GLOBAL CAPITAL MARKETS, HOUSING PRICES, AND PARTISAN FISCAL POLICIES

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ARGUMENT

- Global capital flows affect the fiscal policy preferences of voters and political parties by way of their impact on <u>housing prices</u>
- Where capital inflows are large and housing prices are rising, we expect voters to respond by demanding both:

    (a) lower taxes

    (b) less publicly-provided social insurance

- Intuitions: (a) housing is a taxable asset, (b) rising house prices allow homeowners to “self insure” against income losses due to unemployment, illness, old age

LITERATURE

- Prior work examines the extent to which capital flows constrains the ability of partisan governments to pursue distinctive fiscal priorities

    Garrett and Lange 1991, Rodrik 1997

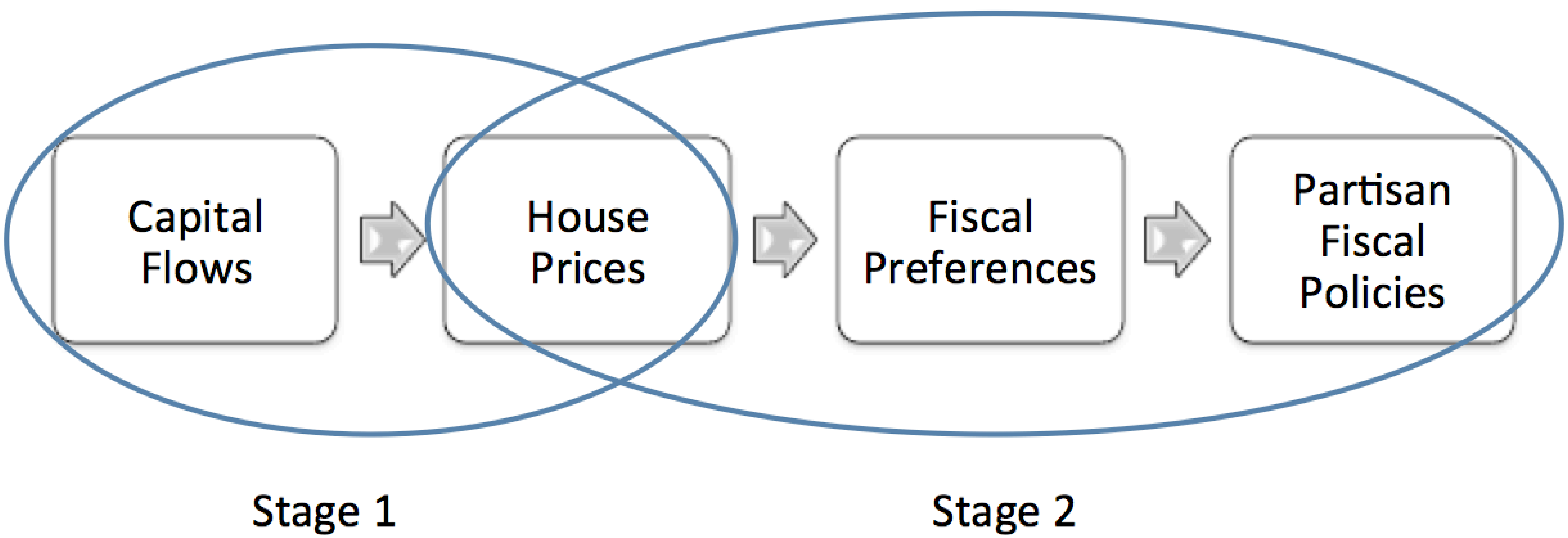
- Another strand (“Varieties of Capitalism”) emphasizes labor market skills and the role that social policy plays in insuring workers’ investment in specific skills

    Hall and Soskice 2001, Iversen and Soskice 2001

- We introduce a novel mechanism whereby global capital flows affect fiscal preferences and fiscal policy via house prices

