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Voting against Spending Cuts

The Electoral Costs of Fiscal Adjustments in Europe

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ABSTRACT

This article analyses the electoral consequences of fiscal adjustments for the governments that implement them. Using probit analysis on a panel of 15 EU member states between 1960 and 2000, this article tests whether an improving budgetary situation has any effect on the probability of prime minister re-election. Contrary to what previous influential studies concluded, results from this article confirm that governments are held accountable for their fiscal policy decisions. In Europe, the probability of the prime minister's re-election decreases when fiscal adjustments have taken place, especially if these consolidations relied on spending cuts. Nevertheless, the strong electoral costs associated with expenditure-based adjustments weakened during the post-Maastricht years. The reason for this was partly a change in voters' tolerance of fiscal discipline and partly because public opinion put the blame on 'Brussels' for the strongest budget cuts.

KEY WORDS

- economic voting
- elections
- fiscal adjustments

the probability of government termination and fiscal adjustments. Alesina et al. (1998) test whether fiscal adjustments increase the probability of government termination, assuming that the causality runs from fiscal policy to government tenure. Nonetheless, it is equally plausible that causality runs in the opposite direction, from government tenure to fiscal policy decisions. In fact, it is very likely that long-lasting governments (those with a lower probability of termination) take on more easily the political risk of launching a fiscal adjustment, counting on the room for manoeuvre that their past strength and stability grant them.

Finally, a third problem in the model of Alesina et al. (1998) is multicollinearity, resulting from the simultaneous inclusion as regressors of the two main indicators of political fragmentation (majority status in the parliament and coalition size) and a measure of fiscal adjustment. These indicators of fragmentation are the most robust predictors of government tenure, but they are also predictors of fiscal policy. This causes multicollinearity between independent variables and makes 'the effect of the latter (fiscal variables) difficult to pin down' (Obstfeld and Eichengreen, 1998: 260).

Maybe owing to these serious problems, Alesina et al. (1998) arrive at paradoxical conclusions that leave the reader wondering why, if fiscal adjustments are economically beneficial and politically costless, politicians would be so reluctant to implement them. The authors never raise this obvious question or address the statistical problems of their study. The only partial answer that they provide to the paradox is that successful fiscal adjustments rely on spending cuts in those items of the budget that are most strongly opposed by the recipients of public outlays and by public employees. Although Alesina et al. (1998) do not go much further, they implicitly admit with this statement a potential connection between public discontent and future electoral punishment for the government. If this connection did not exist, governments would never refrain from implementing adjustments, regardless of the public opposition that they might face.

Taking into account all these problematic aspects, this article proposes a different and more direct approach, which consists of exploring the relationship between fiscal adjustments and the probability of prime ministerial re-election. Therefore, this article exclusively focuses on the electoral dimension of these potential political consequences by using the probability of re-election as their main indicator.

Hypotheses and research design

This section introduces the main assumptions and hypotheses. It also presents the statistical model that will be estimated to reject or accept these conjectures.

Main hypotheses

This study draws on three basic assumptions. First, politicians are pure office-seekers and thus their main preoccupation when formulating public policies is the relative impact that these policies might have on their chances of winning re-election. Second, voters prefer economic growth and employment to recessions, and they also dislike taxes and like government outlays. This assumption is based on the existence of a common-pool resource situation, whereby every voter demands more outlays because the associated cost will be shared with more tax payers. Third, both policy-makers and voters have perfect information about the preferences and actions of each other, which ensures that voters will be capable of attributing responsibility for government actions. Under these assumptions, the main hypotheses that this article tests are the following:

- *The 'economic voting' hypothesis:* Following the literature on economic voting, the electorate is expected to reward governments when the economy is doing well, when prices are under control and when new jobs are being created. In addition, I assert that the electorate in Europe rewards a fair distribution of economic prosperity.
- *The 'fiscal voting' hypothesis:* The main hypothesis is that fiscal adjustments decrease the chances of being re-elected if the electorate considers that governments are responsible for such measures. Fiscal adjustments imply taking decisions (increasing revenues, cutting expenditures, or a mix of both) that the electorate dislikes. The alternative would be that the public is fiscally conservative and does not punish governments that consolidate the budget, as Alesina et al. (1998) affirm.
- *The 'Europeanization' hypothesis:* Finally, I consider the possibility that voters may have stopped punishing governments for fiscal adjustments in Europe not because they have become fiscally conservative but because they consider that these policies are being imposed by European institutions. If this were the case, voters could have stopped punishing national governments just because they had transferred responsibility for fiscal adjustments to the European level. Since it was the project of monetary union that motivated the European authorities to insist on fiscal discipline, it is reasonable to expect that public support for monetary union decreased as the number and scope of budget cuts increased across Europe.

The statistical model

To start with the analysis of the economic and fiscal voting hypotheses, this article uses a baseline probit model in which the probability of re-election is

a function of the change in the budget balance, the change in a set of economic factors, and the present values of different political and social accompanying conditions. Equation (1) summarizes this model:

$$REELEC_{i,t} = \alpha_0 + \alpha_1 \Delta BBAL_{i,t} + \beta_1 \Sigma \Delta ECON_{i,t} + \beta_2 \Sigma POLIT_{i,t} + \beta_3 SOCIAL_{i,t} + \beta_4 DECFADJ_{i,t} + C_i + \varepsilon_{i,t} \quad (1)$$

The dependent variable ($REELEC_{i,t}$) takes two different forms: *re-election* and *government termination*. The purpose of considering these two alternative dependent variables is to make my results comparable with those of Alesina et al. (1998). Note, however, that they used a sample of 19 OECD countries between 1965 and 1995, whereas this article uses a sample of 15 EU member states between 1960 and 2000.

These variables are constructed as follows. First, I create a dummy variable called government termination, which takes value 1 when a government ends, regardless of the reason,⁵ and 0 otherwise. I calculate the duration of each government by counting the number of years between two consecutive terminations. In order to keep the correspondence between fiscal policies and government changes that occurred as a response to those policies, I have considered in line with Alesina et al. (1998) that government terminations that occur between 1 July of year t and 30 June of year $t + 1$ fall into calendar year t .

