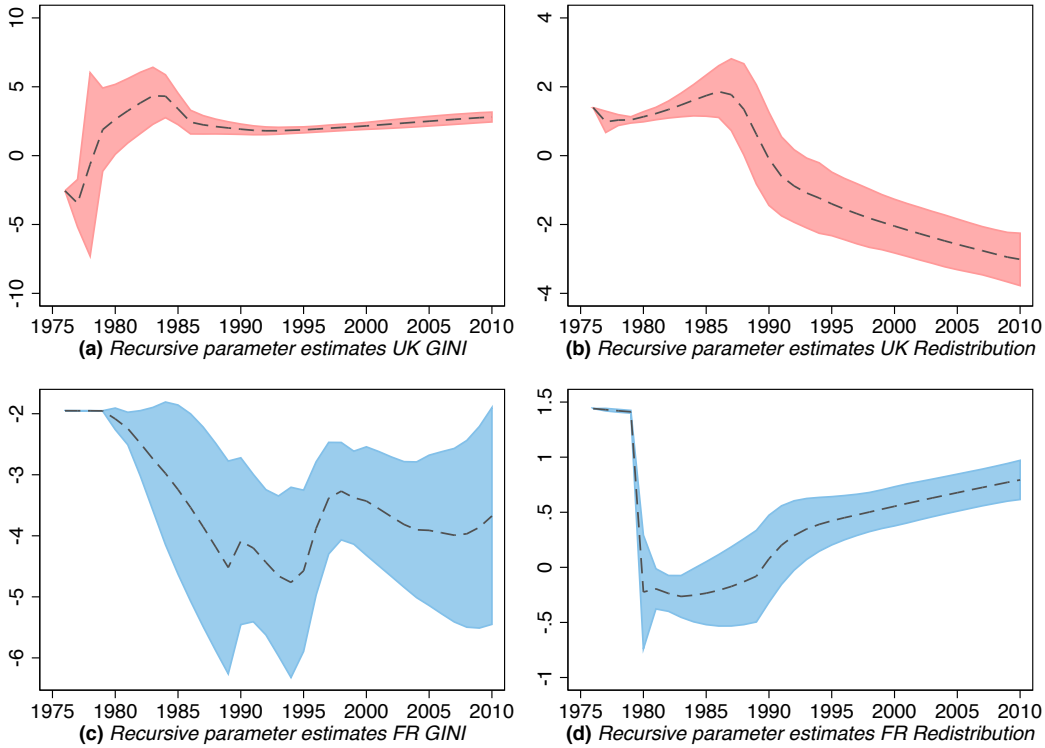


Figure 5.8: Recursive parameter estimates

One caveat should be born in mind though: the CUSUM test suffers from low power. In CUSUM tests, the model is stable under the null hypothesis. If the model is unstable, CUSUM often does not reject the null hypothesis of model stability: it finds stability when there is a break, and therefore the deck of cards is stacked against the researcher. Therefore, for the sake of robustness, we also report the results from recursive parameters estimates (see figure 5.8). Recursive parameter estimates are a series of regression analyses performed on changing subsamples with different time frames which are visualized to check whether regression coefficients are stable: $1 \rightarrow k+1$, $1 \rightarrow k+2$, $1 \rightarrow k+...$, until $1 \rightarrow T$. This implies that although recursive parameters estimates are used here as a robustness check, these tests should also be taken with a pinch of salt: due its recursive nature, the method needs a "burn-in" period because it starts with the smallest sample and ends with the biggest one, therefore the confidence interval of the first estimates will likely be large and insignificant. Consequently, this makes it very hard to detect structural breaks at the outset of a time series, which is precisely what we are looking for due to austerity episodes starting right at the end of the 1970s.

Table 5.3: Attrition and austerity after 2010, OLS regressions

	(1) Tax	(2) Spend	(3) Social	(4) Tax	(5) Spend	(6) Social	(7) Tax	(8) Spend	(9) Social
Inequality	**-0.186***	**0.320***	0.069						
	(-2.33)	**(2.41)**	(1.34)						
Top 1%				-0.224	0.604	0.283			
				(-0.74)	(1.85)	(1.85)			
Polarization							**-0.048***	0.023	0.006
							(-2.35)	(0.90)	(0.72)
Debt	**0.032****	0.009	-0.009	**0.036***	-0.003	-0.006	**0.031****	-0.006	-0.007
	(3.47)	(0.64)	(-1.47)	**(2.89)**	(-0.32)	(-1.31)	**(3.47)**	(-0.54)	(-1.86)
Deficit	-0.029	-0.181	-0.005	-0.016	-0.161	-0.027	0.0285	**-0.325***	-0.022
	(-0.56)	(-1.28)	(-0.15)	(-0.30)	(-1.56)	(-0.88)	(0.54)	**(-2.50)**	(-0.71)
GDP	-0.078	-0.195	-0.068	-0.020	-0.183	0.029	-0.024	-0.309	-0.053
	(-0.63)	(-1.00)	(-0.84)	(-0.11)	(-1.07)	(0.37)	(-0.20)	(-1.78)	(-0.95)
Cons	4.816	**-9.015***	-1.438	0.046	-1.552	-1.240	0.478	0.864	0.351
	(1.93)	**(-2.22)**	(-0.88)	(0.02)	(-0.76)	(-1.30)	(0.58)	(0.78)	(0.89)
N	41	41	41	26	26	26	38	38	38
R^2	0.440	0.422	0.161	0.475	0.363	0.235	0.468	0.282	0.126
adj. R^2	0.354	0.333	0.037	0.335	0.236	0.089	0.380	0.186	0.021

t statistics in parentheses

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 5.4: Attrition and austerity after 2010, robust regressions

	(1) Tax	(2) Spend	(3) Social	(4) Tax	(5) Spend	(6) Social	(7) Tax	(8) Spend	(9) Social
Inequality	**-0.294*****	**0.314***	0.009						
	(0.069)	**(0.136)**	(0.052)						
Top 1%				-0.260	0.602	0.191			
				(0.303)	(0.359)	(0.185)			
Polarization							-0.044	0.023	0.005
							(0.022)	(0.028)	(0.009)
Debt	**0.040*****	0.012	-0.008	**0.036***	-0.004	-0.006	**0.032****	-0.006	-0.006
	(0.007)	(0.014)	(0.006)	**(0.012)**	(0.010)	(0.005)	**(0.010)**	(0.012)	(0.004)
Deficit	**-0.211****	**-0.473***	-0.008	-0.145	-0.164	-0.022	0.030	**-0.323***	-0.016
	(0.072)	**(0.198)**	(0.035)	(0.093)	(0.113)	(0.037)	(0.055)	**(0.145)**	(0.031)
Growth	-0.046	-0.034	-0.111	-0.059	-0.192	0.001	-0.035	-0.316	-0.053
	(0.099)	(0.213)	(0.083)	(0.179)	(0.188)	(0.097)	(0.128)	(0.194)	(0.056)
Const	**6.779****	**-10.37***	0.242	-0.011	-1.490	-0.756	0.311	0.868	0.232
	(2.085)	**(4.213)**	(1.670)	(2.050)	(2.229)	(1.157)	(0.887)	(1.235)	(0.391)
N	41	41	41	26	26	26	38	38	38
R^2	0.693	0.474	0.110	0.561	0.327	0.126	0.438	0.242	0.093
adj. R^2	0.644	0.389	-0.022	0.436	0.192	-0.041	0.344	0.141	-0.017

Standard errors in parentheses

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 5.5: Summary statistics

Variable	Mean	Std. Dev.	Min.	Max.	N
Tax hikes	1.2	1.79	-2.8	5.4	41
Spending cuts	1.43	2.775	-2.91	7.29	41
Social cuts	-0.02	0.87	-1.57	2.39	41
Inequality	29.78	3.56	23.6	37	41
Top 1%	4.83	1.24	2.4	7.7	26
Polarization	23.38	16.64	2.73	75.90	38
Debt	61.26	39.19	6.54	215.95	41
Deficit	-3.69	5.00	-26.84	8.98	41
Growth	2.18	2.75	-4.94	9.15	41

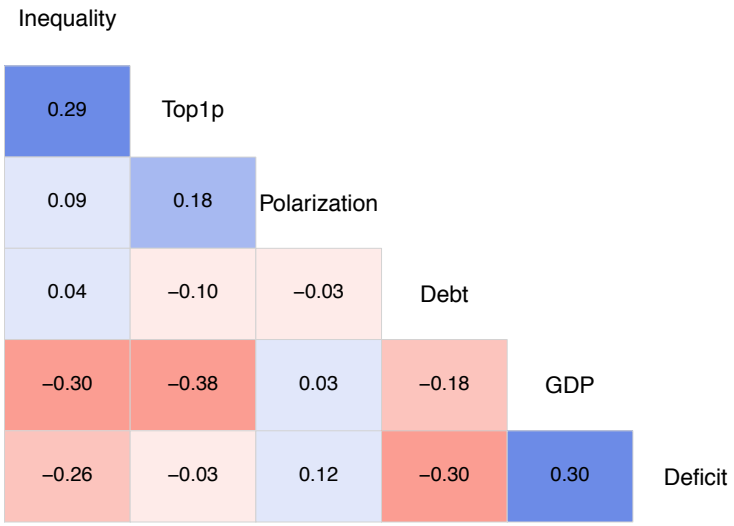


Figure 5.9: Correlogram for cross-sectional regressions

6

Coalitions and austerity: *Social gravity when the party ends*

> *"Nowhere the entirety of any given society is reflected as clearly as in the public household."*
>
> Goldscheid (1958)

One of the main themes of the previous mechanisms was that political parties face serious limitations during austerity. These restrictions suggest to push the investigation of austerity politics further and to ask under which conditions political parties are able to implement their austere preferences, under which conditions left parties converge to the right and cut spending, and under which conditions right wing parties converge on the left and increase taxes.

The answer proposed in this chapter is that the interaction between tax linkages and attrition constrains political parties during austerity. In the following, I will suggest that in the UK, the combination of weak tax linkages and increasing attrition have favored right wing strategies of austerity, helped Tories to get reelected even after deep spending cuts and forced Labour to converge to the right. Thatcher's policies increased inequality in $\zeta(p_1)$ and thus reshaped social coalitions around a new consensus of comparatively low spending and low taxes in $\zeta(p_2)$. In France, strong tax linkages and low attrition have initially favored left-wing parties and pulled right wing parties towards tax hikes. The ironic twist in the French case is that this strategy found its limits in the 2000s and pushed inequality higher. Thus France finds itself in a tricky fiscal position: strong tax linkages make social coalitions oppose spending cuts and higher attrition levels have eroded the tax peace established in the 1970s. As a result, social coalitions erode and fiscal politics become chaotic. Neither tax hikes nor spending cuts are backed by strong social coalitions: this is the French paradox highlighted in the previous chapter.

Therefore, this chapter invites to ponder the two-directional link between economic policies and the political equilibrium. Most of the literature on austerity mainly zooms in on the macro-economic effects of austerity (does it spur or stifle growth?) or on its political effects (do governments get re-elected?) but it does not really ask whether austerity affects the balance of power between social groups, if yes, how and if so, whether future austerity episodes can be affected. One of the main messages of this chapter is that fiscal consolidations reorder social coalitions through tax linkages and attrition and therefore one should pay attention to the intertemporal coalitional constraint. The paradox is that sometimes "first-best" economic policies can lead to efficiency loss if not supported by political coalitions. The old political equilibrium can unravel at the seams and will thus not support new policies. It is vital for the reforms to generate new coalitions sustaining new policies, lest they unravel. Theory and empirics show that the political economy of reforms is "sustainable" mostly under these conditions (Acemoglu and Robinson 2013; Amable et al. 2012a; Hellman 1998; Przeworski 1991).[51]

The argument of this chapter is very simple. I construct two ideal types of coalition regimes during austerity, explaining why in some cases austerity reshapes coalitions and enables new future policies, and why in other cases austerity erodes social coalitions and blocks future policies. The first ideal type is *Zwischenzug*.[52] It refers to situations when past austerity policies remodel social coalitions so that they support new policies. In such a situation, the party who wins the argument constrains the opponent party with its competence and credibility and the only way for the opponent party to regain office is to play the game of the party which initiated the politics of *Zwischenzug*.

The second ideal type is called *Zugzwang*.[53] It refers to situations when previous policies undermine old coalitions without creating new ones, and erode the old fiscal contract without creating consensus for a new one. In this situation, the government as an actor is always a loser. Whatever the steps undertaken, coalitions are fragmented, resistance increases and the remedy turns out to worsen an aspect of the disease. *Zugzwang* thus conveys conceptually a situation where a player is forced to move, but any move will worsen his situation. In this case, even first best economic policies can turn a political equilibrium into a vicious circle that will end up in social resistance. Whatever the party in office, they cannot implement their preferred policy solution and the key question is then how to gather enough escape velocity to escape from the pull of *Zugzwang* politics.

Figure 6.1 summarizes visually this argument and suggests that when tax linkages are strong

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[51] Perhaps the simplest illustration of this interdependence between political order and economic reform is the well-known "J curve" (Przeworski 1991) where the curve describes the distribution of the costs and benefits of reform: things get worse before they get better. The extreme example of what happens when policies violate the intertemporal coalitional constraint is political violence erupting in Africa after IMF adjustments removed economic rents (van de Walle 2001).

[52] From German, it can be translated as "intermediate move". In chess, a player uses *Zwischenzug* as a move instead of another one to force the opponent to answer. From a game theoretical perspective, the move is aimed to change the outcome of a game from loss to win.

[53] From German, it can be translated as "compulsion to move". In chess, a player is deemed to be in "Zugzwang" when any possible move will worsen his position. In game theory, *Zugzwang* refers to a move that changes the outcome of the game from a win to a loss.

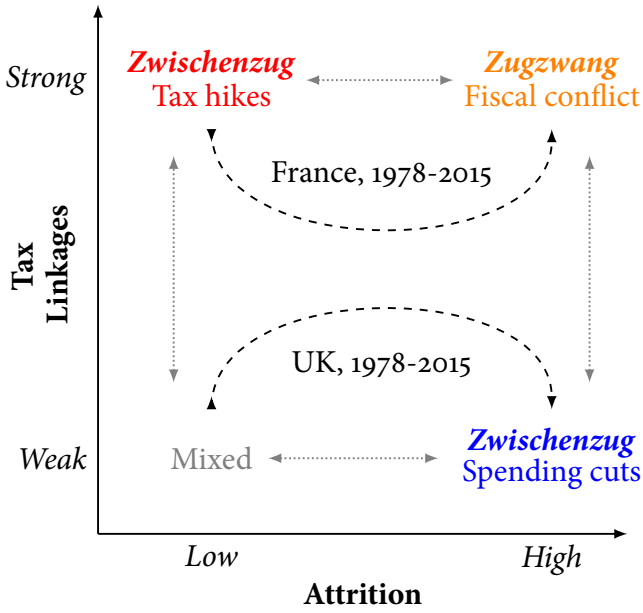


Figure 6.1: Social coalitions, fiscal pathways and austerity bias

and attrition is high, governments find themselves in a *Zugzwang*: opposition to tax hikes and spending cuts makes fiscal consolidation very difficult. Moving towards this combination of strong tax linkages and high attrition is a recipe for fiscal troubles, and I argue that this is where France is heading. Conversely, *Zwischenzug* implies moving away from strong tax linkages *and* high attrition is a way to create new social coalitions, either biased towards spending cuts (weakening tax linkages and keeping attrition high), towards tax hikes (keeping strong tax linkages and decreasing attrition) or accepting equally well tax hikes and spending cuts (weak tax linkages and low attrition). *Zwischenzug* can also happen when governments move away from the "mixed" position and move either towards tax hikes or spending cuts biases. The UK embodies the latter case of moving from a "mixed position" to new social coalitions accepting spending cuts.

Table 6.1 disaggregates and operationalizes the concepts of *Zwischenzug* and *Zugzwang* into several dimensions:

- *Fragmentation:* In *Zwischenzug* coalitions, the party that implemented austerity sees its share of votes increase or at least remain stable, while that of fringe parties and the opposition does not increase. In *Zugzwang* coalitions, the reformist party loses vote shares over time, together with other mainstream parties. Fringe parties rise as a sign of fragmented old coalitions.

- *Reelections:* In *Zwischenzug* coalitions, parties implementing austerity get reelected while in *Zugzwang* coalitions, any party implementing austerity loses elections. This section and the previous one will use data from the ParlGov database (Manow and Döring 2012).

- *Political gravity:* I use the RILE indicator of left-right party positions of Volkens et al. (2014) to answer the questions: are left and right parties far or close to each other? Do they converge on new center of political gravity, left or the right? Going beyond the simple measure of

Table 6.1: Austerity as *Zwischenzug* and *Zugzwang*

	Coalitions	**Zwischenzug**	**Zugzwang**	Data
Electoral	Fragmentation	No	Yes	ParlGov
	Reelection	Yes	No	
	Political gravity	Facilitates policy	Hinders policy	Manifesto
Social	Social conflicts	Diminished	Augment	Qualitative
	Fiscal rents	New ones	Erosion of old ones	
	Policy reversal	No	Yes	
	$\zeta(p_2)$	*Coalition formation* *New fiscal contract*	*Coalition erosion* *Old fiscal contract*	

NB: Summary table showing how coalitions can be observed on two levels, electoral and social.
Source: own elaboration.

partisanship in government, it is important to underline here that this indicator is used here not simply as a proxy for the median voter but as a way to map how parties position themselves to cement their coalitions. Do left-wing parties lurch to the right to put together a winning coalition? If so, when exactly? Do right-wing parties venture into left territory to do the same? Given that both country cases are more often than not majoritarian electoral systems, one can focus on the main party of the left and the main party of the right and see where the political center of gravity lies and avoid the fallacy of taking local shares of government portfolio for an absolute scale of left or right. Looking at political gravity will also allow us to see whether austerity is centripetal - drawing parties and social coalitions towards a new consensus - or centrifugal - pulling parties and social coalitions apart and provoking erratic patterns of decisions.

- *Rents*, i.e. whether austerity replaces old rents - e.g. social benefits - with new rents - e.g. tax cuts - and entrenches a new political economy of privileges. In *Zwischenzug* coalitions, austerity is used to formulate a new fiscal contract where some groups benefit more than others. For example, some parties may propose tax cuts, financial liberalization and easier access to credit as *quid pro quo* for expenditure cuts. Conversely, other parties propose to keep expenditures high if taxes are increased. The point is that once new rents are created, they are hard to change. This part of the analysis will use qualitative fiscal data mainly from national sources, case studies and the OECD tax database.

- *Policy reversals:*, Are the rents suppressed by austerity policies restated or not? Do governments operate a policy U-turn due to social resistance? For this section I use qualitative data from the historical process tracing of the UK and France.

The remainder of the chapter will proceed as follows. First, I examine the partisan thesis of austerity. If this theory is true, then we should expect to see a strong partisan effect during fiscal austerity: right wing parties cut taxes and spending, left wing parties increase both. In

order to do so, we need to do stack the deck of cards in favor of the partisan theory: contrary to the literature which uses cyclically adjusted measures, I will use a new dataset that measures government *intentions* as the dependent variable, i.e. their fiscal plans, cleaned of all political frictions and economic fluctuations. If the theory was proven correct on data such as the cyclically adjusted balance (Mulas-Granados 2006), then if it was no coincidence that this happened we should see an even stronger effect with fiscal plans. If, however, we see that parties have no effect on the shape of austerity, the empirics will imply that the partisan theory should be strongly qualified and that we need to understand under which conditions partisanship does make a difference.

