## PULITICS IN THE AGE OF AUSTERITY

EDITED BY ARMIN SCHÄFER AND WOLFGANG STREECK

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### POLITICS IN THE AGE OF AUSTERITY

To the memory of Peter Mair, friend and model scholar, who passed away on 15 August 2011, while this book, with his contribution, was being prepared for publication.

#### Contributors



Mabel Berezin is Associate Professor and Chair of Sociology at Cornell University, Ithaca, New York.

Colin Crouch is Emeritus Professor at the University of Warwick and External Scientific Member of the Max Planck Institute for the Study of Societies, Cologne.

Philipp Genschel is Professor of Political Science at Jacobs University, Bremen.

Peter Mair was Professor of Comparative Politics at the European University Institute, Florence.

Daniel Mertens is a Researcher at the Max Planck Institute for the Study of Societies, Cologne.

Claus Offe is Emeritus Professor of Political Sociology at the Hertie School of Governance, Berlin, and of the Humboldt University, Berlin.

Armin Schäfer is a Researcher at the Max Planck Institute for the Study of Societies, Cologne.

Fritz W. Scharpf is Emeritus Director at the Max Planck Institute for the Studies of Societies, Cologne.

Peter Schwarz is Visiting Professor of Public Economics at the University of Göttingen and a former Research Associate at Jacobs University, Bremen.

**Sven Steinmo** is Professor of Political and Social Sciences at the European University Institute, Florence.

Wolfgang Streeck is Director at the Max Planck Institute for the Study of Societies, Cologne.

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### Introduction: Politics in the Age of Austerity Armin Schäfer and Wolfgang Streeck

<u></u>

Democracy depends on choice. Citizens must be able to influence the course of government through elections. If a change in government cannot translate into different policies, democracy is incapacitated. Many mature democracies may well be approaching such a situation as they confront fiscal crisis. For almost three decades, OECD countries have - in fits and starts - run deficits and accumulated debt. Rising interest payments and welfare-state maturation have meant that an ever smaller part of government revenue is available today for discretionary spending and social investment. Whichever party comes into office will find its hands tied by past decisions. The current financial and fiscal crisis has only exacerbated the long-term shrinking of the room governments have to manoeuvre. As a consequence, projects for policy change have lost credibility – at least if they imply the redistribution of resources from old purposes to new ones. This is clearly the situation in those countries that were hit hardest by the 'Second Great Contraction' (Reinhart and Rogoff 2009). In Ireland, Italy, Portugal, Spain and of course Greece, governments of any colour will for decades be forced to cut and hold down spending.

In a number of farsighted articles, Pierson has outlined what he calls a 'fiscal regime of austerity' (Pierson 2001a, 2001b). Permanent austerity, according to Pierson, results when the ability to generate revenues is limited while at the same time spending needs to increase. In the 1990s, three causes came together that were not present in the decades immediately following the Second World War: diminished growth rates, the maturation of welfare states and an aging population. The diminished growth rates had their start in the mid-1970s, and since then rates have been lower on average than during the *trente glorieuses*. After the 'easy financing era' (Steuerle 1996: 416) had come to an end, revenues increased more slowly and, with few exceptions, public expenditure since

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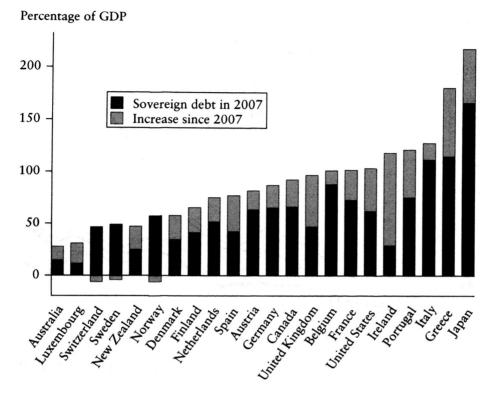
then has exceeded government receipts (Streeck and Mertens, chapter 2 in this volume). In principle, governments could have counteracted this tendency through higher taxes. However, growing international tax competition has rendered it more difficult to raise taxes on companies and top income earners (see Genschel and Schwarz, chapter 3 in this volume). At the same time, taxing ordinary citizens more heavily through higher indirect taxes and social security contributions has become politically more costly, since real wages have also grown more slowly, if at all, than in the past (Pierson 2001b: 62).

On the expenditure side, Pierson emphasizes the 'maturation' of the welfare state and demographic change, both of which he suggests are bound to keep expenditure at high levels. Welfare-state maturation means that today a much larger share of the population is entitled to receive pensions than when public pension programmes were created. In the beginning, a very limited number of people qualified for benefits, while the working population financed the welfare state through (payroll) taxes. This favourable demographic profile changes, however, once the first generation of contributors retires (Pierson 2001b: 59). What is more, in an aging society people will receive benefits for a longer period of time, whereas the number of contributors will stagnate or even shrink. In combination, these long-term trends lead to a mismatch of spending obligations and public revenue.

