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Economic Freedom in the Early 21st Century: Government Ideology Still Matters

Kai Jäger*

SUMMARY

Empirical studies show that government ideology has hardly influenced welfare expenditures since the 1990s, casting doubt on the general ability of national governments to design economic policies according to their programmatic appeals. This study takes a comprehensive view on policy-making by using a modified version of the Fraser institute's Economic Freedom of the World Index: I focus on the aspects of economic freedom that provoke party polarization and that national governments are capable to influence. The results suggest that government ideology still matters in the early 21st century: The empirical analysis of 36 OECD or new European Union member states from 2000 to 2012 shows that left-wing governments are associated with significantly lower economic freedom. Economic freedom continues to be the guiding principle that divides left and right in economic policy-making because the left still promotes relatively higher levels of far-reaching government spending and regulation.

Keywords

Government ideology; partisan hypothesis; party politics; party realignment; economic freedom; economic policies; public expenditures; transfers and subsidies; privatization; taxation; regulation

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I. INTRODUCTION

Economic policies ~~have always received~~ a ~~great deal~~ lot of public and scientific attention. Intellectuals, journalists, politicians, and citizens frequently disagree about the desired size and scope of government. The dispute on economic policies is often reflected by party polarization~~based on different ideological convictions that party competition often reflects~~. Left-wing parties prefer an activist state ~~which would aim to rectify~~ that reduces economic inequality through regulation and redistributive policies. Right-wing parties, ~~by~~ contrast, advocate a free-market economy with restrictions on state intervention to avoid market distortions.

But the established polarization between left and right on economic policies has recently been called into question. Rodrik (2011) argues that government ideology retreats to the background because of external constraints such as globalization, which would subordinate democratic governance. Iversen and Soskice (2015) disagree, maintaining that national governments still have the authority to shape their economies on predictable partisan lines, but the declining class cleavage forces them to ~~ad~~apt their policy stances in order to appeal to a wider audience.

In the OECD. ~~The~~ empirical evidence is mixed ~~in the OECD~~. Some studies show that the partisan effect disappears for some areas, particularly for welfare spending (Garrett and Mitchell 2001; Huber and Stephens 2001; Kittel and Obinger 2003; Potrafke 2009; Kwon and Pontusson 2010; Herwartz and Theilen 2014), while it remains strong significant for market regulation and privatization (Bortolotti and Pinotti 2008; Iversen and Stephens 2008; Potrafke 2010a; Obinger et al. 2014).

The previous studies have mostly focused on selected areas of economic policy-making in order to reach their conclusions on the influence of government ideology. I use the Fraser institute's Economic Freedom of the World (EFW) Index to provide a unified measurement for many aspects of economic policies.

The EFW Index measures a country's economic freedom for 42 variables, which are combined to form five distinct policy areas (Gwartney et al. 2014). In order to study the influence of government ideology, I only include those policy areas in the index that provoke partisan disagreement and that are controlled by the national government. The result is a modified EFW Index that consists of all policy-areas for which political economists discuss the

role of government partisanship: Government expenditures, transfers, subsidies, privatization, government investment, income and payroll tax policies, and the regulation of labor and business.

Based on ~~theis~~ modified EFW Index, ~~this studyI wants to~~ investigate the following question:

Are left-wing governments more active in restricting economic freedom?

~~The empirical analysis is based on a~~ time-series cross-sectional analysis for 36 OECD or new European Union member states ~~during over~~ the period ~~of 2000_ to 2012~~. ~~The findings suggest shows~~ that government partisanship still plays an important role in designing economic policies: Left-wing governments are significantly more likely ~~than right-wing administrations~~ to restrict economic freedom ~~than right-wing governments~~.

II. DOES GOVERNMENT IDEOLOGY STILL MATTER?

II. 1. The classic partisan hypothesis

The polarization of political parties across a programmatic left-right dimension is constitutive for historical cleavage theorists and for spatial theorists of party competition (Kitschelt 2000: 846). In both traditions, government accountability and responsiveness arise from implementing the economic policies that the public desires. If parties polarize and offer a distinctive ideological program, voters are supposed to have a clear choice at the ballot-box. Voters could use ideologies and party labels as a shortcut to reduce information cost and may still reach rational decisions (Lupia and McCubbins 1998).¹

Given the importance of partisan differences for democratic legitimacy, scholars have continuously evaluated how parties differ across the left-right continuum. Hibbs (1977) argues that left-leaning governments prefer reducing unemployment while a right-wing government would opt for price stability, assuming a politically exploitable Phillips curve trade-off between unemployment and inflation. Studies show that left-wing governments have expanded the scope and expenditures of the welfare state up until the 1980s (~~Esping-Andersen 1985~~; Hicks and

¹ For a critical discussion of how partisanship could lead to biased information processing instead of rational decisions, see Friedman (2006) ~~and Murakami (2008)~~.

Swank 1992; Huber et al. 1993; Hicks 1999; Iversen and Cusack 2000). The classic partisan hypothesis suggests that a left-wing government implements expansionary fiscal and monetary policies to decrease unemployment, whereas a right-wing counterpart prefers lower inflation and implements restrictive fiscal and monetary policies.

II. 2. Government ideology in an era of austerity and globalization

The classic partisan hypothesis has come under attack by newer empirical findings. They suggest that the partisan effect on welfare expenditures has disappeared since the 1990s (Garrett and Mitchell 2001; Huber and Stephens 2001; Kittel and Obinger 2003; Potrafke 2009; Kwon and Pontusson 2010; Herwartz and Theilen 2014).

The literature provides several explanations for the disappearing partisan effect, highlighting the rise of economic constraints, such as the shift to a postindustrial economy (Iversen and Cusack 2000), an aging population (Tepe and Vanhuyse 2009), and expanding international competition through globalization (Frieden and Rogowski 1996; Rodrik 2011). Economic constraints would force leftist governments to refrain from ~~further~~ expanding the welfare state, but popular support for the existing welfare state would also restrict the efforts of right-wing governments to cut back on welfare benefits in the “era of new politics” (Pierson 1996, 2001).