In fact, I show that there are little partisan patterns to be found. Building on this finding, the next part of this chapter asks why this is the case and inspects what amounts to the best comparative example of fiscal consolidation that we have on political parties and austerity: a controlled comparison of two similar parties (conservatives) in similar countries (the UK and France) at the same time periods (1978-1983, 1993-1997 and 2010-2015). It turns out that despite similar partisan orientation and fiscal institutions, the UK ends up in a *Zwischenzug* whereas France is stuck in a politics of *Zugzwang*. In the UK, Conservatives obliged Labour to play on their terms, while in France neither party seem to be able to gather enough escape velocity to break free from the gravitational pull of *Zugzwang* politics.

6.1 Partisanship and austerity

Partisan approaches have a very long tradition in political economy (Hibbs 1977; Schmidt 1996a), spanning research topics covering inflation, central bank independence and growth. This strand of research has become vigorous since the mid-1980s when comparable country data became more available and panel data techniques were used to test larger time-series cross-sectional datasets (Boix 1997, 1998; Franzese 2002; Garrett 1998; Iversen 1999). This strand of research has been particularly powerful and widespread in the realm of public finance, covering various budgetary topics such as political business cycles, levels of expenditures (Blais et al. 1993, 1996; Cameron 1978; Clark and Hallerberg 2000, to name but a few) and the politics of austerity (Boix 2000; Cusack 1997, 1999; Mulas-Granados 2003, 2006; Tavares 2004).

This partisan literature is voluminous and it is not our aim to review it here. Rather, I report the main results. In normal times, when the fiscal pie expands, the literature has yielded mixed evidence of partisan bias in conduct of fiscal policy, depending on how you define it. The first set of results concerns deficits and political business cycles: while, for instance, Alesina et al. (1993) claim that partisan effect exist in the business cycle, for Hahm et al. (1996) the partisan effects are not statistically significant. Concerning deficits, common wisdom suggests that the left would run higher deficits than the right because the right cares more about macroeconomic imbalances while the left seeks to increase benefits. In the conduct of fiscal policy this translates into a more active role of left parties when unemployment is high and a more restrictive policy stance when there is full employment, while in general conservative governments are more restrictive (Cusack 1999). But the partisan logic behind fiscal policy can become more twisted still: as Persson and Svensson (1989) suggest, right wing governments may have an incentive to borrow more if they know the opposition will win the next elections. It does so to constrain future left wing governments and put

them in a situation where the budget has to be consolidated.

So far the aforementioned literature has focused on "normal times". Austerity may represent the perfect storm for the partisan conduct of fiscal policy. Governments seek to protect their constituency and push the burden of adjustment onto the constituencies of the opponent (Mulas-Granados 2006): as the partisan argument goes, conservatives labor to cut taxes and spending, while labor parties strive to conserve spending levels and increase taxes. This is the main result of quantitative approaches to fiscal austerity, but qualitative analyses suggest some important qualifications. The logic of partisan austerity can get more complex if one takes into account economic conditions, the need for the government to get reelected (Hübscher and Sattler 2014; Hübscher et al. 2015; Kemmerling and Truchlewski 2015) and the impact of electoral institutions. In certain electoral systems, parties may be more prone to target the median voter and thus are more willing to spread the burden of adjustment equally. Some left-wing governments in Sweden, New Zealand and Denmark - not to mention the UK - have conducted typically right wing fiscal adjustments. Parties can choose to follow a "Nixon-goes-to-China" strategy (Ross 2000): parties "punish" their own constituents because they know they will vote for them anyways and therefore, counter-intuitively, governments that engage in painful deficit reduction are also able to win elections (Alesina et al. 2006; Kitschelt 2001; Ross 2000).

The reason for the blurred picture that emerges from this literature stems from four inter-related problems. One is the data. Usually, quantitative researchers use outcome-based data to measure the effects of partisanship on fiscal policy: headline deficits, primary deficits (without the interest rate) and cyclically adjusted (primary) balances that filter out - very imperfectly - the effects of the business cycle. While this is a widely accepted measure in economics, which is nonetheless not without its critics (Devries et al. 2011), in analyzing partisan politics I rather aim at identifying the *intention* of governments and nowhere is this less noisy than in fiscal plans. Indeed, outcome measures can result from so many conditions that it is hard to extract that political ingredient, while the latter is mainly present in governmental communication because office holders have to send signals to their electorate.

Second, as already argued, econometric approaches are treating austerity episodes as discrete episodes for obvious reasons[54] but in doing so they do not help to show the link between different points in time in national fiscal pathways and make it harder to uncover critical junctures. Related to this already explored issue is the fact that, thirdly, these studies take as independent variable the share of left wing ministers in a cabinet and use it as a proxy for the position of a party in the policy space (Armingeon and Careja 2004). This is problematic because it assumes that left parties do not differ over time and across countries. Now, the Labour party in 1997 was quite different from its former self and from the French socialist party. Therefore, one has to capture this variation to see how politics impact austerity. Parties are not the same over time and across countries. Therefore, one also needs to control for the institutional and sectoral contexts. Fourth, and last, regression analysis shows average effects while partisan effects can vary over time and across countries. The last three issues will not be dealt with in the following regression analysis but will be tackled in the

[54] Here in the case of the *process* of fiscal consolidations over a longer time period like the age of austerity (1978-2015), I refer to assumptions such as the independence of observations in a random sample and no auto-correlation (Wooldridge 2009, p. 84).

controlled comparison of the UK and France.

Given the mixed evidence in the literature, what do my data suggest? Figure 6.2 displays the estimation for a range of panel data models (see the appendix of this chapter for a discussion of the estimation strategies) for three dependent variables (total austerity, tax hikes and spending cuts) and a full partisan model with the aforementioned controls. Focusing on partisanship, it is clear that, in figure 6.2, political parties do not seem to have a substantively and statistically significant impact: on all dependent variables, the partisan coefficient is indistinguishable from the null hypothesis.

On the side of the political vector, apart from partisanship, we see two political forces pushing in different directions. On one side, financial actors may press for more fiscal adjustment. This makes sense. After all, if the financial sector holds government debt, it has a strong interest in making sure public debt is on a sustainable path. But here lies a seemingly surprising finding. It may be natural for the financial sector to advocate spending cuts. They signal that, in the long run, the government will incur less spending liabilities and will thus be more credible when it comes to repayment. But it is counter-intuitive for the financial sector to ask for tax hikes because on the one hand they give room for spending increases in the future and on the other they may well apply to financial sector actors (through higher income or corporate taxes). The financial sector acts through its structural power (Culpepper and Reinke 2014), that is its capacity to sell debt and move away from a country, increasing the interest rate on debt. This was the case during the Eurozone crisis with Greece: between Q4 2009 and Q4 2010, the exposure to Greek sovereign debt of European banks fell by 29.3% with an important variation between countries: from 90.2% for Ireland and 85.1% for Sweden to 9% for the UK (Truchlewski 2011). On the other side, trade unions resist fiscal consolidation because they have much to lose on several levels. First, spending cuts often fall on the welfare state and union members are in general its main constituency. Second, tax increases may, for instance, either be channeled through social contributions, which may increase the cost of labor and thus cause unemployment, or be achieved through VAT, which is considered as regressive. For these reasons it is not surprising to see the opposition of organized labor to austerity.

Concerning the economic vector, one can see that, as posited in the literature, debt has the expected substantive effect: when it runs high, government plans for austerity are much more serious. This makes sense: not only is the situation more serious, it also bears more consequent measures. It may also be that a higher debt is more risky to manage because it is more vulnerable to high interest rates, especially in a low growth environment.

The same applies to interest rates: the higher they stand, the more important the total fiscal consolidation plans are, and the effect is consistent across the dependent variables and is robust to different specifications. An increase by one basis point in the interest rate in general pushes austerity up by 0.02% of GDP (average effect for total plans, tax and spending). Thus, to a certain extent statistical analysis confirms the austerity trade-off as developed in the appendix to chapter 2 and according to which debt sustainability depends on the level of debt, the interest rate and economic growth.

Here we also see that growth plays a non-negligible and robust role: in fact higher growth diminishes fiscal consolidation because, as the denominator in the Domar (1944) equation, higher growth makes debt more sustainable and thus reduces the urgency of fiscal consolidation. This

explains why fiscal consolidations are often happening in pro-cyclical conditions. In good times, growth makes debt sustainable, while in bad times it makes it unsustainable and thus austerity is implemented, even if it damages growth. As for deficit, the robust relationship seems to make sense: lower deficits (i.e. negative integers further from zero) increase the need for fiscal consolidation while higher ones (positive numbers, which amounts to a surplus) reduce this urgency. Therefore, on the side of the economic vector, the model seems robustly consistent with hypotheses.

All in all, the evidence for the partisan theory of fiscal consolidation is pretty weak. Parties ($\hat{\beta}_{\text{Party}}$) seems to have no significant effects on average on austerity plans. However, we may be interested to ask whether this average effect is non-significant constantly over our long time period, or whether the coefficient has changed as the age of austerity progressed: do specific subsamples of the panel data reveal the withering away of partisan influence over austerity, or was it always the case that parties had no influence over fiscal consolidations? To find out, one can perform rolling regressions, and in our case we do so using a thee-year window. With these three-year windows we perform a series of regressions for the panel data, using the data within the window to estimate a coefficient, standard errors and confidence intervals for each subsample. The trick is then to plot these over time. The result is to be found in figure 6.3 (the figure stops at the year 2000 because there are not enough fiscal consolidations after that point to run regressions).

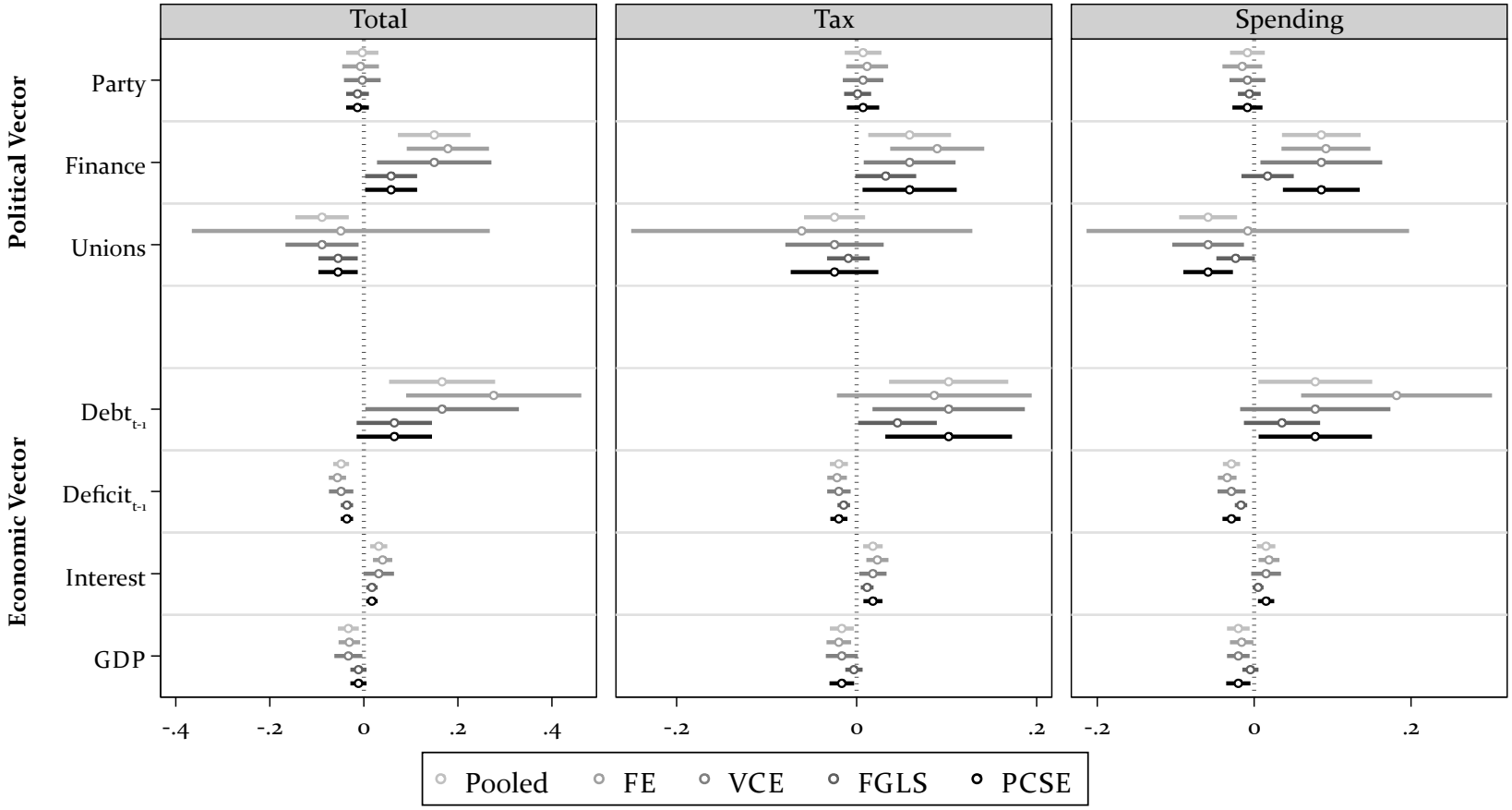


Figure 6.2: Partisan models of austerity

NB: Panel data regression on 17 countries from 1978 to 2009: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Portugal, Spain, Sweden, the United Kingdom and the United States. The dependent variables are the "total" fiscal consolidation, spending cuts and tax hikes. The ropeladder plot shows the coefficients and the confidence intervals for each independent variable and for each estimation method of the panel data models, and thus helps to gauge visually their robustness. Confidence intervals are at the 95% level. Full regression tables by estimation techniques with all the results can be found in the appendix. Note: results for the lagged dependent variable are not displayed.
Source: own elaboration based on tables 6.6, 6.7 & 6.8.

Looking more closely at $\hat{\beta}_{\text{Party}}$ we see that a student interested in the partisan theory of austerity in the early 1980s would have found that, after performing regressions, left wing parties did indeed plan lower fiscal consolidations, and that this was due mostly to lower spending cuts. At the end of the stagflation age this makes sense: left-wing parties supported by workers were probably seeking to protect their constituencies. Think of France's François Mitterrand arriving to power in 1981 and reversing austerity policies that were the main plank of his predecessor, Valéry Giscard d'Estaing. But as the crisis protracted, fiscal consolidations could not be avoided, and so the partisan effect on spending disappears. Left-wing parties had to stop resisting spending cuts - think about the policy-U-turn of François Mitterrand in 1983. But left wing parties then also turned to tax hikes: another, younger, student interested in partisan austerity may find evidence for the theory on the tax side in the second half of the 1980s (but not on the spending side). Yet, as taxation becomes too high, social groups start opposing the left's strategy, and so both left and right end up implementing the same strategy. This fact may have been accentuated by the process of monetary integration in Europe where the lack of an exchange rate instrument for adjustment put a break on tax increases: devaluation was not possible to regain competitiveness and compensate for taxes that increased the cost of labor (social security contributions). As a result, an even younger student focusing on austerity in the 1990s finds not partisan effect: this confirms the findings of Boix (2000) of a gradual convergence of parties over policies in the late 1980s and 1990s due to the development of financial markets, fixed exchange rate regimes and reduced capital controls. In a way, this story fits with the estimates of the financial actors in figure 6.5. Weaker trade-unions may also have had an effect, diminishing the capacity of the left to shape austerity. But if trade-unions started playing second fiddle on the political scene and financial markets moved to the foreground, why do students of partisan austerity do not see a negative correlation between partisanship and austerity? In this case, even if left parties lose power, one could expect right-wing parties to implement their preferred option from the point of view of the partisan theory: cutting taxes faster than spending. Yet, what we see in figure 6.3 is that $\hat{\beta}_{\text{Party}}$ is just converging on zero. Therefore, right wing parties also face powerful constraints during austerity.

These findings and puzzle invite to ask the following question: if time dynamics and previous adjustments play such a tremendous role in the partisan politics of fiscal adjustment, then under which conditions do parties manage to implement their favorite austerity policies? We need to look closer at the politics of fiscal adjustment over time on a smaller scale, i.e. a systematic historical comparison of most similar cases. To this we now turn.

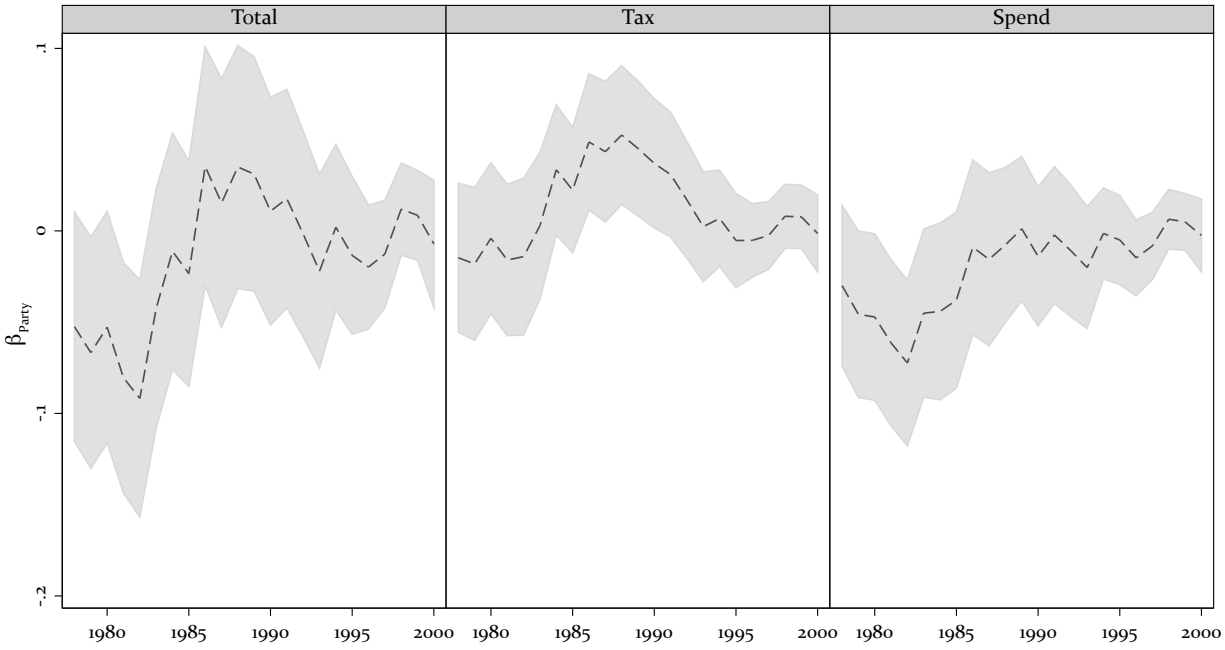


Figure 6.3: Behavior of $\hat{\beta}_{\text{Party}}$ over time

NB: The plots show the behavior of $\hat{\beta}_{Party}$ over time in order to go beyond average point estimates and to understand when and why parties stop influencing the shape of austerity. The procedure estimates a panel model and then performs the regression over a moving window (here, ten years) extracting coefficients, standard errors and confidence intervals, enabling us to visualize when a given covariate has most influence on the dependent variable.
Source: own elaboration based on regressions from table 6.5.

