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The Politics of Fiscal Policy during
Economic Downturns, 1981-2010

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Abstract:

This article investigates fiscal policy responses to the Great Recession in historical perspective. We explore general trends in the frequency, size and composition of fiscal stimulus as well as the impact of government partisanship on fiscal policy outputs during the four international recessions of 1980-81, 1990-91, 2001-02 and 2008-09. Encompassing 17-23 OECD countries, our analysis calls into question the idea of a general retreat from fiscal policy activism since the early 1980s. The propensity of governments to respond to economic downturns by engaging in fiscal stimulus has increased over time and we do not observe any secular trend in the size of stimulus measures. At the same time, OECD governments have relied more on tax cuts to stimulate demand in the two recessions of the 2000s than they did in the early 1980s or early 1990s. Regarding government partisanship, we do not find any significant direct partisan effects on either the size or the composition of fiscal stimulus for any of the four recession episodes. However, the size of the welfare state conditioned the impact of government partisanship in the two recessions of the 2000s, with Left-leaning governments distinctly more prone to engage in discretionary fiscal stimulus and/or spending increases in large welfare states, but not in small welfare states.

Keywords: fiscal policy, business cycle, government partisanship, welfare state

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Introduction

The politics of macro-economic management featured prominently in the comparative political economy literature of the 1980s. From the mid-1990s onwards, however, the concerns of comparative political economists have focused on other issues, notably skill formation, social protection and redistribution. Many political economists seem to have become convinced that governments are no longer willing or able to respond to economic downturns by engaging in fiscal stimulus. Yet virtually all OECD governments resorted, albeit briefly, to deficit spending during the Great Recession of 2008-09. In light of this experience, it is time, we think, to bring macro-economic policy, and fiscal policy in particular, back to the center-stage of comparative political economy.¹

Building on Pontusson and Raess (2012), this article situates fiscal policy responses to the Great Recession in historical perspective. We engage in a multifaceted descriptive analysis of fiscal policy responses to the four international recessions that the OECD countries have experienced since 1980, i.e., the recessions of 1980-81, 1990-91, 2001-02 and 2008-09. Our goal is to explore broad patterns of change over time, across many OECD countries. To this end, we must necessarily rely on quantitative data and ignore the intricacies of policy-making and specific policy choices. Encompassing 17-23 OECD countries, the fiscal policy data that we present have been adjusted for the budgetary effects of cyclical economic fluctuations and thus pertain to the fiscal outcomes produced by discretionary government decisions or, in other words, ‘discretionary fiscal policy outputs’.

We begin by situating our approach in relation to existing literature. The empirical analysis that follows is organized into two parts: first, we explore general trends in fiscal policy responses to economic downturns since 1980; and, secondly, we explore changes over time in the impact of government partisanship on fiscal policy outputs. General trends and

partisan effects ought to be considered in tandem, for the absence of partisan effects might signify either of two very different scenarios: (a) all governments, regardless of partisan colors, respond to recessions by engaging in fiscal stimulus or (b) all governments instead pursue pro-cyclical policies.²

With respect to government partisanship as well as general trends, our discussion addresses three separate questions. The first question concerns the *frequency of fiscal stimulus* in response to economic downturns. Have governments become less inclined to undertake stimulus measures? At any given point in time, are Left-leaning governments more likely to undertake fiscal stimulus measures than Right-leaning governments? The second question concerns the *size of fiscal stimulus*. When governments choose to stimulate domestic demand, how aggressively do they do so? Do Left-leaning governments differ from Right-leaning governments in this respect? Finally, we consider the *composition of fiscal stimulus*, conceived in terms of the mix of spending increases and tax cuts. Have governments come to rely more on tax cuts over time? Do Left-leaning governments favor spending increases while Right-leaning governments favor tax cuts?

To anticipate, the data presented below call into question the idea of a general retreat from fiscal policy activism since the early 1980s. The propensity of governments to respond to economic downturns by engaging in fiscal stimulus has actually increased across the four international recessions included in our analysis and we do not observe any secular trend in the size of fiscal stimulus measures. At the same time, our data indicate that most OECD governments relied more on tax cuts to stimulate demand in the early 2000s and in the Great Recession than they did in the early 1980s and 1990s.

We explore the role of government partisanship descriptively, but also estimate simple cross-section regression models for each of the four recession episodes, with Left parties' share of cabinet portfolios as the independent variable of primary interest. While our

descriptive analysis suggests that Left-leaning governments have often behaved differently than Right-leaning governments, our regression analysis does not yield any significant partisan effects. Adding further complexity, we explore the implications of public welfare provisions for the partisan politics of fiscal policy during economic downturns. Generous public provisions cushion the impact of economic downturns on citizens and arguably reduce the pressure on elected officials to engage in fiscal stimulus. Does this logic affect governing parties of the Left and the Right differently? Our analysis suggests that the answer is ‘no’ for the recessions of the early 1980s and 1990s. For the recession of the early 2000s, however, we find that Left-leaning governments were significantly more likely than Right-leaning governments to engage in fiscal stimulus and to rely on spending increases as the source of fiscal stimulus in large welfare states. In the Great Recession, Left-leaning and Right-leaning governments in large welfare states diverged with respect to the reliance on spending increases to stimulate the economy, but not with respect to the size of fiscal stimulus.

Existing literature and working hypotheses

The emphasis on supply-side and distributive issues in recent comparative political economy appears to be motivated by a common belief that governments have retreated from fiscal policy activism. Several broad arguments have been advanced to explain the supposed retreat from fiscal policy activism or, in other words, the abandonment of the Keynesian policy paradigm of the *trentes glorieuses*. Some scholars (e.g., McNamara 1998; Blyth 2002) emphasize ideational paradigm changes among economists and other policy experts. Recent research in this vein has documented the ascendancy of the idea of ‘expansionary fiscal

contraction' and its role in the general turn to austerity in 2010 (Blyth 2013; Dellepiane-Avellaneda 2014).

Other scholars propose more structuralist explanations of the retreat from fiscal policy activism. One prominent idea along these lines is that increased dependence on trade reduces the effectiveness of fiscal stimulus. As trade increases, fiscal stimulus increasingly benefits foreign producers, via demand for imported goods and services, while its negative consequences for export competitiveness matter more to the economy as a whole. In the absence of international coordination, something of a prisoner's dilemma arises as each government waits for its trade partners to undertake stimulus measures (Cameron 2012). It is also commonplace to argue that the internationalization of financial markets has constrained the ability of governments to pursue countercyclical fiscal policies or, more precisely, the cost-benefit calculus involved. In a world of capital mobility, interest-rate premiums on fresh borrowing by highly indebted governments arguably motivates governments to run smaller public-sector deficits (Garrett 1998).