Second, from the sample of general elections that occurred during the period of study, I create a dummy variable called re-election, which takes value 1 when the same prime minister was reappointed, and takes value 0 in all other cases. Here I depart from Alesina et al. (1998: 220), who 'use the sample of changes irrespective of whether a transition to a new cabinet occurs by means of elections, cabinet reshuffling or other procedures'. As the following section will show, taking this difference into account is crucial to rejecting their conclusion that fiscal adjustments do not have major political consequences.⁶

According to the model specified in equation (1), the observed variation in the dependent variables can be explained by a set of fiscal, economic and political independent variables or regressors. The vector of *fiscal regressors* ($\Delta BBAL_{i,t}$) comprises two variables that capture the fiscal policy stance: the change in the budget balance and the change in the cyclically adjusted primary budget balance (both as a percentage of GDP). It is important to include both definitions because public opinion tends to find it easier to follow the evolution of the budget balance, whereas politicians and economic authorities prefer instead to focus on the cyclically adjusted primary balance. Any amelioration in either fiscal variable is expected to be negatively associated with the probability of the prime minister's re-election.

The vector of *economic regressors* ($\Sigma \Delta ECON_{i,t}$) comprises four macroeconomic indicators: real GDP growth and changes in the price level (inflation), in the unemployment rate, and in income inequality (measured by the annual change in the Gini coefficient). As mentioned above, these variables allow me to test for the possible presence of economic voting. Note that almost no empirical studies on the effect of fiscal adjustments on income inequality exist. Nevertheless, fiscal consolidations have a variety of economic consequences on most macroeconomic aggregates, including economic growth and income distribution (Mulas-Granados, 2003a). Therefore, a proper exploration of any type of economic voting pattern justifies the inclusion of these four macroeconomic variables. In all cases, higher rates of economic growth, lower rates of unemployment, lower inflation and a lower level of income inequality are expected to be positively associated with the probability of prime ministerial re-election.

The vector of *political regressors* ($\Sigma POLIT_{i,t}$) comprises three variables that attempt to capture additional factors not included among the main hypotheses formulated in this article but that are likely to affect the chances of government survival. The first is the number of years in power (government duration). The second is the parliamentary status of the government (whether it is supported by a majority or a minority in parliament). The third is the number of parties that form the government (coalition size). The reason for including government duration among the explanatory variables is to control for the likely presence of anti-incumbent forces. In addition, with office and power come scandals and corruption that tarnish any administration. Incumbent status is generally associated with an erosion of electoral support. Therefore, long-lasting governments are expected to have an increased probability of government termination and to feature a decreased probability of re-election compared with short incumbencies. For the same reasons, a majority in parliament is expected to reduce the chances of re-election. Furthermore, bigger coalitions are typically associated with internal fights and thus are also expected to increase the likelihood of government termination and to reduce the chances of electoral success.

Moreover, the equation includes a variable that proxies public discontent with the most controversial adjustment initiatives. Such public discontent tends to be more acute among the net recipients of public outlays (typically the least well-off), and generally ends in strikes and demonstrations against welfare cuts across Europe. The social unrest variable ($SOCIAL_{i,t}$) is an interaction between the variable that measures the variation in income inequality and a variable that measures the total number of working days lost per year owing to strikes.

To allow for important institutional differences in the 15 countries analysed, I included *country dummies* (C_i).

There is no reason to think that temporal dynamics have had any effect on the probability of re-election, but time may have played a role in the frequency and composition of fiscal adjustments. In order to control for these temporal dynamics, the equation includes four interaction terms between four decade dummies and the budget balance variables ($DECFADJ_{i,t}$). These four decade dummies are the following: 1960s (1963–1972); 1970s (1973–1982); 1980s (1983–1992); 1990s or *Post-Maastricht* (1993–2000). There are three reasons to select these intervals: (1) four countries in the sample have missing data between 1960 and 1962; (2) no fiscal adjustment took place in those two years in any EU country; (3) there is a substantive interest in having a single dummy variable that covers all the post-Maastricht years.

The electoral consequences of fiscal adjustments – estimation results

This section estimates the statistical model using a panel of economic and political data for the 15 EU member states between 1960 and 2000. Economic data are from AMECO (European Commission, 2002) and political data from Armingeon et al. (2001). In the first part of the analysis, all years of the panel are included for the probit estimations. This means that adjustment and non-adjustment years are included together in the same data set.⁷ Therefore, 615 data points are used in the analysis of the first subsection, which estimates the effect that fiscal adjustments have on the chances of re-election. The same applies for the second subsection, which adds some variables to the equation to deal with the composition of these adjustments. I then replicate this analysis in the third subsection but only for fiscal adjustment episodes that cover several years. The purpose of this additional analysis is to test whether the results are robust to a different definition of fiscal adjustment, which considers as fiscal adjustments only those improvements in the budget balance that last more than one year, and not just one year as assumed in the first and the second subsections.

The budget balance and re-election

The expected negative effect of fiscal policy variables on the probability of re-election is confirmed in the results presented in Table 1.

As we observe in the first two columns, in model 1 and model 2 the '*fiscal voting*' hypothesis, which affirms that fiscal adjustments have electoral costs, is corroborated. Positive annual variations in the budget balance (fiscal adjustments) clearly reduce the probability of a prime minister's re-election. These

Introduction

Since the early 1990s, most scholars working on fiscal adjustments in advanced democracies have focused on the economic impact that these measures have.¹ However, the question of whether or not these adjustments have any political consequence is equally important. Recent studies have shown that the probability of ending a fiscal adjustment episode increased when elections were imminent (Maroto and Mulas-Granados, 2002; Mulas-Granados, 2003b; Buti, 2003; and European Commission, 2003).

These works also demonstrate that taxes decreased, and public transfers and consumption increased, when governments felt the pressure of again facing their electorates. This suggests that politicians think that voters dislike fiscal adjustments and will not re-elect them in the aftermath of fiscal consolidations. The only study that has indirectly tested this belief concludes that the probability of government termination after fiscal adjustments is not higher than the average. As Alesina et al. (1998: 241) write, 'governments do not seem to be systematically punished at the ballot box for engaging in fiscal adjustments'.²

This finding is paradoxical. If fiscal policy decisions did not have any political implications, budgetary consolidation strategies would always strictly respond to economic criteria. Abundant empirical evidence demonstrates that this is far from reality (Roubini and Sachs, 1989; Clark and Hallerberg, 2000; Franzese, 2003; Mulas-Granados, 2003b). In addition, if voters did not really care about fiscal adjustments but politicians were making their fiscal decisions dependent on the proximity of elections, this would imply that politicians are totally misinformed about voters' preferences.

The purpose of this study is to contribute to solving this paradox by reformulating previous approaches to the electoral consequences of fiscal adjustments. The first question that motivates this study is thus the following: Is the probability of re-election (instead of government termination) in EU member states affected by fluctuations in the budget balance or other economic conditions?

