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'Leaning Against an Open Door': Ideology and the cyclicality of public expenditure

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Abstract

When is government expenditure likely to be procyclical? While economists tend to anticipate counter-cyclical expenditure, recent studies report procyclical expenditure. This paper explores the impact of political ideology on the cyclicality of government expenditure. Predictions are tested with reference to government expenditure in the USA between 1950 and 2008. The likelihood of procyclical expenditure increases if groups that press for increased public expenditure are'. . .leaning against an open door'.

JEL classification: E62; H50; H60

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1. Introduction

Alesina, Campante, and Tabellini (2008) argue that economists tend to anticipate counter-cyclical government expenditure (to stabilise economies), even though recent empirical studies report procyclical expenditure. Government expenditure is procyclical when expenditure increases in an economic upturn and decreases in an economic downturn. Procyclical expenditure was first identified in developing countries (e.g. Gavin, Hausmann, Perotti, & Talvi, 1996; Kaminsky,

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Reinhart, & Vegh, 2004; Talvi & Végh, 2005; Woo, 2009), but now there is evidence of procyclical expenditures in OECD countries (e.g. Abbott & Jones, 2011; Arreaza et al., 1998; Hercowitz & Strawszynski, 2004; Lane, 2003).

In this paper the objective is to explore the determinants of the cyclicality of government expenditure. There are normative rationales for counter-cyclical expenditure and for procyclical expenditure. Keynes' advocated counter-cyclical intervention to minimise the social cost of unemployment and inflation. Lane (2003) argues that procyclical expenditures will maximise social welfare if public-sector goods are complements for private-sector goods (produced in competitive markets). By comparison, this paper explores the proposition that it is the mix of incentives that vote-maximising politicians face over the economic cycle that will *explain* the pattern of government cyclicality.

Buchanan and Wagner (1977) emphasise this distinction. They argue that politicians have incentives to increase government expenditure to win votes. Politicians are more indulgent if there is fiscal illusion. The more that governments borrow, the more voters under-estimate the 'tax cost' of government spending. In economic downturns (when governments rely heavily on deficit finance), fiscal illusion is pervasive. Buchanan and Wagner are critical that the Keynesian rationale provides politicians with the justification to borrow to increase public expenditure. R.F. Harrod (Keynes' biographer) stated that Keynes believed economic policy would be made by "*. . .a small group of enlightened men. . .in accordance with the 'public interest*'' (cited by Buchanan & Wagner, 1977: 84). Buchanan and Wagner are more critical. They argue that politicians make decisions to increase the likelihood that they will win elections.

If a Keynesian argument provides a rationale for counter-cyclical expenditure, Lane's (2003) argument provides a rationale for procyclical expenditure. Once again, the distinction between a welfare-maximising rationale and political ambition stands proud. When explaining procyclical government expenditure, Lane and Tornell (1996) and Tornell and Lane (1999) identify the significance of 'voracity effects'. Voracity effects are experienced when political pressures to increase public expenditures increase as national income increases. Lane (2003) tested the proposition that political pressures are relevant in the OECD. He measured the impact of pressures for increased public spending in the OECD with reference to Henisz's (2000) index of 'power dispersion'. The index, based (in part) on differences between group preferences, was statistically significant when explaining the cyclicality of some government budgets e.g. when explaining procyclical government wage expenditure.

It is impossible to ignore the importance of pressure to increase government spending, but in this paper the intention is to focus on *politicians*' *response* to these pressures over the economic cycle. Acknowledging insights from analysis of the 'demand' for public expenditure (insights to be discussed later in the paper), here the objective is to focus on the 'supply' of public expenditure. What explains politicians' willingness to accommodate pressure for increased government expenditure? Are politicians more willing to increase government expenditure in an economic upturn (than in an economic downturn)? Are left-wing politicians' more willing to respond than right-wing politicians? Are politicians more indulgent if they feel secure in their political office?

The argument in this paper is that willingness to accommodate pressure in an economic upturn is particularly important when predicting the cyclicality of government expenditure. Downs (1957) argued that vote-maximising politicians are myopic. In their attempt to win electoral support, they discount future difficulties. But the more they indulge pressures in an economic upturn, the more they face difficulty sustaining government spending in an economic downturn – and the greater the likelihood of procyclical government expenditure.