But the influence of external constraints on policy-making should not be overemphasized. Globalization ~~leads to increased~~fosters international competition, economic integration and mobile capital markets, but the development has not triggered a race-to-the-bottom of welfare spending, taxation, or labor market regulation (Schulze and Ursprung 1999; Dreher 2006a; Dreher et al. 2008; Plümper et al. 2009; Potrafke 2010b, Potrafke 2015).

Different outcomes in economic policy-making can be reliably linked to government ideology in the OECD (Boix 1998; Korpi and Palme 2003): Left-wing governments tend to enact more protective labor market regulation (Botero et al. 2004) and spend more on work training (Iversen and Stephens 2008). By contrast, right-wing governments are relatively more supportive of deregulating product markets (Potrafke 2010a) and privatization (Bortolotti and Pinotti 2008; Obinger et al. 2014).

External constraints have certainly affected policymaking and party competition. But it remains questionable whether they undermine governments' general ability to shape the economy according to partisan goals.

III. DRAWING A MORE COMPREHENSIVE PICTURE: ECONOMIC FREEDOM AND GOVERNMENT IDEOLOGY

III. 1. Why economic freedom is a guiding principle for party competition

The previous discussion ~~has shown~~suggests that it is insufficient to focus on only one or a few aspects of policy-making in order to evaluate the partisan hypothesis. This section suggests that economic freedom is a comprehensive concept that accounts for existing partisan differences in economic policy making.

The underlying concepts of economic freedom are “(1) personal choice, (2) voluntary exchange coordinated by markets, (3) freedom to enter and compete in markets, and (4) protection of persons and their property from aggression by others” (Gwartney et al. 2014: 1). Economic freedom is a core principle that separates left and right on the economic dimension of party competition. Kitschelt and Rehm (2014: 1671) summarize the left-right divide with the following question: “Should the polity authoritatively (re)allocate resources in an egalitarian fashion to all members or should privilege or the spontaneous inequality of the market place have free reign and govern the acquisitiveness of members?”²

~~Potrafke (2010a: 136) describes the Austrian School of Economics by Ludwig von Mises and Friedrich von Hayek, and the Chicago School by Milton Friedman, as the main philosophical champions of economic freedom. The Austrian and Chicago schools of thought have a lasting impact on the political ideas held by the political right, as evidenced by Margaret Thatcher's or Ronald Reagan's admiration for Friedman or Hayek (Jones 2014).³~~

As a consequence of the continuously decline of the size of the working class, the left needed to adapt its economic program to attract new voters among the middle class (Kitschelt 1994; Bartolini 2000; Arndt 2014). Full-time working women and higher educated sociocultural

² Kitschelt and Rehm (2014) argue that the types of preferences that drive political behavior and left-right polarization can be categorized into group (identity), grid (governance), and greed (distribution or economic policy-making). This study focuses on the left-right polarization of mainstream parties on the economic greed dimension. Whether this distinction applies for the group and grid dimensions is beyond the scope of the paper.

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professionals in public service sector jobs have become core supporters of left-wing parties (Iversen and Rosenbluth 2006; Kitschelt and Rehm 2014). Programmatically, the left appeals to their new constituents by promoting the provision of public sector jobs, and by emphasizing active state policies, such as government investment in education and vocational skills (Iversen and Stephens 2008; Häusermann et al. 2013: 226-8). The left also embraces business and labor market regulations in order to address social risks that their electorate is facing. Regulatory proposals range from laws protecting full-time employees from their dismissal (Rueda 2007) to fostering child care facilities and parental leave policies (Häusermann 2006). Left-wing cultural values also spill over into the economic realm as most left-wing parties support tougher employment regulation through gender quotas or anti-discrimination laws (Terjesen et al. 2015).

These left-wing policies are hardly in accordance with the principle of economic freedom. ~~Consequently, Even though mainstream left wing parties have accepted or initiated some free market reforms—such as Anthony Blair’s Labour government in the UK or Gerhard Schröder’s leftist red green coalition in Germany—~~there should ~~be~~ on average be a significant reduction in economic freedom when the left governs.

III. 2. Modifying the Economic Freedom of the World Index

The EFW Index by the Fraser Institute is considered to be the gold standard to measure economic freedom (Dawson 2007: 185). Most scholar utilize the EFW Index as the main explanatory variable to evaluate whether economic freedom can explain desirable outcomes. For instance, they ~~demonstrate~~ find a positive association of economic freedom with economic development (Gwartney et al. 2006), democratic institutions (Peev and Mueller 2012), social trust (Berggren and Jordahl 2006), and tolerance (Berggren and Nilsson 2013).

Only a few studies examine the influence of government ideology on economic freedom. On the federal level, right-wing government ideology is associated with more freedom on labor markets in American and Canadian states (Bjørnskov and Potrafke 2012, 2013) and with economic freedom in Western German states (Potrafke 2013). But there is only one time-series cross-sectional analysis of the relationship between the EFW Index and government ideology:

Pitlik (2007) uses five-year averages for 23 OECD countries to show that right-wing governments are relatively more supportive of economic freedom over the period 1970-2000.

It is, however, necessary to modify Pitlik (2007)'s work and to re-examine the relationship between economic freedom and government ideology for three reasons:

First, his period of observation ranges from 1970 to 2000 and thereby conflates the early decades, for which the literature considers government ideology to be relevant, with the period, for which many political economists dispute the influence of government ideology. This study aims to focus solely on the early 21st century to evaluate whether government ideology has recently retired to the background.

Second, using five-year averages does not capture the effects of government ideology if the composition of government changes more frequently. Specifically, five-year averages cannot exclude the possibility of an inverse partisan effect. For instance, let t 's assume that a country has a right-wing government at period t and that the administration does not change economic freedom; the left wins the election at $t+3$ and strongly increases economic freedom in the next year. Averaging over five years yields a dominant right-wing government composition and a net increase in economic freedom, thereby falsely confirming the partisan hypothesis. The limited availability of data forced Pitlik (2007) to rely on five-year averages, because the Fraser Institute publishes their EFW Index only annually since 2000.