The financial and subsequent economic crisis of recent years has resulted in a vast deterioration in public finances. In all OECD countries except Norway, Sweden and Switzerland, the need to save banks and jobs has meant a sharp rise in public debt (figure 1.1). In some countries, it has more than doubled since the onset of the crisis, surpassing 100 per cent of GDP in eight countries in 2012 (Obinger 2012). High levels of public debt make it even more difficult to allocate resources from old to new purposes, since mandatory expenditures will tend to consume almost the entire budget. This puts pressure on governments to make unpopular choices. 'Responsible' or, for that matter, fiscally prudent choices may be at odds with citizens' needs and demands, in effect rendering governments less responsive to their constituencies (Mair, chapter 6 in this volume).

In parallel with the faltering capacity for discretionary spending, public fatigue with democratic practice and core institutions has grown. Turnout in parliamentary elections has been declining almost everywhere (Franklin 2004); electoral volatility is rising (Mair 2006); trust in politicians, parties and parliaments is on the decline (Putnam et al. 2000); party membership is collapsing (Van Biezen et al. 2012); and there is a noticeable gap between democratic aspirations and satisfaction with the way democracy actually works (Norris 2011). As opposition parties in heavily indebted countries can no longer promise not to cut expenditure

Figure 1.1: Increase in sovereign debt during the financial crisis, 2008-2012



Source: OECD Economic Outlook No. 90.

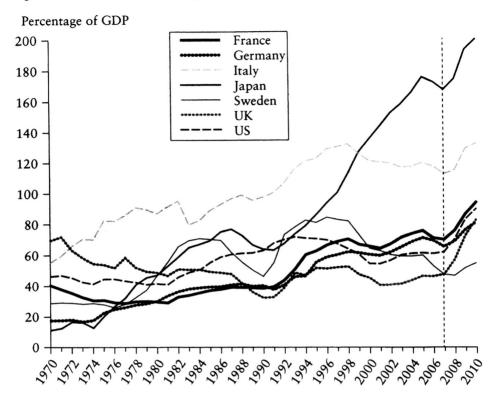
in order to consolidate public finances, electoral choice becomes limited. At the same time, new anti-establishment parties have emerged or have gained new impetus in many countries (Norris 2005; Berezin, chapter 10 in this volume), and incumbent parties are finding it more difficult than in the past to stay in office. This book investigates what mechanisms may be at work to link rising debt and democratic disaffection. In this introduction, we focus more narrowly on the link between debt and falling turnout. After discussing each trend separately in the next two sections, we will discuss a number of direct and indirect pathways that seem to connect the two trends.

#### 1 Rising debt

While the fiscal crisis of today's rich democracies became apparent only after 2008, it has long been in the making. Since the 1970s, almost all

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Figure 1.2: Government debt as a percentage of GDP, seven countries, 1970-2010

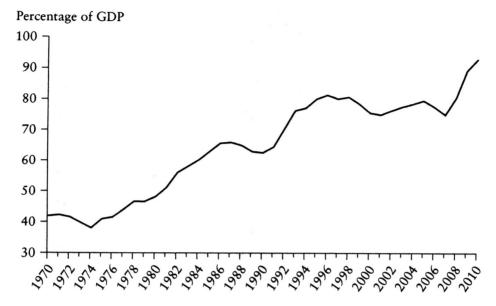


Source: OECD Economic Outlook No. 87.

OECD countries have had to borrow money to cover a chronic gap between public expenditure and public revenue, resulting in a steady increase in public debt. Like declining electoral participation, rising indebtedness was also observed throughout the OECD: in Social Democratic Sweden as well as in the Republican United States; in 'liberal market economies' such as the UK and in 'coordinated' ones such as Germany, Japan and Italy; in presidential as well as parliamentary democracies; under first-past-the-post systems and under proportional representation; and in competitive as much as in one-party democracies such as Japan.