6.2 Austerity and coalitions in the UK and France

Going beyond the partisan logic, this section scrutinizes austerity politics with a focus on coalition formation and erosion in the UK and France. I will focus on whether social groups are coherent or whether social conflict prevails both at the electoral and social level, whether they are polarized (i.e. how distant they are from each other, which signals conflicts and lack of consensus) and whether the center of gravity of their coalitions is left or right skewed, in the political sense of the concept. To do so, I will develop the analytical framework of *Zwischenzug* and *Zugzwang* on two levels: the electoral level, which should be the first evidence of the changing politics of a country, and the social level, to confirm the fact that social coalitions are either reshaped or eroding.

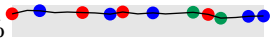
It appears that coalitions change significantly over time. During the age of austerity social coalitions end up on the opposite side of their initial position in the age of plenty (1945-1978). In the UK coalitions evolved from a coherent left skew in 1951-1964 (where both Tories and Labour were oriented to the left) to an increased polarization between 1966 and 1992 (when Labour stayed on the left and Tories made a sharp move to the right) and a more coherent right skew from 1997 to 2010 (when Labour shifted to the right). In France, coalitions were very much polarized from 1946 to 1988, with left and right coexisting in a dance of power. In this period, left and right were constantly adjusting to each other, resulting in a polarized *pas de deux* where they alternatively switched between more extreme positions. Interesting, around 1986-87, in both countries the political scene was almost equally polarized (50 points of distance according the RILE indicator), the French and British right both significantly moved to the right (the shift was much more pronounced for the Gaullists), and the left-wing parties moved to the center (see figure 6.4 and 6.6). But by the 1990s and 2000s, as the third and fourth periods in the age of austerity unfolded, the UK moved towards a right-skewed polity while France ended up in a left-skewed polity. At the same time, British social blocks acquired a new fiscal coherence that laid the basis for a permissive consensus for spending cuts and opposition to tax hikes: this is what I call *Zwischenzug* politics in the UK, where fiscal consolidation in $\zeta(p_1)$ during Thatcher imprint fiscal austerity under Cameron in $\zeta(p_2)$. This fiscal coherence eroded in France, without creating new social blocks that would support spending and tax cuts. Given that taxes are very high and spending cuts are very much contested, France entered what I call the politics of *Zugzwang*: any fiscal move of the government worsens its situation and undermines its credibility, feeding the extremes. In last analysis, it is crucial to see how French parties in power after 2010 will try to use austerity to put some glue on new winning coalitions. These findings thus yield a question: how come that during the age of austerity Britain veered to the right and France to the left, and that Albion managed to reshape coherent coalitions while the Hexagone is entangled in a blocked political economy?

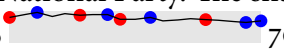
In the remainder, I will show how the concepts of *Zwischenzug* (reshaping coalitions) and *Zugzwang* (coalition erosion) apply to the UK and France respectively. Following table 6.1, I will process trace the evolution of each of the aspects of *Zwischenzug* and *Zugzwang* over the period 1978-2015 with additional historical data to compare the age of austerity to the age of affluence [1945-1978]. This will enable us to see how the first generation of austerity policies in $\zeta(p_1)$ [1978-1983] influenced austerity in the next $\zeta(p_2)$ [1993-1997] and $\zeta(p_3)$ [2010-2015].

6.2.1 UK: fiscal Zwischenzug and the transformation of social coalitions

The electoral level of *Zwischenzug*

Fragmentation and reelection

I look at how stable coalitional politics are in the UK. Starting with the election turnout, one can see that it has been quite stable between 1945 and 2015 (ranging between 72.8%  66.1%).[55] This implies that social coalitions were keen to use their voice (and loyalty) and not to exit the electoral competitive process. This statement should be nuanced nonetheless: the trend has seen a sharp decrease between 1992 and 2001, after the Lawson boom and the ensuing bust (see the green dots on the sparkline) plunging below 60% for the first time in 2001. But soon enough, the participation rate came back to trend. Interestingly, it increased between 2010 and 2015. It thus appears that, despite expenditure-led adjustments, voters did not turn their back on elections too much, although the average turnout during the age of plenty was 77% and during the age of austerity it was 68.25%.

What about majorities and the share of seats in Parliament of mainstream parties implementing austerity? If one takes into account the share of parliamentary seats of Labour and Tories, it stayed high over time (92.2%  86.5%). The difference between the age of plenty and the age of austerity is not substantive (95.6 vs. 89.4%). The share of mainstream parties in the popular vote is even higher if we add the votes for the Liberals, being constantly above 95% of the votes, with the exception of the last election in 2015 (but still 87.7%), which is mainly due to voters switching from the Labour and Liberal parties to the Scottish National Party. The share of mainstream parties' votes is, however, lower but still quite high (80.6%  70.3%) with a peak in 1951 (96.8% of the votes) and a low in 2010 (65.1%). The latter may be explained by the crisis. Interestingly enough, the harsh fiscal adjustment was followed by an increased share of the vote of mainstream parties. If one adds the Liberals, then this proportion never goes below 85.5%. Although there seem to be a significant difference between the age of plenty and the age of austerity (85.7 vs. 71.2% of vote share for Labour and Tories), this difference almost vanishes once we include the Liberals (96.4 vs. 91.3%).

The evolution of the effective number of party votes and party seats seem to confirm the relative stability of British parliamentary coalition despite the conflicts in social coalitions mentioned above. The effective number of party votes increased slightly during the age of austerity (from 2.6 to 3.3), as did the effective number of party seats (2.2 to 2.3). This signals that party fragmentation only marginally increased during the age of tough budgetary decisions. All in all, the electoral translation of coalitions is pretty coherent and robust over time, with a slight erosion during the age of austerity. It is quite surprising to see the contrast between the turbulent coalitional politics at the social level (the conflicts between labor, business and finance described above) during the age of plenty and the relative stability of electoral politics. Fringe parties do not threaten the cartel of mainstream parties despite their fiscal retrenchments.

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[55] These sparklines as well as the following ones span the years 1945-2015 and cover all elections conducted since WII. I show a blue dot when Tories win elections and stay in office and a red one for Labour. Not all elections are thus represented for reasons of lisibility. The date of the dots are: 1945, 1951, 1964, 1970, 1974, 1979, 1997 and 2010.

Political gravity and effects

This section asks how the political center of gravity evolved over time in the UK during the age of plenty and the age of austerity (unfortunately the data is available only until 2010, not 2015 as in the previous sparklines). To start with how the position of political parties evolved over time. This is important because, as argued previously in the chapter, it is not the color of the party in office that counts for the shape of austerity, but the gravity field into which a party is caught. A right wing party may be pulled to the left as much as a left wing party may be pulled to the right. Both situations actually happened in the UK between 1945 and 2010. To see this, one can represent both parties on a left-right scale as measured by the RILE indicator of the Manifesto dataset. The combination of the two yields a two-dimensional map of British politics. Negative measures mean that parties are more left-leaning and positive values mean that parties are more leaning to the right.

Figure 6.4 shows that in the "age of plenty", between 1950 and 1964, the British political gravity was very much on the left: as a matter of fact, in 1959, Labour and Tories were almost equally very much to the left (respectively -26.60 and -23.30). It was only four years before that the Eden-led, post-Churchill Tories reached the most left-ward position in a new electoral victory. The apex of these left-tilted social coalitions was reached between 1959 and 1964, when the three political sensitivities were closest to each other and the liberals were even to the left of Labour in 1964. Between 1959 and 1970, however, British political coalition operated a sharp turn to the right with Labour moving closer to the political center and the right swinging back to a right-wing position. In the apex of the age of plenty, the political center of gravity thus moved to the center right, as the indicator on the sparkline shows.[56] Indeed, on the account of this measure, more rigorous than in figure 6.4 which does not weigh the votes, the British center of political gravity switched from the left to the right between the age of plenty and the age of austerity (-10.71  7.91). The minimum value of the median voter was reached in 1955, as previously mentioned, and mirrors the extreme left positioning of British politics: -33.75. Interestingly, the political center of gravity reached its most right-wing position in 1997, when Labour moved to the center-right to win the elections under Tony Blair (the value of the median voter was 10.95). The average value for the center of gravity between 1945 and 1979 was -12.95, while during the age of austerity it averaged at 4.97 (1983-2010).

Figure 6.4 offers also additional information to the political center of gravity. It shows how distant political parties are from each other. In other words, it suggests visually how much polarization there is (i.e the points should move towards the northwest and southeast corners of the political map) and whether British politics are centrifugal (moving away from a center) or centripetal (moving towards a center) over time. Thus, starting with the elections of 1970, British partisan politics became increasing polarized and centrifugal. The Tories moved much more to the right between 1970 and 1987, with the Labour party adjusting hectically. For reasons of clarity, figure 6.4 only shows the second election of 1974 in the connected plot, so a small explanation is due here (the results of February 1974 are represented by a single square, though). The result of the February 1974

[56] The center of gravity is calculated in the following manner: $\sum_{i=1}^{n}(\frac{V_i}{T} \cdot p_i)$. T is the sum of vote share at the election, V is a party's vote share and p a party's left-right position (RILE). See Gross and Sigelman (1984).

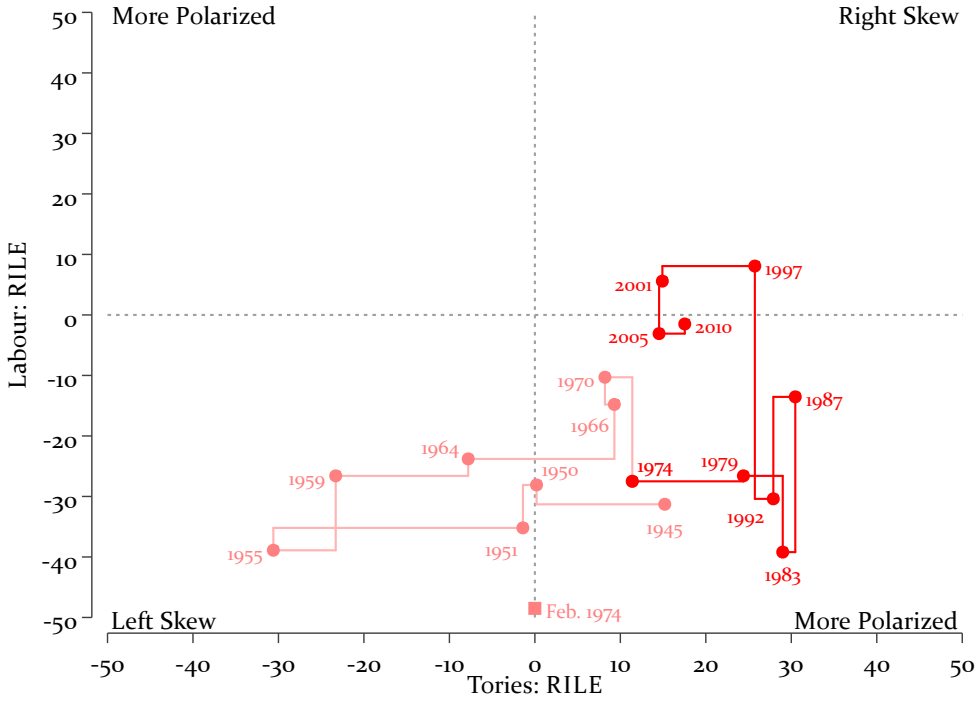


Figure 6.4: Political map of the UK, 1945-2010

NB: For each British parliamentary elections, the left-right position is compiled for the two main parties and plotted against each other, thus providing a proxy for the visualization of the political center of gravity (whether it is skewed to the left or to the right) and the polarization of the political scene (how far are the main parties from each other).
Source: own elaboration based on data from Volkens et al. (2014).

elections was a "hung" parliament. No party won an outright majority of seats, and even though Labour won slightly more seats, the Tories got more popular vote. Compared with the elections of 1966 and 1970, the Tories moved to the center (RILE=0) while Labour moved aggressively to the left (RILE=-48.5). Interestingly, the Liberals, who got almost 20% of the popular vote, and who were very much to the left in the 1950s and 1960s, had moved to a center-right position in 1970 (RILE=6.4), but then came back very much to the left in February 1974 (RILE=-23.4) and lurched back to the right in October 1974 (RILE=2.6). Therefore, the elections of February 1974 clearly showed that the time of left-leaning social coalitions was over and all three parties moved to the right, but Labour more reluctantly than the other parties. In fact, in the following elections (1979-1997), Labour alternated extreme left and center right positions. Therefore, in the decades of economic and fiscal adjustments (1970-1980s) politics started being centrifugal and were reflected very much in the stop-and-go policies of small-majorities governments and the IMF crisis of 1976. British politics nonetheless found a new center of political gravity after 1992: the centripetal aspect of British politics is suggested in the Fibonacci spiral between 1992 and 2010.

Therefore party positions were increasingly polarized starting in 1970 but with the elections of 1997, polarization receded as Labour moved to the center together with the LibDems and thus

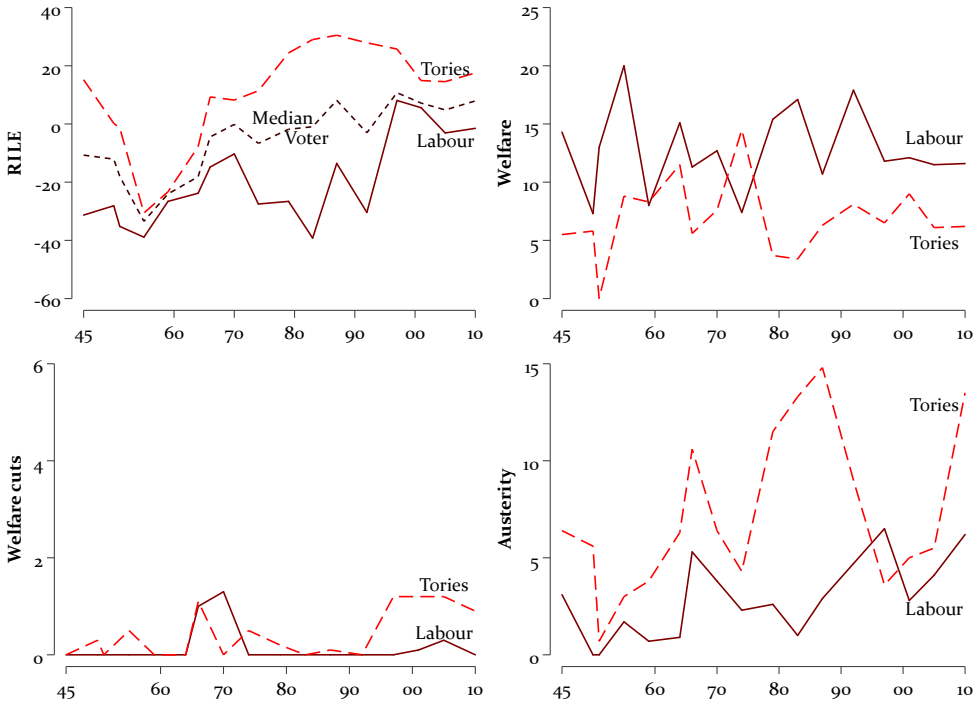
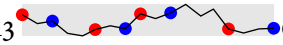


Figure 6.5: UK partisan positions, 1945-2010

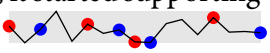
NB: RILE comes from figure 6.4, the median voter is weighted for the election results, "Welfare" comes from the Manifesto dataset per503+504, "Welfare cuts" is per505 and "Austerity" is per303+414+505+507. Explanations in text.
Source: own elaboration based on data from Volkens et al. (2014).

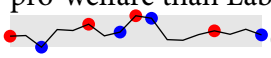
the center of gravity of the political space shifted to the center right. As a matter of fact, a more rigorous measure of polarization[57] confirms this impression of a highly polarized British polity between 1974 and 1997: 2.13  0.78. In fact, during the age of plenty, polarization averaged 1.37, while during the age of austerity, polarization averaged 1.54.

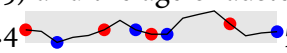
So far, our analysis has focused on the electoral participation of coalitions, their fragmentation, the median voter and polarization. We have seen that British coalitions underlying the parties in office have veered to the right with the Tories leading the way and Labour being pulled in the changing center of gravity after election losses. Still these are broad policy positions. What about more specific policies?

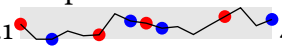
Fortunately, the Manifesto Dataset has some flexibility in this regard. I have constructed two indicators for both Labour and Tories based on the sub-indices of RILE to gain a more fine-grained picture of how coalitions moved in the UK (figure 6.5 summarizes the following data). First, I have constructed an indicator capturing a pro-welfare position (per503+504) which is an arguably imperfect proxy for lower expenditure cuts during austerity. It operationalizes the positive attitude towards redistribution and social equality. The result is that, if we look at the difference between

[57] The polarization index varies between 0 and 10: $\sqrt{\sum_{i=1}^{n}((\frac{p_i - wmean}{100})^2 \cdot V_i)}$. Here, p is a party's left-right position, V is a party's vote share and $wmean$ the weighted left-right mean. See Dalton (2008).

averages in the golden and austerity ages, Labour has become more pro-welfare (11.74 vs. 13.78) while the Tories have become less so (8.33 vs. 6.15). More concretely, the peak of Labour support for the welfare state happened in 1955 and with the victory of Conservatives in 1955, it started supporting welfare less and less until it reached its second time low in 1979, 7.4 (14.29  11.51). As the previous sparkline shows, the second peak in welfare support happened in 1997, when Labour regained power. So did Labour enter office with the same position as in 1955? These data do not tell us which type of redistribution parties favor over time and based on which economic ideas. Indeed, while Labour may have favored redistribution in the 1970s based on ideals such as general equality, in the 1990s and 2000s Labour's economic software maybe different. Anecdotal data on this issue suggest that Labour welfare policies were aimed at reducing poverty rather than reducing broad social inequality by taxing high incomes (Cobham et al. 2013; Joyce and Sibieta 2013; Lindley and Machin 2013; Propper and Venables 2013). Labour's policies may have less in common with equality of outcome than with providing the right incentives to optimize the supply side of the economy (e.g. skills) through equality of opportunity. For this reason, Labour's government did increase spending on education and health more than Tories, but it increased social expenditures much less: it thus became more workfarist than welfarist (Deeming 2015; Glyn and Wood 2001).

Other trends unfold from the data. First, Labour was always more pro-welfare than Tories in the age of plenty, but only marginally so. In fact, in the 1970s, the Tories were pretty much more pro-welfare than Labour. It is only in 1979 that Tories became less supportive of redistribution (5.5  6.1). In 1987, the Tories reached almost their all time low of 1951 (3.4 vs. 0). As an aside, it was precisely at that time that the difference with Labour was almost the greatest (12.9 points of difference), the real polarization moment was, again, 1987 (13.7). This confirms that, if anything, there never was a consensus in the 1950s when the early construction of the British welfare state happened.

Another way of looking at social coalitions and the politics of austerity is to construct an index of "austerity-friendly policies" (per303+414+505+507) which includes slimming down civil service (the "efficiency drive"), economic orthodoxy (reduction of deficits, retrenchment in crisis), welfare state limitation (reducing social security expenditures) and limiting state expenditures on education. The resulting measure, however imperfect it may be, confirms that in general the conservatives are more prone to implement "austere" policies, their average having increased between the age of plenty (5.15) and the age of austerity (8.96), and peaked at 14.08 in 1992 and were smallest at 0.7 in 1961 (6.4  5.52). .

