Chapter 6

Conclusion

6.1 Main findings

Through economic policy reform politicians can induce economic change in their country. This thesis investigates the factors that trigger or delay economic policy reforms across developed economies. Likewise, it evaluates the economic consequences of economic policy reforms. The overarching research question is: what causes economic policy reforms and what are the economic consequences of these changes in economic policy? This research question is split into four sub-questions:

1. How can economic policy reforms be identified?
2. What drives economic policy reforms?
3. How does individuals’ voting behaviour impact the likelihood of economic reforms?
4. What are the economic consequences of economic policy reforms?

Chapter 2 deals with the identification of gradual structural reforms, for example, privatisation of healthcare financing. A novel and versatile sequential methodology that utilises both economic outcome and policy input data is developed. The methodology consists of structural break testing to identify potential economic reforms. The number and timing of the structural breaks are treated as unknown a priori. Hence, the Bai and Perron (1998; 2003) endogenous structural break filter is used to identify potential reforms based on economic outcome data. However, these potential reforms might stem from economic fluctuations unrelated to policy changes. Therefore de jure evidence of policy changes is employed to validate whether the potential reform originated from policy changes. The application of this methodology to identify healthcare financing privatisations shows that 22 out of 33 potential privatisations could be validated. We therefore believe that our proposed methodology is a step forward to minimize the number of errors in identifying reforms.

The second aim of the chapter is to examine empirically which political economy variables trigger or delay economic reforms. In line with the findings of Drazen and Easterly (2001) and Pitlik and Wirth (2005) we find that significant reform is more likely in periods with severe economic crisis compared to periods with less severe economic crisis, and even more so compared to periods with no economic crisis. Government ideology, government size
fragmentation, and electoral cycles are not found to have an impact on the likelihood of healthcare financing privatisations significantly.

In chapter 3 the focus is on the triggers of successful fiscal adjustments. We now apply the Bai and Perron (1998; 2003) endogenous structural break filter to identify (the start of) periods in which countries have significantly adjusted their budget balance (i.e., a fiscal adjustment). The adjustment period continues as long as the change in cyclically adjusted budget balance is positive. Using this identification method we identify periods of fiscal adjustments that are less prone to result from identification error compared to identification using ‘ad hoc’ filters.

The conventional finding in the literature is that governments need to rely on expenditure cuts rather than tax increases if they want to obtain sustained debt reduction through budget improvements (Alesina and Perotti 1995; McDermott and Wescott, 1996; Alesina and Ardehna 1998; 2010; Alesina et al. 1998; von Hagen et al. 2001; Broadbent and Daly, 2010; Biggs et al. 2010 and Hernandez de Cos and Moral-Benito 2012). Our main finding is that there is no significant difference in the likelihood between achieving successful adjustments based on expenditure cuts and tax-based adjustments. Although this finding contradicts the conventional view, Heylen and Everaert (2000) also reject the hypothesis that to succeed, consolidation should rely on cutting the government wage bill. Likewise, Ardagna (2004) and Holden and Larsson Midthjell (2013) find no indication that it matters for the success of the adjustment whether it is achieved via spending cuts or tax increases; only the magnitude of the adjustment determines its success.

Furthermore, most previous studies have ignored potentially important political economy drivers of successful fiscal adjustments. Our results show that most ‘usual suspects’ are unimportant in triggering successful adjustments. However, we do find robust evidence that higher ideological fragmentation and greater ideological distance between parties in government increases the likelihood of successful fiscal adjustments.

Finally, our results indicate that a higher debt to GDP ratio increases the likelihood of successful adjustment. A high debt to GDP ratio may signify crises and hence the need for adjustment and therefore make the attempt to restore fiscal balance more credible. This is broadly in line with the crisis effect found in chapter 2.

In chapter 4 we investigate how instrumental and expressive ideological preferences of individual voters affects voting behaviour. In particular, we examine whether and how non-selfish ideological considerations affect voters’ choices in large elections. We develop a decision-theoretic model of voting behaviour. This model captures the decision-relevant components specific to the individual voter in political elections and takes into account that
voters have three sources of utility: monetary utility, ideological instrumental utility, and ideological expressive utility. Voting is costly and a strict majority rule determines the outcome. Evidence from a laboratory experiment shows that voters do behave ideologically expressive in large-scale elections. In line with our theoretical predictions, non-ideological voters are more likely to abstain from voting than ideological voters when the electorate grows large. This is in line with the finding of Fowler (2006) that benevolent voters with a strong party affiliation are more likely to participate in national elections. Partly as a consequence of this turnout effect ideology matters in explaining the choices of participating voters. Contrary to Feddersen et al. (2009) our evidence for expressive voting concerning the choice between two options is less strong. We do find a clear ideological effect that does not depend on the size of the electorate regarding the socialist voters in our sample. That is evidence in favour of expressive voting. However, this effect is not there for the capitalist voters. In fact, we have some indication that these voters also become more socialist when the electorate is large and the pivotal probability is small.

In chapter 5 we analyse whether healthcare financing privatisations curb total healthcare expenditures. The main finding is that healthcare financing privatisations lead to cost savings in total health care expenditures in the countries included. The main results suggest an annual average cost saving over a 5-year period following the privatisation of 0.75 percentage points of GDP per year, which amounts to 3.75 percentage points of GDP to be saved over 5 years. Over a 3-year evaluation period the results only weakly indicate cost saving. This difference in effect between the 3- and 5-year evaluation periods suggests that the effect of healthcare financing privatisations only materialise after several years. These main findings are largely robust to various sensitivity tests, which leads us to the conclusion that healthcare-financing privatisations seems a viable approach to reduce the fiscal burden. However, the results must be interpreted with caution as outlined in the next section.