The shift of focus from government termination to re-election implies a more direct approach to the topic. This approach excludes possible government terminations owing to a prime minister's resignation or coalition rearrangements and focuses exclusively on those government changes brought about by elections. Since it is through elections that governments and voters primarily interact, this new approach proves crucial to establishing a link between fiscal policy initiatives by the executive and the electorate's reaction to them.

The reason for restricting the study to EU member states also deserves clarification. First, the European Union accounts for the bulk of fiscal adjustment episodes that have occurred in advanced economies in recent decades,³

This concentration of cases became more acute and especially relevant during the 1990s, when all EU member states reduced their budget deficits to comply with the strict provisions of the Maastricht Treaty and the Stability and Growth Pact.

Second, to study if governments have been held accountable at the polls for their fiscal policies in the restricted sample of EU countries offers the possibility of going one level up in the possible attribution of responsibilities. Typically, governments justify unpopular policies to their electorates as the necessary response to external shocks or constraints outside their control (Ferejohn, 1986). For example, economic reforms are usually justified by reference to unexpected international economic conditions. In this case, spending cuts across Europe were justified by the need to comply with a supranational agreement that imposed specific limits on national fiscal policies. The constant use of this scapegoat mechanism for diverting responsibilities during each fiscal adjustment motivates the second question that this article poses: If European voters did not really punish national politicians for undertaking fiscal adjustments, did they blame anyone else, maybe Brussels?

In response to these questions, this paper develops a comprehensive statistical analysis and reports direct empirical evidence. The results confirm that European governments have been held accountable for their fiscal strategies in recent decades. Not only did the probability of re-election decrease during years of fiscal adjustment, but the probability of losing the next election rose when these adjustments took place on the expenditure side of the public budget.

These findings contradict those of Alesina et al. (1998) but are perfectly consistent with the literature on economic voting and the empirical evidence for adjustment episodes in Europe, according to which the proximity of elections is an important factor explaining the timing, the duration and the composition of fiscal adjustment strategies (Maroto and Mulas-Granados, 2002; Mulas-Granados, 2003b). These results also explain why European governments have not always unconditionally embraced all fiscal adjustment measures recommended to them by the European Commission or various leading economists.

In addition to this main result, this work also highlights the fact that the strongly adverse effect that expenditure-based adjustments had on the probability of re-election between 1960 and 1992 weakened during the post-Maastricht period. This article elaborates two related arguments to explain this phenomenon: (1) The tendency among national economic authorities to use 'Brussels' as an excuse to justify hard fiscal measures alleviated internal electoral punishment but eroded support for the single currency project; this 'Europeanization' of responsibilities was, however, temporary and support for the euro resumed in the late 1990s. (2) Parallel to these developments, the

1990s witnessed a real change in voters' attitudes toward budget cuts. This shift owes much to the explicit agreement between governments and oppositions in Europe about the need to commit to fiscal discipline; this simultaneous commitment offered no fiscal alternative to the electorate. Official campaigns for the euro, which insisted on the future economic benefits of the single currency, also played a role.

The article proceeds as follows. In the next section, I review the literature on political accountability and economic voting that is relevant to justify the main hypotheses of the article. I then elaborate on the research design, focusing on these hypotheses and on the statistical model. After testing the model for the complete sample of 15 EU countries between 1960 and 2000 during both adjustment and non-adjustment years, I summarize the main findings and conclude.

Economic policy and elections – what does the literature say?

In its simplest form, the fundamental contention in the literature on economic voting is that voters tend to reward incumbents when the economy is sound and punish them when it is not. Citizens assess past performance rather than looking at economic promises (Key, 1966; Fiorina, 1981; Norpoth et al., 1991). The effect of economic performance on government tenure has been widely studied, with unclear and even contradictory results. There is a wealth of evidence confirming that short-term economic conditions influence electoral outcomes in the United States (Tuftes, 1978; Kramer, 1983; Markus, 1988; Erikson, 1989), although the strength of the relationship appears to be weaker in other democracies (Lancaster and Lewis-Beck, 1986; Rattinger, 1991; Sanders et al., 1991). Most agree that economics matter for the election outcome (Paldam, 1991), but the relative effect is by no means constant in all countries, and there is no agreement about what explains such differences (Lewis-Beck, 1988).⁴

In relation to fiscal policy issues, this literature has traditionally assumed that voters dislike taxes and prefer government outlays in relation to public health, education, unemployment benefits and pensions. These assumptions are the basis for the literature on political business cycles (Nordhaus, 1989), according to which politicians undertake fiscal expansions just before elections take place in order to artificially accelerate the economy and the rate of job creation because they expect to be rewarded at the polls if the economy is doing well when the election arrives. Consequently, the basis for believing that voters dislike fiscal adjustments relies on two explanations: fiscal adjustments imply raising revenues and/or the reduction of government outlays that in a Keynesian framework is likely to cause a temporary economic

recession and a loss of jobs. Because neither of these options is desirable for voters, governments expect to be punished at the ballot box if they undertake a fiscal adjustment just before an election.

The past 40 years have offered consistent evidence that policy-makers acted according to this expectation. The proximity of elections systematically decreased the probability of starting consolidations, shortened their duration (Maroto and Mulas-Granados, 2002), and also affected their composition (Mulas-Granados, 2003c). Although this evidence demonstrates that policy-makers take into account the expected reaction of the electorate to these measures, we know very little about whether the electorate has actually used its vote to make the government accountable for having pursued unpopular fiscal policies.

In democratic politics, the only way to punish governments is to abandon the incumbent government at the polls (Cheibub and Przeworski, 1998; Maravall, 1998). Only Alesina et al. (1998) have, to my knowledge, studied the political consequences of fiscal adjustments in advanced democracies. However, their research design does not directly explore the electoral costs of such adjustments. They prefer to study instead whether fiscal adjustments increase the probability of government termination or whether these decisions affect the popularity of the incumbent cabinet. In my opinion, this indirect approach generates misleading results. Since the authors do not find any significant statistical relationship between fiscal adjustments and government terminations or popularity losses, their interpretation is that fiscal adjustments are politically costless.

The first and most important problem in the research design of Alesina et al. (1998) arises from the definition of the dependent variables. The problem with government termination as the first dependent variable is that governments can end and change for a multiplicity of reasons that are totally independent of the electorate's reaction to fiscal adjustments. This is the case, for example, when governments end as a result of coalition rearrangements or the voluntary resignation of the prime minister. In neither case does the electorate intervene in the process, which makes it very difficult to establish any link between fiscal adjustment measures and their political consequences. Acknowledging this shortcoming, the authors also test the relationship between fiscal policy and government popularity, measured as the intention to vote for the government if the election were held the next day. Although this variable captures the reaction of the electorate much better, it retains a margin of error because what really matters in making the government accountable for past actions is the actual vote on the election day rather than the intended vote declared to an opinion pollster (Obstfeld and Eichengreen, 1998).