Third, Pitlik (2007) employs the complete EFW Index score as dependent variable. But the recent delegation of policy competences implies that national governments do not have full authority on all areas of economic policy-making anymore. In a similar case, Potrafke (2013)'s analysis of economic freedom in German states adjusts the economic freedom index to exclude policy areas for which the federal states have limited or no authority.

As a consequence of the discussed limitations, this study extends the annual period of observation from 2000 to 2012 to evaluate whether government ideology still matters in an era of austerity and globalization, and to exclude the possibility of inverse partisan effects. It modifies the EFW Index to only include 1) policy areas that national governments generally control, and 2.) policy areas that exhibit ~~ideological~~ polarization between mainstream left and right.

<<< **TABLE 1** >>>

Table 1 ~~graphically summarizes~~ shows the modification of the EFW Index. The EFW Index consists of five equally weighted policy areas: Size of Government; Legal System and Security of Property Rights; Sound Money; Freedom to Trade Internationally; and Credit, Labor, and Business Regulation.

“Size of Government” includes government consumption, transfers and subsidies, privatization and government investment, and income and payroll taxes. National governments have not delegated competences to external institutions and parties differ ideologically for the desired scope and size of government. “Size of Government” consequently remains in the modified EFW Index.

However, this is not the case for Areas 2 to 4. A left-right conflict for Area 2 “Legal System and Security of Property Rights” has disappeared since virtually all mainstream left-wing parties accept secure property rights. The other items of Area 2 appear to be desirable outcomes such as sound law enforcement and keeping the military out of politics. They are issues of valence competition, but not of programmatic disagreement. Consequently, Area 2 is not part of the modified EFW Index.

The large mainstream parties could still have different preferences for monetary and trade policies of Areas 3 and 4, but domain authority for both areas has largely been delegated to external institutions. Most countries have adopted independent central banks, or completely given up national monetary policy as in the case of the European Central Bank (Arnone et al. 2007). The delegation and conduct of monetary policy does not appear to be statistically related to partisanship (Way 2000; Gilardi 2007; Jäger 2016). The introduction of the euro was largely supported by all mainstream parties and rather caused preference divergence between the political elite and the general public, particularly in Germany (Jäger 2013: 117-8). Similarly, tariffs, capital controls, and travel restrictions have been abolished within the EU. Bilateral or general trade agreements often regulate the ability of administrations to impose new tariffs and restrictions. As governments cannot substantially alter economic freedom in Area 3 “Sound Money” and Area 4 “Freedom to Trade,” both areas are removed from the modified EFW index.

Area 5 refers to the regulation of capital, labor and business. Governments still have the capacity to shape business and labor market regulation. An expert survey indicates that left- and right-wing parties substantially differ in their preferences regarding regulation across different sectors (Benoit and Laver 2006). Thus, the modified EFW index includes business and labor market regulation.

Parties could disagree over the regulation of credit markets, but national governments have limited say in this area. The interest rate policy by the central bank and ~~the course of the~~ business cycle ~~strongly-patterns can~~ influence the score for credit regulation. For instance, the Great Recession caused a drastic drop in the score for most countries – suggesting that governments can play a minor role at best in influencing the score. As a consequence, the modified EFW index does not include credit market regulation.

<<< FIGURE 1 >>>

The modified EFW Index consists of the three equally weighted areas “Size of Government”, “Labor Market Regulation” and “Business Regulation” and is multiplied by 10 to range from 0 (the least economic freedom) to 100 (highest economic freedom). The inclusion of policy areas is in line with an expert survey, which finds that national governments of EU members have at least some degree of influence in economic development and planning and social/industrial policy (Hooghe and Marks 2001). Additionally, Nanou and Dorussen (2013) confirm that the ideological distance between parties has dwindled in policy areas that are increasingly under the realm of the EU.

Figure 1 shows the development of the modified EFW Index and the three sub-areas since the 1990s. Economic freedom strongly increases ~~inaeross~~ all areas in the first years of the 21st century, but the three areas subsequently diverge. While economic freedom in Labor Regulation increases slightly, it decreases for Size of Government and Business Regulation; overall economic freedom reaches its highest value in 2005 and remains stagnant until 2012.

IV. EMPIRICAL ANALYSIS

IV. 1. Data overview and some anecdotal evidence

The study covers the following 36 OECD or new European Union member states from 2000 to 2012: Australia, Austria, Belgium, Bulgaria, Canada, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan,

Latvia, Lithuania, Luxembourg, Malta, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, the UK, and the USA.⁴

I use the first differences of the modified EFW Index as dependent variable to control for autocorrelation. Armingeon et al. (2014)'s Comparative Political Data Set III (2014) provides the partisan measurement as main explanatory variable. "Government Ideology" is based on the composition of cabinet posts, ranging from one to five. The categories of "Government Ideology" are the following: Hegemony of right-wing (and centrist) parties (percentage left cabinet posts=0), dominance of right-wing (and centrist) parties (left<33.3), balance of power between left and right/center (33.3<left<66.6), dominance of social-democratic and other left parties (left>66.6), hegemony of social-democratic and other left-wing parties (left=100). The correlation coefficient between the modified EFW Index and Government Ideology is -0.23.

<<< FIGURE 2 >>>

Figure 2 shows the mean changes in economic freedom for each five categories of Government Ideology. Hegemonic right-wing governments have the highest value with an average annual increase in economic freedom of 1.02 points. The remaining values are not categorically decreasing as a balanced government (0.69) has a higher score than a dominant right-wing government (0.50), and a hegemonic left-wing government (0.07) exceeds a dominant left-wing government (-0.12).