Yet another line of argument is that welfare-state expansion over the period 1960-90 has rendered discretionary fiscal policy activism unnecessary. Welfare states not only cushion the impact of unemployment on individuals and thus protect incumbent governments from electoral punishment when unemployment rises, but also stimulate domestic demand through the mechanism of 'automatic stabilizers' (see Darby & Melitz 2008; Auerbach et al. 2010). Economic openness and welfare-state expansion might be invoked not only to explain a general retreat from fiscal policy activism, but also to explain cross-national variation around this general trend. Everything else being equal, conventional wisdom suggests that open economies with large welfare states will be less prone to respond to economic downturns by engaging in fiscal stimulus than countries that are less open and provide less of a social safety net.

European Monetary Union (EMU) features prominently as constraint on fiscal expansion in ‘ideationalist’ as well as ‘structuralist’ accounts of European responses to the Great Recession. For example, Cameron (2012) invokes the deficit restrictions of the Growth and Stability Pact to explain why EU member states engaged in less fiscal stimulus than the United States in 2008-09 and were quicker to apply the breaks in 2010. However, one must also keep in mind that the restrictions of EMU were put in place precisely because member states would not be able to use monetary and exchange rate policy and might thus be expected to rely more heavily on fiscal policy to stimulate domestic demand (Iversen & Soskice 2012).

As noted at the outset, we seek to go beyond existing literature by analyzing cross-temporal and cross-national variation in the composition of fiscal stimulus as well as the frequency and size of fiscal stimulus. Needless to say perhaps, governments may stimulate domestic demand either by increasing spending or cutting taxes, or by some mixture of the two. Based on a handful of country cases, Pontusson and Raess (2012) suggest that, irrespective of their partisan composition, governments relied more heavily on tax cuts to stimulate the economy during the Great Recession of 2008-09 than they did during the ‘Long Recession’ of the 1970s. The contrast with the 1970s is particularly striking in the Swedish case: Center-Right coalition governments responded to the downturn of 1976-77 with deficit spending and subsequently closed the deficit by raising taxes while a new Center-Right coalition government responded to the downturn of 2008-09 by cutting taxes and relied heavily on spending cuts to restore budget balance in 2010-11.

In what follows, we seek to assess whether the Swedish case is emblematic of a general shift from ‘social Keynesianism’ to ‘liberal Keynesianism’. Our expectation that this is indeed the case follows from the observations that real estate and financial assets have become increasingly important to the life-time income of middle-income households and that asset bubbles have featured prominently in recent recessions. To the extent that employment

insecurity has become, in relative terms, less important to pivotal middle-income voters, tax cuts arguably represent a more efficient way for incumbent government to protect themselves against electoral backlash during economic downturns (see Ansell 2012a; 2012b).

This brings us to the question of government partisanship. The ‘old’ literature on the political economy of macro-economic management, most notably Hibbs (1977), posits that parties of the Left and the Right have systematically different macro-economic priorities because their core electoral constituencies differ (see also Garrett 1998). Representing voters whose income derives primarily from employment, Left parties prioritize fighting unemployment. By comparison, voters with financial assets are more important to Right parties and consequently these parties care more about price stability. The implication of this reasoning is that Left governments should be more likely than Right governments to engage in fiscal stimulus during economic downturns. Assuming, reasonably, that spending on unemployment benefits and other compensatory programs primarily benefit low-income households while the benefits of tax cuts are spread more evenly across the income distribution, the same logic would also lead us to expect that Left governments will rely more on spending increases while Right governments will rely more on tax cuts to stimulate domestic demand during economic downturns.

We are particularly interested in the question of whether the effects of government partisanship have changed over time. If it is indeed the case that the political-economic environment has become less permissive of fiscal policy activism, it stands to reason that partisan differences over the appropriate amount of fiscal stimulus during economic downturns have diminished. In a different vein, Rueda (2007) argues that growing labor-market dualization renders Hibbs’ partisan model of the macro-economic management, based on the distinction between wage-earners and asset-owners, outdated. In Rueda’s alternative model, labor-market ‘insiders’, who are protected against business-cycle fluctuations in the

rate of unemployment, constitute the core constituency of mainstream Left parties these days. The implication is that, over time, Left parties (governments) have become less concerned with increases in the rate of unemployment and therefore less prone to engage in fiscal stimulus. Rueda's argumentation might also be taken to imply that Left governments have become more favorable to tax cuts (rather than spending on unemployment benefits) as a means to stimulate aggregate demand.

In an important new book, Starke et al. (2013) argue that generous social welfare provisions not only reduce the need for fiscal policy activism during recessions, but also reduce partisan conflict over fiscal policy responses to recessions. Based on case studies of policy change in Australia, Belgium, the Netherlands and Sweden during the recessions of the 1970s, the early 1990s, and 2008-2009, Starke et al. (2013: 179-180) propose the following generalization:

... there are two types of crisis management, depending on the size of the welfare state. In large welfare states, crisis management relies on automatic stabilizers. It usually involves a relatively consensual adjustment of specific social policy instruments, often targeted at vulnerable groups in the labour market. In smaller welfare states, crisis management is based more on discretionary macro-stabilization. It is more conflictual, as it concerns the very shape of the welfare state. Additional spending needs to be explicitly devoted to welfare measures via 'crisis packages'. Hence, there is a higher probability that these measures become subject to partisan struggles.

For Starke and his co-authors, partisan effects on discretionary fiscal policy outcomes should be less pronounced in large welfare states than in small welfare states. In our view, however, it is equally plausible to suppose that partisanship matters more in large welfare states than in small welfare states. The absence of a strong safety net exposes incumbent governments to the threat of electoral backlash during economic downturns. As a result, we hypothesize, Right-leaning governments will be more likely to adopt expansionary fiscal policies that run counter to the interests of their core constituencies or, in other words, to behave more like Left-leaning governments. Put the other way around, generous public

welfare provisions reduce the electoral pressure on Right-leaning governments to engage in fiscal stimulus and compensatory spending, allowing them to adopt fiscal policy responses that correspond more closely to the interests of their core constituencies.³

Left parties can usefully be conceived as electoral coalitions of (a) private-sector workers with an interest in social protection and redistribution by virtue of their labor-market status, (b) public-sector employees who benefit from public spending in terms of wages and employment security, and (c) a wide range of individuals for whom government transfers represent a major source of income. Workers in sectors exposed to international competition have an interest in social protection, but they also have reason to worry about the implications of deficit spending for competitiveness. This is less obviously the case for public-sector employees and other ‘welfare-state clienteles’ (Pierson 2001). The relative size of these different constituencies of Left parties varies as a function of the size of the welfare state. In large welfare states, we hypothesize, Left parties will be less sensitive to the competitiveness concerns of exposed sectors, especially export-oriented industries and their employees. Relative to Left-leaning governments in small welfare states, Left-leaning governments in large welfare states might thus be expected to adopt more expansionary fiscal policy in response to economic downturns.⁴

