



Ideology and redistribution through public spending



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ABSTRACT

For a panel of OECD economies (1980–2013) we analyse the scope of government ideology to shape patterns of public expenditures. To address if public expenditures are used to channel redistributive outcomes, we adopt a flexible panel error correction model and proceed in two steps: Firstly, we analyse if ideological positions matter for the sizing of the public sector. Secondly, we address the actual impact of government ideology on two disjoint categories of public expenditure that are characterized by distinguished redistributive effects. Under both, left-wing and right-wing governments, public spending shows progressively redistributive effects which are indirectly channelled through their policy response to changing macroeconomic, fiscal and demographic fundamentals. While right-wing governments act progressively redistributive under favourable socio-economic conditions, their left-wing counterparts do so under unfavourable conditions. Comparing the two effects in terms of their explanatory content, we find that the latter is stronger than the former.

1. Introduction

A central aspect of political programmes of left-wing parties is the reduction of inequality in income distribution.² Historically, this objective has been primarily achieved through changes in the tax structure. However, since the early 1980s with the liberalization of goods and capital markets, most governments have reduced top marginal income and capital tax rates as a response to the globalization process.³ A consequence of this process is that political parties have lost most of their influence on tax policies. Indeed, numerous recent studies have shown that party ideology has no significant influence on the progressiveness of tax systems (Volkerink and De Haan, 1999; Galli, 2002; Swank and Steinmo, 2002; Cusack and Beramendi, 2006). Instead, it has been argued that, nowadays, parties pursue welfare redistribution mainly by putting emphasis on distinguished spending policies that favour more than proportionally low income earners such as health care, unemployment, and social spending in general, and not through changes in the tax structure.⁴ Thus, in the mid-2000s, the average redistributive effect in OECD countries achieved through public

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² See Bradley et al. (2003) for an overview of distribution and redistribution in modern societies and the (expected) decisive role of leftist governments.

³ As pointed out by Peter et al. (2010), the GDP-weighted average top statutory marginal personal income tax rate in a sample of 189 countries has fallen from more than 60% at the beginning of the 1980s to less than 40% in 2005. Overall, progressiveness of tax schemes has also declined. A similar downward convergence of tax rates over this period can be observed for capital taxation. In 24 OECD countries the average central government corporate top statutory tax rate has decreased from 42% in 1980 to 25% in 2012 (Chengrui, 2014).

⁴ That such a redistributive public spending can effectively redistribute income has been shown, e.g., by Afonso et al. (2010).

social spending was already twice as large as that achieved through income taxation (OECD, 2008, 2011; Wang et al., 2012, 2014).

From these findings we would expect that left-wing parties, which advocate more income redistribution in party manifestos than their right-wing counterparts, promote higher spending in public expenditure categories that primarily benefit low income earners. However, recent studies have shown only a muted effect of party ideology, for example, on social expenditure after the 1990s (Iversen, 2001; Kittel and Obinger, 2003; Potrafke, 2009; Herwartz and Theilen, 2014a). Furthermore, right-wing parties are, generally, more in favour of a reduced public sector and, therefore, aim to limit overall public expenditure (see, e.g., Hibbs 1977, 1987; Cameron, 1978; Alesina, 1987; Cusack, 1997; De Donder and Hindriks, 2007; Pickering and Rockey, 2011). This means that more social spending of left-wing parties only testifies their larger preference for social justice, if it does not come along with more spending in other expenditure categories where an increase of public spending has redistributive effects that go into the opposite direction.

The objective of our study is to analyse if party ideology has a distinguishable effect on redistributive justice. For this purpose we adopt a two-step approach. In the first step, we analyse the socio-economic and political determinants of public expenditure. In the second step, we analyse the impact of government ideology on redistributive spending by decomposing public expenditure in two disjoint categories: social spending and 'non-social' spending. Social spending comprises, among other categories, health care, old age, survivors, incapacity-related benefits, family programmes, active labour market programmes, unemployment benefits, and housing programmes. Social spending is equivalent to a progressive welfare redistribution, as more social spending more than proportionally benefits low income earners.⁵ 'Non-social' spending comprises, for example, expenditure on education, infrastructure, security and administration. Higher expenditures on these categories more than proportionally favour the middle and upper income classes. Hence, public spending on the 'non-social' spending categories is more regressive compared with social expenditure. The adopted two-step approach has two advantages. First, it reflects the political decision process that first determines the size of the total budget and, then, decides on its *distribution* on different spending categories (top-down budgeting). Secondly, it allows us to separate ideologically motivated adjustments of the size of the public sector from ideologically motivated prioritization of specific spending programmes.

The framework adopted in this study allows us to analyse three questions that have not been addressed previously in the literature:

1. Does ideology (and other political variables such as the timing of elections, the polarization of the party system or the number of coalition partners) influence progressively redistributive public spending?
2. Do parties react differently to social and economic changes?
3. Do these reactions have distinguished effects on social and 'non-social' public spending?

The first question emphasizes that differences in social expenditure between parties of different ideologies do not necessarily reflect differences in their wish to redistribute income when they are accompanied by similar differences in other spending categories. In such a case, they rather indicate divergent party positions regarding the total size of the public sector. With the first question (Q1) we analyse if government ideology and other political variables have a *direct* redistributive impact on distinguished spending categories. With the second question (Q2) we want to take into account of the fact that party ideology does not necessarily impact directly on public spending. Rather it can impact *indirectly* through the channel of distinct reactions of parties to changes in the socio-economic environment. This is because parties might adjust public expenditure in different ways over the business cycle, and react differently to changes in the population structure, changes in the size of government deficits, or in the level of public debt. We respond to this question by analysing the interaction effects of party ideology with several socio-economic variables. With the third question (Q3) we explore if the before-mentioned indirect channel of party ideology on public expenditure works differently for social and 'non-social' expenditure. We respond to this question by comparing the interaction effects of party ideology with our socio-economic variables on social expenditure with those they have on 'non-social' expenditure.

Related studies have focused on specific spending categories or the determinants of the composition of public spending. These studies are mostly based on cross-sectional data and underscore the importance of differences in the political institutional settings (e.g., Persson and Tabellini, 1999; Persson et al., 2007), income distribution (Meltzer and Richard, 1981; Shelton, 2007), or ethnical fractionalization (Alesina et al., 1999; Shelton, 2007) to explain cross-country differences in public spending patterns.⁶ However, once such types of 'country-specific factors' are allowed for the impact of different ideological positions of governments can be hardly distinguished in cross-sectional studies. Therefore, as the objective of this study is to identify the impact of changes in government composition on redistributive spending, we take especially into account of country-specific time patterns of public spending composition.

Our analysis is based on data from 21 OECD economies over the period 1980–2013. As a particular merit, the considered panel dimension allows us to figure out how ideology matters in government responses to macroeconomic, fiscal and demographic conditions that are subject to both cross-sectional and time variation. Noting that the considered time period covers several business cycles, the sample information is likely rich on information how governments holding diverse ideological positions cope with more or less favourable domestic socio-economic performance. Moreover, the framework of the adopted panel error correction model (ECM),

⁵ For example, see Hicks and Swank (1992) for an overview on the literature regarding the link between party ideology, voter preferences and welfare spending.

⁶ Though some studies are based on panel data, the time series dimension of the data is not fully explored in the analysis. For example, Shelton (2007) builds five-year averages such that 31 annual observations per country are transformed into six observations per country.

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