Figure 2 suggests that economic freedom remains rather stagnant under left-wing governments and increases under a right-wing administration. A t-test of means shows that hegemonic and dominant left-wing governments differ significantly in changing economic freedom: Grouping both leftist government types together yields a mean of -0.02 for changes in economic freedom, while the average annual change for all other government types is 0.82. The difference is significant with a t-value of 2.26 at the 95 percent confidence level. Alternative categorizations that are based on a leftist government portfolio of at least 50 or 34 percent are also significant different from other, non-leftist government types.⁵

⁴ The analysis does not include the OECD member states Chile, Israel, Mexico, South Korea, and Turkey, because they are not part of the Comparative Political Data Set III.

⁵ The average change in economic freedom for governments with a leftist government portfolio of at least 50 (34) percent is 0.05 (0.15) while it is 0.85 (0.92) for all other government types. The differences are significant at the 95 percent confidence level with a t-value of 2.29 (2.33).

Some anecdotal evidence ~~also could~~ suggests that left and right tend to differ ~~significantly from each other in their mean economic freedom score~~ economic policy-making. Under the hegemonic left-wing governments of Portugal and Spain, changes in economic freedom were always negative between 2005 and 2010, with an overall reduction of about five and eight points. In Austria, the right-wing “ÖVP-FPÖ government has pursued particularly rapid rate of privatisation” (Hofbauer 2006: 16), leading to more economic freedom of over seven points between 2002 and 2005. And in Australia, the right-wing Howard administration increased economic freedom by over 12 points between 2000 and 2007. Howard enacted labor market deregulation that has been described as “the most fundamental recasting of the industrial relations system in over 100 years” (Hall 2006: 291) – until Rudd’s Labor Party returned to power and overturned this reform, reducing overall economic freedom by nearly seven points until 2012. Similarly, right-wing governments in Slovakia (2004), the Czech Republic (2007), and Hungary (2011) increased their economic freedom score by about six, three, and one point(s) in just one year by introducing a flat tax regime. As a first re-election measure, the Slovakian left-wing government brought a progressive income tax scheme back into effect in January 2013.

There are also cases in which left-wing parties have accepted or initiated some free-market reforms, such as Anthony Blair’s Labour government in the UK or Gerhard Schröder’s leftist red-green coalition in Germany. By contrast, a general minimum wage – traditionally championed by left-wing parties – was introduced 2015 in Germany by Angela Merkel’s grand coalition. Nonetheless, the concept of economic freedom had a much greater impact on the political ideas held by the political right, as evidenced by Margaret Thatcher’s or Ronald Reagan’s admiration for Milton Friedman or Friedrich von Hayek (Jones 2014).⁶

Potrafke (2010a: 136) describes the Austrian School of Economics by Ludwig von Mises and Friedrich von Hayek, and the Chicago School by Milton Friedman, as the main philosophical champions of economic freedom. The Austrian and Chicago schools of thought have a lasting impact on the political ideas held by the political right, as evidenced by Margaret Thatcher’s or Ronald Reagan’s admiration for Friedman or Hayek (Jones 2014).⁷

⁶ More examples of governing politicians who explicitly refer to the Austrian or Chicago free-market schools, or were awarded by free-market think tanks include, but are not limited to, John Howard (Australia), Stephen Harper (Canada), Václav Klaus (Czech Rep.), Anders Fogh Rasmussen in early writing (Denmark), Andrus Ansip, Mart Laar (Estonia), Sauli Niinistö (Finland), Jean-Pierre Raffarin (France), Valdis Dombrovskis (Latvia), Leszek Balcerowicz (Poland), Mikuláš Dzurinda, Ivan Mikloš, and Robert Sulik (Slovakia).

IV. 2. Model specification and empirical analysis

The empirical analysis is based on the following regression equation:

$$\Delta \text{Modified EFW Index}_{it} = \alpha \text{Government Ideology}_{it} + \sum_{j=0}^M \beta_j X_{ijt} + \pi_i + \tau_t + \varepsilon_{it}$$

(1) with $i = 1, \dots, 36$ (number of countries); $t = 1, \dots, 12$ (number of years); $j = 0, \dots, M$ (number of other explanatory variables)

where “ Δ Modified EFW Index” measures the first differences of the modified EFW Index and is the dependent variable, while “Government Ideology” denotes the main explanatory variable.

“ $\sum X_{ijt}$ ” contains other explanatory variables as controls. The International Country Risk Guide provides a measurement for government stability and public popularity, as governments could shy away from economic reforms if they have to face falling approval rates. The variable “Government Stability” combines the three subcomponents government unity, legislative strength, and popular support,⁸ which ranges from 0 to 12.

Moreover, effective domestic veto players can also restrict governments from enacting economic reforms (Tsebelis 1995). Hallerberg and Basinger (1998: 339) show that a high number of veto players leads to a status quo bias in tax policies. The Political Constraints Index 5 by Henisz (2000) accounts for “Veto Players” within the executive, two legislative chambers, the federal level, and the judiciary. “Veto Players” potentially ranges from 0 to 1. The dummy “Government Change” indicates whether there was a turnover in government in a given year. “EU” denotes whether a country is a member of the European Union.

⁸ The International Country Risk Guide does not separately provide the three subcomponents as individual measurements.

The next variables relate to external constraints. First differences of Dreher (2006b)'s KOF Index of Globalization combine social, political, and economic dimensions to provide a comprehensive measurement for globalization. And the analysis includes the first differences of the following domestic economic constraints: real GDP per capita in thousand US\$, unemployment rate, national debt, as drawn from the World Bank Global Development Indicators. Additionally, the level of the EFW Index at t-1 is used as a control variable to capture converging trends. Table 2 ~~depicts shows~~ the descriptive statistics of all variables and their first differences.

<<< **TABLE 2** >>>

“ π_i ” denotes country fixed effects to control for country-specific time-invariant effects, such as national culture, federalism, the electoral or monetary systems; “ τ_t ” represents annual time effects to adjust for common positive or negative shocks; “ ε_{it} ” is the error term. The model specification is based on an ordinary least squares (OLS) regression with robust standard errors because the Breusch-Pagan test rejected the hypothesis of homoskedasticity.