Our discussion sets aside the question of varieties of capitalism and their implications for macro-economic policy choices. The argument that ‘liberal market economies’ tend to pursue more expansionary macro-economic policies than ‘coordinated market economies’ (Soskice 2007; Iversen & Soskice 2012) involves social protection and economic openness, which we include as control variables in our regression analysis. Whether or not we gain analytical leverage by treating these variables as complementary components of different political-economy clusters is a complicated question that we cannot pursue here.⁵ Due to space limitations and our small number of observations, we also ignore the distinction

between single-party and coalition governments. For a sample of thirty-four countries, Armingeon (2012) shows convincingly that one-party governments were more likely to pursue expansionary fiscal policies than coalition governments in 2008-09. Soskice may well be right that governments in CMEs behave differently from governments in LMEs, and Armingeon may be right that coalition governments behave differently from single-party governments, but there is no obvious reason why either of these claims being true would call into the question the findings we present below.

Empirics I: General trends

To assess general trends in fiscal policy responses to economic downturns, we engage in two complementary exercises. To begin with, we look at changes in fiscal policy during single or consecutive years in which more than two-thirds of the countries in our dataset experienced year-on-year decelerations in (real) GDP growth.⁶ Defined in this manner, the international recession years in our dataset are 1981, 1990-91, 2001 and 2008-09. Some countries did not experience recessions in the technical sense (two consecutive quarters of negative growth) during these years, and some countries experienced recessions at other times, but there can be little doubt that these years are indeed the years since 1980 in which the OECD area as a whole experienced major economic downturns. Focusing on OECD-wide downturns, we assume that governments consider economic conditions abroad in making fiscal policy decisions. To take into account cross-national differences in the timing of the business cycle, the second exercise reports on the frequency, size and composition of stimulus measures over more extended time periods, varying between three and five years.

Taken from the OECD, the measure of discretionary fiscal stimulus on which we rely refers to year-on-year changes in the ‘underlying government primary balance’, expressed in percent of potential GDP.⁷ Based on econometric estimates, this measure adjusts for fluctuations in government expenditures and revenues due to the business cycle and thus pertains to changes in expenditures and revenues that can be attributed to government decisions. Essentially, the measure captures changes in expenditures and revenues that cannot be explained by rising claims for social benefits at constant benefits generosity and falling revenues at constant tax rates. It also eliminates one-off fiscal operations that distort the accuracy of cyclically-adjusted fiscal balances (OECD 2008). Most notably, the public expenditure figures used by the OECD to estimate the underlying primary balance do not include the massive capital payments associated with the bailout of financial institutions in 2008-09.

For seventeen countries, the OECD provides annual data on the underlying government primary balance from 1980 onwards. Another six countries (Germany, Iceland, Luxembourg, New Zealand, Portugal and Switzerland) enter the OECD dataset in the 1990s. We will include these six countries in our analysis of determinants of fiscal policy responses to the recessions of 2001-02 and 2008-09, but for the sake of comparability our descriptive analysis of general trends focuses on the seventeen countries for which we have measures of discretionary fiscal policy going back to 1980.

As a first cut, Table 1 presents annualized measures of discretionary fiscal stimulus for 1981, 1990-91, 2001 and 2008-09. Positive numbers mean that the underlying government primary balance moved towards deficit, stimulating domestic demand. The data clearly call into question the idea of a general retreat from fiscal policy activism. Of the seventeen countries for which we have a complete data series, eleven pursued contractionary fiscal policies in 1981, three in 1990-91, four in 2001, and zero in 2008-09. Among the full set of

twenty-three countries, Switzerland alone did not engage in fiscal stimulus in 2008-09.

Judging by the unweighted 17-country averages reported at the bottom of Table 1, the size of the fiscal stimulus packages implemented by OECD governments also appear to have increased over the four recessions since 1980. On average, EMU countries stimulated less than non-EMU countries during recessions since 2000, but it is noteworthy that the difference between EMU and non-EMU countries was bigger in 2001 than in 2008-09.

[Table 1]

The Great Recession was much deeper than the recessions of the early 1980s, early 1990s and early 2000s. By comparison to earlier recessions, the Great Recession was also more uniform in the sense that all OECD economies entered into recession and began to recover at more or less the same time. Some of the countries with negative numbers for 1981 in Table 1 were experiencing acceleration of GDP growth and thus did not, strictly speaking, pursue ‘pro-cyclical’ policies. In retrospect, fiscal policy responses to the recession of the early 1980s still stand out as quite exceptional, reflecting the breakthrough of monetarist ideas and the leadership of the newly-elected governments of Thatcher and Reagan.

In admittedly crude fashion, Table 2 takes into account the extent of economic downturns. For countries characterized by fiscal stimulus as well as deceleration in GDP growth over the one- or two-year window, the figures in this table are the product of dividing the fiscal stimulus by the size of the GDP deceleration. In other words, they represent the discretionary fiscal stimulus associated with a one-percentage-point contraction of GDP.⁸ By this measure, the average fiscal policy response to the Great Recession is no longer particularly expansionary. Adjusting for GDP contraction, OECD governments that did stimulate did so more aggressively in the early 1980s than in subsequent recessions. On average, however, fiscal policy was more expansionary in 2001 and in 2008-09 than in 1990-91. To summarize, the data presented in Tables 1-2 convey two main points. First, the

propensity of OECD governments to respond to international recessions by engaging in fiscal stimulus has increased over time. Secondly, taking the extent of economic downturns into account, we do not observe any secular trend in the size of stimulus measures.

[Table 2]

Table 3 addresses changes in the composition of fiscal stimulus, measured by the mix of spending increases and tax cuts employed by governments to stimulate aggregate demand. For all cases in which governments engaged in discretionary fiscal stimulus, this table shows the contribution of discretionary changes in government expenditures to the change in the government primary balance over one or two years. The figures have been ‘censored’ to range between zero and 100%. Whether expenditures were constant or reduced, their contribution to the stimulus equals zero if tax cuts equal or exceed the total stimulus. Conversely, the contribution of spending increases equals 100% if spending increases equal or exceed the total stimulus.

