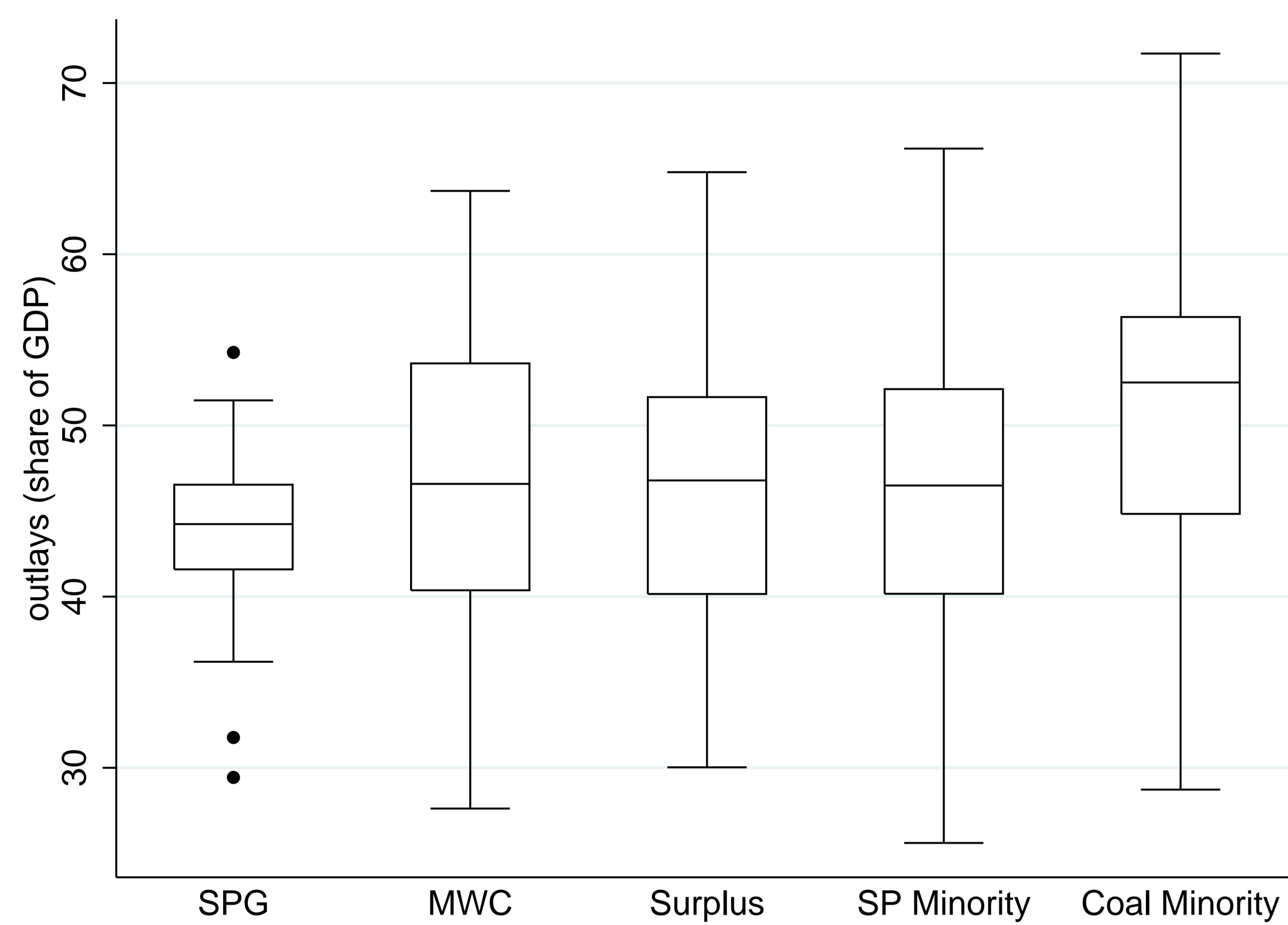# The Effect of Government Parties' Outside Options on Budget Composition

Maiko Isabelle Heller ◇ University of Michigan ◇ miheller@umich.edu

1. The Puzzle

Arguments in the tradition of the Common Pool Resource Problem lead us to expect spending to increase in the number of parties in government. However, government spending does not differ significantly across different government types.