It is possible, however, that government ideology has a time-delayed effect on economic freedom, and that some explanatory variables, such as GDP per capita or unemployment, might be affected by economic freedom. As a consequence, all explanatory variables are lagged by ~~t~~ ~~+one year~~ in additional model specifications in order to tackle potential time-lags and reverse causality issues.

<<< **TABLE 3** >>>

Table 3 summarizes the regression results for five different models. The first model includes only Government Ideology as main explanatory variable and fixed and period effects. The second and third models add the other explanatory variables and the lagged level of economic freedom as controls. Models 4-6 re-examine the previous specifications with lagging the explanatory variables by ~~t~~ ~~+one year~~ to tackle potential endogeneity problems. Government Ideology has a negative sign and is statistically significant at the 99 percent confidence level in columns (1), (2), (3), and (6), at the 95 percent confidence level in column (4), and at the 90 percent confidence level in column (5), indicating that left-wing governments are significantly more likely to restrict economic freedom.⁹

⁹ The appendix also confirms the empirical results of Table 3 with dependent and continuous explanatory variables in levels based on a general least squares Prais-Winsten transformation with a first order autoregressive process

The significant negative coefficient for the lagged level of economic freedom suggests that countries with already high levels of economic freedom are associated with negative changes. Among the other variables measuring various constraints on government, none significantly affects economic freedom in all models; there is some evidence that EU membership has a positive influence on economic freedom when not controlling for the previous EFW level. Government Stability only appears to be conducive for economic freedom when it is lagged by one year in the full model. The results are mixed for the coefficient of changes in globalization. It is significantly positive but becomes significantly negative when the explanatory variables are lagged by one year.

The numerical effect of Government Ideology appears to be quite large: A unit change in Government Ideology towards the left decreases the first differences of economic freedom by 0.19 to 0.36 points across the different model specifications, which equals about 5.7 to 10.7 percent of a standard deviation. Moving from a hegemonic right-wing to a hegemonic left-wing government reduces annual average changes in economic freedom by about 0.76 to 1.44 points, or by 22.6 to 43 percent of a standard deviation.

More evidence on the numerical effects of Government Ideology is obtained by relying on King et al. (2000)'s simulation-based approach. The Stata [software package Clarify](#) utilizes the results of the multiple regression analyses of Model 3 of Table 3 to draw 1000 sets of simulated coefficients from each posterior distribution to account for estimation uncertainty (Tomz et al. 2003). Government Ideology is set at one of its five values while all other explanatory variables are fixed at their means, yielding five counterfactual scenarios for the numerical effect of hegemonic right, dominant right, balanced, dominant left, and hegemonic left governments on the first differences of economic freedom.

<<< **FIGURE 3** >>>

Figure 3 plots the density estimates for the five counterfactual scenarios over the first differences of economic freedom. As government ideology becomes more left-wing, the density estimates move to the left, indicating that left-wing governments tend to reduce economic

(AR1), which accounts for the serial correlation of the dependent variable. The Prais-Winsten transformation provides a robustness test for the long-term effects of government ideology on economic freedom (Plümper et al. 2005: 349). Additional tests show that Government Ideology is not conditional on other factors, such as the age of the government, government stability, or veto players, across all model specifications. An interaction term between Government Ideology and age of government is significantly positive at the 95 percent confidence interval for the model specifications of columns (4) and (5); an interaction term between Government Ideology and veto players is significantly negative at the 95 percent confidence interval for column (5).

freedom. On average, hegemonic left-wing governments reduce the first differences of economic freedom by 0.30 points, and ~~its~~ the density estimate is relatively steeper than the other distributions, which suggests that the outcome variation among hegemonic left-wing governments ~~in changing economic freedom~~ is relatively larger. The average increases in first differences of economic freedom ~~is are~~ 0.04 for dominant left governments, 0.39 for balanced governments, 0.74 for dominant right governments, and 1.08 for hegemonic right governments. Thus, the average simulated difference between hegemonic left and right governments is about 1.38 points of the annual changes in economic freedom. As the density estimates for hegemonic left and right governments are not overlapping, we can confirm this numerical difference with a high degree of certainty (King et al. 2000: 357).

<<< **TABLE 4** >>>

In order to evaluate whether a group of countries drives the significant results of Government Ideology, Table 4 divides the data into several subsamples based on membership in the Eurozone, and on electoral system. Eurozone membership might be another constraint thwarting government ideology ~~(Crum 2013), as southern Eurozone members, in particular, have limited capacities to fulfill their electoral promises since the advent of the euro crisis (Crum 2013).~~ In the case of the electoral system the dominance of government ideology might be stronger in Australia, Canada, France, Japan, Lithuania, UK and USA, because countries with plurality formulas tend to produce two-party systems with one governing party. The proportional rules of the other countries, in contrast, tend to lead to multi-party systems with coalition governments ~~coalitions~~.

Table 4 shows that the coefficient for Government Ideology stays significant in all subsamples with contemporaneous and lagged explanatory variables. The findings of Table 4 suggest that a cluster of countries does not drive the negative association between left-wing government and economic freedom.

As another robustness test, Table 5 replaces the dependent variable with the first differences of alternative measurements of economic freedom to examine if the empirical results are a result of selection bias caused by modifying the EFW Index in section 3.2. Models 1-4 adjust the weighting of the three sub-areas of the modified EFW Index in the following way: Models 1-2: Size of Government (1/2), Business Regulation (1/4) and Labor Regulation (1/4); Models 3-4: Size of Government (4/6 to account for each of its four subareas), Business Regulation (1/6) and Labor Regulation (1/6).

Models 5-6 are based on the original EFW Index. Using the first differences of the original EFW Index as dependent variable is a strong robustness test for the validity of the partisan hypothesis because national governments have only limited or no authority to directly influence the remaining policy areas of the EFW Index. These previously excluded areas account for 2/3 of the weighting of the original EFW Index.