[Table 3]

With the exception of Norway, governments that pursued expansionary fiscal policies in 1981 relied more or less exclusively on spending increases to stimulate aggregate demand. In 1990-91, Denmark, Japan, Sweden and the US primarily stimulated aggregate demand through tax cuts, but ten of the fourteen countries that pursued expansionary fiscal policies over these two years still relied more or less exclusively on spending increases to stimulate aggregate demand. In marked contrast, tax cuts became part of the stimulus repertoire of almost all countries in 2001. Relative to the previous recession, the contribution of spending to the stimulus was, on average, bigger in 2008-09. In our view, however, the important point is that tax cuts have featured more prominently in the two recessions of the 2000s than they did in the early 1980s or early 1990s.

The results of our second exercise, which considers fiscal policy changes over more extended ‘recession episodes’, are summarized in Table 4. The figures in this table refer to yearly observations of changes in fiscal policy for the seventeen countries for which we have data going back to 1980. For each recession episode, the window of analysis includes the first year in which two-thirds of the countries experienced acceleration in GDP growth (1984, 1994, 2004 and 2010). For the Great Recession, this yields a window of three years, for a total of 51 country-years. Reflecting the uneven and protracted character of the international recession of the early 1990s, we end up with a five-year window and a total of 85 country-years for the early 1990s. For the early 1980s and early 2000s alike, we have four-year windows (68 country-years). For each recession episode, we categorize country-years based on two criteria: (1) whether or not GDP growth decelerated and (2) whether or not governments engaged in discretionary fiscal stimulus.

[Table 4]

Table 4 confirms that the frequency of fiscal stimulus in response to economic downturns increased steadily across our four recession episodes. This observation holds even if we discount the exceptional experience of the early 1980s. During the early 1990s, governments engaged in fiscal stimulus in 59% of all years in which GDP growth decelerated. For 2008-10, the corresponding figure is 86%. On average, governments that engaged in fiscal stimulus in 2008-10 did so on a bigger scale than in previous recessions. Table 4 also confirms that tax cuts have been a more important instrument of fiscal stimulus in the two most recent recessions.

The figures for average size of stimulus reported in Table 4 do not take into account the extent of economic downturns. What distinguishes the Great Recession, it seems, is first and foremost the consistency with which OECD governments responded by engaging in fiscal stimulus (not a more aggressive deployment of fiscal stimulus). The Great Recession is also

distinguished by the low frequency of fiscal stimulus in years when GDP accelerated. In a temporal sense, fiscal stimulus measures were better targeted in 2008-10 than in earlier recessions, i.e., governments were more likely to stimulate in downturns and less likely to stimulate in upturns.

Might the consistency of fiscal policy responses in 2008-10 and their more targeted nature be attributed to international coordination? As detailed by Helleiner (2012), Cameron (2012) and Dellepiane-Avellaneda (2014) the G20 and the EU both endorsed fiscal stimulus as the ‘correct crisis response’ in 2008, but there is very little evidence to suggest that any government implemented expansionary fiscal policies in response to international pressure. It is noteworthy that IMF/EU bailouts in 2008-10 imposed austerity on Iceland, Greece and Ireland and that fiscal policy responses in the Eurozone countries—presumably the countries most capable of engaging in macro-economic coordination—were, on average, less expansionary than in other OECD countries.

For the most part, ‘self-interested’ calculations by domestic political actors explain the fiscal stimulus measures implemented in 2008-09. However, the experience of the Great Recession suggests that the implications of globalization for fiscal policy responses to economic downturns may be more ambiguous than conventional wisdom would have it. Everything else being equal, domestic demand stimulation surely makes less sense for more export-oriented economies. On the other hand, globalization arguably renders fiscal stimulus in response to downturns more likely because it entails greater synchronization of business cycles. Two distinct arguments along these lines seem very plausible: first, synchronization of business cycles enables governments to gauge more accurately where they are in the cycle; and, secondly, synchronization renders the macro-economic policies of trading partners more predictable. For either or both reasons, globalization might produce fiscal policy behavior that appears to be coordinated.

Empirics II: Government partisanship

Let us now turn to the comparison of partisan effects across the four recession episodes since 1980. The setup of Table 5 is the same as that of Table 4, but we now distinguish between country-years with Left and non-Left governments. Following common practice in the comparative political economy and welfare-state literature, our measure of government partisanship is the percentage of cabinet portfolios held by Left parties, with Greens and left-socialist parties as well as social democratic labor parties classified as ‘Left parties’. The results presented here are based on coding the US Democrats and Canadian Liberals as ‘centrist’ or, in other words, as ‘non-Left’ parties, but we obtain very similar results with these parties coded as ‘Left’.⁹

On the assumption that discretionary changes in expenditures and revenues in a given year are affected by decisions made in the previous year, we code as ‘Left government’ all country-years in which Left parties held more than 50% of cabinet portfolios in the year in question and the previous year. Table 5 indicates that Left governments were more likely to respond to economic downturns by engaging in fiscal stimulus than non-Left governments in 2001-2004, but they were less likely to do so in 1981-84, and more or less equally likely to do so in 1990-94 and 2008-10. Left governments appear to have stimulated on a considerably bigger scale than non-Left governments during the Great Recession but this is not the case for earlier recessions. Indeed, the opposite seems to be the case for the early 1980s.¹⁰

[Table 5]

In years when GDP growth accelerated, Left governments were more prone to pursue expansionary fiscal policies than non-Left governments prior the Great Recession. Arguably,

Left governments have historically been more inclined to sustain economic recovery by fiscal stimulus. During the Great Recession, however, Left governments appear to have been somewhat more prone than non-Left governments to retreat from fiscal stimulus when domestic economic conditions improved. Finally, the last row of Table 5 indicates that spending increases accounted, on average, for a higher share of fiscal stimulus under Left governments than under non-Left governments in the early 1990s and especially the early 2000s, but not during the Great Recession. The overall shift towards greater reliance on tax cuts to stimulate domestic demand appears to have been spearheaded by non-Left governments and initially resisted by Left governments.

Tables 6 and 7 report the results of estimating simple cross-sectional OLS models with change in the government primary balance and change in cyclically-adjusted expenditures as dependent variables. Depending on the recession episode, change is measured over the same one- or two-year window for all countries (as in Table 1-3). For all four recessions, we report results based on data for seventeen countries. For the two most recent recessions, we also report results estimated with data for twenty-three countries.¹¹

[Tables 6 and 7]

The independent variable of primary interest is government partisanship, measured as the average percentage of cabinet portfolios held by Left parties over the recession year(s) in question and the year preceding the recession (i.e., over two years for 1981 and 2001 or over three years for 1990-91 and 2008-09). Given the small number of observations, we include only four control variables: (1) non-elderly social spending in percent of GDP prior to the recession (e.g., 2007 for 2008-09); (2) change in GDP growth from the pre-recession year to the first year of the recession (e.g., from 2007 to 2008); (3) the level of public debt in the year prior to the downturn (e.g., 2007); and (4) economic globalization in the year prior to the downturn.¹²

The coefficients for the control variables tend to be correctly signed but are seldom significant. Deceleration of GDP growth turns out to be a significant predictor of fiscal stimulus and spending growth only for the early 1980s and the constraints of public debt are only significant for 1990-91 and 2001. Governments in large welfare states were significantly less likely to stimulate and increase spending in 1981 and 2001, but not in 1990-91 and 2008-09.