A second problem is the potential presence of reversed causality between

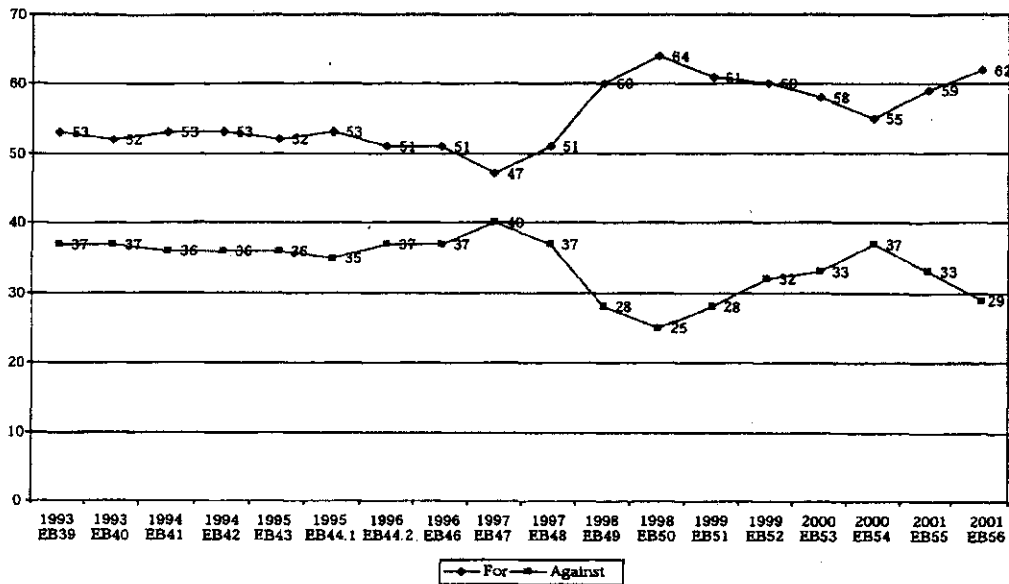


Figure 1 Support for the single currency, 1993–2001.
 Source: Own elaboration of data from Eurobarometer (EB) 39 to 56.

Blaming Brussels for budget cuts

There is one major difficulty when studying the possible ‘Europeanization’ of the accountability mechanism by which the electorate uses its vote to reward or to punish its national government for its economic and fiscal policies. European citizens do not vote directly for the European executive every five years. Instead, they vote for local candidates for the European Parliament, and it is the Parliament that ratifies the President and the members of the European Commission proposed by member states. In addition, the European Commission’s main role is to serve as the guardian of the treaties, which are signed by the member states at the end of long inter-governmental conferences.

Such a complex institutional setup complicates the selection of a direct indicator to test the hypothesis that voters may have started to blame Brussels for fiscal adjustments in the 1990s. Those adjustments were driven by the necessity to comply with the provisions of the Maastricht Treaty to introduce the euro. Thus, it is plausible to assume that any possible ‘Europeanization’ in the attribution of responsibilities for hard fiscal consolidations will have affected support for the single currency. The evolution of this indicator can then be used to test the ‘Europeanization’ hypothesis.

Evidence from public opinion polls on the support for the European currency shows that there was a cost in public support when fiscal adjustments were stronger. As can be observed in Figure 1, the loss of popularity

measures to consolidate the budget and qualify for the third stage of Economic and Monetary Union (EMU), for instance.

There are two alternative explanations for the observed change in the voting patterns during the post-Maastricht years: either voters changed their initial aversion to fiscal adjustments, or they stopped considering national governments as being responsible for fiscal adjustments because they perceived that these measures were being imposed from Brussels. As the rest of the article will show, there is partial evidence to support both arguments.

Two factors explain the increase in the tolerance of public opinion towards fiscal adjustments during the 1990s. The first is the strong commitment on the part of European officials and national governments to maintain the compromises signed in 1992 in Maastricht. The second factor is the unprecedented degree of campaigning by government officials in favour of undertaking any sacrifice necessary to qualify for the third stage of monetary union. In this respect, European politicians pursued a strategy of 'crafted talk' to change public opinion in order to offset the potential political costs of not following the preferences of average voters (Jacobs and Shapiro, 2000). They did so by reshaping their messages, insisting on the need to reduce budget deficits but in a way that was more appealing to national public opinion. Arguments such as 'unique historical opportunity', 'national pride', and 'the best for our country's future' were among the slogans preferred by politicians to convince their electorates that reforms were necessary.

In addition, the 1990s witnessed a fiscal policy consensus across Europe between national governments and oppositions to qualify for the third stage of EMU. As a consequence, the public did not perceive real fiscal policy alternatives in the opposition, which reduced the voters' tendency to make politicians responsive to their demands (Ferejohn, 1986). Occasionally, discrepancies arose over the rhythm of the fiscal consolidation efforts and their composition, mostly regarding pension reforms or cuts in unemployment benefits. But the electorate did not interpret these discrepancies as clear signs of fiscal policy alternatives since the main parties of the left and the right were committed to the fulfilment of the Maastricht criteria at any cost.

However, the fiscal policy consensus at national level may have really transformed voters' attitudes towards fiscal adjustments. An alternative hypothesis to explain the economic voting phenomenon during the post-Maastricht years is that voters may have accepted the discourses of their different national politicians if they used Brussels as a scapegoat to justify their fiscal policy initiatives. If this hypothesis holds, electorates have stopped punishing their governments for severe spending cuts, and have shifted the burden to the European sphere.

Table 4 Probability of re-election during/after fiscal adjustments

<i>Average probability of re-election</i>	<i>Whole sample 1960–2000</i>		<i>Pre-Maastricht 1960–1992</i>		<i>Post-Maastricht 1993–2000</i>	
	<i>Prob.</i>	<i>Obs.</i>	<i>Prob.</i>	<i>Obs.</i>	<i>Prob.</i>	<i>Obs.</i>
(1) During adjustment & non-adjustment years	0.49	184	0.48	121	0.54	63
(2) During adjustment years	0.48	93	0.47	65	0.50	28
(3) After adjustment episodes	0.48	51	0.46	36	0.53	15
Adjustments by leftist cabinets	0.41	28	0.28	18	0.66	10
Adjustments by rightist cabinets	0.59	23	0.66	18	0.25	5
Revenue-based adjustment episodes	0.65	27	0.70	17	0.60	10
Expenditure-based adjustment episodes	0.35	24	0.30	18	0.40	6

Source: Own elaboration of data from AMECO (Commission of the EC, 2002) and Armingeon et al. (2001).

period. This indicates an increasing tolerance of fiscal adjustments on the part of the electorate during the past decade precisely when the most important fiscal consolidations took place across Europe.