Table 5 shows that Government Ideology remains significantly negative in the first four model specifications. The results indicate that the negative relationship between left-wing partisanship and economic freedom is robust for weighting changes in the composition of the modified EFW Index. While the coefficient for Government Ideology shrinks in Models 5 and 6, the coefficient remains significant at the 99 and 90 percent confidence level.

Overall, the robustness tests tend to confirm the continuing influence of government ideology on economic policy-making.

<<< **TABLE 5** >>>

V. CONCLUSION

The influence of government ideology on economic policies remains vitally important for democratic legitimacy and government accountability, leading to recurring interest ~~on~~in how government ideology leaves its programmatic footprint in the economy.

~~In the “Golden Age” of the welfare state, N-~~national governments had the sovereignty and fiscal capacity to shape monetary and welfare policies according to their ideological manifestos until the 1980s(~~Esping Andersen 1996~~). But expanding global markets, the shift to a postindustrial society, and tightening fiscal conditions have distinctively changed party politics in recent decades. International organizations such as the EU have increasingly encroached on the national sovereignty of economic policy-making; delegating monetary policy to independent central banks has become a global trend. Fiscal constraints have forced many governments to cut back on social benefits and restructure the welfare state, sometimes even orchestrated by leftist administrations. In fact, a significant portion of the left-wing spectrum has fully embraced free trade and central bank independence. But on the other hand, the left continues to share a commitment for active state policies that effectively restrict economic freedom relative to policies by right-wing parties.

~~But this does not imply. And thus, it would be wrong to conclude that~~ that partisanship is generally retrenching. The empirical section shows that government ideology still matters for economic policy-making when using a comprehensive measurement that includes government consumption, transfers, subsidies, privatization, government investment, tax policies and labor and business regulation from the EFW Index. As the partisan hypothesis suggests, left-wing administrations still tend to be more active in restricting economic freedom.

~~What could explain the persistent influence of government ideology? The disappearing partisan effect in some domains could have actually fostered a distinct partisan effect in other policy areas. Delegating monetary policy and restructuring the welfare state could have freed up the financial and political capital that governing parties need to impose their program on other areas of the economy (Dellepiane Avellaneda 2013).~~

~~Nonetheless, it is possible that the partisan effect could vanish in the future under pressures for further delegation and policy coordination. Particularly, southern Eurozone members increasingly have limited capacities to conduct autonomous economic policies since they were required to adopt austerity measures after the advent of the euro crisis. If this trend continues, the capacity to formulate and pursue national policies that reflect a political party's constituency could vanish altogether. The shift to new economic policies might have been an electoral necessity, particularly for the mainstream left. The ongoing shift to a postindustrial economy in the OECD and Europe has affected the composition of their electorate: The working class voting bloc has become less important for left-wing parties, which needed to adopt their program to successfully appeal to new middle-class voters. But it would be mistaken to believe that voter realignment has generated left-wing policy proposals that are similar to those preferred by the political right. In fact, both old and new left-wing agendas continue to share a commitment for active state policies that effectively restrict economic freedom relative to policies by right-wing parties.~~

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Figure 1

Average development of modified ~~EFW-economic freedom index~~ and of the three policy areas



Figure 2

Mean changes in modified economic freedom index ~~EFW Index~~ based on government ideology

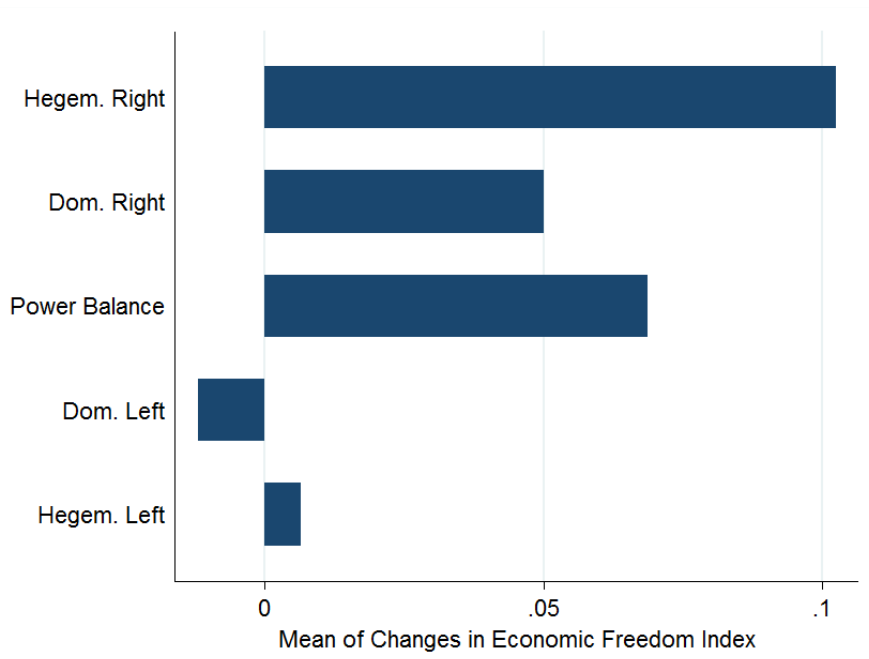


Figure 3

Simulated effects of Government Ideology on first differences in economic freedom