With the 23-country sample as well as the 17-country sample, we do not obtain any significant direct effects of government partisanship. Simply put, it does not appear to be the case that more Left-leaning governments consistently pursued more expansionary fiscal policies or relied more heavily on expenditure increases to stimulate aggregate demand during any of these recession episodes.¹³

The analysis presented in Tables 6-7 is based on one- or two-year windows and fails to capture what is arguably the main difference between Left and non-Left governments displayed in Table 5, namely the greater propensity of Left governments, in the early 1990s and the early 2000s, to pursue fiscal stimulus for longer periods of time or, in other words, to sustain economic recovery by means of fiscal stimulus (and public spending in particular).¹⁴ In future work, we plan to explore this question by engaging in pooled cross-section time-series analysis of fiscal policy responses to changes in GDP growth across the entire period 1981-2010.

Adding an interaction between government partisanship and non-elderly social spending in percent of GDP to the models reported in Table 6 yields a statistically significant interaction effect for the early 2000s, but not for previous recessions nor for the Great Recession of 2008-09. In large welfare states, Left-leaning governments stimulated more in response to economic downturns than Right-leaning governments in 2001.¹⁵ For 2001 and 2008-09, we also observe a statistically significant effect of interacting these two variables in

the models with discretionary change in government expenditures as the dependent variable (see Table 7). In large welfare states, Left-leaning governments relied more on spending increases to stimulate aggregate demand than Right-leaning governments did in 2001 and 2008-09, but not in the early 1980s or the early 1990s.¹⁶ Based on the last model presented in Table 7, Figure 1 shows the estimated conditional effects of government partisanship at different levels of non-elderly social spending in percent of GDP during the Great Recession.

[Figure 1]

Is welfare-state size a proxy for labor encompassment? In that case, the positive interaction between size of the welfare state and government partisanship could be interpreted as confirmation of Garrett's (1998) thesis that encompassing unions willing to engage in wage restraint allow Left governments to stimulate growth through government spending. Testing this idea by substituting labor encompassment for non-elderly social spending, we have not found any significant interaction between labor encompassment and government partisanship for either 2001 or 2008-09.¹⁷

Table 8 explores the partisan politicization of spending choices during the Great Recession further. Leaving aside three countries in which government partisanship changed in the course of 2008-09 (Iceland, Italy and New Zealand), this table sorts the remaining 20 countries on two dimensions: first, by the level of non-elderly social spending in 2007 (vertical axis); and, secondly, by the percentage of cabinet portfolios held by Left parties in 2008-09 (horizontal axis). We report the change in cyclically-adjusted government expenditures over 2008-09 for each country and the average for each constellation of government partisanship and non-elderly social spending.¹⁸

[Table 8]

Among large welfare states, we observe a marked difference in spending growth between countries with some Left participation in government and those without any Left

participation. We also observe that Left majority governments were more spending-prone than coalition governments with Left parties. (This is particularly true if we disregard the case of Luxembourg). Among small welfare states, by contrast, non-Left governments were nearly as spending-prone as Left governments. Conversely, Table 8 shows that Left governments in large welfare states were significantly more spending-prone than Left governments in small welfare states and that non-Left governments in small welfare states were significantly more spending-prone than non-Left governments in large welfare states.

As noted at the outset, social protection might promote partisan differentiation for either of two reasons. On the one hand, it might cushion the social impact of economic downturns and their electoral consequences for incumbent governments, leading Right-leaning government to eschew compensatory spending measures. On the other hand, large welfare-state constituencies might generate electoral incentives for Left-leaning government to be more ‘leftist’. The evidence in Table 8 suggests that both mechanisms are in play or, in other words, that the size of the welfare state conditions the behavior of both Left and Right parties.

Our findings concerning the conditions effects of the welfare state contradict the core argument of Starke et al. (2013).¹⁹ They also raise questions about Rueda’s (2007) implicit claim that labor-market dualization reduces partisan differences over policy responses to rising unemployment. Much of the literature on dualization, including Rueda’s own work, indicates that countries with large welfare states have undergone more labor-market dualization than countries with small welfare states. Yet it is precisely in these countries that we observe partisan differentiation with regard to discretionary spending during the Great Recession. Substituting a measure of labor-market dualization for the size of the welfare state, we find, for both recessions in the 2000s, that the interaction with government partisanship has a positive coefficient while the coefficient for government partisanship itself

is negative.²⁰ Neither coefficient clears conventional thresholds of statistical significance, but these results (available upon request) run counter to the idea that partisan differences over spending diminish with dualization.

Concluding remarks

To summarize, we do not find any evidence of a general retreat from fiscal policy activism over the time period covered by our analysis. Over time, governments across the OECD area have become more prone to engage in fiscal stimulus in response to economic downturns. Taking the size of economic downturns into account, there is no OECD-wide trend in the amount of stimulus undertaken by governments that pursue counter-cyclical fiscal policies. Regarding the composition of fiscal policy, we find that tax cuts have featured more prominently in the two most recent recessions than they did in earlier recessions. We do find some direct partisan effects on fiscal policy choices, but these effects are not very large or robust, and primarily pertain to the greater willingness of Left government to increase discretionary spending as the economy begins to recover. Most intriguingly, our analysis indicates that the size of the welfare state conditioned the impact of government partisanship in the two recessions of the 2000s. In large welfare states, but not in small welfare states, Left-leaning governments were more prone to engage in discretionary fiscal stimulus as well as spending increases than Right-leaning governments during the recession of the early 2000s. In large welfare states, Left-leaning governments were again significantly more likely than Right-leaning governments to rely on spending increases as a means to stimulate demand during the Great Recession.