The values of Labour evolved in parallel with Tories' preferences for austerity during the age of plenty, but at a lower level (3.1  4.1). The difference for Labour between the age of plenty and the age of austerity is small but increasing, confirming the policy shift after 1987 (2.11 vs. 3.51). As a matter of fact, the highest value on the austerity index for Labour was in the 2001 election, the first time that the Labour party in the UK was more pronounced on austere policies than the Tories. This may well have been due to the fact that at the time Tories were trying to regain power and probably wanted to downplay their austere preferences in an election that happened against the backdrop of slowing economic growth.

Before we start analyzing the politics of fiscal *Zwischenzug* in the UK at the social level, it is useful to summarize the findings of this section focused on the electoral level. First, Thatcher's

austerity policies did not fragment popular vote as much as might have been expected given their policies under Thatcher. Electoral participation remained quite high and even increased since 2001. Conversely, the share of popular votes and seats in parliament going to the two mainstream parties was reduced only marginally. If one cannot talk of a duopoly anymore as between 1945 and 1992, there is nonetheless a strong Cartel of parties supporting the need for orthodox fiscal policy, low taxation and keeping expenditures in check. The increasing territorial fragmentation of Great Britain is probably a force promoting electoral fragmentation: serious centrifugal forces push Scotland out of the Union and thus give more voice to Scottish Parties in national elections, as the 2015 vote has shown. While several factors are at play in this case, it is important to understand that with the onset of the age of austerity in 1979, Scotland has voted Labour but has consistently received conservative policies between 1979 and 1997 and 2010 and 2015. Given that Tory austerity strategies were mainly aimed at Labour constituencies, we could have expected austerity in the UK to have fragmentary and centripetal effects, leading potentially to a *Zugzwang*. Despite these political currents, austerity rather provoked a *Zwischenzug*: as we have seen, since 1979 the lowest participation rate in elections was in 2001, and it increased in 2015 with a victory of the Conservatives.

To be sure, initial Tory austerity policies encountered a great many obstacles and the endogeneity mechanisms did not start working before 1987-1992. Exogenous events may have deeply facilitated such a movement of fiscal *Zwischenzug*. The most important is the Falkland war between April and June 1982. Data from polls[58] suggest that in Thatcher's first term, her approval rate dropped quite fast from 50% in June 1979 to less than 30% in March 1982. With the onset of the war, Thatcher's poll quickly recovered to almost 50% in July 1982 and then stayed at more than 40% until the elections. One would thus think that the Falkland war saved Thatcher. But did Thatcher need to be saved? A closer look at the polls shows that the crucial 1981 budget had no impact on the trend of polls for the Tories. It is rather Labour polls that collapsed, quite surprisingly so given Tories' austerity, and reached the level of unpopularity of the Tories in March 1982. Instead, public opinion shifted from an increasingly left-leaning Labour to the Liberals and the Social Democratic Party who were moving to the center (their RILE indicators were -18.9 for 1979 and -9.5 for 1983). Thus the Falkland war was only a partial *Deus Ex Machina* in a political landscape moving already to the right anyways.

In sum, the median voter moved to the right with a centripetal movement making Labour gravitate towards the Tories. Polarization decreased significantly after the elections of 1992, after having been high since the elections of 1974. Tories kept being reelected while applying expenditure-led adjustments. How does this electoral reality translate into coalitions at the social level?

The social level of *Zwischenzug*

From 1945 to 2015, the coalitions that structured the British political economy changed dramatically. From the end of WWII to the 1970s, these coalitions were mostly fragmented and their conflicts unfolded in the shadow of international monetary matters and against the backdrop of a peculiar welfare state that did not generate as strong constituencies in its favor as in France.

[58] Accessible here.

On the monetary side, Britain had to manage a transition, in the words of Susan Strange, from a top and master currency (respectively that of an economic leader and that of an empire) to a neutral one (use widely like the Swiss Frank), which implied that it had to maintain or improve confidence in the Sterling and manage the increasing costs of having an international currency in a world dominated by the dollar (Helleiner 1996; Strange 1971; Bulpitt 1986; Brittan 1983). This not only generated unnecessary costs that put fiscal policy under the dominance of monetary policy. In practice this meant higher than necessary interest rates, subsidized influence against devaluation, giving development and military aid and importantly, potential massive outflows of private capital. It also put British monetary policy at the mercy of "disruptive" monetary manipulations that exacerbated recurring crises of the balance of payments. These monetary manipulations could be enacted even by small countries formerly in the Empire and now members of the Commonwealth. Some of these countries had important monetary reserves. The case of Zambia is an emblematic example of how sensitive this issue was. Zambia had the largest Sterling reserves in Africa due to its strong copper industry (Shafer 1994). When in 1965, Rhodesia declared independence to ensure White rule, Zambia wanted to force Britain to nip Rhodesia's rebellion in the mud and was supported in this by all newly independent African states. Britain's lukewarm reaction made Zambia to put pressure on the UK to act against Rhodesia. But given the need to maintain confidence in the Sterling area, the UK was keeping fiscal austerity tight because it could ill afford an armed conflict in the antipodes. But thanks to its ability to strategically disrupt the system, Zambia in the end extracted substantial amounts of aid from the UK as a concession (Kirshner 1997).

When the crises of the early 1970s hit Britain (end of Bretton Woods, oil shocks), the clashing needs for domestic reflations and maintaining an international currency exacerbated stop-and-go policies (due also to thin gold reserves and large potential foreign claims) thus amplifying Britain's problems. The UK was marred by permanent crisis. It did not help that a fragmented coalition of Labor and business pushing for reflation and the expansion of a poorly designed welfare-state opposed the coalition of the City and the Treasury which was fighting for the international role of the Sterling. With hindsight, those clashing fragmented coalitions showed that there was no clear consensus in Britain on the national social contract, contrary to other contemporary political economies like France (state-led modernization) and Germany (export-based ordoliberalism).

A few ingredients hampered the development of a mature welfare state in Britain: the instability of British taxation was exacerbated by political alternations with small majorities while stop-and-go policies accentuated the decline of Sterling (Rhodes 2000). From this perspective, the following account challenges established views of the British political economy which assume that a strong consensus on the welfare state precluded serious retrenchment (Pierson 1994). In fact, retrenchment in the 1980s happened *because* the welfare state was fragmented and based on contradictory philosophical principles (assurance vs. assistance) that yielded political frictions and a "reluctant welfare state" (Ashford 1986). As a result the British welfare state was never underpinned by a cross-class coalition between labor and business and industrial organisations. The Beveridge report was never fully implemented in the UK because it entailed too important a cost, too rigid social insurance principles (Hess 1981; Hills et al. 1994; Ingham 1984; Lowe 1994) and unstable sources of revenues (a "roller-coaster" in the words of Steinmo 1993) that would have needed a bi-partisan consensus. This suggests a very weak link between revenues and expenditures in the British budget. The late development of a patchy pension system in the UK shows how weak a

political basis the British welfare state had. The UK lagged behind the advanced political economies until 1975 when it adopted an earnings based pension system (SERPS: State Earnings-Related Pension Scheme), and even then this reform lasted only until 1986 (Pierson 1994). Taken together, those characteristics suggest that there was hardly any strong coalition behind the welfare state in Britain, despite strong unions.[59]

One should note that the coalitions were fragmented because the three actors (labor, finance and business) could not agree with each other. Industries and labor were as much unable to cooperate as industries and capital were. The relationship between labor and industries was problematic for structural reasons. First, contrary to most of Europe, wage bargaining in the UK is unlinked to the welfare regime and labor market policy. Second, the link between labor and businesses is also weaker. Third, unions had only limited institutional support, which implies that they are more dependent on internal power resources (Hyman 2001). Fourth, British unions had to face permanent government hostility since 1979, either under Conservative rule (introduction legislation hampering union organization and action) or under New Labour (which bifurcated towards "supply-side trade unionism" i.e. more favorable to firms' competitiveness and embraced controversial policies as privatization and fiscal restraint).[60] Other structural changes include the rise of fragility on the labor market with the UK having the lowest ratio of fixed-term contracts on the labor market (Gumbrell-McCormick and Hyman 2013, p. 35). Finally, as already mentioned, union density fell dramatically since the 1980s, and so has collective bargaining coverage as well as the number of shop stewards (workplace union representatives) which diminished by two thirds between 1984 and 2004.

At the same time when labor was having problematic coalitions with industries and political parties, financial and industrial capital hardly saw eye to eye. In the 1960s, due to the problem of the international role of the Sterling, deflationary episodes made the situation of domestic producers more difficult because it squeezed profits and thus their capacity to invest, which, repeated over a few decades, hampered the adaptation of British industry to world markets (Judt 2005, chapter 10). This problem underlines the dual character of British capitalism before Thatcher: the financial separation of the City and industry, where the former has been diverted to deal with international commercial activity (commodities, credit, insurance and currencies and clearing house for most of the world's economic transactions) and the latter failed to modernize and adapt to the growing competition of France, Germany, Japan and the US. In the 1960s and 1970s the weakness of UK trading position and chronic current account deficits implied that the maintenance of Sterling's value could only happen through fiscal and monetary deflation.[61] This policy acted as barrier of long term planned productive growth (Ingham 1984; Zysman 1983) and drove a wedge between

[59] At least compared to France and the OECD countries: union density peaked at 51.8 in 1978 but then declined to 25.8 in 2012 according to the OECD database with the number of members shrinking from over 13 million to less than 7 million.

[60] This rebranding of the Labour party gave way to a "contentious alliance" with the unions (Minkin 1991) already strained by the willingness of Labour to reduce their financial dependence on the unions which they considered as an electoral handicap.

[61] To be sure, Sterling's fragility was also due to the willingness to maintain City as a world financial center: reopening the City as a platform for short-term funds attracted to London by high interest rates meant that hot money could flow in and out of the economy together with the fluctuations of economic uncertainty.

industrial and financial capital. This split the political economy into two broad coalitions: after the 1960 conference "Next Five Years" of the Federation of British Industries (later Confederation), Labour sided definitely with powerful workers, the industry and its for long-term patient capital while the Tories sided with the City and the strong Sterling (and thus the Bank of England and the Treasury as well as small and medium sized enterprises who were unwilling to see Labour install new monopolies in the economy by using state-led modernization).[62]

The first fiscal consolidations under the Thatcher government happened in the wake of these fragmented coalitions and botched adjustments that led to stop-and-go policies resulting in an IMF bailout in 1976 and in social crises (the Winter of Discontent of 1978-79). Thus in 1979, none of the coalitions prevailed. But because change was badly needed, Thatcher was elected on a program of radical change and fiscal consolidation. Those fiscal consolidations gradually weakened the influence of trade unions not only through laws changing industrial relations but also through increased unemployment, reduced subsidies to public industries which were privatized in a context of shrinking manufacturing sector. This enabled the retrenchment of the welfare state by lowering replacement rates, the length of benefits and toughening eligibility for benefits. This all happened in the 1980s when unions were still relatively strong and voters still keen on redistribution.

Coupled with financial reforms beneficial to the City[63], the fragmented coalitions of the 1970s gave way to more coherent coalitions in the 1980s. With financial liberalization and austerity, alternative insurance and distributive mechanisms (consumer credit, private ownership) in fact reshaped the welfare state and eroded support for its old form. A coalition between homeowners, the construction sector and financial institutions emerged in the late 1980s with the Lawson boom that was supported by both Tories and later by Labour over the years (Crouch 2009; Watson 2009).

It is worth highlighting a few mechanisms through which this newly emerged coalition exerts influence on a deflationary fiscal policy: during housing booms, households take on debt and due to mortgages (frontloaded repayment if the household is young) tax acquiescence is pretty low (Conley and Gifford 2006; Kemeny 2005). During busts, households are hit both by mortgages (and their rising rates in a financial crisis, until the central bank lowers interest rates) and the diminishing value of their asset. This makes it harder to sell the house because of the losses and also to stay in it due to the cost of the interest rate. In any case, households do not consider higher taxes and/or higher public expenditures with a keen eye.

It is crucial to understand the endogenous mechanism that leads from one fiscal consolidation under Thatcher to the other under Cameron and how it has reshaped social coalitions. After 1979, with distorting taxes, expenditure cuts, the privatization of the housing stock and financial liberalization which resulted in the Lawson boom in the end of the 1980s, the Thatcher government aimed at limiting the welfare state that she considered a source of inefficiency, labor market rigidity and inflation. Thus the expansion of the financial system - the financialization of the political economy - was targeted at limiting the welfare state and creating a supporting coalition

[62] Industry was so opposed to Tories that when Thatcher was later elected, the president of the CBI (Sir Terrence Beckett) challenged Thatcher to a "bare-knuckle fight" on monetarism, deflation and her coalition with the City.

[63] The removal of exchange controls in 1979 encouraged the City to expand foreign earnings and strengthened further its position. The Big Bang of 1986 liberalized and "re-regulated" the City which strengthened its hand - see Vogel (1998, chapter 5)

for deflationary fiscal adjustments. The second housing bubble, that swelled under Labour, rather sought to transform the welfare state into an asset based one. Insurance mechanisms were to be individualized and preferences for redistribution changed, which ultimately happened in the end of the 2000s (Ansell 2014).

To sum up, British fiscal consolidations in the 1970s were deflationary due the international role of the sterling and the fragile balance of payment. These were the bones of contention that provoked recurrent conflicts between fragmented coalitions. The public budget was hostage to the forces of international finance and a fragmented labor movement, which acted against the backdrop of a declining industry. With Thatcher's financial and fiscal reforms, the budget became hostage to an overblown financial sector influencing the everyday lives of voters (housing) and firms competing on the world stage. The end of dual capitalism and the slow establishment of a financialized polity explain this change in social coalitions: the budget was re-embedded from fragmented coalitions at loggerheads with each other to coherent financialized coalitions at ease in a context of weak tax linkages and high attrition. The source of shocks to the budget is not the balance of payments anymore, but the financial sector.

6.2.2 *France: fiscal Zugzwang and the erosion of old coalitions*

As with the case of the UK, the following will scrutinize the political context in which right wing parties implemented austerity in France. It turns out that a whole different dynamic unfolded as the age of austerity progressed: the old social blocks that underpinned national reconciliation since 1945 started to slowly unravel at the seams, making spending cuts more difficult due to the lack of consensus on what to cut. A period of long political stability gave way to alternations and "cohabitation", i.e. the French pattern of policy-making whereby the president and the prime minister come from opposing parties. Consequently, French right wing parties have been caught in the gravitational field of *Zugzwang* politics.

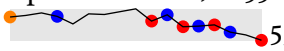
The electoral level of *Zugzwang*

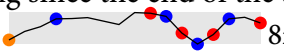
This section investigates the electoral level of the French *Zugzwang* politics and seeks to understand what prevented the Gaullists (the dominant right wing party in France) from pursuing the austerity politics of their British counterparts.

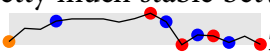
Fragmentation and reelection

To implement fiscal policies, political parties need a clear mandate from the voters. Those can send powerful signals by participating or not at the elections. In the French case, contrary to the UK, the electoral turnout in legislative elections has not been stable between 1946 and 2012.[64] In

[64] Here, in order to have a reasonably comparable measures for the age of plenty (1946-1979), the "control" period, and the age of austerity (the "treatement" period), I take legislative elections, not presidential ones, which start only in 1965. Data from the latter nonetheless confirm the broad trends presented in the legislative data: falling turnout at least until 2007, although to a lesser extent, and a plummeting vote share of mainstream parties whether the centrists are included or not (with the exception of the 2007 elections).

the French case, electoral turnout started higher after WWII at slightly below 80%, and ended up much lower, at 55.41% in the legislative elections of 2012, with a peak in 1978 at 84.05% (76.6%  55.41%).[65] The average electoral participation during the age of plenty was 78.07% while during the age of austerity it was 66.1%. The drop between the maximum value in the election turnout at the outset of the age of austerity (84.05%) and at its end (55.41%) is quite impressive and suggests that, contrary to the stability of British electoral participation, during the age of austerity voters have steadily reduced their use of electoral voice. In a sense, this diminished the legitimacy of austerity policies that right wing policies may have wanted to implement: this drop accelerate particularly after the contested austerity package of Juppé and its continuation by Jospin to qualify for the EMU.

Did this disaffection of voters for the electoral process translate into a lower seat and vote share for the mainstream parties? Here we separate these into two groups: on the one side, main left and right wing parties (Socialists and Gaullists), on the other side, Socialists, Gaullists and the centrists, which have played a prominent, but shrinking role in French politics since 1946. Concerning the share of seats in the parliament, the trend has been diminishing since the end of the age of plenty with a zenith in 1978 at 95.8 and a nadir in 1993 at 54.4 (59.9%  82.1%). Those values change slightly if we add the centrists: the maximum is reached in 1958 (100%) and the minimum is reached in 2012 (82.4%). In any case, there is clearly a downward trend during the Fifth Republic, which accelerates with the onset of the age of austerity. The low values in the first data point is due to the exclusion of the Communists who played a pivotal role in French politics during the whole Fourth Republic, capturing regularly a third of the vote. They remained key in the 1970s and the 1980s but have drifted into oblivion ever since. All in all during the age of plenty, the average share of seats for mainstream parties was 81.43% and 79.39% in the age of austerity (93.94 vs. 90.09% if we add the center right).

The share of popular votes confirms this story but shows that the mainstream parties never fully recovered after 1993. The share of popular vote was pretty much stable between 1958 and 1981, averaging 87.4%, 95.2% together with the centrists (60%  56.5%). In fact, the difference in vote shares between the age of plenty and the age of austerity is quite impressive if one does not take the centrists into account: 82.25% vs. 65.13% (the gap widens once we add the centrists: 92.72 vs. 74.07). All in all, the share of popular votes going to mainstream parties diminished much more than the share of seats, and much more than in the British case. On top of that, contrary to the UK, the share of votes dropped mostly after the politics of austerity started in earnest. While this share increased slightly between 1978 and 1981, reflecting the will to contest the onset of austerity policies as implemented by Raymond Barre, there was a stunning drop in the share of votes for mainstream parties (from 94.1% to 56%). In the meantime, the electoral turnout dropped in 1981 by 11% points.

Concerning the effective number of party votes and party seats, France is not quite as stable as

[65] The French sparkline contains all the legislative elections between 1946, when the first legislative elections of the Fourth Republic were held, and 2012. The red dots refer to the left (in general the socialists) and the right ones to the conservatives (the Gaullists in most cases), while the orange dots is for the centrist coalitions of the Fourth Republic that governed together to exclude the Communists and the Gaullists from power. For clarity, I picture red and blue government only when there is an alternation: in 1946, 1958, 1981, 1986, 1988, 1993, 1997, 2002 and 2012.

the UK. In fact, the effective number of party votes is double during the age of plenty (which is not surprising given the electoral system of the Fourth Republic) and almost double during the age of austerity (which is suprising given the comparable majoritarian electoral system). Interesting, presidential elections may also signal this increasing political fragmentation: the effective number of presidential candidates before 1980 was 3.17 vs. 5.17 after 1980 (Blais and Loewen 2009).