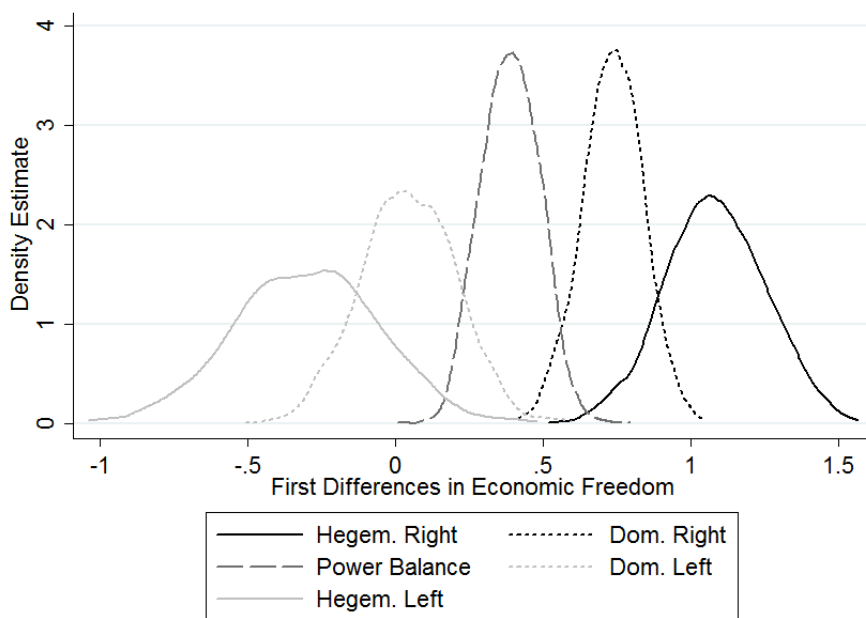


Table 1

Modifying the ~~EFW Index~~ economic freedom index: Which should be considered?

	Controlled by national government?	Mainstream party polarization?	Part of Modified EFW Index?
Area 1			
Size of Government			
Government Consumption	✓	✓	✓
Transfers and Subsidies			
Privatization and Government Investment			
Tax Rates			
Area 2			
Legal System and Property Rights	✓	✗	✗
Area 3			
Sound Money	✗	✓	✗
Area 4			
Freedom to Trade Internationally	✗	✓	✗
Area 5a			
Credit Market Regulation	✗	✓	✗
Area 5b			

Labor Market Regulation	✓	✓	✓
Area 5c Business Regulation	✓	✓	✓

Table 2

Descriptive statistics

	Obs	Min	Max	Mean	Std. dev.
Mod. EFW Index	428	41.05	80.28	61.40	7.86
Δ EFW Index	424	-12.42	11.96	0.60	3.35
Government Ideology	431	1	5	2.40	1.45
Government Stability	432	4.04	11.08	8.19	1.32
Veto Player	432	0.34	0.89	0.77	0.08
Government Change	432	0	1	0.26	0.44
EU	432	0	1	0.65	0.47
KOF Globalization Index	432	58.93	92.37	80.52	7.57
Δ KOF Globalization Index	432	-4.80	10.61	0.26	1.52
GDP per Capita	432	2.94	86.13	30.20	18.17
Δ GDP per Capita	432	-6.01	4.02	0.30	0.94
Unemployment	432	1.8	25.2	7.79	3.97
Δ Unemployment	432	-5.4	9.70	0.13	1.56
Debt	424	7.31	218.80	60.95	36.55
Δ Debt	423	-15.33	48.93	1.92	6.20

Table 3

OLS regression analyses. Dependent variable: First differences in modified economic freedom index

	(1)	(2)	(3)	(4)	(5)	(6)
Government Ideology	-0.30*** [2.91]	-0.27*** [2.60]	-0.35*** [3.74]	-0.20** [2.06]	-0.19* [1.81]	-0.36*** [3.97]
Government Stability		0.03 [0.28]	0.15 [1.44]		0.12 [0.96]	0.32*** [2.68]
Veto Player		-1.07 [0.50]	-1.86 [1.05]		-1.83 [0.76]	-2.93 [1.33]
Government Change		-0.07 [0.23]	-0.17 [0.67]		0.22 [0.75]	-0.00 [0.01]
EU		0.40 [0.53]	1.83*** [2.92]		0.10 [0.15]	1.66*** [2.91]
Δ Globalization		0.32** [2.56]	0.20** [2.19]		-0.24*** [2.66]	-0.21** [2.49]
Δ GDP per Capita		0.15 [0.99]	0.28** [2.11]		-0.21 [1.48]	0.03 [0.26]
Δ Unemployment		-0.03 [0.36]	-0.01 [0.17]		0.12 [1.15]	0.08 [0.86]
Δ Debt		-0.01 [0.55]	-0.00 [0.10]		-0.03 [1.36]	-0.03* [1.79]
Level of Economic Freedom t-1			-0.42*** [8.65]			-0.46*** [8.77]
Lagged Explanatory Variables	No	No	No	Yes	Yes	Yes
Year Dummies	Yes	Yes	Yes	Yes	Yes	Yes
Country Dummies	Yes	Yes	Yes	Yes	Yes	Yes
N	423	415	415	424	415	415
R-Squared	0.6026	0.6214	0.7201	0.5969	0.6135	0.7244

* p < 0.10; ** p < 0.05; *** p < 0.01. Absolute t-values in brackets.

Table 4

Robustness tests – OLS regression analysis for different subsamples. Dependent variable:
First differences in modified economic freedom index