Why do we not observe any significant conditioning effects of the welfare state in earlier recession episodes? There are two alternative ways of approaching this question that ought to be pursued. One approach focuses on the political-economic dynamics of specific recession episodes. For example, the early 2000s were characterized by the dominance of Left governments across Western Europe. Left-leaning governments were in power in the three largest European economies (France, Germany and the United Kingdom) and other large welfare states (Belgium and the Netherlands as well as the Nordic countries). It is plausible that policy coordination among these governments reduced the collective action problems associated with fiscal stimulus in an open economy. During the Great Recession, government interventions to rescue the financial sector featured prominently. Studies of banking bailouts have shown that Left governments were no less likely than non-Left governments to provide larger rescue packages to troubled banks (Weber & Schmitz 2011; Ansell 2012a; Grossman & Woll 2014), but Left governments arguably faced stronger political pressures to deliver compensatory benefits to wage-earners.

In a different, more ‘generalist’ vein, globalization pressures might plausibly be invoked to explain our findings. Our analysis shows that globalization provides little explanatory leverage on cross-national variation in fiscal policy responses to recessions. However, all OECD countries have become more exposed to the global economy since 1980. Furthermore, the competitive pressures associated with openness have increased since the early 1990s, with the formation of the Eurozone, the rise of emerging market economies and the volatility of global financial markets. These developments may have been a source of intensified partisan conflict over fiscal policy in large welfare states. In future research, we plan to explore the three-way interaction of government partisanship, welfare-state generosity and globalization through a quantitative analysis of fiscal policy outputs over the entire period since 1980.

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Table 1. Annual average change in the discretionary fiscal balance

	1981	1990-91	2001	2008-09
Australia	0.5	1.5	0.9	2.6
Austria	-1.4	0.1	-2.3	0.7
Belgium	-0.1	0.2	-0.3	1.6
Canada	-2.2	0.4	2.4	2.0
Denmark	-0.2	1.0	1.2	1.9
Finland	-2.0	2.1	1.8	1.9
France	1.1	0.5	0.0	1.3
Germany	.	.	1.8	0.5
Greece	4.3	-2.1	0.5	2.3
Iceland	.	-1.0	2.5	3.7
Ireland	-0.2	1.0	4.1	2.3
Italy	3.1	-1.1	1.1	0.7
Japan	-0.8	0.3	-0.5	1.9
Luxembourg	.	.	1.2	0.7
Netherlands	-0.9	-0.5	2.0	2.1
New Zealand	.	0.5	0.3	2.6
Norway	1.0	1.9	1.3	1.1
Portugal	.	1.3	1.2	2.3
Spain	0.1	1.0	-0.1	4.5
Sweden	-1.0	1.8	1.9	0.1
Switzerland	.	.	1.5	-0.3
United Kingdom	-1.8	1.3	0.8	2.4
United States	-1.0	0.1	2.0	3.0
17-country average	-0.1	0.6	1.0	1.9
EMU average			0.9	1.7
Non-EMU average			1.3	1.9

Note: Averages are unweighted.

Table 2. Discretionary fiscal stimulus per one-percent contraction in GDP growth

	1981	1990-91	2001	2008-09
Australia	.	0.9	.	3.6
Austria	.	.	.	0.2
Belgium	.	0.3	.	0.6
Canada	.	0.1	0.7	0.8
Denmark	.	.	0.4	0.5
Finland	.	0.4	0.6	0.3
France	1.6	0.3	0.0	0.5
Germany	.	.	1.2	0.1
Greece	1.9	.	1.9	0.7
Iceland	.	.	6.1	0.6
Ireland	.	0.5	0.9	0.4
Italy	1.2	.	0.6	0.2
Japan	.	0.3	.	0.5
Luxembourg	.	.	0.2	0.1
Netherlands	.	.	1.0	0.6
New Zealand	.	0.8	.	2.5
Norway	0.3	.	1.1	0.5
Portugal	.	1.2	0.6	0.9
Spain	0.0	0.9	.	1.3
Sweden	.	0.9	0.6	0.0
Switzerland	.	.	0.6	.
United Kingdom	.	0.7	0.6	0.6
United States	.	0.1	0.6	1.2
17-country average	1.0	0.5	0.8	0.7
EMU average			0.8	0.5
Non-EMU average			1.3	1.1
Non-EMU average w/o Iceland			0.7	

Note: A country-year has a missing value if GDP growth accelerated and/or if there was no stimulus.

Source: The data on GDP growth (expenditure approach) are from OECD.Stat.

Table 3. Contribution of spending increases to stimulus

	1981	1990-91	2001	2008-09
Australia	63.5	59.3	2.7	45.0
Austria	*	100	*	100
Belgium	*	100	*	92.3
Canada	*	100	46.6	74.7
Denmark	*	0	32.1	50.9
Finland	*	100	0	74.3
France	100	100	0	41.9
Germany	.	.	0	100
Greece	86.2	*	16.5	70.9
Iceland	.	*	25.7	0
Ireland	*	97.0	51.0	46.1
Italy	86.9	*	55.3	58.2
Japan	*	10.6	*	54.2
Luxembourg	.	.	100	100
Netherlands	*	*	29.4	68.2
New Zealand	.	0	0	35.8
Norway	22.4	100	100	100
Portugal	.	100	67.7	66.0
Spain	100	100	*	31.3
Sweden	*	27.6	0	0
Switzerland	.	.	44.3	*
United Kingdom	*	74.3	100	64.1
United States	*	0	39.2	39.6
17-country average	76.5	69.2	36.4	59.5
EMU average			35.5	70.8
Non-EMU average			39.1	46.4

Note: "*" if there was no stimulus.

Table 4. Frequency, size and composition of discretionary fiscal stimulus

	1981-84	1990-94	2001-04	2008-10
in deceleration years	35.7% (28)	59.2% (49)	79.5% (39)	85.7% (35)
in acceleration years	35.0% (40)	52.8% (36)	55.2% (29)	31.3% (16)
<i>all stimulus years:</i>				
average stimulus	1.01	1.08	1.20	1.93
contribution of spending to stimulus (%)	62.6	68.3	45.6	55.0

Note: The numbers in parentheses are the total number of country-years to which the percentages refer.

Table 5: Frequency, size and composition by type of government

	1981-84		1990-94		2001-04		2008-10	
	Left	non-Left	Left	non-Left	Left	non-Left	Left	non-Left
<i>stimulus:</i>								
in deceleration years	20.0%	39.1%	60.0%	58.8%	93.8%	69.6%	80.0%	88.0%
	(5)	(23)	(15)	(34)	(16)	(23)	(10)	(25)
in acceleration years	38.5%	33.3%	63.6%	48.0%	83.3%	47.8%	25.0%	33.3%
	(13)	(27)	(11)	(25)	(6)	(23)	(4)	(12)
<i>all stimulus years:</i>								
average stimulus	0.61	1.14	1.12	1.06	1.23	1.19	2.38	1.78
contribution of spending to stimulus (%)	55.3	65.0	73.0	66.0	53.5	39.8	47.5	57.5

Note: See Table 4.