Figure 1.2 shows the more or less steady rise of public debt as a percentage of GDP for seven selected countries over four decades, with the United States and the United Kingdom as the prototypical Anglo-American democracies, Japan as the leading capitalist democracy in Asia, France and Germany standing for the 'Rhineland capitalism' of continental Europe, Italy representing the Mediterranean pattern, and Sweden exemplifying the Scandinavian one. While there are differences between the seven curves,

Figure 1.3: Government debt as a percentage of GDP, OECD average, 1970-2010



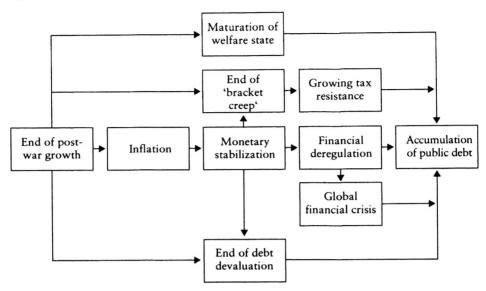
Note: Countries included in unweighted average: Austria, Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Norway, Sweden, UK, US.

Source: OECD Economic Outlook No. 90.

the overall trend is the same for all of them, and indeed for the OECD as a whole (figure 1.3). Initial questions as to whether rising debt levels were 'sustainable' in the longer term came up as early as the late 1970s in several countries, and there were various attempts by economists to determine a maximum level of debt beyond which macro-economic performance would suffer. In the meantime debt continued to increase, however, falsifying successive claims that the debt build-up had hit a ceiling.

In the 1990s, led by the United States under the Clinton administration, an OECD-wide attempt was made to consolidate public budgets, mostly through privatization and cuts in social welfare spending, with the hope of using the post-1989 'peace dividend' towards fiscal relief. It was at this time that Pierson saw a new age of permanent austerity on the horizon, one in which public spending would be cut back to match stagnant or even declining tax revenue. Much hope was placed by economists and political leaders, increasingly including those on the left, in institutional reforms of national parliaments' budgeting procedures, as strongly propagated by international organizations. Apart from Sweden, however, which went through a dramatic financial-cum-fiscal crisis in the mid-1990s (see Steinmo, chapter 4 in this volume), and the United States, which by the end of the century was running a budget surplus, not

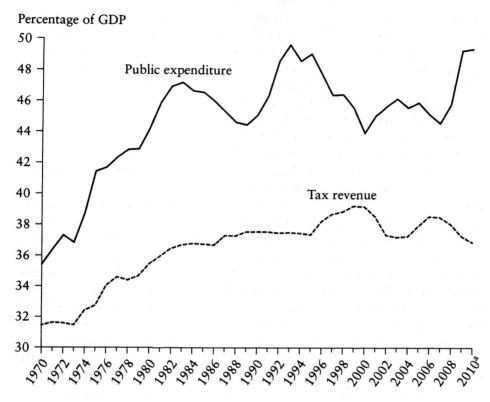
Figure 1.4: The causes of the fiscal crisis



much was achieved. It is important to keep in mind that the latest jump in public debt (which wiped out the gains of the – politically very costly – consolidation efforts of the 1990s and early 2000s almost completely) was caused by the financial crisis of 2008 turning into a fiscal crisis when governments needed to rescue financial institutions that had been allowed to become 'too big to fail' and had to reinflate the 'real economy' through 'Keynesian' deficit spending.

Naturally there has been and continues to be discussion on the causes of the long-drawn build-up of public debt in an entire family of countries in the absence of major wars. On the surface, we may observe that indebtedness began to develop with the end of the postwar growth period in the late 1960s (figure 1.4). At this time public expenditure continued to increase, while the rising taxation that had accompanied it up to this point began to come to an end (figure 1.5). The 1970s was a period of high inflation throughout the industrialized capitalist world, which for a while served to devalue national debt burdens, just as growth had in the preceding period. When OECD countries, under the leadership of the Federal Reserve Bank of the United States, ended inflation in the early 1980s, however, three developments coincided to push up public debt. First, structural unemployment ensued almost everywhere, resulting in rising demand on the coffers of the welfare state. Second, the end of 'bracket creep' - the automatic advancement of taxpayers with nominally increasing incomes to higher tax rates under progressive taxation - made for rising tax resistance. And third, with lower nominal growth rates, in

Figure 1.5: Government expenditure and revenue, as a percentage of GDP, seven countries, 1970–2010



Note: a Estimate.

Source: OECD Economic Outlook No. 87.

addition now to continuously lower real growth, past debt was no longer devalued with time. At this point, monetary stability encouraged holders of financial assets to lend money to governments, while governments felt encouraged to borrow by the low interest rates that followed the victory over inflation. Expanding asymmetries in international trade contributed as well. As surplus countries, first in the Middle East and later also in Asia, were seeking safe havens for their export earnings, the United States deregulated its financial industry to attract and absorb foreign capital, in an effort to finance the country's double deficit. Financial deregulation then resulted in the crash of 2008, which led to further accumulation of public debt and became the proximate cause of the current fiscal crisis in most advanced capitalist countries.