This electoral fragmentation is further epitomized by the appearance of "cohabitation" just after the first years of the age of austerity. Cohabitation happens with the dyarchy of a president and prime ministers from opposing parties, something that de Gaulle was keen to avoid when he changed the constitution in 1958. De Gaulle believed that if voters put in office a new government different from the president's favorite party, the president should resign. Things happened differently, however, and when Mitterrand was elected in 1981 he called for new elections. Thereby Mitterrand affirmed the primacy of the president. In 1986, Mitterrand's party, the socialists, lost the elections and Mitterrand refused to resign.

The notorious instability of the three cohabitations (1986-88, 1993-1995 and 1997-2002) added to the political fragmentation provoked by political alternations and exacerbated by fiscal austerity. Indeed, between 1978 and 2007, no parliamentary majority was reelected. The crisis reached such a tension in the third cohabitation that it was decided to reduce the presidential term to five years and to align it with the parliamentary term: henceforth, presidential and parliamentary elections would be held close to each other, with presidential elections having priority. Still, the political reform did not alter fundamentally the political dynamics of fiscal *Zugzwang*: the electoral turnout and the share of votes of mainstream parties in legislative elections continued their slump. After 2010, despite holding presidential power and commending a solid majority in the Assemblée, Sarkozy declared the word austerity as "taboo" and adjusted France's budget only marginally compared to Cameron's Tories, mostly because fringe parties such as the Front National and the Front de Gauche were on the lookout for distressed voters.

Political gravity and effects

During austerity in 1978-1983, 1993-1997 and 2010-2014, the French right not only faced a fragmented political landscape but it was also pulled into a leftist center of political gravity. As with the British case, this section uses data from the Comparative Manifesto. Figure 6.6 shows that in the age of plenty, French politics was indeed turbulent. As with the British political map, the French political map plots against each other the RILE values of the Gaullists and the Socialists. The result shows how French politics evolved in the last seven decades. Contrary to what data on electoral fragmentation suggested so far, but consistent with historical evidence, the Fourth Republic and the onset of the Fifth Republic were not politically stable. Right and left were constantly switching positions, alternating between center and extremes, but it was the left that mostly fluctuated (the range of RILE indicator is almost 40). This may have been due to the presence of a strong communist party and the pressure of international events such as the war in Indochina (with the defeat in 1954) and Algerian independence (proclaimed in 1962).

As suggested by figure 6.6, during the age of austerity, the right pulled progressively more to the right from 1973 to 1986, positioning itself to the right of the Tories in 1986, while the left progressively adopted a more centrist outlook. But here, French and British pathways diverge:

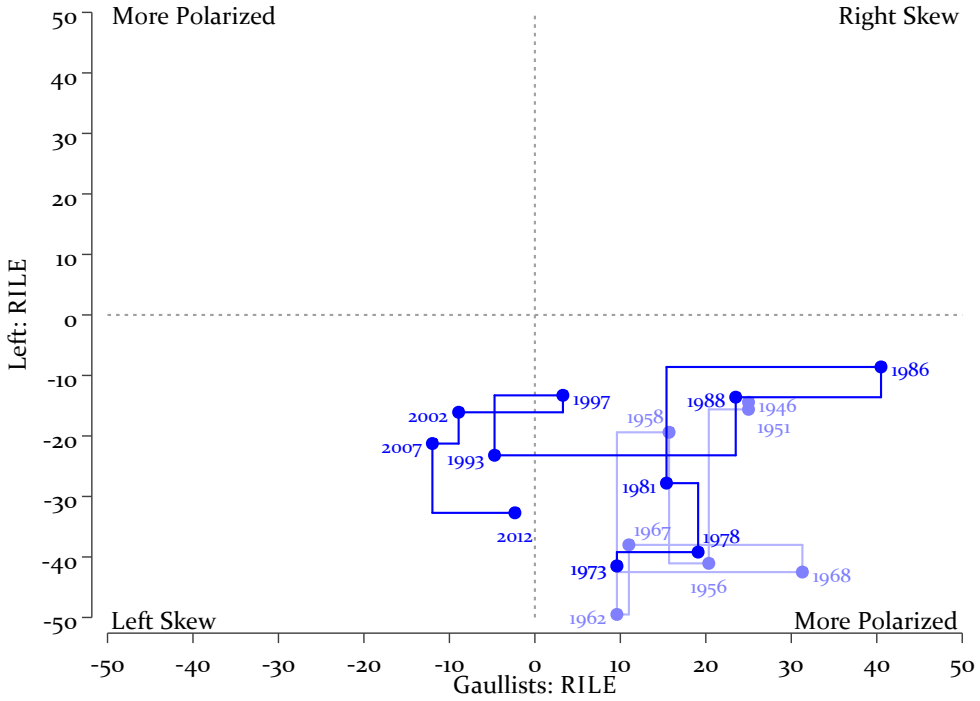
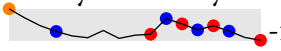


Figure 6.6: Political map of France, 1946-2012

NB: For each French parliamentary elections, the left-right position is compiled for the two main parties and plotted against each other, thus providing a proxy for the visualization of the political center of gravity (whether it is skewed to the left or to the right) and the polarization of the political scene (how far are the main parties from each other).
Source: own elaboration based on data from Volkens et al. (2014).

while after 1987 Labour moved to the center right and the Tories moved slightly to the center, in France the opposite happened. The Socialists pulled the right towards the center left, a movement that the failure of the Gaullists at the presidential and legislative elections of 1988 precipitated.

The political center of gravity, as defined in the British case study, confirms the centrifugal dynamics of the French politics. While in the British case the political center of gravity moved slowly but surely from left to right, in the French case the evolution is much more hectic (23.98  -18.09). In the 1950s and the 1960s, France experienced mostly centrists and right-wing governments, but moved steadfastly from a right-wing center of gravity (23.98 on the weighted RILE measure, 26.08 for the median voter) to a a left-wing center of gravity in 1973 (-15.49 for the center of political gravity, -18.75 for the median voter), then moved back to a right of center position (11.6 and 6.25) and finally ended up on an almost continued path to a left-wing position (-18.09 for the political center of gravity and -24.69 for the median voter).

If the political center of gravity moved to the left and made the right's job of implementing expenditure cuts much more difficult, what about the consensus behind this evolution? Polarization offers a hint here: as suggested by figure 6.6, French politics were much polarized around 1968 and in the end of the 1980s when the decisions about fiscal adjustments became more pressing after

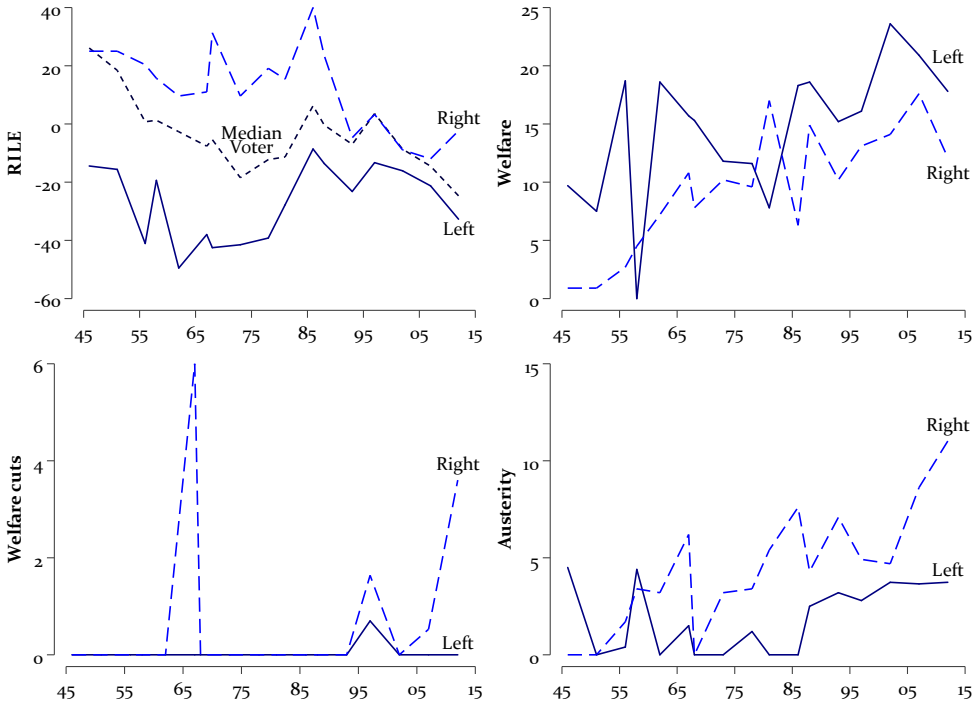
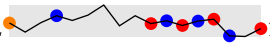
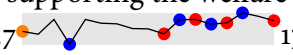


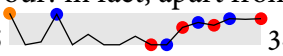
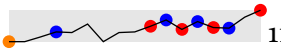
Figure 6.7: French partisan positions, 1946-2012

NB: RILE comes from figure 6.6, the median voter is weighted for the election results, "Welfare" comes from the Manifesto dataset per503+504, "Welfare cuts" is per505 and "Austerity" is per303+414+505+507. Explanations in text.
Source: own elaboration based on data from Volkens et al. (2014).

the failure of the Mitterand's prime minister and when it became clear that the EMU will be built. Another, more robust measure of polarization also used in the British case, shows that French politics were actually always more polarized than in the UK (2.12  1.76). While in the age of plenty polarization average 2.35, in the age of austerity it diminished only slightly to 1.88. But polarization dropped only after 1997, when the right was pulled towards a left leaning center of gravity. The irony is that the right then regained power for another ten years and the left was left in disarray in 2002 when the Socialist candidate and Prime Minister, Lionel Jospin, did not make it to the second round of the Presidential elections, leaving the place to the leader of Front National Jean-Marie Le Pen. A seemingly very liberal and conservative president, Nicolas Sarkozy took office in 2007. Evidence suggests, however, that French politics were as much to the left as they were in 1978-1981. Also, polarization in France remained slightly higher than in the UK (hovering at 1.5 vs. 0.5) and therefore one may surmise that Labour converged more on the Tories than the Gaullists on the Socialists, and that the political consensus was stronger in the UK than in France.

As with the British case study, I use the sub-indices of the RILE measure to capture the evolution of Socialists and Gaullists on resistance to expenditure cuts and the need for austerity (see figure 6.7). Here, the empirics paint a surprising picture: while both parties increasingly supported the welfare state with the Gaullists converging on the Socialists, they also increasingly backed austerity, with

the Socialists converging on the Gaullists. Indeed, on the pro-welfare index (per503+504) the left was always consistently supporting the welfare state with a clear upward linear trend that is mostly above Labour values (9.7  17.8). The average of left support for welfare was 11.89 during the age of plenty and 18.64 during the age of austerity. The same trend can be observed for the right-wing party (0.9  12.1). In the age of plenty, average Gaullist support the welfare amounted to 7.86 while in the age of austerity it increased to 12.61. In fact, the maximum value for the support of the welfare state by the right was in 2007 with the elections of Sarkozy, which reached the level of preferences for welfare of the centrist president Valéry Giscard d'Estaing in 1974 (the only time, with 1958, that a right wing president was more supportive of the welfare state than the Socialists).

Positions on the need for "austerity" as operationalized by the sub-indices of RILE (per303+414 +505+507) show, counter-intuitively, that the left and the right in France are increasingly austere. Concerning the left, its preferences towards austerity between 1946 and 1986 were pretty much null, but after that it started to converge on the Gaullists and actually reached a similar position to Labour: in fact, apart from 2001, the evolution of the Socialists and Labour is pretty much similar (4.5  3.73) and reaches a comparable level: while in the age of plenty, the left's preference for austere policies average 0.83, it increased to 2.80 during the age of austerity (3.51 for Labour). The right's austere preferences are, not surprisingly, much more pronounced: in fact, there is an important difference between the age of plenty and the age of austerity, the averages being 2.94 vs. 6.89 (0  11.01). To be sure, the right started low and reached a first peak in 1986 (7.6) before losing elections in 1988 stabilizing at 4-5 before increasing during the Sarkozy and post-Sarkozy period (8.6 and 11 in 2007 and 2012 respectively). Interestingly, the Gaullists preferences for austerity have been much more pronounced than the Tories' since 2001, which is puzzling: after all, the British adjustment after 2010 was much more pronounced than in France.

Summing up, one can see several paradoxical trends in the French electoral politics of *Zugzwang*. In the age of austerity, electoral participation and the share of votes going to mainstream parties petered out at the same time as alternations unleashed political conflict and stop-and-go policies. Contrary to the UK, and despite the dominance of right wing parties in office, the French political center of gravity shifted to the left. Even though the Socialists mitigated their positions following their coming to power in 1981, the Gaullists gravitated towards the center left and thus reshaped the distribution of policies ($\zeta(p_2)$) more towards tax based fiscal adjustments: it is the result of the paradoxical preferences of wanting both more welfare and more austerity and the repeated failed fiscal adjustments undertaken by right wing governments (Barre, Juppé and Fillon).

The social level of *Zugzwang*

The coalitions that formed the basis of the Fifth Republic established in 1958 were eroded by attempts at fiscal consolidations. These initial coalitions emerged from the chaotic Fourth Republic and were formed around the left/right cleavage that also reflected to a certain extent a class cleavage (working vs. middle classes) and a religious cleavage (secularism vs. catholicism). These stable cleavages translated into the party system by the stability of the so called "quadrille bipolaire", i.e.

a bipolar domination of four parties: the Gaullists and the Liberals on the centre-right, and the Socialists and the Communists on the centre-left (Evans and Mayer 2005).[66]

The left (Socialists and Communists) represented workers and the public sector, had a strong preference for intervening in the economy and protecting low-income earners by raising taxes. The right (Gaullists and Liberals) voiced the preferences of middle and upper-middle classes with the independent private sector (self-employed professionals *and* workers, who will later defect to the extreme right) and farmers. These preferences were not to nationalize industries, to protect the national economic interests (read large French firms) and to keep taxes low (Amable et al. 2012a).

This two-block, four-party system started to crumble with the first austerity episodes of Raymond Barre (on the right) and then of Pierre Maurois and Jacques Delors (on the left). The share of votes going to this "quadrille" started to crumble after 1978-81. Cohabitation and political alternations also became the new norm. Since 1981, all incumbents were voted out of office in legislative elections. In 2002, the incumbent President, Jacques Chirac, received the lowest ever share of votes for the incumbent (19.9). It is only the dispersion of the left-wing voters and the stellar - if not ominous - rise of the Front National that prevented the right from losing. In 2007, one can hardly talk of a victory of incumbents: Sarkozy's pronounced conflict with Chirac dates back to 1993, and even if they stem from the same party, they represent different political affinities (Grunberg 2006; Haegel 2005).

In France, the main austerity cleavage is shaped around the retrenchment of the welfare state and the intervention of the state in the economy (Guillaud and Palombarini 2006, for a precise and thorough factor analysis of cleavages in post-electoral surveys), not the international status of the domestic currency and the financial sector as in the UK. The repeated crises since 1973 (the last year France posted a balanced budget) have seriously dented the postwar economic model of high growth and low unemployment. This has crystallized socio-economic conflicts around the welfare state that is supposed to provide a "social anesthesia" (Levy 1999) to the vast and deep liberalization of the economy since 1983 (Schmidt 1996b).

The "incremental reforms" adopted at each fiscal consolidation package, starting with Raymond Barre in 1978, and finishing on Manuel Valls in 2014, aggravated the conflict about the welfare state because it provoked a dualization of the labor market: increasingly flexibilized labor markets at the margins, diminished job prospects for the low skilled, a stratified education system increased the feeling of economic insecurity. Hence the increased demand for protection, which explains why partial reforms in France were coupled with an extraordinary expansion of the welfare state, but mainly for the "insiders". As a result, France now tops Scandinavian countries in term of social and public expenditures above 50% of GDP.

Thus the traditional view that increased exposition to the world economy leads to the expansion of the welfare state needs to be qualified (Rodrik 1996; Cameron 1978). This also reflects a rather ambiguous state of politics: it reveals the conservatism of trade unions, wary and suspicious of the élites' adjustment strategies. As one author put it, France built an "economic half-way house" (Levy et al. 2005) where it "repudiated *dirigisme* but rejected the anglo-saxon model", after flirting with the Rhine model of capitalism one may add (Albert 1991). This resulted in a permanent

[66] The French Communist Party (PCF), like the Italian one, has commended more than a quarter of the votes in elections since the end of the Second World War.

and protracted social conflict between trade unions and the business sector. Most French fiscal consolidation packages since 1978 entailed a certain liberalization that did not satisfy business and implied an amount of economic insecurity among the working class. In the end, all social groups are left unsatisfied: businesses are too burdened by the welfare state and its constituents do not feel protected adequately. Thus, the fragmentation of the French social coalitions translated into a cyclical policy sequence that underpins each austerity episode, in 1978-1986, 1995-2002 and 2010-2014, each inaugurated by a fiscal consolidation of a right wing government:

Right→ *Consolidation* → Left → Expansion → *Consolidation* → Extremes

The time dimension of this policy cycle is shortening worrisomely: eight years in the 1980s, six years in the 1990s and four years in 2010s.

This volatility of the French electorate stems partially from the repeated attempts to consolidate state finances by retrenching the welfare state. The extreme right gains mostly among two kinds of electorates: the endowed voters of the private sector and the fragile uneducated working class, which voted traditionally for the right (Evans and Mayer 2005). The voting patterns of different social strata suggest that between 1978 and 2002, workers - the class most vulnerable to economic and social changes and thus to the retrenchment of their safety net - are more and more likely to vote for the extreme right, while the profile of left wing voters is moving upwards in terms in social status. For instance, people with assets in class 0-1 (low salary) were 5% less likely to vote for the Socialist Party in 2002 while voters with the same types of assets were marginally more likely to vote for the extreme right. But perhaps the most striking is that people with the highest class of assets are more than 20% more likely to vote for the left than they were in 1978 and those with the highest university education have a 10% higher probability of voting for the left (Mayer 2014). Another way to measure how the French voters desert the mainstream parties is to see the relationship between votes shares: it seems that both center right and center left parties are loosing out votes to the extreme right, although the negative correlation between the two is much stronger in the presidential elections than in European ones.

This electoral evidence of the fragmentation of the two blocks invites to reflect on its sources (Guillaud and Palombarini 2006). Concerning social coalitions in 1978, workers and public servants leaned towards more redistribution and nationalization, business, liberal professions and self-employed workers leaned towards less redistribution and more privatization, with the bulk of people being in the coalitions. In 2002, those coalitions have split around the European cleavage. Why would thus Europe split coalitions focused on redistribution? To understand this, let us analyze the erosion of the two opposing social blocks, left and right.

Concerning the left vote, the first major crack appeared not in the 1990s (Amable et al. 2012a) but in the early 1980s, precisely with the U-turn on austerity operated by Mitterrand to stay in the European Monetary System (EMS) in 1983. The "tournant de la rigueur" clearly signaled to distressed voters that a reflationary policy was not on the cards anymore and that the government was willing to implement austerity to deal with the current account, capital flight and inflation. Naturally, unemployment increased. The government clearly signalled that austerity meant cost containment for the insiders and no expansion for the outsiders of the French political economy. In other words, austerity would favor the competitive sector, the public sector (financing the welfare

state through social security contributions) but not the unemployed. This rift would increase in the following years, threatening to derail the ratification of the Maastricht Treaty in 1992 and burying the Constitutional Treaty in 2005. Therefore, the issue of austerity and Europe is linked in the left block through the issue of "neo-liberal policies".