The second interesting finding is that voters became more tolerant not only towards fiscal adjustments in general but also towards those consolidations that relied on spending cuts. The probability of re-election after an expenditure-based adjustment stayed at 30% during the three decades of the period 1960–92. This probability increased 10 percentage points in only one decade, to reach a 40% re-election probability during the 1990s.

Finally, the probabilities reported in Table 4 show that the traditional electoral punishment of left-wing governments that pursued fiscal adjustments (Lowry et al., 1998) was also radically reversed during the post-Maastricht years. In fact, during that period, the probability of re-election was higher when a leftist cabinet had launched the adjustment than when a rightist government did so. This may show that electorates across Europe voted for leftist governments while conscious that fiscal consolidations were a 'must' that any government was going to undertake anyway. In such historical circumstances, the electorate may have even rewarded these leftist governments for sacrificing their policy preferences and taking the necessary

Table 3 Sensitivity analysis of budget composition and re-election, 1960–2000: Probit estimates – sample of adjustment episodes

	Probability of re-election		
	1960–2000	Pre-Maastricht 1960–1992	Post-Maastricht 1993–2000 ^a
Δ Real GDP _{t, t-1}	0.186 (1.18)	0.027 (0.13)	0.048 (1.08)
Δ Price Index _{t, t-1}	-0.027 (-0.94)	-0.028 (-0.36)	
Δ Unemployment Rate _{t, t-1}	-0.080 (0.35)	-0.057 (0.19)	
Δ Inequality Index _{t, t-1}	-0.176 (0.52)	-0.182 (0.42)	0.576 (0.52)
Adjustment Duration _t	-0.231 (1.03)	-0.336 (1.14)	-2.227 (1.38)
Majority Parliament _t	0.813 (1.35)	0.721 (1.07)	1.166 (0.73)
Coalition Size _t	0.275 (1.48)	0.367 (1.55)	
Social Unrest _t	-0.021 (-0.12)	-0.011 (-0.49)	
Expenditure-based Adjustment _t	-0.838* (1.69)	-1.492* (1.84)	-2.710 (1.34)
Constant	-1.743* (1.70)	-1.306 (0.82)	-7.501 (1.64)
Observations	51	36	15
Log likelihood	-25.23	-15.80	-15.35
Pseudo R ²	0.19	0.28	0.38
LR Chi ² (9)	11.89	14.52	6.62
Prob > Chi ²	0.024	0.018	0.025

Absolute value of z-statistics in parentheses.

* significant at 10%; ** significant at 5%; *** significant at 1%.

^a In order to avoid problems derived from lack of degrees of freedom, some independent variables have been excluded.

episodes, the probability of re-election is lower than during non-adjustment years. This is the case for the four decades between 1960 and 2000. Nevertheless, it is surprising to observe that in the post-Maastricht years the probability of re-election after fiscal adjustment episodes is 53%, very close to the average probability for the whole sample, and seven points higher than the probability of re-election after an adjustment episode during the 1960–92

followed during the consolidation episode. As a consequence, the re-election variable here was defined as follows: it takes the value of 1 whenever the prime minister who pursued the consolidation was re-elected in the first election following the end of the adjustment episode, and 0 otherwise.

The question is whether the first two hypotheses of this article also hold when they are tested on a new and restricted sample of adjustment episodes. It is not possible to test whether fiscal adjustments have any electoral cost using this restricted sample of adjustment episodes. Since all data points in this new sample correspond to strong consolidations performed by different governments, the emphasis should be on the question of whether different types of adjustment episodes (in terms of duration and composition) have a different impact on the probability of re-election after the adjustment has come to an end. As Table 3 shows, the results of the probit regressions for this new sample of adjustment episodes partially confirm previous findings.

Although the evolution of economic and political variables during episodes of fiscal adjustment is no longer a statistically significant determinant of the probability of re-election, signs are however in the expected direction. As before, a majority in parliament increases the probability of re-election, whereas a fragmented government diminishes it. The latter finding indicates that more parties are likely to run in the election and therefore the probabilities of re-election are lower. Furthermore, longer consolidations tend to reduce the probability of re-election, and higher levels of social mobilization reinforce this effect.

Finally, and most importantly, the statistical significance of the variable that labels expenditure-based consolidations confirms that voters are likely to stop voting for the incumbent government when the adjustment is based on spending cuts. However, the importance of this variable vanished during the post-Maastricht period. In the following section, I will explore why this was the case.

The post-Maastricht period

Growing tolerance toward fiscal adjustments

In order to explore the existence of a different voting pattern during the post-Maastricht years, Table 4 presents a comparison of re-election probabilities in three different samples: (1) the whole sample of adjustment and non-adjustment years; (2) the same sample but only for adjustment years; and (3) the sample of adjustment episodes lasting longer than one year.

As can be observed, during adjustment years and after adjustment

Table 2 Budget composition and re-election, 1960–2000: Probit estimates – sample of adjustment and non-adjustment years