Expectations of an impending 'fiscal crisis of the state' have been around for some time (O'Connor 1973; Bell 1976). In the public finance theory tradition, the anticipated problem was that the revenue the

'tax state', or Steuerstaat (Goldscheid 1926; Schumpeter 1991 [1918]), would over time be able to raise ('confiscate') in a democratic-capitalist society whose assets were mostly privately owned would not be enough to cover the growing collective needs that social and economic progress were expected to generate. One can easily recognize the background to this argument in nineteenth-century debates on the future of capitalism and industrialism, where bourgeois-conservative Kathedersozialisten such as Adolph Wagner (with his 'law of expanding state activity') agreed with the Marxian diagnosis of a growing 'socialization of production' (Vergesellschaftung der Produktion) that required more and more collective regulation and support.<sup>2</sup> It was only in the 1970s and 1980s that the fiscal problem of capitalist political economy was redefined by the theory of 'public choice'. Rather than declaring that the fiscal means made available by society to the state were lagging behind growing collective needs, public-choice theorists now attributed the crisis appearing on the horizon to collective demands on the public purse having frivolously exceeded what was necessary and sustainable in a market economy, the ostensible result of pressures from competition between office-seeking politicians. Where public finance saw a potential fiscal crisis resulting from society being unwilling to pay for what it needed, public-choice theorists blamed society and its politics for excessively extracting resources from a private economy that would do much better if left in peace and to its own devices.<sup>3</sup>

The latest version of the public-choice account of the fiscal crisis of the state is the common pool theory, which has become established as the received opinion of the so-called new institutional economics. In essence it is just another version of the 'tragedy of the commons' story, which in turn is the riposte of standard economics to the Marxian analysis of primitive accumulation (Marx 1967 [1867, 1887]), in particular the 'enclosure' of the common land of English villages by the landed gentry, which is presented as prudent economic policy in pursuit of higher overall economic efficiency (North and Thomas 1973). Just as common ownership and the absence of private – i.e., capitalist – property allegedly resulted in irresponsible 'overgrazing' of common farmland, requiring a forcible modernization of the property regime, it is now being claimed that the public nature of government finance causes individually rational actors to take more out of the 'common pool' of state resources than they can sustain. In the popular version of the theory, democracy is the leading culprit, with its central actors - voters, interest groups and political parties - portrayed as being fundamentally irresponsible and unable to resist the temptations inherent in the free access to collectively owned resources. Vulnerable as its institutions are to popular pressure, so the story goes, democracy will inevitably result in irrational economic decisions, including commitments to public spending in excess of public revenues and resulting in ever rising indebtedness. Obviously the theory of the common pool has a strong Hayekian flavour in that it supports the conclusion that economic policy-making must be protected from electoral pressure and political opportunism and be vested in politically sterilized institutions such as independent central banks or regulatory authorities such as the European Commission. With respect to public finance and the fiscal crisis of the state, it was thinking along these lines that inspired the institutional reforms of the national budgeting procedures that were promoted in the 1990s, as well as the 'fiscal pact' that is currently being negotiated among European nations.

It is not our intention here to debate common pool theory in detail, as the main interest of this volume is to trace the impact of deteriorating public finances on democracy rather than vice versa. We may, however, note that the build-up of public debt since the 1970s did not exactly coincide with a parallel build-up in political participation and popular pressure on governments and markets. It was not only, as we have indicated, voter turnout that declined rather than increased during the period in question – and as we will see, disproportionately so among those at the bottom of our societies, who would be most likely to make demands on government spending. Trade union membership fell as well throughout the world of democratic capitalism, and often enough as a result of successful efforts at union-breaking by governments and employers (Visser 2006). Collective bargaining declined as a consequence, and with it the wages at the lower end of the labour market, while the earnings of shareholders and, even more so, managers improved dramatically, making for a stunning and sustained rise in inequality inside democratic-capitalist societies (Salverda and Mayhew 2009; OECD 2011; Schäfer, chapter 7 in this volume). Needs for 'restructuring' under alleged pressures of 'globalization' were and continue to be invoked to justify the retreat by governments from politically guaranteed full employment, the growing individualization of the employment contract, increasingly precarious employment, the renewal of managerial prerogative, the privatization of government services, and 'reformed' - i.e., recommodifying - social policy – all of which can be observed almost everywhere in rich democracies. Public debt, that is to say, accumulated alongside a long-drawn-out, pervasive process of economic liberalization rather than during a time of growing state intervention. The effective result of this was that capitalism withdrew from the commitments extracted from and entered into by it at the end of the Second World War. However this process may be interpreted or explained, it cannot possibly be conceived as having been driven by a rising influence over policy by democratically organized citizens.<sup>4</sup>

That the rise of public debt was not exactly due to a rise in the power of democracy may also be seen at present as governments, at the