The right block lost its cohesion in two steps: after the brief stint of Chirac as prime minister in 1986-1988 and his U-turn after he was elected President in 1995 on a platform of reducing the "fracture sociale". In 1986, Chirac continued the privatization program of the socialist government, tried to implement a "Thatcherian" set of reforms to satisfy the liberalization-prone self-employed but in the end utterly failed to muster support at the 1988 elections due to the private sector voters who were fearing that neo-liberal austerity would increase their economic insecurity. Given this shaky experience, the right choose to avoid this kind of strategy and opted for reform by stealth and social anesthesia. Even Sarkozy, elected in 2007 on the seemingly most liberal platform in France since Chirac in 1986, would cut expenditures indirectly: Sarkozy decided not to replace half of the retiring civil servants.

To summarize, French coalitions eroded since the 1970s from two coherent and opposed blocks (workers and civil servants on the left, and the private sector, liberals, self-employed and farmers on the right) into two divided groups around the issue of austerity and Europe. On the left, public workers are pitched against civil servants and on the right the private sector against the self-employed and liberals. While the self-employed (business sector) want liberalization and flexibilization, the public and a major part of the private sector want protection from increased competition. French austerity would provide for both by cutting expenditures on the margins and raising taxes such as VAT and social contributions (thereby tightening the link between status and protection to the benefit of insiders).

The key episode in France to explain the gravitation pull of fiscal policy towards the left was the attempted fiscal consolidation in 1995. The then Prime Minister Alan Juppé sought to dramatically reform pensions and health care on the eve of the qualification for the EMU but, facing large strikes that brought the country to a halt, pulled back and switched back to the old strategy of raising taxes. This episode is emblematic of the problem of the French right and of the puzzling policy cycle: as a crisis shakes public finances, it embarks on consolidation and looses elections to the Socialists: in 1981, in 1997 and in 2012.

It is important to understand that the fragmentation of French social coalitions comes from the endogenous effects of fiscal consolidations. In order to deal with rising deficits of the social security sector, and in order to avoid the wrath of voters, the right in France always increased social security contributions. But this implied an increased cost of Labour, which drives a wedge between different coalitional partners and propels the fiscal politics of *Zugzwang*. The public sector and insiders refuse to release the power they have over the welfare state, while the competitive sector refuses to be taxed more, especially in the context of EMU where devaluation is not possible any more. Hence the attempts of French governments to raise new taxes, such as the CSG or VAT to pay for the welfare state.

Table 6.2: *Zwischenzug* in the UK and *Zugzwang* in France

	Coalitions	UK: *Zwischenzug*	France: *Zugzwang*
Electoral	Fragmentation	No	Yes
	Reelections	Yes (Tories)	No (Gaullists)
	Political gravity	Center right	Center left
Social	Social conflicts	Decreased	Increased
	Fiscal rents	New ones	Erosion of old ones
	Policy reversal	No	Yes
	$\zeta(p_2)$	*Coalition formation* *New fiscal contract*	*Coalition erosion* *Old fiscal contract*

NB: Overview of social coalitions during austerity in the UK (where Zwischenzug implies the emergence of new fiscal coalitions) and France (where Zugzwang suggest hardening social conflict).
Source: own elaboration.

6.3 Conclusion

Do parties make a difference during fiscal austerity? How do social coalitions enable or constrain their power during austerity? This chapter has suggested that there is little evidence to support the claim that parties influence austerity on their own. It has rather argued that partisan effects are conditional on the context under which they operate, that is the dynamic interaction of tax linkages and attrition which translate into the present the effects of previous fiscal consolidations. Past effects can either drive austerity politics towards a political situation that I described as *Zwischenzug* (new social coalitions support new policies) or towards *Zugzwang* (fragmented old coalitions block fiscal adjustment).

The UK epitomizes the ideal type of *Zwischenzug* whereas France embodies the difficult politics of *Zugzwang*. In the UK, the right managed to implement fiscal adjustments against the backdrop of stable election results (turnout, share of votes and seats) and reconstructed fiscal coalitions. This was seen through the right-leaning median voter, diminished polarization and centripetal politics. In France, by contrast, elections were less and less legitimate with turnout dropping to about half of the electorate while mainstream parties losing more and more votes to fringe rebellious parties. I have showed that the social blocks behind the mainstream parties from left and right crumbled as government implemented austerity measures that split well established, historical coalitions.

Table 6.2 summarizes the results of this chapter. In short, while the UK reconfigured political coalitions around a new fiscal contract, France did not. In the terminology of Acemoglu and Robinson (2013), the UK respected the "political incentives constraint", while France violated it increasingly. From the perspective of the political economy of reforms, British austerity created new winners that put the British political economy on a new path, the higher equilibrium of the J curve. France is still stuck in the low equilibrium of the curve, each time creating more losers than winners when implementing fiscal austerity. In the words of Adam Przeworski, France is stuck in the "valley of transition", while the UK is on the top of "the hills of reform" (Przeworski 1991).

This is certainly not a normative conclusion. I do not mean to say that France should implement British fiscal adjustments which increased inequality dramatically. Rather, the take home message and main contribution of the chapter is that fiscal consolidations do have an endogenous effect that constrains political parties.

Appendix to Chapter 6

Panel modelling: data and specification

Data presentation

Since I want to focus on *political intentions* rather than on *economic outcomes*, my dependent variable consists of fiscal plans from 17 countries from 1978 to 2009 (Devries et al. 2011).[67] There are 173 episodes of austerity, 64 are tax-based, 105 are spending-based and 4 episodes are balanced equally between revenues and expenditures.

As for the independent and control variables, the data are divided into a political and an economic vector, which, for the sake of reproducibility, are taken from Armingeon et al. (2010).

The political vector includes first the partisan orientation of government and then the controls that may affect the room for maneuver of governments such as financial markets (Mosley 2003) and trade unions, which according to the power resource approach, should strive with left wing parties for a more balanced austerity, i.e. less spending cuts, more tax hikes (Korpi 1995).

Concerning parties, for robustness, I measure the partisan orientation of governments in three ways, but in the end they yield the same result. First, I use the "government party", i.e. the cabinet composition of the Schmidt index where 1 denotes the hegemony of right wing parties, 2 their dominance, 3 the balance of power between left and right, 4 the dominance of social democrats and 5 their hegemony; second, I use the share of left wing parties in the cabinet and third, the share of right wing parties. Thus, according to the partisan hypothesis, the higher the government party index and the share of left wing parties, the lower the fiscal consolidation, the higher the tax consolidation and the lower the spending cuts.[68]

Capital openness suggests how much financial power can constrain political parties when in power. Because financial capital holds debt in an era of financial integration, it can choose to "vote with its feet" if it deems fiscal policy unsustainable: therefore the more open capital accounts are, the more pressure the financial markets can exert by threatening to sell government securities. Here I rely on the Chinn and Ito (2008) index of financial openness. Finally, trade unions may play a major role by putting pressure on the government (Visser 2010, I use the log of net union membership).

As for the economic vector, it contains all the classic controls of the literature analyzing the determinants of fiscal consolidations, which I lag following the literature because when governments make budgetary decisions, the best information they have is from the past year (Mulas-Granados 2006). The primary deficit does not include the interest rate paid on debt which I proxy with the variable interest. It is an extremely important piece of information for policymakers. I do not use the cyclically adjusted balance (CAB, primary or not) because this is not an information that policymakers have in real time when they take decisions. It involves calculations. In fact, in most

[67] Australia, Austria, Belgium, Canada, Germany, Denmark, Spain, Finland, France, Great Britain, Ireland, Italy, Japan, Netherlands, Portugal, Sweden, USA.

[68] The Italy of Lamberto Dini in 1995 is coded as a missing value in Armingeon et al. (2010), but because the technical caretaker government had the support of both the right and the left, I replaced the missing value with 3. This change does not affect the results.

cases, there is no data available before the mid-1980s.[69] The summary of the data is available in table 6.3.

Discussion of model specification

I estimate panel data models exploring partisanship during austerity. As suggested by Stimson (1985, p. 929), the analysis of panel data depends on the shape of the data: here, we have time-serial dominance in our dataset with 17 countries over 32 year-periods, with an important panel heteroskedasticity (the countries are very different from each other, from a continent-country like the US to a "city" sized state like Denmark, which is confirmed upon inspection of the dataset). This is a classic setup in comparative and international political economy since the mid-1980s when large datasets became available and gave rise to "OECD studies", US States studies and IR dyads.[70]

Normally, one would use a least-squares model with country and year dummies, or at least discuss whether to use random or fixed effects. But the way panel data has been approached has changed in the last two decades. For a long time, the "Beck and Katz" standard was applied (Beck and Katz 1995) through ordinary least squares (OLS) and panel corrected standard errors (PCSE)[71] accounting for heteroskedasticity across units and contemporaneous correlations between units, but not for non-contemporaneous correlations and serial correlation.[72] The latter is the main reason why, currently, most researchers add a lagged dependent variable (LDV, which makes a dynamic panel data model) and fixed effects (FE, country and year dummies).

Still, the LDV has proved to be a bone of contention in the political science literature, seen with "suspicion, if not outright objection" (Keele and Kelly 2006, p. 187). In general, the argument for a LDV stipulates that it should be done if past levels of the dependent variable influence future ones (thus not including the LDV would result in omitted variable bias and would also introduce serial autocorrelation). From the perspective of our argument this makes sense. But the opponents would argue that including LDV "absorbs" cross sectional and time-series variance (Plümper et al. 2005) out of other independent variables which then have smaller β and higher standard errors, and are less significant as a result (Huber and Stephens 2001). Thus, the LDV induces the coefficients to be biased, especially if there is correlation in the error term (Achen 2000). When T is short, one may need to think about the Nickel bias - but this is not the case.[73]

Given that the LDV yields smaller coefficient estimates for the independent variables, the main issue is that I may be testing an alternative theory - partisan fiscal consolidations - with an

[69] First, the output gap is calculated as the difference between actual and estimated output based on trend; second, this enables to filter the cyclical component of the budget by estimating the sensitivities of taxes and spending and then, third, the CAB is obtained by the difference between the actual budget balance and cyclical component.

[70] But the origin of most panel data estimators is to be found in micro-economics as well as household and invidual surveys but here the data structure is based on cross-sectional dominance: $T \approx 5$ and $N \approx 1000$.

[71] Note that PCSE estimates are more conservative since they tend to increase standard errors.

[72] I did a serial correlation test for my data (Drukker 2003) but the results do not reject the null of no serial correlation.

[73] When the regressor and the error are correlated, estimates are biased and inconsistent with a degree of bias ϕ of order $\frac{1}{T}$, so the longer the T, the better (Adolph 2012).

estimation method that "biases" the deck of cards against the alternative theory.[74] The problem is that in my theory of austerity as a repeated game, past consolidation episodes play an important role. Importantly, Keele and Kelly (2006) argue that the LDV is therefore part of the data generating process and thus not including it implies an omitted variable bias and thus biased estimates. The case to include LDV is thus quite strong (Beck and Katz 2011) and I therefore included it in the following functional form:

$$\begin{cases} Y_{it} = \alpha Y_{t-1} + \beta_{1_{it}}^{\text{Gov}} + \beta_{2_{it-1}}^{\text{Debt}} + \beta_{3_{it-1}}^{\text{Deficit}} + \beta_{4_{it}}^{\text{Interest}} + \beta_{5_{it}}^{\text{GDP}} + \beta_{6_{it}}^{\text{Unions}} + \beta_{7_{it}}^{\text{Finance}} + \nu_{it} \\ \text{with} \quad \nu_{it} = u_i + e_{it} \end{cases} \tag{6.1}$$

The estimation method may vary depending on what one may want to emphasize. Apart from a pooled model that can be used as base line model for comparison, there are several classical estimation methods for panel data: the fixed effects are the mainstay of political economic models that study groups of countries which are not a random sample with independent variables that are not time-constant (contrary to random effects). Now, other ways exist: on one side researchers may be concerned by efficiency - in this case one should use the Parks method of Feasible Generalized Least Squares (FGLS), especially in the case of time dominance (Reed and Ye (2011) recommend that $\frac{T}{N} \geq 1.50$, which in our case is 1.88). If, on the other side, scholars are focusing on accurate confidence intervals, then PCSE is fine.

Showing the effects of political parties using one functional form (LDV with fixed effects, see 6.1) and different estimation methods implies to focus visually on the robustness of those findings rather than on the results of one debatable estimation method. Therefore, I prefer to show results visually and to make their interpretation easier through box-and-whisker plots. I also take care to show the range of coefficients estimates under alternative estimation methods in order to gauge the robustness of a theory and its empirical testing (Adolph 2013a; Kastellec and Leoni 2007, see figure 6.2). In general, researchers make the case for one model and then present it in a table that makes it hard to compare not only between coefficients (how much bigger is the partial effect of an independent variables compared to another one) but also between estimation techniques (which estimation gives us the best confidence intervals). As such, coefficient plots are also useful for readers not acquainted with statistical estimation.

[74] In all honesty, estimations without a LDV were already tried in Truchlewski (2013) and the results, reported in table 6.4, suggest that parties have little effect on the shape of austerity. Robustness checks were used with different measures of partisanship. Instead of the Schmidt index measuring the dominance of one party or the balance of power between the two main parties, I also used the percentage of cabinet posts attributed to left and then to right parties. Both turned out substantively and statistically insignificant albeit with often times the right sign posited by the partisan theory of austerity. This suggests that parties have a marginal effect on the shape of fiscal consolidation packages as measured as *intentions*.

Table 6.3: Summary statistics for panel data regressions

Variable	Mean	Std. Dev.	Min.	Max.	N
Total austerity	0.297	0.684	-0.75	4.74	576
Tax hikes	0.112	0.361	-0.75	2.54	576
Spending cuts	0.185	0.468	-0.29	3.71	576
Right partisanship	39.375	40.437	0	100	576
Left partisanship	33.772	38.612	0	100	576
Party in office	2.405	1.541	1	5	575
Finance	1.672	1.147	-1.86	2.46	573
Unions	4130.103	4433.206	467	20986.1	573
Outlays	46.164	8.241	28.63	70.540	576
Receipts	42.762	8.412	24.35	63.2	576
GDP growth	2.397	2.343	-8.35	10.92	576
Inflation	4.761	4.859	-4.48	28.88	576
Debt	67.159	29.747	13.27	188.8	563
Deficit	-0.325	3.31	-12.59	9.01	576
Interest	8.185	4.4	1	29.74	559
Unemployment	7.791	3.732	1.62	24.17	576
Social transfers	14.202	3.625	6.17	23.66	576

NB: Fiscal consolidations are measured as fiscal plans (see text for more details).
Source: Armingeon et al. (2010); Chinn and Ito (2008); Visser (2010) & Devries et al. (2011).

Table 6.4: Partisan models of fiscal austerity, without LDV

	(1) Total Pooled	(2) Total FE	(3) Total PCSE	(4) Tax Pooled	(5) Tax FE	(6) Tax PCSE	(7) Spend Pooled	(8) Spend FE	(9) Spend PCSE
Party	0.002	-0.005	0.002	0.008	0.014	0.008	-0.020	-0.020	-0.006
	(0.14)	(-0.24)	(0.17)	(0.82)	(1.25)	(0.99)	(-1.35)	(-1.35)	(-0.55)
$Debt_{t-1}$	**0.004*****	**0.005*****	**0.004*****	**0.001****	0.001	**0.001***	**0.004*****	**0.004*****	**0.002*****
	(4.08)	**(3.34)**	**(3.51)**	**(2.88)**	(1.41)	**(2.51)**	**(3.76)**	**(3.76)**	**(3.50)**
$Deficit_{t-1}$	**-0.049*****	**-0.061*****	**-0.049*****	**-0.0176*****	**-0.019*****	**-0.017*****	**-0.042*****	**-0.042*****	**-0.032*****
	(-5.44)	**(-6.32)**	**(-4.56)**	**(-3.56)**	**(-3.67)**	**(-3.55)**	**(-6.28)**	**(-6.28)**	**(-4.17)**
Interest	0.014	0.010	0.014	**0.009***	0.007	**0.009***	0.003	0.003	0.004
	(1.95)	(1.26)	(1.59)	**(2.51)**	(1.69)	**(2.08)**	(0.49)	(0.49)	(0.81)
GDP	**-0.035****	**-0.035****	**-0.035***	**-0.019****	**-0.022****	**-0.018***	-0.012	-0.013	-0.016
	(-2.83)	**(-2.84)**	**(-2.16)**	**(-2.83)**	**(-3.28)**	**(-2.46)**	(-1.51)	(-1.51)	(-1.39)
Constant	-0.008	-0.036	-0.007	-0.042	-0.008	-0.042	-0.028	-0.028	0.035
	(-0.07)	(-0.24)	(-0.06)	(-0.68)	(-0.10)	(-0.63)	(-0.27)	(-0.27)	(0.47)
N	545	545	545	545	545	545	545	545	545
R^2	0.116	0.132	0.116	0.074	0.070	0.074	0.124	0.124	0.088
F/Wald χ^2	14.20	15.92	47.93	8.647	7.881	28.21	14.72	14.72	40.53

t statistics in parentheses. NB: Wald χ^2 for PCSE only.

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 6.5: Partisan models of fiscal austerity, with LDV

	(1) Total Pooled	(2) Total FE	(3) Total PCSE	(4) Tax Pooled	(5) Tax FE	(6) Tax PCSE	(7) Spend Pooled	(8) Spend FE	(9) Spend PCSE
DV_{t-1}	**0.394*** **	**0.354*** **	**0.394*** **	**0.093***	0.060	0.0934	**0.518*** **	**0.468*** **	**0.518*** **
	(10.22)	**(8.87)**	**(6.56)**	**(2.20)**	(1.40)	(1.35)	**(14.35)**	**(12.30)**	**(9.24)**
Party	9.1E-04	1.5E-04	9.1E-04	0.007	0.014	0.008	-0.005	-0.010	-0.005
	(0.05)	(-0.01)	(0.06)	(0.77)	(1.21)	(0.92)	(-0.45)	(-0.78)	(-0.54)
$Debt_{t-1}$	**0.002***	0.002	0.002	**0.001***	0.001	**0.001***	7.5E-04	0.001	7.5E-04
	(2.04)	(1.66)	(1.82)	**(2.49)**	(1.25)	**(2.21)**	(1.27)	(1.44)	(1.22)
$Deficit_{t-1}$	**-0.039*** **	**-0.050*** **	**-0.040*** **	**-0.017*** **	**-0.019*** **	**-0.017*** **	**-0.023*** **	**-0.031*** **	**-0.023*** **
	(-4.64)	**(-5.40)**	**(-4.24)**	**(-3.38)**	**(-3.55)**	**(-3.38)**	**(-4.26)**	**(-5.17)**	**(-3.90)**
Interest	0.008	0.006	0.008	**0.009***	0.007	0.009	0.002	0.001	0.002
	(1.32)	(0.83)	(1.08)	**(2.27)**	(1.57)	(1.88)	(0.58)	(0.26)	(0.59)
GDP	**-0.034** **	**-0.037** **	**-0.034***	**-0.018***	**-0.022** **	**-0.018***	**-0.020** **	**-0.020** **	**-0.020***
	(-3.03)	**(-3.17)**	**(-2.53)**	**(-2.69)**	**(-3.18)**	**(-2.40)**	**(-2.78)**	**(-2.64)**	**(-2.37)**
Constant	0.061	0.063	0.061	-0.034	-0.003	-0.03	0.077	0.064	0.076
	(0.58)	(0.45)	(0.56)	(-0.54)	(-0.04)	(-0.51)	(1.13)	(0.70)	(1.19)
N	545	545	545	545	545	545	545	545	545
R^2	0.260	0.246	0.260	0.083	0.074	0.083	0.341	0.321	0.341
F/Wald χ^2	31.51	28.36	92.18	8.067	6.908	29.93	46.36	41.02	128.28

t statistics in parentheses. NB: Wald χ^2 for PCSE only.