	Probability of re-election ^a _t			
	Model 1	Model 2	Model 3	Model 4
Δ Budget Balance _{t, t-1}	-0.311**	-0.336*	0.328**	0.341*
*Post-Maastricht ^b	(-1.96)	(1.85)	(1.97)	(1.88)
Δ C.A.P. Budget Balance _{t, t-1}	0.106*	0.143*	0.133	0.141*
*Post-Maastricht	(1.82)	(1.84)	(1.67)	(1.83)
Δ Real GDP _{t, t-1}	0.045**	0.047**	0.048**	0.046*
	(1.99)	(1.98)	(1.98)	(1.80)
Δ Price Index _{t, t-1}	-0.158	-0.101	-0.091	-0.123
	(-0.76)	(-0.87)	(-0.79)	(-0.96)
Δ Unemployment Rate _{t, t-1}	-0.140	-0.143	-0.151	-0.165
	(-0.71)	(-0.72)	(-0.77)	(-0.82)
Δ Inequality Index _{t, t-1}	-0.620**	-0.634**	-0.636**	-0.616**
	(2.44)	(2.47)	(-2.47)	(-2.48)
Government Duration _t	-0.881***	-0.878***	-0.882***	-0.894***
	(-4.40)	(-4.34)	(-4.38)	(-4.39)
Majority in Parliament _t	-0.900	-0.810	-0.878	-0.743
	(-1.04)	(-0.92)	(-1.01)	(-0.85)
Coalition Size _t	-0.291	-0.292	-0.288	-0.332
	(-0.85)	(-0.87)	(-0.84)	(-0.99)
Social Unrest _t	1.834**	1.932**	1.894**	1.956**
	(1.99)	(2.05)	(2.02)	(2.02)
Quality of Budget _t	0.005			
	(0.02)			
Total Public Expenditures (% GDP) _t		0.025**		
		(2.70)		
Social Transfers (% GDP) _t			0.042	
			(1.51)	
Public Wages (% GDP) _t				0.156*
				(1.85)
Constant	-0.971	-1.915	-1.525	-2.422
	(-0.74)	(-0.99)	(-0.88)	(-1.11)
Observations	163	165	165	165
Log likelihood	-36.83	-36.69	-36.75	-36.56
Pseudo R ²	0.41	0.40	0.41	0.42
LR Chi ² (9)	51.57	52.45	52.22	52.71
Prob > Chi ²	0.000	0.000	0.000	0.000

Absolute value of z-statistics in parentheses.

* significant at 10%; ** significant at 5%; *** significant at 1%.

Notes:

Coefficients of country dummies are not on the table.

^a Coefficients for Austria, Belgium, Denmark, France, Germany, the Netherlands, Spain and Sweden were significantly different from zero in the regression on the probability of re-election.

^b Only the interaction term for Δ Budget Balance*Post-Maastricht is included in the table. The other interaction terms for previous decades were statistically insignificant but had a negative sign for the regression on the probability of re-election and a positive sign for the regressions on the probability of government termination.

(as a percentage of GDP) grow (model 2). The same is true for the share of social transfers (model 3) and public wages (model 4), although their statistical significance is weaker. Finally, it is worth noting that the inability of voters to reward or punish the quality of the budget (model 1) signals a limit to accountability for fiscal policy decisions, and demonstrates how difficult it is for voters to understand the details of budgetary policies.⁹

Sensitivity analysis: Adjustment episodes

Finally, the main results from the previous two subsections must be tested against an alternative research design. Up to now, the article has performed all its analyses on a sample of 41 years and 15 countries, in which both adjustment and non-adjustment years entered the regressions together. For every year in which the budget balance improved, we observed that the probability of re-election decreased. The advantage of this research design is that it combines the *factual* cases (the adjustment years) and the *counterfactual* ones (the non-adjustment years), and thus avoids a likely problem of selection bias, which is very common in the related literature. This approach allows us to extract general conclusions regarding the effect that changes in any independent variable have on the probability of re-election.

Nevertheless, it could be argued that this approach does not take into account the multi-annual dimension of budgetary consolidations. Since governments typically design their adjustment strategies with a medium-term perspective, the most relevant works in the literature have based their studies around a set of adjustment episodes. The criteria for selecting these episodes are very standard, and aim at selecting groups of years during which strong fiscal adjustments occurred and where the government's intention to consolidate the budget could be easily identified. Therefore, according to the most standard definition in the related literature, episodes of fiscal adjustment would include every year in which the amelioration of the cyclically adjusted primary balance was greater than at least 1.25% of GDP and when there was a positive variation in the budget balance in the next or the previous year as well (von Hagen et al., 2001: 8).

Applying these criteria to the original sample used in previous sections, I obtain a new sample of 53 episodes of strong fiscal adjustments with an average duration of two years. Note that, of a total of 53 episodes of strong fiscal consolidation between 1960 and 2000, 18 occurred during the 1990s. This means that 34% of the cases occurred in the past decade. All adjustments that experienced a government change in the middle of the episode were split into two cases. This was the only way to attribute each different episode to a single government that could be punished or rewarded for the type of policy it

results hold for both indicators of fiscal policy. Nevertheless, as the interaction term in the third row of Table 1 shows, fiscal adjustments that occurred during the post-Maastricht years stopped having a negative effect on the probability of re-election. Note that the positive coefficient of the interaction variable (Δ budget balance * post-Maastricht) not only shows that fiscal adjustments stopped leading to electoral punishment during most of the 1990s, but it also points to the existence of positive electoral effects for undertaking such adjustments before the introduction of the euro. This result will be explored in further detail later in the article.

Results for the regressions on government termination, calculated in model 3 and model 4, are very similar to those presented by Alesina et al. (1998) using a different sample. As they also find, there is no relationship between the probability of government termination and the amelioration of the budget balance, regardless of the type of indicator and the decade in which the consolidation occurs.

With respect to the '*economic voting*' hypothesis, Table 1 shows that the impact of economic variables on the probability of re-election is important in the case of economic growth, unemployment and inequality. However, it is statistically insignificant for inflation rates.⁸ Higher rates of economic growth increase the probability of prime ministerial re-election, whereas increases in the unemployment rate or in the inequality index reduce the chances of winning office again. These results are similar to those reported by Paldam (1991) and Cheibub and Przeworski (1998), who found a moderate positive electoral effect of economic growth and unemployment reduction on the chances of remaining in office.

Political variables also show the expected signs. Longer government duration decreases the probability of a prime minister's re-election and increases the probability of government termination. Parliamentary majorities decrease the probability of re-election, and larger coalitions make government survival increasingly difficult. Social unrest does not have any effect on the probability of government termination, but it does play a moderate role in the probability of prime ministerial re-election. Fiscal adjustments that increase inequality and generate social mobilization are likely to become an electoral burden. This is probably why politicians are reluctant to implement such adjustments as often as economists recommend them.