	Eurozone Member				Electoral System			
	Yes	Yes	No	No	Plural	Plural	Prop.	Prop.
Government Ideology	-0.34** [2.13]	-0.42*** [2.78]	-0.33*** [2.99]	-0.34*** [2.93]	-0.43*** [2.80]	-0.32* [1.72]	-0.32*** [2.98]	-0.37*** [3.33]
Government Stability	0.10 [0.53]	0.17 [0.80]	0.22* [1.73]	0.46*** [3.01]	0.19 [1.34]	0.53*** [2.80]	0.05 [0.40]	0.22 [1.43]
Veto Player	0.21 [0.11]	-1.06 [0.41]	-5.71 [1.24]	-8.81* [1.90]	2.30 [0.13]	13.00 [0.40]	-2.26 [1.19]	-3.70* [1.66]
Government Change	-0.17 [0.52]	-0.29 [0.82]	-0.10 [0.28]	-0.02 [0.06]	-0.07 [0.14]	-0.09 [0.16]	-0.15 [0.53]	0.06 [0.22]
EU			2.31*** [3.34]	2.05*** [3.13]	4.45*** [3.58]	4.37*** [2.67]	1.43** [2.13]	1.30** [2.08]
Δ Globalization	0.02 [0.22]	-0.07 [0.69]	0.34*** [2.97]	-0.29*** [3.02]	0.18 [1.08]	-0.03 [0.19]	0.22** [2.29]	-0.23** [2.39]
Δ GDP per Capita	0.14 [1.00]	0.04 [0.27]	0.53** [2.19]	0.02 [0.10]	0.28 [0.61]	-0.60 [1.40]	0.35** [2.35]	0.08 [0.54]
Δ Unemployment	-0.29* [1.96]	-0.00 [0.03]	0.09 [0.80]	0.04 [0.35]	-0.21 [1.44]	0.22 [1.34]	-0.12 [1.39]	-0.00 [0.04]
Δ Debt	0.00 [0.07]	-0.03 [0.70]	-0.03 [0.91]	-0.04 [1.64]	-0.02 [0.28]	-0.13** [2.25]	0.01 [0.23]	-0.02 [1.04]
Level of Economic Freedom t-1	-0.56*** [6.81]	-0.60*** [7.03]	-0.45*** [7.73]	-0.48*** [7.75]	-0.29*** [3.44]	-0.44*** [4.30]	-0.46*** [8.19]	-0.49*** [8.12]
Lagged Expl. Variables	No	Yes	No	Yes	No	Yes	No	Yes
Year Dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country Dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	163	164	252	251	86	86	329	329
R-Squared	0.7856	0.7798	0.7360	0.7355	0.8715	0.8693	0.7125	0.7112

* p < 0.10; ** p < 0.05; *** p < 0.01. Absolute t-values in brackets.

Table 5

Robustness tests – using first differences of other economic freedom indices as dependent variable

	(1)	(2)	(3)	(4)	(5)	(6)
Government Ideology	-0.31*** [3.06]	-0.33*** [3.47]	-0.26** [2.244]	-0.32*** [2.89]	-0.16*** [2.83]	-0.10* [1.77]
Government Stability	0.20* [1.75]	0.33** [2.48]	0.26* [1.87]	0.32** [2.02]	-0.07 [0.93]	0.09 [1.08]
Veto Player	-2.89 [1.31]	-3.66 [1.53]	-4.24 [1.48]	-4.83* [1.74]	0.45 [0.36]	-1.68 [1.53]
Government Change	-0.16 [0.59]	-0.05 [0.18]	-0.22 [0.66]	0.02 [0.07]	-0.05 [0.34]	0.16 [0.90]
EU	1.63** [2.27]	1.43** [2.35]	1.02 [1.07]	1.00 [1.32]	1.49*** [2.76]	0.69 [1.36]
Δ Globalization	0.16* [1.89]	-0.22*** [2.62]	0.13 [1.39]	-0.22** [2.42]	0.20*** [2.91]	-0.08 [1.36]
Δ GDP per Capita	0.30** [2.03]	0.07 [0.44]	0.34* [1.94]	0.07 [0.40]	0.09 [1.22]	-0.02 [0.19]
Δ Unemployment	-0.01 [0.12]	0.07 [0.75]	-0.02 [0.24]	0.05 [0.50]	-0.03 [0.62]	0.01 [0.10]
Δ Debt	-0.01 [0.53]	-0.04** [1.98]	-0.02 [0.71]	-0.05** [2.03]	-0.05** [2.05]	-0.03* [1.87]
Level of Economic Freedom t-1	-0.40*** [8.75]	-0.43*** [9.17]	-0.38*** [8.00]	-0.41*** [8.32]	-0.35*** [8.14]	-0.33*** [6.89]
Lagged Expl. Variables	No	Yes	No	Yes	No	Yes
Year Dummies	Yes	Yes	Yes	Yes	Yes	Yes
Country Dummies	Yes	Yes	Yes	Yes	Yes	Yes
N	415	415	405	405	422	422

R-Squared	0.6311	0.6383	0.5357	0.5440	0.5652	0.5143
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The weighting of the specifications is the following:

Models 1-2: Size of Government (1/2), Labor Regulation (1/4), Business Regulation (1/4)

Models 3-4: Government Consumption (1/6), Transfers and Subsidies (1/6), Privatization and Government

Investment (1/6), Tax Rates (1/6), Labor Regulation (1/6), Business Regulation (1/6)

Models 5-6: Original EFW Index: Size of Government (1/5), Legal System and Property Rights (1/5), Sound Money (1/5), Freedom to Trade Internationally (1/5), Credit Market Regulation (1/15), Labor Market Regulation (1/15), Business Regulation (1/15); * p < 0.10; ** p < 0.05; *** p < 0.01. Absolute t-values in brackets.

APPENDIX

Appendix Table

GLS Regression analyses. Dependent variable: Level of modified economic freedom index

	(1)	(2)	(3)	(4)
Government Ideology	-0.27* [1.81]	-0.31** [2.24]	-0.25** [1.97]	-0.29** [2.48]
Government Stability		0.16 [1.31]		0.45*** [3.01]
Veto Player		-0.05 [0.01]		0.14 [0.05]
Government Change		-0.06 [0.22]		0.15 [0.56]
EU		0.48 [0.45]		1.74* [1.77]
Globalization		0.40*** [4.32]		0.14 [1.52]
GDP per Capita		0.08 [0.57]		-0.26** [1.99]
Unemployment		-0.09 [1.09]		0.01 [0.09]
Debt		-0.06*** [3.84]		-0.07*** [4.02]
Lagged Explanatory Variables	No	No	Yes	Yes
Year Dummies	Yes	Yes	Yes	Yes
Country Dummies	Yes	Yes	Yes	Yes
N	459	451	460	451
R-Squared	0.9094	0.9192	0.9092	0.9128

A Prais-Winsten transformation (AR1) accounts for serial correlation; * $p < 0.10$; ** $p < 0.05$; *** $p < 0.01$.
Absolute t-values in brackets.