Sustainable Public Finance: The Politics of Budget Consolidation, Tax Reform and Expenditure Control

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I. Outline of the topic

Since the mid-1970s, the subject of public finance has gained in importance. Many industrialised countries – for the first time in history, under conditions of peace and democracy – faced increasing public debt and deficits. The consequences for governments with substantial public debt can be extremely serious. High levels of public debt can undermine political stability and reduce the capacity of governments to supply public goods. These restrictions occur because interest payments arising from the accumulated public debt absorb an increasingly larger proportion of the total government outlays and tax revenues. This situation was particularly acute in certain countries where extraordinarily large proportions of total outlays were devoted to debt service payments: Often more than 20 per cent of all public expenditure was spent on debt interest. Looking at debt interest spending as a share of the overall government revenues, the picture for the early 1990s was even grimmer, with several OECD countries temporarily spending almost 25 or more per cent of revenues on debt interest payments.¹

Since the enactment of the Maastricht treaty, a shift in fiscal policies can be observed in many of the OECD countries. The issue of sustainable public finance was put on the political agenda, leading to significant budget consolidations and policy reforms. Such reforms focused on public debt targets, tax and expenditure limitations, budget institutions and accommodating social policy reforms. Moreover the future drag on public finance tends to be high, since intergenerational effects resulting from the ageing societies and demographic changes will have a significant impact on taxes and expenditures.

An important aim of this workshop is to extend the current political economic research on public finance. We are therefore primarily interested in detailed research on public expenditure programmes, which are less covered in comparative literature (see Castles 2007). New data sources, like the Classification of Functions of Government (COFOG), will stimulate this branch of research. New findings (Castles 2007) reveal that governments’ core expenditures suffer more from cutbacks than social expenditures.

However, the huge body of work on social expenditure has – to a very considerable degree – crowded out research on these other policy areas. This crowding-out has

¹ Greece’s interest payments of 34.2 per cent of the budget in 1994 represented an OECD post-war high.
been a function of the growing predominance of social programmes, which in total now amount to around 50 per cent of all government expenditures in the OECD world.

Public expenditure programmes are also closely related to the revenue side. Successful budget reforms have sometimes been carried out together with tax reforms. Usually tax reforms are discussed in the context of globalisation and a supposed “race to the bottom” due to tax competition. The empirical evidence for such a race is rather poor; the tax revenues have not been eroded. Nevertheless several important changes and developments can be observed, e.g. a change in the tax mix, a competition on tax rates in order to attract corporations and variations in the extent of tax reforms which can be traced back to different veto players.

Research questions which could be addressed in the workshop:
(1) Which strategies, i.e. revenue-based or expenditure-based, have been successful in budget consolidations?
(2) How important are budget institutions and rules (e.g. constitutional limitations), especially their changes during the reform process?
(3) Which factors – e.g. socio-economic determinants (e.g. demography), the partisan complexion of governments and political-institutional configurations (e.g. veto players, federalism, and decentralisation) – in a country can explain for a successful consolidation?
(4) How important are international factors (e.g. globalisation) and path dependency?
(5) Which kind of reform approach (i.e. commitment or delegation approach) is chosen by a government and why? How is this approach linked to the political system?
(6) Are there any interaction effects between the relevant factors?
(7) Which accommodating reforms have been carried out and in which policy areas (e.g. taxation, social system)?

II. Existing research
Economic research on budget consolidation is well established. However this research focuses mainly on the effects of consolidations (Bertola/Drazen 1993; Zaghini 2001; Ardagna 2004), on measurement problems (Zaghini 2001; Brandner 2003; Larch/Salto 2003) and on different strategies of government (Alesina/Perotti 1995, 1997; von Hagen/Hallett/Strauch 2002). Earlier economic research on the determinants of public debt included also institutional and political variables (e.g. Roubini/Sachs 1989) and differences in the preferences of governments (Persson/Svensson 1989).

While economic research became more interested in political and institutional variables, the political science research on public finance became more formal (e.g. Franzese 2002) and methodologically ambiguous. The contribution of political science to budget analyses deals mainly with institutions (Hallerberg 2004), including partisan
complexion of governments (Castles 2007) or tests a mix of socio-economic, political and institutional theories (Wagschal 1996; 2005). Related research on tax policies (Steinmo 1993; 1995) stresses the influence of interest groups, power resources and corporatism. New theoretical innovations like veto player theory (Tsebelis 2002) also stimulated the research on public finance (e.g. Bawn 1999; Tsebelis/Chang 2004).

The workshop is also closely related to the retrenchment debate. The “old” school of thought (Castles 1982; Schmidt 1996; Cusack 1999) found that the partisan complexion of government was a major factor shaping the growth of spending and also the composition of spending. This view came under attack while some researchers argued, that for explaining the retrenchment of social expenditure the old partisan divide no longer made a great deal of difference (Pierson 2001; Huber/Stephens, 2001). Besides, conventional wisdom in public opinion and some comparative literature is that the policy reforms of the last decades have triggered a decisive retreat of the post-war interventionist state and that this process is still continuing (Jessop 2002; Schuknecht/Tanzi 2005). However, it is puzzling that most comparative research has shown that substantial cutbacks in social expenditures, despite some reductions in the overall generosity of the system, can only be observed in a few countries (Korpi 2003, Siegel 2002; Castles 2007).

III. Possible participants
We hope to attract the attention of academics from a wide range of subject disciplines and research backgrounds, e.g. comparative and international political economy, economics, public finance and even law. Since the workshop topic covers various aspects from these disciplines we hope for interdisciplinary research. We especially encourage applications from doctoral researchers or young academics.

IV. Types of papers
We are looking for contributions with a strong empirical focus and approach, but based on a theoretical reasoning. We are not imposing any limitations on the “cases”, i.e. the papers can focus on cross-national research (e.g. OECD countries), sub-national units (e.g. cantons, Länder or states) or local units. Though this kind of research is usually based on a rather limited number of cases we also welcome case studies.

V. Funding
Individual participants are expected to fund both travel and accommodation from sources in their own country. The workshop directors try to raise additional funding from the Deutsche Forschungsgemeinschaft (DFG).

VI. Biographical note
Uwe Wagschal is professor for comparative politics at the University of Heidelberg. He previously was professor for public policy analysis and empirical methods at the Ludwig-Maximilians University in Munich (2003-2005). He has published several books and various articles related to the subject of the workshop. His most relevant books are on the determination of public debt and deficits (Wagschal 1996), comparative welfare states (Obinger/Wagschal 2000), tax reforms (Wagschal 2005) and budget consolidation in OECD countries (Wagschal/Wenzelburger 2006). His current research is directed at the budget consolidation of the German Länder.

Mark Hallerberg is associate professor at Emory University. Previous appointments include Georgia Institute of Technology (1996-99) and the University of Pittsburgh (1999-2004). He has specialized in political economy (comparative and international) and has worked as a consultant for the Dutch Ministry of Finance, the International Monetary Fund, the Organisation for Economic Co-operation and Development, and the World Bank. Current research projects focus on fiscal institutions and fiscal policy in developing countries, coalition governments, and the consequences of internationalisation for European Union countries. He has published on tax competition (Hallerberg 1995; Hallerberg/Basinger 1998 and Basinger/Hallerberg 2004), public deficits (Hallerberg 2004) and budget institutions (Hallerberg/Strauch/von Hagen 2006).

VII. Contact details

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VIII. References