The budget's composition and re-election

Previous results are confirmed when the analysis is extended to take into account the electoral effect of the budget's composition. As Table 2 shows, the probability of a prime minister's re-election increases when total expenditures

Table 1 Budget balance and re-election, 1960–2000: Probit estimates – sample of adjustment and non-adjustment years

	Probability of re-election ^a _t		Probability of gov't termination ^a _t	
	Model 1	Model 2	Model 3	Model 4
Δ Budget Balance _{t,t-1}	-0.323** (-2.07)		-0.081 (-1.07)	
Δ C.A.P. Budget Balance ^b _{t,t-1}		-0.341** (-1.99)		-0.111 (-1.24)
Δ Budget Balance _{t,t-1} *Post-Maastricht	0.101* (1.87)		-0.011 (-0.22)	
Δ C.A.P. Budget Balance _{t,t-1} *Post-Maastricht		0.107* (1.85)		-0.394 (-0.81)
Δ Real GDP _{t,t-1}	0.044** (1.98)	0.036** (1.96)	-0.009 (-0.19)	-0.014 (-0.49)
Δ Price Index _{t,t-1}	-0.106 (-0.99)	-0.082 (-0.65)	0.134** (2.48)	0.129** (2.17)
Δ Unemployment Rate _{t,t-1}	-0.314* (-1.83)	-0.177* (-1.86)	0.031 (0.26)	0.021 (0.29)
Δ Inequality Index _{t,t-1}	-0.526** (-2.32)	-0.640** (-2.49)	0.123 (1.17)	0.117 (0.99)
Government Duration _t	-0.867*** (4.45)	-0.924*** (4.22)	0.526*** (4.28)	0.526*** (4.23)
Majority in Parliament _t	-1.825** (-2.22)	-1.175 (1.22)	-0.343 (-0.89)	-0.288 (-0.73)
Coalition Size _t	-0.249 (-0.85)	-0.255* (1.89)	0.091 (0.61)	0.106 (0.70)
Social Unrest _t	-1.393 (-1.52)	-1.79** (-1.95)	0.522 (1.32)	0.533 (1.34)
Constant	-6.964** (-4.04)	-1.226 (-0.89)	-1.405 (-1.37)	-0.482 (-0.54)
Observations	175	165	195	185
Log likelihood	-41.35	-36.67	-107.99	-101.61
Pseudo R ²	0.39	0.42	0.19	0.20
LR Chi ² (19)	53.29	52.56	51.33	51.19
Prob > Chi ²	0.000	0.000	0.000	0.000

Absolute value of z-statistics in parentheses.

* significant at 10%; ** significant at 5%; *** significant at 1%.

Notes:

Coefficients of country dummies are not reported on the table.

^a Coefficients for Austria, Belgium, Denmark, France, Germany, the Netherlands, Spain and Sweden were significantly different from zero in the regression on the probability of re-election. Also, coefficients for Austria, Belgium, Denmark, France, Germany, Ireland, the Netherlands, Portugal, Spain and Sweden were significantly different from zero in the regression on the probability of government termination.

^b Only the interaction term for Δ Budget Balance*Post-Maastricht is included in the table. The other interaction terms for previous decades were statistically insignificant but had a negative sign for the regression on the probability of re-election and a positive sign for the regressions on the probability of government termination.

that reduce the most rigid items of the budget are normally punished by European voters. The presence of these electoral costs explains why politicians tend to avoid spending cuts, even if they guarantee successful adjustment.

Nevertheless, the electoral costs traditionally associated with expenditure-based adjustments vanished during the post-Maastricht years, precisely when the most important consolidations took place. The article offers a double explanation for this event. On the one hand, there was a process of 'Europeanization' of responsibilities by which public opinion considered Brussels to be responsible for constraining national fiscal manoeuvrability. As a consequence, the single currency project suffered an important decline in popularity during the years of strongest fiscal effort. On the other hand, the fact that this 'Europeanization' of responsibility was only temporary suggests that the change in voting patterns observed during the 1990s can also be attributed to a parallel real change in voters' tolerance of fiscal discipline. This alteration in public attitudes was probably influenced by the general consensus around the fulfilment of the Maastricht criteria and the advantages of joining the euro.

Notes

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- 1 For a literature review on the political economy of budget deficits, see Alesina and Perotti (1995) and Persson and Tabellini (1999). Most of the recent literature on the economic consequences of fiscal adjustments has focused on the non-Keynesian effects that certain types of fiscal consolidation produce (Giavazzi and Pagano, 1990; McDermott and Wescott, 1996; Alesina and Perotti, 1996; and Alesina et al., 1998). According to these studies, those fiscal adjustments that rely on spending cuts in the most rigid items of the budget (public transfers and public wages) tend to last longer and to be expansionary.
- 2 Peltzman (1992) and Kraemer (1997) have reached similar conclusions for Latin America and the USA, respectively. In the same vein as Alesina et al. (1998), Lowry et al. analysed the electoral response of American voters to the fiscal policy implemented by American state-level governments and found that 'the incumbent governor's party is punished in legislative elections for failing to maintain fiscal balance' (1998: 759). Nevertheless, Obstfeld and Eichengreen (1998) reject the idea of fiscally conservative voters at the national

Table 5 Fiscal adjustments and net support for the euro in the post-Maastricht period

	<i>Net support for the euro</i>	
	1993–2001	1995–1997
Δ Primary Budget Balance _{<i>t, t-1</i>}	-2.67* (-1.74)	-3.431*** (-3.45)
Δ Quality of Budget _{<i>t, t-1</i>}	0.352 (1.23)	-1.909** (-1.98)
Δ Real GDP _{<i>t, t-1</i>}	3.947** (2.29)	1.009 (0.37)
Δ Price Index _{<i>t, t-1</i>}	1.137*** (2.83)	1.066* (1.69)
Δ Unemployment Rate _{<i>t, t-1</i>}	3.137 (1.37)	1.798 (0.30)
Δ Inequality Index _{<i>t, t-1</i>}	3.386 (1.45)	1.853 (0.45)
Constant	7.632* (1.90)	16.14** (2.47)
Observations	112	45
Adj. <i>R</i> ²	0.14	0.27
<i>F</i> -test	3.52	4.28
Prob > <i>F</i>	0.005	0.003

Absolute value of *t*-statistics in parentheses.

* significant at 10%; ** significant at 5%; *** significant at 1%.

heavily influenced by Europe-wide information and propaganda campaigns, as well as by the national fiscal consensus around the historic importance of the euro and the subsequent need to comply with the Maastricht deficit criteria.

Conclusion

This study has focused on the electoral consequences of fiscal adjustments for those governments that undertake them.

By looking at the probability of prime ministerial re-election, instead of the probability of government termination, this article questions previous findings in the literature. The results provide strong empirical evidence supporting the thesis that voters punish governments that implement expenditure-based fiscal adjustments. The composition of fiscal adjustments is an important determinant of their political consequences, since fiscal adjustments

responsibility for strong budget cuts is the most plausible hypothesis to explain the observed change in voting patterns during the post-Maastricht period. Although the greatest loss in popularity of the single currency coincided with the period of strongest fiscal adjustments across Europe, support for the euro resumed immediately after. This development, together with the increasing tolerance of fiscal adjustments during the 1990s, supports the alternative hypothesis that information campaigns and domestic political consensus succeeded in transforming voters' traditional aversion to fiscal adjustments.