Table 6: Determinants of discretionary stimulus

	1981	1990-91	2001	2008-09	2001	2008-09	2001	2008-09
Left	0.001 (0.012)	0.001 (0.014)	0.009 (0.008)	0.009 (0.016)	0.006 (0.008)	0.018 (0.017)	-0.106*** (0.031)	0.006 (0.157)
Non-elderly social spending	-0.278* (0.135)	0.082 (0.153)	-0.285** (0.118)	-0.263 (0.264)	-0.184 (0.108)	-0.186 (0.255)	-0.774*** (0.178)	-0.200 (0.316)
Left*spending							0.008*** (0.002)	0.001 (0.010)
GDP	-0.483* (0.232)	0.329 (0.275)	-0.416 (0.236)	0.057 (0.348)	-0.210 (0.192)	-0.198 (0.347)	0.033 (0.158)	-0.195 (0.360)
Debt	0.024 (0.027)	-0.059*** (0.019)	-0.019* (0.010)	-0.025 (0.021)	-0.012 (0.010)	-0.009 (0.022)	-0.001 (0.008)	-0.009 (0.024)
Globalization	-0.016 (0.036)	0.048 (0.053)	0.036 (0.037)	-0.039 (0.094)	0.020 (0.035)	-0.037 (0.093)	0.099*** (0.034)	-0.037 (0.097)
Constant	2.593 (1.942)	0.660 (3.084)	2.104 (2.881)	12.366 (7.014)	2.085 (2.918)	8.578 (7.482)	2.830 (2.208)	8.902 (8.789)
Observations	17	17	17	17	23	23	23	23
R-squared	0.39	0.56	0.54	0.31	0.28	0.19	0.62	0.19

Note: * significant at 10%; ** significant at 5%; *** significant at 1%

Table 7. Determinants of discretionary spending

	1981	1990-91	2001	2008-09	2001	2008-09	2001	2008-09
Left	-0.005 (0.008)	-0.001 (0.014)	0.008 (0.006)	0.010 (0.009)	0.006 (0.005)	0.009 (0.011)	-0.036 (0.029)	-0.170* (0.088)
Non-elderly social spending	-0.210** (0.083)	0.020 (0.158)	-0.231** (0.086)	-0.173 (0.158)	-0.199*** (0.065)	-0.102 (0.160)	-0.416*** (0.133)	-0.303 (0.176)
Left*spending							0.003* (0.002)	0.012* (0.006)
GDP	-0.317** (0.143)	-0.084 (0.284)	-0.186 (0.173)	0.100 (0.208)	-0.209* (0.115)	-0.002 (0.217)	-0.119 (0.119)	0.052 (0.201)
Debt	0.013 (0.016)	-0.037* (0.020)	-0.008 (0.008)	0.000 (0.012)	-0.007 (0.006)	0.002 (0.013)	-0.003 (0.006)	-0.010 (0.014)
Globalization	-0.013 (0.022)	0.062 (0.055)	0.016 (0.027)	0.023 (0.056)	0.008 (0.021)	0.030 (0.059)	0.037 (0.025)	0.019 (0.054)
Constant	3.014** (1.195)	-0.671 (3.186)	2.008 (2.116)	2.814 (4.201)	2.196 (1.757)	0.735 (4.689)	2.470 (1.652)	5.557 (4.904)
Observations	17	17	17	17	23	23	23	23
R-squared	0.50	0.37	0.44	0.24	0.44	0.08	0.54	0.27

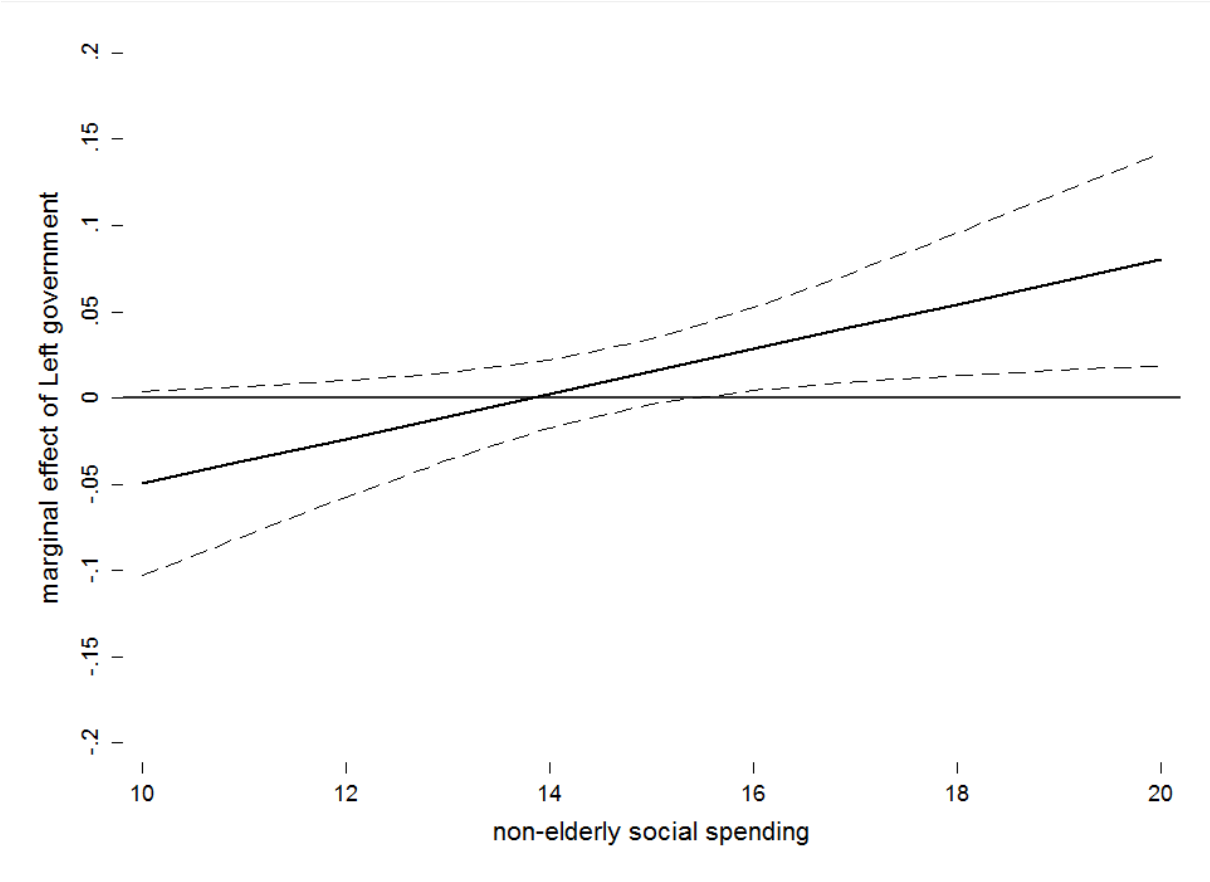
Note: * significant at 10%; ** significant at 5%; *** significant at 1%