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 6.6: Partisan models of total austerity, with LDV and controls

	(1) Total Pooled	(2) Total FE	(3) Total VCE	(4) Total FGLS	(5) Total PCSE
$Total_{t-1}$	**0.366*****	**0.311*****	**0.366*****	**0.414*****	**0.366*****
	(9.54)	**(7.73)**	**(7.85)**	**(10.57)**	**(6.14)**
Party	-0.003	-0.007	-0.003	-0.013	-0.003
	(-0.19)	(-0.36)	(-0.17)	(-1.10)	(-0.21)
Finance	**0.150*****	**0.179*****	**0.150***	**0.058***	**0.150*****
	(3.81)	**(4.02)**	**(2.41)**	**(2.05)**	**(3.57)**
Unions	**-0.089****	-0.049	**-0.089***	**-0.055***	**-0.089***
	(-3.07)	(-0.30)	**(-2.24)**	**(-2.57)**	**(-2.46)**
$Debt_{t-1}$	**0.166****	**0.276****	**0.166***	0.065	**0.166****
	(2.90)	**(2.91)**	**(2.00)**	(1.58)	**(2.76)**
$Deficit_{t-1}$	**-0.048*****	**-0.0562*****	**-0.0483*****	**-0.0360*****	**-0.0483*****
	(-5.63)	**(-6.01)**	**(-3.65)**	**(-5.39)**	**(-5.48)**
Interest	**0.0317*****	**0.0399*****	0.0317	**0.0173****	**0.0317*****
	(3.42)	**(3.81)**	(1.92)	**(2.78)**	**(3.40)**
GDP	**-0.033****	**-0.031****	**-0.033***	-0.0115	**-0.033****
	(-2.92)	**(-2.65)**	**(-2.17)**	(-1.31)	**(-2.75)**
Constant	-0.227	-1.091	-0.227	0.120	-0.227
	(-0.62)	(-0.78)	(-0.36)	(0.47)	(-0.55)
N	540	540	540	540	540
R^2	0.294	0.285	0.293	n.a	0.294
F/Wald χ^2	27.57	25.62	202.38	213.58	160.57

t statistics in parentheses.

NB: Wald χ^2 for VCE, FGLS & PCSE. Unions and debt are logged.

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 6.7: Partisan models of tax hikes, with LDV and controls

	(1) Tax Pooled	(2) Tax FE	(3) Tax VCE	(4) Tax FGLS	(5) Tax PCSE
Tax_{t-1}	0.082	0.044	0.082	**0.153*****	0.082
	(1.93)	(1.02)	(1.16)	**(3.58)**	(1.19)
Party	0.007	0.012	0.007	0.001	0.007
	(0.69)	(0.98)	(0.62)	(0.15)	(0.78)
Finance	**0.059***	**0.089*****	**0.059***	0.032	**0.059***
	(2.51)	**(3.37)**	**(2.26)**	(1.87)	**(2.21)**
Unions	-0.025	-0.061	-0.024	-0.009	-0.025
	(-1.42)	(-0.63)	(-0.88)	(-0.76)	(-0.99)
$Debt_{t-1}$	**0.102****	0.086	**0.102***	**0.045***	**0.102****
	(3.03)	(1.57)	**(2.37)**	**(2.04)**	**(2.85)**
$Deficit_{t-1}$	**-0.019*****	**-0.022*****	**-0.019****	**-0.014*****	**-0.019*****
	(-3.87)	**(-3.92)**	**(-2.96)**	**(-4.01)**	**(-4.07)**
Interest	**0.018****	**0.023*****	**0.018***	**0.012****	**0.018*****
	(3.28)	**(3.69)**	**(2.35)**	**(3.23)**	**(3.35)**
GDP	**-0.016***	**-0.020****	-0.016	-0.003	**-0.016***
	(-2.44)	**(-2.84)**	(-1.82)	(-0.61)	**(-2.36)**
Constant	-0.348	-0.087	-0.348	-0.185	-0.348
	(-1.60)	(-0.11)	(-0.91)	(-1.25)	(-1.21)
N	540	540	540	540	540
R^2	0.102	0.102	0.102	n.a	0.102
F/Wald χ^2	7.541	7.262	100.73	61.45	65.47

t statistics in parentheses.

NB: Wald χ^2 for VCE, FGLS & PCSE. Unions and debt are logged.

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 6.8: Partisan models of spending cuts, with LDV and controls

	(1) Spend Pooled	(2) Spend FE	(3) Spend VCE	(4) Spend FGLS	(5) Spend PCSE
$Spend_{t-1}$	**0.492*****	**0.426*****	**0.492*****	**0.501*****	**0.492*****
	(13.63)	**(11.03)**	**(6.62)**	**(13.15)**	**(8.86)**
Party	-0.008	-0.015	-0.008	-0.006	-0.008
	(-0.76)	(-1.17)	(-0.74)	(-0.83)	(-0.88)
Finance	**0.086*****	**0.091****	**0.086***	0.017	**0.086*****
	(3.35)	**(3.17)**	**(2.16)**	(1.01)	**(3.43)**
Unions	**-0.059****	-0.008	**-0.059***	-0.024	**-0.059*****
	(-3.13)	(-0.08)	**(-2.52)**	(-1.89)	**(-3.64)**
$Debt_{t-1}$	**0.078***	**0.18****	0.078	0.036	**0.078***
	(2.11)	**(2.93)**	(1.59)	(1.43)	**(2.11)**
$Deficit_{t-1}$	**-0.029*****	**-0.034*****	**-0.029****	**-0.017*****	**-0.029*****
	(-5.19)	**(-5.67)**	**(-3.18)**	**(-4.18)**	**(-4.94)**
Interest	**0.015***	**0.019****	0.015	0.005	**0.015****
	(2.54)	**(2.80)**	(1.57)	(1.43)	**(2.87)**
GDP	**-0.020****	**-0.016***	**-0.020****	-0.005	**-0.020***
	(-2.75)	**(-2.09)**	**(-2.74)**	(-0.91)	**(-2.56)**
Constant	0.030	-0.819	0.030	0.052	0.030
	(0.13)	(-0.90)	(0.09)	(0.33)	(0.14)
N	540	540	540	540	540
R^2	0.366	0.347	0.365	n.a	0.366
F/Wald χ^2	38.24	34.17	194.01	229.81	177.84

t statistics in parentheses.

NB: Wald χ^2 for VCE, FGLS & PCSE. Unions and debt are logged.

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

7

Conclusion: *Social coalitions and austere politics*

> "*[A people's] social structure, the deeds its policy may prepare – all this and more is written in its fiscal history, stripped of all phrases.*"
>
> Schumpeter (1991)

This thesis has asked why countries implement different types of fiscal consolidations and follow different fiscal pathways. I have argued that to shed light on this puzzle, it is useful to look at how social coalitions shape austerity through their embeddedness in tax systems and levels of attrition, and how those coalitions evolve over time. I have argued that different tax systems lead to different social coalitions. If a tax system is mainly based on "strong linkages", i.e. hypothecated taxes, which are investments or sunk costs that yield strong expectations of future benefits, then social groups have an incentive to oppose expenditure cuts. If the tax system is built on "weak linkages", i.e. it is unclear which benefits it may yield, then social groups have more incentives to oppose tax hikes. Furthermore, the effect of tax linkages is conditional on attrition levels. If inequality is low, then social acceptance of taxes is higher for the simple reason that equal income implies equal tax shares and thus equal benefits. Therefore, even in a society with weak tax linkages, taxes can be increased if it is for the benefit of all. But if inequality is high, different dynamics shape social coalitions. Unequal incomes imply probably unequal taxes, and thus social groups may resist tax hikes.

From a dynamic perspective, the interaction of linkages and attrition has important policy and theoretical implications. First, my argument urges to pay attention to the endogenous effects of fiscal consolidations and to the probable shape of future social coalitions. In tax systems with weak tax linkages, higher attrition increases resistance to tax hikes. Social coalitions are thus reshaped

in favor of a spending cuts bias, which I call *Zwischenzug*. This case is embodied by the UK. But in societies with strong tax linkages, higher attrition entails a specific type of fiscal situation that I called *Zugzwang*: governments cannot cut spending because people oppose it and they cannot increase taxes because of social resistance (for a visualization of the argument, see figure 1.3). This case is embodied by France.

In the remainder of this conclusion, I spell out the contributions that this dissertation makes to policy issues and theoretical debates. First, the main takeaway message for policymakers is that my framework can be generalized to shed light on austerity politics in other countries (the US, Italy and the Eurozone crisis countries, Ireland, Portugal and Greece). These comparisons suggest that my argument is valid beyond the British and French cases. Second, I show that my argument may have important consequences for partisan politics and fiscal governance. I suggest that where tax linkages are weak and attrition is high, right wing parties have a political advantage. In this case, the delegation form of fiscal governance also works better. Conversely, where tax linkages are strong and attrition is low, left wing parties have an advantage and the contract form of fiscal governance is a better choice.

7.1 Policy implications

7.1.1 The United States

My argument predicts spending cuts and acute tax conflicts for the US due to weak tax linkages and high attrition. On the one hand, the American tax structure is very much tilted towards the federal income tax: apart from Denmark which is a peculiar case, the US is one of the few countries (New Zealand, Australia and Canada) in the world that approaches 40% of total budget revenues in personal income taxes. Contrary to these countries, the share of personal income taxes in federal budget revenues has been quite stable from 1965 onwards, with a peak at 42.45% in 2001 (vs. 35.7 in 1993). This was indeed the last year of the Clinton fiscal consolidation started in 1993 (Alesina 2000). This pattern of increasing the share of the federal income tax in total revenues repeats itself during other fiscal consolidations, jumping from 35.3 to 40% between 1977 and 1982, and from 33.9 yo 38.7% between 2010 and 2013. On the other hand, inequality in the US has always been quite high: even though the Gini coefficient decreased from 35 to 30 between 1960 and 1980, it increased back to 37 in 2010. This is not only the highest level in my sample of OECD countries (together with the UK), it is also one of the biggest increases in inequality since 1970. Likewise, the World Top Incomes Database informs us that between 1978 and 2014, the top 10% income share went from 32.44% to 47.19% in 2014, while over the same time period, the top 5% income share increased from 20.86% to 34.63%. This suggests a very high inequality level in the United States.[75]

This configuration has political implications. High inequality combined with weak tax linkages based on personal income taxes entail that rich people pay a larger share of taxes and yield more political power.[76] In 2010, the richest 10% pay 43.4% of income taxes (38.1% in the UK), which

[75] Attrition on the social level is also confirmed by polarization on the political level and the right shift of the polarized spectrum (Gelman 2009; McCarty et al. 2006).

[76] Some authors have shown that US policy-making is mostly influenced by affluent constituents (Bartels 2008; Gilens

increased from 37.4 (29.7% in the UK) in 1986 (International Monetary Fund 2013). The richest 1% paid 12.2% (8.1% in the UK), which increased from 7.4% in 1986 (4.5% in the UK). One can thus see that since 1978, the share of the federal income tax has increased (and thus tax linkages became weaker) but also that an increasing share of this tax was paid by people having strong incentives to oppose it, and this despite the important tax cuts granted under Presidents Reagan and George W. Bush. This configuration helps the richest to favor political forces strongly opposing tax hikes (such as the Tea Party) and to ask for spending and tax cuts during austerity, not least through the voice of wealthy presidential candidates hailing from the business sector (e.g. Mitt Romney and Donald Trump in 2012 and 2016 respectively).

The US has been characterized by increasingly acute tax conflicts since the onset of the age of austerity. From 1976 onwards, eighteen funding gaps (i.e. when Congress does not pass legislation which would fund the government) and twelve federal government shutdowns happened. Of these shutdowns, six were due to a polarized debate over fiscal consolidations (1981, 1986, 1990, 1995, 1996 and 2013). Since 2008, hardly a year has passed where there was no question of fiscal cliffs, debt ceiling and filibusters. Any tax increase after 2010 mostly stems from expiring previous tax cuts over which many bitter conflicts unfolded (e.g. the Bush tax cuts). But those tax increases are only partial: the American Taxpayer Relief Act of 2012, which solved the fiscal cliff, increased mostly taxes on the richest part of the population.

Anecdotal evidence seems to confirm the spending cuts bias despite the implementation of Obamacare and tax resistance in the US. For 2010-2014, unadjusted data[77] show that spending was reduced by 3.29 percentage points while taxes increased by 2.67 percentage points. Cyclically adjusted data[78] confirm this bias, with respectively 3.1 vs. 2.13 percentage points. Other authors have classified American austerity as spending-cuts led (Alesina et al. 2015).

7.1.2 Italy

With its strong tax linkages and high attrition, my framework predicts fiscal conflict for Italy. There were four Prime ministers between 2008 and 2014, with Italy being the only big advanced economy to mount a technical government of unelected experts in a repeat of the early 1990s. In the same way as Ciampi and Dini in the early 1990s, former EU Commissioner Mario Monti was called to govern so that the conflicted political situation would become less tense (Culpepper 2014).

Despite huge external pressure from financial markets, European institutions and politicians, and mounting public debt (133% of GDP in 2015), the Italian austerity has been strangely subdued. The cumulated fiscal consolidation plans amounted to 7.49% of GDP over four years of which only 47% was achieved, with 29% of spending cuts (Alesina et al. 2015).[79] This was enough, however, to anger Italian voters in 2013 and split them into three social blocks: a little less than one third for the center right and the center left and 25% for the anti-austerity Five-Star movement (Monti's

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and Page 2014; Hacker and Pierson 2010; Volscho and Kelly 2012).

77 From the IMF's World Economic Outlook.

78 From the OECD Economic Outlook 95.

79 In terms of cyclically adjusted measures, Italy increased spending by 0.8% and taxes by 2.3% of GDP, i.e. a cumulated adjustment of 1.5% of GDP. It seems that Italy did even less than calculated by Alesina et al. (2015).

centrists received just 10% of the vote).

This outcome is even more surprising given the impressive Italian fiscal turnaround in the 1990s: the primary net government lending has been consistently above or equal to fiscally responsible Germany and has dramatically improved from 1988 to 1997 (from -2.17 to 5.64% of GDP), enabling to decrease gross public debt to GDP 1996 to 2007. To be sure, a few factors helped Italy then. First, a more pluralistic electoral system has been introduced in 1994, together with an empowerment of fiscal institutions (Hallerberg 2004, chapter 7). Second, the 1990s fiscal adjustment was facilitated by lower inflation, lower interest rates and the devaluation of the Lira, which functioned as a side payment that enabled businesses to gain some competitiveness and be more amenable to accepting tax hikes (Marzinotto 2015; Padovano and Venturi 2001; Walsh 1999).

In my theoretical framework, this outcome is not puzzling. Italy has very strong tax linkages (SSC represent between 30 and 32% since the 1990s). Inequality has been consistently high and comparable to the UK since the early 1990s, implying high levels of attritions. As a result, social coalitions drifted into *Zugzwang*. Although Matteo Renzi pushed through important structural reforms in the labor market and in constitutional matters, his fiscal policies have been set on a conflicting course with Brussels: spending cuts have been few and far between and tax measures are rather aimed at boosting the economy rather than balancing the books. All in all, Italy illustrates a situation where France could be cornered if attrition increased too much: the erosion of dominant social blocs yield no coherent political coalitions, which in turn block any serious reforms that could yield new coalitions (Amable et al. 2012b).

7.1.3 Fiscal crises on the Eurozone's Atlantic rim

Ireland and Portugal experienced fiscal problems at the same time during the Euro crisis, with bailouts only five months apart (December 2010 and May 2011, respectively). Both countries had similar debt levels (87 and 96% of GDP) with similar subsequent increases (120 and 129% of GDP in 2013). But since then, their pathways have diverged markedly. Ireland repaid its international loans in advance. Portugal is mired in social conflicts and political alternations. Why?

Ireland planned a fiscal consolidation amounting to 11.93% of GDP with 5.73% of GDP allocated to tax hikes and 6.2% to spending cuts between 2010 and 2014 (Alesina et al. 2015). In terms of cyclically adjusted variables, this amounts to an adjustment of 7.1% of GDP with 6.3% of GDP in spending cuts and only 0.8% of GDP in tax hikes. These numbers seem to suggest that Irish austerity is clearly biased towards spending cuts: while it realized only 60% of its planned consolidation, only 14% of tax hikes were implemented while 101% of spending cuts happened. Despite a dramatic banking crisis, during austerity Irish politics were relatively stable, having two Prime Ministers only between 2008 and 2015 and relatively strong protests in 2010. The Fiscal Stability Treaty of the EU was approved with more than 60% of votes. It can be concluded that austerity was more or less socially accepted. In 2013, Ireland regained access to financial markets and left the Troika bailout program.

The fast adjustment in Ireland is a case of "mixed austerity" where weak tax linkages and diminishing inequality allow for a fast adjustment on both sides of the budget. Irish tax linkages are quite weak (SSC amount to 14% of total tax revenues, while IT increased from 33 to 40.4% over the last three decades). Between 1990 and 2010, the Irish Gini coefficient has decreased from 33

(around American and British levels) to 28 (comparable to France and Germany): attrition is thus quite low in Ireland. To be sure, Ireland has been helped by the relatively buoyant growth that its main trading partner, the UK, enjoyed and which boosted its economic growth. Since 2010, the yearly increase in GDP has constantly outperformed the Euro Area.

Portugal planned a bigger austerity package than Ireland (13.7% of GDP), with 6.56% of GDP dedicated to tax hikes and 7.14% of GDP dedicated to spending cuts. Of these measures, 62% were globally implemented if measured with the cyclically adjusted balance, but with 53% of tax hikes realized and 70% of spending cuts implemented. But fiscal politics have been more bumpy. In the October 2015 elections, the right wing party of Prime Minister Coelho may have limited the damage, remaining the main political party, but it has lost its majority and formed a minority government, while the socialists claimed to have a sufficient coalition with the more radical Left Bloc and the Democratic Union. The Portuguese President called on the socialists to join in a coalition with the conservatives to continue austerity. But after several weeks of political confusion that yielded an eleven-day conservative minority government, the socialists finally got to form a government with a slim majority, despite the opposition of a conservative president. Portugal has entered a political situation that my model calls *Zugzwang*: no clear winner to shape a fiscal coalition to carry out austerity.