The results for level of spending and spending on Social Security Transfers by government ideology are similar.
With little empirical evidence of differences in government spending this paper asks:

How do governments allocate spending across budget items?
Why are some government parties better able to implement their policy preferences than others?

2. Multiparty Policy-Making

Multiparty policy-making is not isolated from government survival and formation processes. Since governments can fall at any point during the legislative term, coalition governments make policies in the shadow of a new round of government negotiations and other potential governments that could form.

Consensus in government formation research:
▶ Governments minimize potential of future conflict, while maximizing member parties' exit costs.
▶ I argue that **exit costs are not distributed equally across government parties**. Instead, government parties' exit costs decrease in the credibility of their exit threats.
▶ The credibility of government parties' exit threats, in turn, depends on the availability of high-quality outside options.

3. Outside Options

Outside Options: Other potential governments that a government party can enter. The quality of Outside Options depends on their:
Viability: Formation likelihood of each potential government
Attractiveness: Palatability of the government's expected policy output to each potential member

Measuring quality of Outside Options: Generate all $2^n - 1$ possible governments of any sitting parliament with n parliamentary parties.
▶ *Formation Likelihood:* Predicted values obtained from a conditional logit model.
▶ *Attractiveness:* Distance between each government party's policy position and the government's expected policy output.

4. Outside-Options Bargaining-Power – OOBP

▶ The better the quality of a government party's outside options, the greater is its Outside-Options Bargaining-Power (OOBP).
▶ I argue that the credibility of a government party's exit threat increases in its OOBP.

Effect on multiparty policy-making:
▶ Parties with great OOBP are able to extract policy concessions from their government partners, particularly if these partners lack high-quality outside options.
▶ I expect government policies to reflect one party's policy preferences more closely, the more OOBP is concentrated in this party.

5. Hypotheses

Given budget constraints, increases in one spending area lead to cuts in others. Applying the above reasoning to the allocation of government spending across budget items, I expect the allocation of government spending across budget items to reflect the strongest dgovernment party's spending preferences more, the more OOBP is concentrated in this party.

Hypothesis 1: Government spending on Defense and Economic Services increases in the difference in OOBP if the strongest government party is a right-wing party.
Hypothesis 2: Government spending on Public Services, Health, Social Security, and Housing increases in the difference in OOBP if the strongest government party is a left-wing party.

6. Data and Methods

Model Specification:

▶ *Dependent Variables:* IMF Government Finance Statistics Data on government spending on nine spending areas: Public Services, Defense, Health, Education, Social Security, Housing, Recreation and Culture, Economic Services, Other (1970-1997).
▶ *Main Independent Effect:* Difference in OOBP between the strongest and the average of the remaining government parties; left-right indicator for ideological position of the strongest party; interaction
▶ *Controls:* GDP growth (all equations), unemployment rate (social security, housing), share of population aged 65 and older (health, social security)
▶ *Method:* Seemingly Unrelated Regressions; Defense spending used as baseline

7. Results

The main results of my SUR are shown in the table below:

Table: The Effect of OOBP Concentration on Budget Composition

	Strongest Government Party	
	Right	Left
Publ. Services	-0.011	0.003
Education	-0.003	0.004
Health	-0.013*	0.002
Social Security	-0.005	0.000
Housing	-0.031**	0.012
Recreation	0.011	-0.005
Econ. Services	-0.006	-0.001
Other	0.002	0.000
N	170	170

Defense Spending used as baseline

These preliminary results lend some support to my expectation that the composition of government spending reflects more powerful parties' spending preferences more closely.

▶ Governments dominated by right-wing parties spend less on Public Services, Education, Health, Social Security, and Housing than on Defense.

▶ Governments dominated by left-wing parties spend more on Public Services, Education, Health, Social Security, and Housing than on Defense.