These preliminary findings based on a simple graphical analysis must be corroborated by means of regression analysis. This can be done by estimating the following model:

$$\text{NETSUPEURO}_{i,t} = \alpha_0 + \alpha_1 \Delta \text{BBAL}_{i,t} + \beta_1 \Delta \text{QUALITYADJ}_{i,t} + \beta_2 \Sigma \text{AECON}_{i,t} + \varepsilon_{i,t} \quad (2)$$

where the dependent variable *NETSUPEURO* is the difference between people in favour of the single currency and those against it. ΔBBAL is the primary budget balance, $\Delta \text{QUALITYADJ}$ is the contribution of primary expenditures to the amelioration of the budget, and ΣAECON is the vector of the four economic indicators used in previous sections. The regression analysis is performed by OLS on a panel of 15 EU member states between 1993 (the first year in which the question 'Are you against/in favour of the single currency?' was introduced in the *Eurobarometer* surveys) and 2001.

Table 5 shows that any amelioration in the budget balance (fiscal adjustment) reduced net support for the single currency between 1993 and 2001. This effect was, however, particularly significant between 1995 and 1997, when the strongest adjustments took place. In fact, the quality of the budget became a significant predictor only in that period: better-quality adjustments, i.e. those primarily based on spending cuts, considerably diminished support for the single currency. The influence of economic variables on net support for the single currency during the post-Maastricht period is remarkable as well. Economic growth and inflation increased support for the single currency, while variations in unemployment and inequality did not have a statistically significant influence.

In conclusion, the regression analysis confirms that the change in voting patterns during the post-Maastricht period can be attributed only partially to a 'Europeanization' of responsibility for severe budget cuts. The tendency to stop punishing national governments for fiscal adjustments was partly caused by a parallel tendency to put the blame on Brussels, especially between 1995 and 1997, but was also the result of a real change in voters' attitudes towards fiscal adjustments. Most likely, this growing tolerance of fiscal discipline was

of the single currency project between 1995 and 1997 was remarkable – especially by the end of 1997 when the Maastricht deadline was approaching. In fact, most of the countries that made the strongest fiscal efforts during those two years, such as Belgium, Denmark, France, Greece, Portugal, Spain and the United Kingdom, rank among the group of countries in which support for the single currency remained stable or decreased between the end of 1995 and mid-1997 (Ahrendt, 1999).

The popularity losses were only temporary: in spring 1998, European support for the euro resumed. From that moment on, it remained at very high levels, in two phases. First, support for the new currency followed a decreasing path between 1998 and 1999, probably reflecting the early problems that European citizens faced in the use of the new currency as a ‘non-physical currency’ in 1999 (European Commission, 2001b). But, by the end of 2000, the tendency changed and support for the euro exploded in 2001.

Data from *Eurobarometer* 56 (European Commission, 2001a) show a remarkable increase of 12 percentage points in average confidence in the European Union and the European Commission within two years. They also reveal ‘vast majority support of the Union’s policy initiatives’ (European Commission, 2001a: 5) between 1998 and 1999, precisely when the support for the single currency recorded its maximum, over 62%.

The proliferation of media campaigns in the months immediately prior to the circulation of the physical currency in January 2002 may explain this impressive shift. These campaigns had two major objectives: first, to reassure public opinion in the EU11 that all efforts made to join the euro would be compensated in every country by the associated economic benefits; and, second, to reverse the low level of support among the elderly, the less educated, women and manufacturers (groups that normally feel more insecure about their economic stability and that were more afraid of losing social benefits as a result of the convergence criteria).

Both information strategies proved very effective. The emphasis on economic benefits strengthened the perception that the euro would be a vehicle for higher economic growth and lower inflation. Moreover, the strategy of aiming at more hostile social groups to the single currency succeeded in removing some longstanding reservations. For example, between 1995 and 1998, support for the single currency increased among women from 43% to 56%, among people who left school before the age of 16 from 44% to 52%, among retired people from 48% to 56%, among the unemployed from 47% to 55%, and among manual workers from 46% to 54% (European Commission, 2001b).

Summing up, from the evolution of public support for the single currency reported in Figure 1, we cannot conclude that the ‘Europeanization’ of

level pointed out by Alesina et al. (1998) and affirm that they find fiscal conservatism 'much more plausible at the local level, [because] at the national level there are too many "other" onto whom the burden of public spending can be shifted' (Obstfeld and Eichengreen, 1998: 253).

- 3 About 85% of fiscal consolidations in OECD countries between 1980 and 2000 occurred in EU countries (European Commission, 2001a). During this period, which comprises a total of 315 years (15 countries and 21 years), fiscal adjustments took place only during 134 years. Of these, 77 occurred during the 1990s (Mulas-Granados, 2003c).
- 4 Some authors advocate institutional approaches to explain these differences (Pacek and Radcliff, 1995), but others emphasize the role of monitoring difficulties, which may prevent the electorate from correctly attributing responsibility for bad economic outcomes (Powell and Whitten, 1993; Chappell and Veiga, 2000; Anderson, 2000). This monitoring problem could have an institutional origin or be the result of intended disinformation strategies implemented by political party elites and government authorities not interested in making the process of attributing responsibility for economic outcomes easier (Maravall, 1998).
- 5 Government terminations can occur for a variety of reasons: elections, voluntary resignation of the prime minister, resignation of the prime minister for health reasons, dissension within government, lack of parliamentary support, intervention of the head of state, or a broadening of the coalition. The source of data to build this variable is Woldendorp et al. (2000).
- 6 Alesina et al. (1998: 220) say, 'we have examined whether our results vary substantially when we use only changes following elections but we find that they do not'. Unfortunately, they do not show the results of this sensitivity analysis in their paper.
- 7 $\Delta BBAL$ is a continuous variable. If the annual change in the budget balance was positive between year $t - 1$ and t , then year t can be considered a fiscal adjustment year. The rest can be considered non-adjustment years. All are included together in the same sample, since the isolation of adjustment years would generate a problem of selection bias.
- 8 Note, however, that, for the regressions on government termination, positive variations in the price index are associated with higher probabilities of government termination. This is the same finding reported by Alesina et al. (1998).
- 9 The 'quality of the budget' is a variable that measures the contribution of cyclically adjusted primary expenditures to the total amelioration of the budget balance. Most prominent studies in the literature affirm that only 'good-quality' adjustments are sustainable, which implies that sustainability is increased when the relative contribution of primary spending (mainly transfers and wage bill) to the total budget decreases.

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