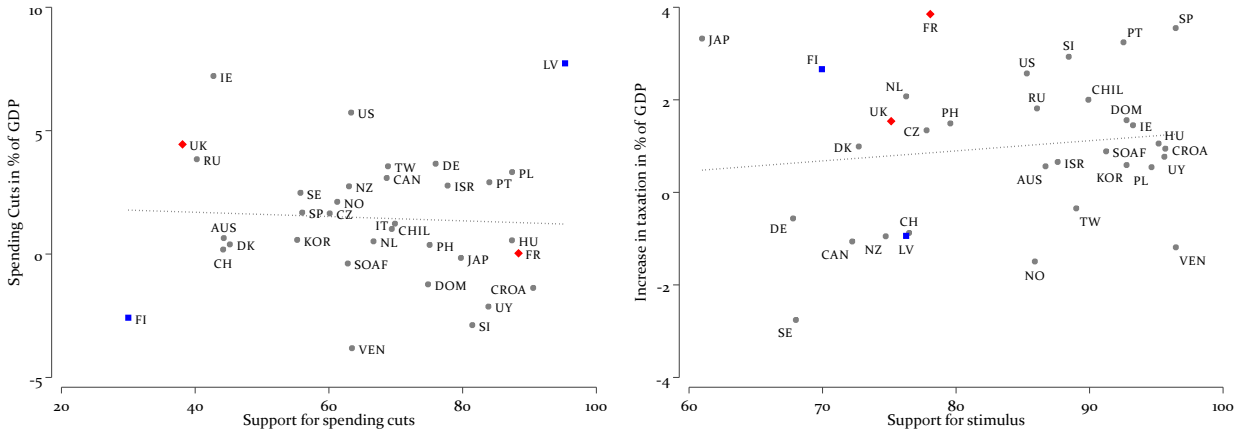
I explain conflicted fiscal politics in Portugal by relatively strong tax linkages (SSC amount to 26% while IT increased to 26% of revenue since 1980). Inequality has increased dramatically in the last five decades (Gini jumped from 22 in 1970 to 36 in 2008) and is comparable to American levels. The increase in the share of income of the top decile has been dramatic (increase from 19% to 37% between 1980 and 2010). As a result, Portugal finds itself in a situation where tax linkages are strong, although weakening, while attrition is rising dramatically. In such a situation, my framework predicts fiscal conflicts between social groups rejecting tax hikes and those refusing spending cuts, which translated into political instability, an outcome observed through the elections of 2015.

7.2 Theoretical implications

7.2.1 Public opinion

Patterns of protest and patience about austerity have fluctuated in the UK and in France. While in the UK the opposition to Thatcher's cuts was very vocal at the beginning of the 1980s, in the 2010s opposition to Cameron's cuts have been less dramatic. Given the limited measures on the tax side, opposition to these measures has been small. In France, opposition to spending cuts was most outspoken in the 1990s with demonstrations bringing the country to a halt in 1995. It the meantime, the country experienced an exceptional "tax peace" between the mid-1970s and early 2010s. Then opposition to tax hikes has come to the fore once the government started taxing specific interest groups directly (e.g. "ecotax" on heavy vehicles).

The paradox is that austerity policies can go against broader trends in public opinion. The literature shows that French people tend to support expenditure cuts (Bermeo and Bartels 2014) and Brits used to support higher tax and spending for a long time (Heath et al. 2001). Figure 7.1 suggests there is no association between public opinion and spending cuts and tax hikes enacted



(a) Spending Cuts **(b)** Stimulus

Figure 7.1: Public support and fiscal outcomes, 2006-2014

NB: Support for spending cuts and tax hikes is averaged for each country.
Source: ISSP 2006 and WEO 2014.

after 2010 if we use data from the 2006 International Social Survey Program (ISSP Research Group 2008).

Concerning public opinion and spending cuts, figure 7.1a suggests little correlation. The United Kingdom and France stand out as countries where the implemented policies run strongly against public opinion. In the UK, high expenditure cuts seem not to be the cup of tea of British public opinion (only 40% support them, while 75% supported stimulus). This finding seems to yield a twin paradox: first, how come that deep expenditure cuts are implemented if public opinion is against, and second, how come Tories got reelected after implementing them? This dissertation has argued that tax linkages and attrition can influence these dynamics. Using BSA surveys in chapter 5 on attrition, it has been showed that support for higher spending and taxes crumbled around 2002, especially among the lower income tercile, from 60% in 2002 to 30% in 2010, while support among the middle income and higher income terciles dropped to 20% (Soroka and Wlezien 2014). Data show the same results for the dwindling net support for welfare spending, paradoxically, as inequality increased since the 1980s. Clearly, the crises have brought deeper trends to the surface. This is confirmed by anecdotal data from YouGov polls: in September 2009, asked about how to reduce the deficit, 60% of respondents preferred spending cuts to tax increases (21%), a result that was confirmed after the elections of 2010 in another poll where 56% of interviewees supported spending cuts.

France has the highest support for spending cuts after Latvia and Croatia (with the former close to 100%), but policy did not follow this preferences. Increase in taxation after the economic crisis seems more in line with support for stimulus, but this covers a more complex reality. In 2014, a YouGov poll showed that 82% of French interviewees strongly backed tax cuts with no significant difference between partisan affiliations. It may well be that France did not cut expenditures and taxes because voters oppose certain types of spending cuts and prefer to increase certain taxes that

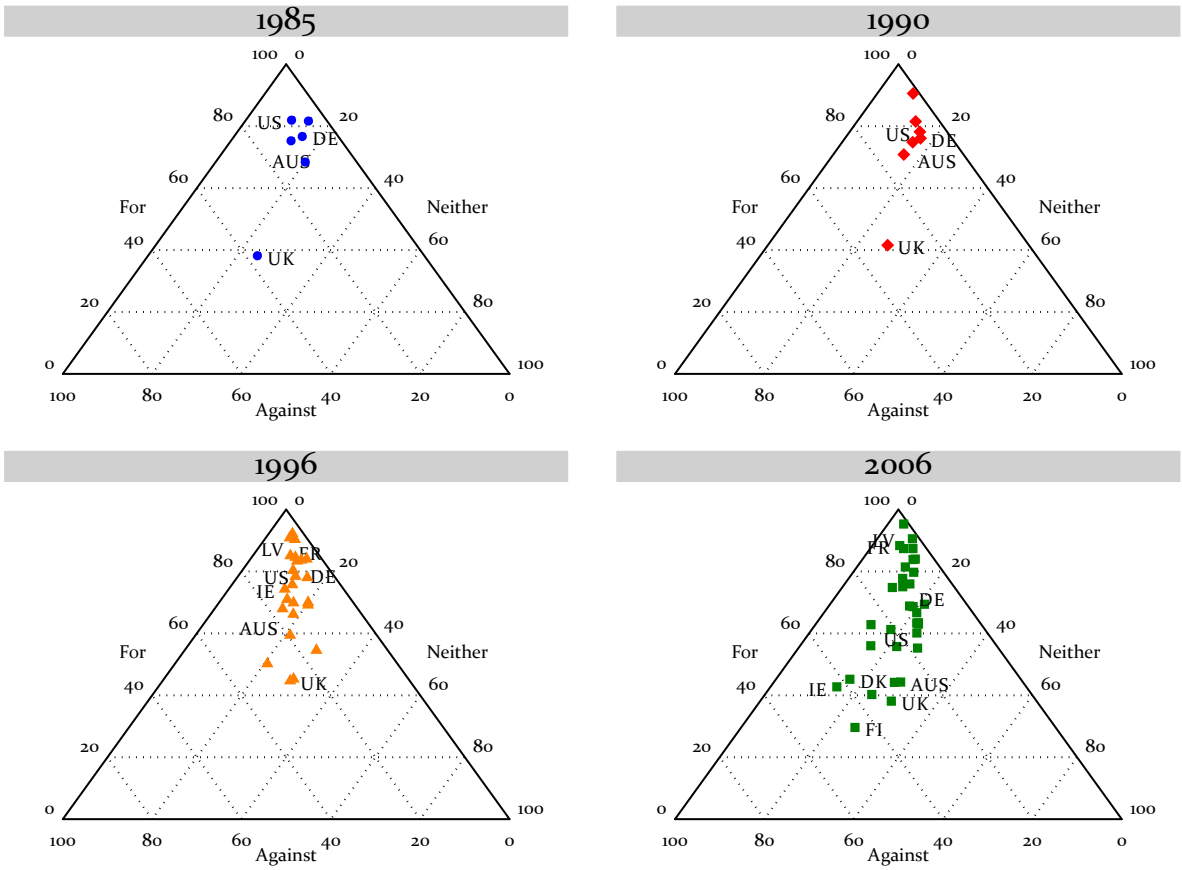


Figure 7.2: Change in public support for spending cuts, 1985-2006

NB: A ternary plot displays compositional data where three variables sum up to a constant and helps to put three dimensional data into a two-dimensional space. Reading it may be simpler than it appears: data are positioned at the sixty degree angle from the 0-100 axis. For example, which percentage of people are against spending cuts in the UK in 1985? Starting from the right side, one arrives at 40%, the same for spending cuts, while 20% have no opinion. Together, these three categories form 100%.
Source: ISSP, 1985-2006.

match my linkage mechanism. First, the same polls show that the French oppose spending cuts other than those dedicated to defense (see the IFOP and the YouGov polls). Second, there may be a semantic issue at play: when the French households refer to "taxes" ("impôts"), they understand personal income taxes which do not imply a compensation. In French a "taxe", which can also be named "redevance" and "côtisation", is usually proportional to an expected benefit. While the French oppose "impôts", they do not necessarily oppose "côtisations".

Figure 7.2 suggests that cross country austerity preferences vary little over time, even if since 1996 public opinion tends to support spending cuts less. In the last two decades support for spending cuts decreased mainly in Australia, Russia, Ireland, Switzerland, Spain and the United States. Perhaps the most interesting drop in public support for spending cuts is to be observed in Australia and Ireland. Otherwise, support for spending cuts remained stable in most of those

countries and increased only in Central Europe and the Baltics (Poland, Latvia, Japan and the Czech Republic).

7.2.2 Political parties

This dissertation suggests that, during austerity, the position of parties is in itself dependent on social coalitions. The implication is that left wing parties may have an easier time implementing their preferred austerity (tax and spending hikes) in the context of strong linkages and low attrition. For right wing parties to cut taxes and spending, attrition has to run high and tax linkages have to be weak. Figure 7.3 sketches out this implication and helps us to map it out on Kitschelt's argument (Kitschelt 2001). When attrition is high and tax linkages are weak we find ourselves in Kitschelt's first configuration of united market liberals and united social democrats. In Kitschelt's argument, the left has little credibility in defending the welfare state, but one can hardly see why. I propose that in such a configuration, the left can defend the welfare state only with great difficulty because tax linkages are weak and attrition is high. The left finds itself in a very tricky position indeed, and to get out of the trap and appear an economically competent party, left wing parties will have to move to the right. Hence the "pre-emptive strike" that Kitschelt argues is the more likely move of left wing parties.

When attrition is low and tax linkages are strong, party competition is structured in a way that favors social democrats and left wing parties. This is what shapes Kitschelt's fourth configuration: but here, I argue, liberal and conservative parties have a structurally weaker hand because of strong tax linkages. Voter do not want spending to be cut because they already paid for it. In this situation, right wing parties can only cut spending marginally and in general this falls on public investments and defense spending. This may explain the lack of "pre-emptive" strikes from the left and the relative failure of the right to impose spending cuts-led fiscal consolidations.

Kitschelt's third configuration on a three way contest between liberals, centrists and social democrats can happen either when linkages are weak and attrition is low - and in that case austerity is mixed because acceptance for spending cuts and tax hikes is equal - or when linkages are strong and attrition is high. But in the latter case, social conflict erupts because none of Kitschelt's parties (left, center and right) are willing to give up.

These conditional configurations constraining left and right parties explains why I did not find any effect of partisanship on austerity and why Kitschelt's argument of political competition and retrenchment is dependent on the shape of social coalitions during austerity. In the most clear-cut cases, some parties seem to be stronger than others and thus draw other parties towards themselves. This is exactly what chapter 6 on social coalitions, partisanship and austerity has suggested. In the UK, Labour is constrained by weak tax linkages and high (and increasing) attrition, and therefore moved to the right to appear as economically competent. This may explain the transformation of socialist Labour into New Labour. In France, Gaullists and liberals are constrained by strong tax linkages and low (albeit increasing) attrition and therefore have moved to the left.

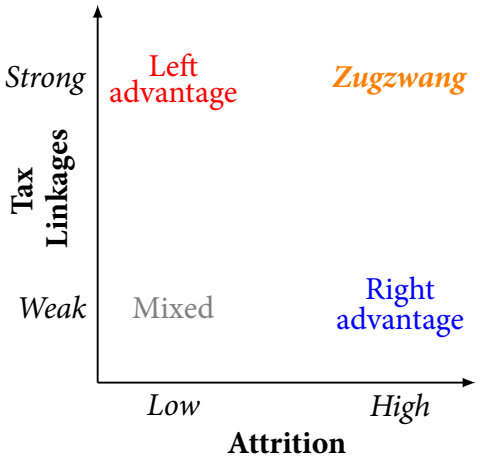


Figure 7.3: Social coalitions and political parties during austerity

7.2.3 Fiscal institutions

Finally, my argument also sheds some light on the choice and effectiveness of fiscal governance in the UK and France (Hallerberg 2004; Hallerberg et al. 2009). My argument suggests that social coalitions make delegation work quite well in the UK but that they undermine it in France. In short, the fiscal governance approach shows that to overcome the common pool resource problem, budgetary institutions have to be centralized either around a strong finance minister (delegation) when majorities govern (in general in majoritarian electoral systems) or around a fiscal "contract" when coalitions form cabinets (stemming generally from PR electoral systems). This approach has been very successful in explaining fiscal consolidations in Europe during qualifications for the EMU. It has also been largely acknowledged by international institutions. In the wake of the SGP crisis in 2003 and the Great Recession, the EC and the IMF made theirs the recommendations of the fiscal governance literature and developed large datasets on fiscal institutions (Annett 2006; Ayuso-i-Casals et al. 2009; European Commission 2006, 2010; International Monetary Fund 2009).

Both the UK and France have a majoritarian electoral system which often yields one party majority governments. Sometimes, smaller centrist parties join the government in an unequal coalition (e.g. in France the frequent coalition of the Gaullists and the centrists, or the LibDems in the UK with the Tories) or the main party in office brings together a larger coalition (e.g. the Socialist Party in France often times governs with the Greens and the more radical left). Given this political constellation, both countries have centralized their budgetary institutions around a strong finance minister - adopting the delegation form of fiscal governance in a comparable manner (see figure 2.1).

This similar fiscal governance has nonetheless worked differently in the UK and France. In the UK, the power of the finance minister increased between the early 1990s and the mid-2000s to the extent that in the sample of Hallerberg et al. (2009), the UK has the highest score. The contract score also increased slightly and remains at the average of the sample. Fiscal rules have been also dramatically strengthened since the election of Labour to government in 1997 (European Commission 2012). In France, delegation was the strongest in the sample in 1991 (0.9) but then fell

quite significantly in 2004 (0.77) while the contract index almost doubled in strength (from 0.46 to 0.78). At the same time, French policy-makers were long reluctant to increase the institutional power of fiscal rules, but they finally got ahead of the Euro pack in 2012.[80]

These institutional reforms offer useful insights into French fiscal politics. The fiscal rule index has increased gradually, reflecting not a dramatic change of power of the finance minister, as in the UK, but internal battles between three actors. Social partners were fighting to keep the state away from social security. The Treasury contested this and sought to regain power over budgetary issues after the traumatic episode of the Juppé consolidation. Last, the parliament sought to gain more power in the budgetary process by launching a reform called the LOLF and which introduced, *inter alia*, a vote on the size of the health care budget and greater accountability of the central government. In this power struggle of three actors dancing around the budget, the central government aimed at regaining control of the social security system by imposing rules, the parliament wanted to hold the central government to greater scrutiny and responsibility mainly due to the strong fiscalization of the welfare state through the CSG. Thus the politics underlying fiscal institutions in France are less straightforward than in the UK because of strong tax linkages and different governance structures of the tax system.

The idiosyncratic fiscal politics of the UK and France may help explain why similar budget institutions yield different fiscal performances. While the UK and France spent the same time in the excessive deficit procedure (around 90%, see figure 2.1), the UK has respected the self-defined medium term objective of the SGP more often than France (55% of the time vs. 30%). The UK has managed to reduce its gross public debt several times after economic shocks (by around twelve percentage points after the recessions of the 1980s and the 1990s) while France has had a slowly rising pile of gross public debt. In fact, from 1991 to 2010, French and German public debt have been very closely associated, meaning that while Germany had to face the huge shock of reunification, France used the same amount of gross debt to GDP to finance deficits.

My argument suggests that the delegation form of fiscal governance works better in the UK than in France because it is better embedded in social coalitions, while in France the fit between fiscal governance and fiscal coalitions is not perfect and is worsening over time. As a result, despite having comparable scores on the fiscal institutions indices, finance ministers in the UK and France play two different political games.

To see this, one needs to consider how finance ministers are embedded in social coalitions (see figure 7.4). The delegation form of governance requires the minister to have a top-down powerful approach to the budget: if her power of initiative and implementation is to be optimal, the finance minister is better off if the budget is embedded in weak tax linkages where social partners have no voice. Conversely, to be able to cut expenditures as she sees fit, the finance minister in a delegation form of governance is better off if attrition is high. But if she wants to raise taxes attrition has to be low.

If tax linkages are strong, the contract form of governance seems to fit better the social coalitions in place, because they would otherwise undermine the strong and independent finance minister. This is because strong tax linkages entail expected benefits and/or they give a veto power to social

[80] The normalized fiscal rules increased from -0.657 in the first half of the 1990s to 3.54 in 2013, the highest value among EU countries.

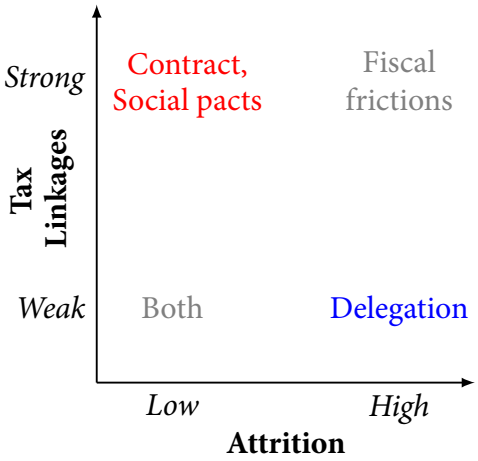


Figure 7.4: Potential social bases for forms of fiscal governance

partners. A contract form of fiscal governance may help bridge the gap between social partners and the state, between taxpayers and technocrats, and between the parliament and the executive. The fact that France moved in this direction is a testimony to the problems that a delegated form of fiscal governance endures with strong tax linkages. To confirm this, one can look at Germany which, as Hallerberg puts it, "tests the limits of delegation" (Hallerberg 2004, p. 113). Like France, Germany has strong tax linkages, low inequality and a competitive party system. Despite the latter, the delegation index was never very high (0.58 and 0.62 in 1991 and 2004) tough Germany has always benefited from a stellar fiscal reputation. The contract indices are far higher (0.77 and 0.73 respectively).

Greece is probably the worst-case scenario for delegation: tax linkages and high attrition strongly constrain finance ministers, and this shows. From 1980 to 1993, gross public debt increased from 20% to 94% of GDP. On the eve of the Great Recession, gross public debt amounted to 109% of GDP. From this point of view, it may be more efficient to change fiscal governance in Greece and switch to a contract form of fiscal governance, as in France, and inject some proportionality into the electoral system in order to bring all political forces behind fiscal consolidations and confer them with broad-based legitimacy.

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