In summary, the results of chapters 2-4 highlight the importance of economic factors in triggering economic policy reforms, both at the macro and micro level. However, we should not discard political factors as drivers of economic policy reform. At the macro level the factors triggering economic policy reform are mainly political. Crises make change possible because they effectively decrease political opposition to change (Drazen 2000). At the micro level we find some evidence that expressive ideological behaviour matters. It is just not strong enough to dominate economic voting behaviour.
6.2 Policy implications, limitations and future research

The main findings of chapter 2 do not lead to any direct policy implications, but rather predictions on which factors that may or may not cause changes in economic policy. Therefore no policy implications are discussed for chapter 2.

The main strength, but also limitation of chapter 2 is that the tests of reform trigger/delay theories concern a specific sector, namely healthcare financing. It is uncertain whether the results can be generalised to other sectors or types of reforms.\(^1\) Nevertheless, the sequential methodology developed in the chapter allows future research to explore the determinant of reforms in different sectors.

The major policy implication of chapter 3 is that our results suggest that tax increases are not detrimental to the likelihood of achieving successful fiscal adjustment. We find no significant difference in likelihood of successful fiscal adjustment between changes increases in taxes and expenditure cuts. Alesina and de Rugy (2013: 8) argue: “evidence suggests that the types of fiscal adjustment packages that are most likely to reduce debt are those that are heavily weighted toward spending reductions and not tax increases.” In policy-oriented publications several references to the research of Alesina and his co-authors can be found. For instance, in the IMF’s World Economic Outlook, October 2010 the work is described as “extremely influential in the debate regarding the consequences of fiscal adjustment”. Our results cast serious doubts on the conventional view, suggesting that fiscal adjustments can also be successful if they are based (also) on tax increase(s).

This suggests that further research along the lines of our study is warranted. Specifically, previous research suggests that changes in specific spending and tax categories have an asymmetric impact on outcomes. For example a higher marginal income tax may be more distortive than an increased value added tax, and therefore impacting the likelihood of success. Using our identification strategy it would be interesting to disaggregate the expenditures and revenues to different categories.

Also, few of the variables included in our fixed-effect models are found to significantly impact the likelihood of successful adjustments. Yet, something must be driving this likelihood. We conjecture that changes in the underlying budgetary institutions, as opposed to mere changes in policy, may be driving the likelihood of success. This view is corroborated by Baldacci et al. (2012) who find that adjustments based on structural fiscal reforms are likely to

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\(^1\) However, we expect that similar factors trigger/delay privatisations in other quasi public good sectors, such as education and law enforcement, both in terms of provision and financing.
generate larger savings and are more durable than fiscal deficit reductions relying on across-the-board spending cuts. This issue is an interesting avenue for future research. In particular, one could incorporate a categorisation of the identified adjustments in terms of the extent to which they stem from institutional changes or mere policy changes.

The main implication from chapter 4 is that voters who participate in elections mainly vote according to their economic self-interest. Ideology seems to be important for the turnout decision, but voters mainly vote in line with their economic self-interest. This finding suggests that it may be of little use for political parties to appeal to ideological beliefs during election campaigns. Only if voters are nearly indifferent in self-interested economic terms, they are likely to vote expressively.

A limitation of the study follows from the object we analyse. An experimental approach is needed to investigate voting behaviour since democratic voting takes place at a secret ballot. In an experiment the researcher needs to isolate the causal relation of interest by keeping other factors constant that may impact voting behaviour. In turn, one could question the generalizability of our results since voting behaviour at real elections is much more complex than the situation we have created in the experimental laboratory. In addition, some scholars may argue that the concept of Expressive Behaviour/Voting is much broader than the narrow and stylised versions of ideology we have applied. However, this is necessary to make a laboratory experiment feasible. We need to give up 'realism' to make the experiment tractable and comprehensible for the sake of analysis and for the experimental participants.

The main policy implication from chapter 5 is that healthcare financing privatisations curb aggregate healthcare expenditures in the analysed countries. Gradual shifts from public to private financing can lead to lower aggregate health care consumption. However, we are not able to draw conclusions about efficiency. The cost saving might come from less desirable effects of the privatisation. Certain groups are more likely to start under-consuming healthcare. In particular, low-income groups are more likely to be excluded due to their budget constraints. Due to data restrictions we are not able to assess whether the analysed privatisations cause health equality and quality to decline. Increased private payment may cause consumers to choose options of lower quality. We cannot assess whether the analysed reforms impact the overall level of health (care) quality.

In conclusion, the results must not be interpreted as if healthcare-financing privatisations will deliver positive outcomes in ‘general equilibrium’, but only that healthcare financing privatisation leads to cost savings in total healthcare expenditures. Overall health quality may deteriorate because of a lower quality choice by consumers or due to the fact that parts of the population may be excluded from the system. Thus, it is not well established
whether healthcare-financing privatisations are optimal from a welfare perspective. If the policy is being pursued to reduce the re-distributional effects of a public tax financed system, it may be exactly the objective to exclude certain parts of the population, or at least restrict their access compared to high-income groups (Cavaliere and Scabrosetti 2008). Clearly these issues are avenues for future research. A particularly important endeavour is to search for a methodology that aggregates healthcare quality in countries over time, and to include this in an efficiency analysis of the effects of healthcare reforms.