Table 8. Discretionary spending increases under different constellations of partisanship and size of welfare state, 2008-09

	Left majority	20-50%	No Left
>14% GDP	NO: 3.85 ES: 2.84 UK: 3.02 3.24	AT: 1.35 BE: 2.93 DE: 1.61 LU: 5.01 NL: 2.87 2.75	DK: 1.92 FI: 2.76 FR: 1.13 SE: -1.04 1.19
<14% GDP	AU: 2.31 PT: 3.10 2.71	CH: 0.87 .87	CN: 3.04 GR: 3.25 IE: 2.10 JP: 2.05 US: 2.37 2.56

Note: Bold numbers are unweighted averages.

Figure 1. The marginal effect of Left cabinet share conditional on the size of the welfare state, 2008-09



Note: 95% confidence intervals

Notes

¹ Recent work by David Soskice and collaborators (e.g., Carlin & Soskice 2009; Iversen & Soskice 2012) also makes the case for ‘bringing the macro-economic dimension back in’.

² Put differently, it is important to distinguish between shifts in the ‘center of gravity’ in partisan politics and convergence or divergence between parties (see Kwon & Pontusson 2010).

³ The experience of the Great Recession illustrates the electoral vulnerability of Right governments in small welfare states. Among the countries that we categorize as small welfare states (see below), there are four clear-cut instances of incumbent Right parties facing elections between the onset of the financial crisis in October 2007 and the end of 2010 (Australia in November 2007, the US in November 2008, Japan in August 2009, and Greece in October 2009). In every instance, the incumbent party was defeated. Among large welfare states, by contrast, incumbent Right parties were the clear winners in every election that occurred over the same time period, gaining the office of prime minister in the Netherlands (September 2010) and retaining it in Germany (September 2009) and Sweden (September 2010).

⁴ This argument draws inspiration from Garrett and Way’s (1999) analysis of divergent interests (or incentives) of public-sector unions and unions in trade-exposed sectors.

⁵ See Amable and Azizi (2011) and Toloudis (2012) for divergent empirical assessments of varieties of capitalism as an approach to fiscal policy.

⁶ The findings reported below remain very similar if we adopt alternative thresholds and therefore different windows of analysis.

⁷ Amable and Azizi (2011) employ an earlier, very similar OECD measure of fiscal stimulus. For alternative measures, see Armingeon (2012), Cameron (2012) and Dellepiane and Hardiman (2012). All the fiscal policy data presented in this paper are from OECD, Economic Outlook (online), No. 84 for 1980-1995 and No. 92 for 1996-2010.

⁸ We have excluded two cases of GDP contraction of less than .25% (Australia in 1981 and Austria in 1990-91). In these cases, our formula produces (very large) numbers that do not seem very meaningful.

⁹ See Döring and Schwander (forthcoming) for a critical discussion of literature using Left cabinet shares as the measure of government partisanship. The pros and cons of alternative measures of government partisanship is a topic that we simply must set aside for the time being.

¹⁰ Needless to say perhaps, the small number of country-years with Left government renders generalizations about the early 1980s very tenuous.

¹¹ Robust standard errors are generally smaller than the conventional standard errors reported in Tables 6-7. Based on conventional standard errors, our tests of statistical significance are conservative.

¹² For data on cabinet shares, we rely on Armingeon et al. (2012). Non-elderly social spending in percent of GDP is measured as total public social expenditures minus old-age expenditures (OECD.Stat). In our view, this represents a better measure of social protection against the effects of economic downturns than total social spending. The data on real GDP growth (expenditure approach) are also from OECD.Stat. The data on public debt, measured as general government gross financial liabilities as a percentage of GDP, are from OECD, Economic Outlook (online), No. 75 for 1980 and 1989; No. 92 for 2000 and 2007. The data on economic globalization, a composite variable comprising trade, FDI and portfolio investment, are from the KOF Index of Globalization (see Dreher 2006; data available at <http://globalization.kof.ethz.ch>).

¹³ Our results for the Great Recession are consistent with those of Toloudis (2012) and Armingeon (2012).

¹⁴ Yet another possible explanation of the discrepancies between Table 5 and Tables 6-7 is that the former relies on a dichotomous categorization of government partisanship while the analysis presented in Tables 6-7 employs a continuous measure.

¹⁵ This result is robust to the inclusion of a dummy for EMU, alternative coding of US Democrats and Canadian Liberals as Left parties, alternative sample sizes, and using data for 2001-02.

¹⁶ The interaction effect for the Great Recession is robust to the stepwise inclusion of a dummy for EMU, a dummy for Greece, Iceland and Ireland as cases of IMF/EU bailout, and two alternative measures of the size of banking bailouts in 2008-09 (based on data from Laeven and Valencia 2011). It is also robust to the stepwise exclusion of any of the reported controls and holds up if we substitute change in unemployment for change in GDP or re-code US Democrats and Canadian Liberals as ‘Left parties’. The exclusion of Greece and/or Ireland, commonly characterized as having pursued strict pro-cyclical policies in 2008-09 (Armingeon 2012; Dellepiane & Hardiman 2012), leave the result unchanged. In contrast, the interaction result for the early 2000s is not particularly robust: it does not hold up when we control for EMU, exclude Greece and/or Ireland, or include data for 2002.

¹⁷ Results available upon request. Following Garrett, we measured ‘labor encompassment’ as the sum of standardized scores for union density and centralization of wage bargaining (with data from Visser 2013).

¹⁸ Our decision to use 14% as the cut-off between large and small welfare states was motivated by the fact that the marginal-effects line in Figure 1 crosses zero at 14% and by the fact that four countries are clustered right around the 23-country average for non-elderly social spending in percent of GDP in 2007 (14.6%). With 14% as the cut-off, these countries (Norway, New Zealand, Spain and the UK) are all coded as large welfare states.

¹⁹ Note that Starke et al. (2013) question the utility of using budget data to gauge policy responses to economic downturns and instead focus on legislative policy enactments. They would presumably not approve of the way that we test their argument in this paper.

²⁰ We measured ‘dualization’ as the strictness of employment protection against individual and collective dismissals for workers with a regular contract (OECD.Stat).