TWO-STAGE ARGUMENT

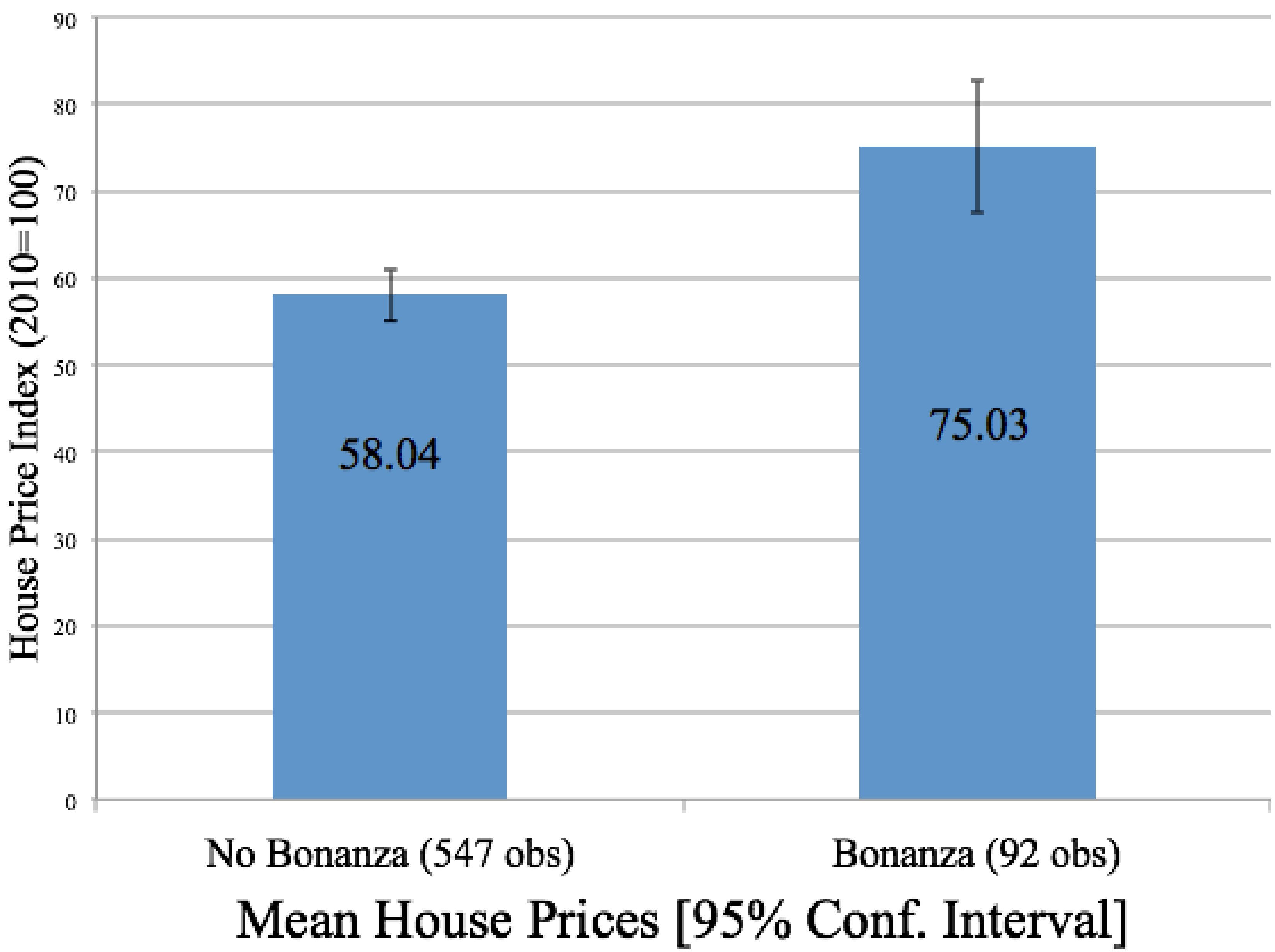
- First, we show that house prices are closely connected to international capital flows
- Second, we evaluate the impact of globally-induced house price changes on fiscal preferences and fiscal policy



HOUSE PRICES AND CAPITAL FLOWS

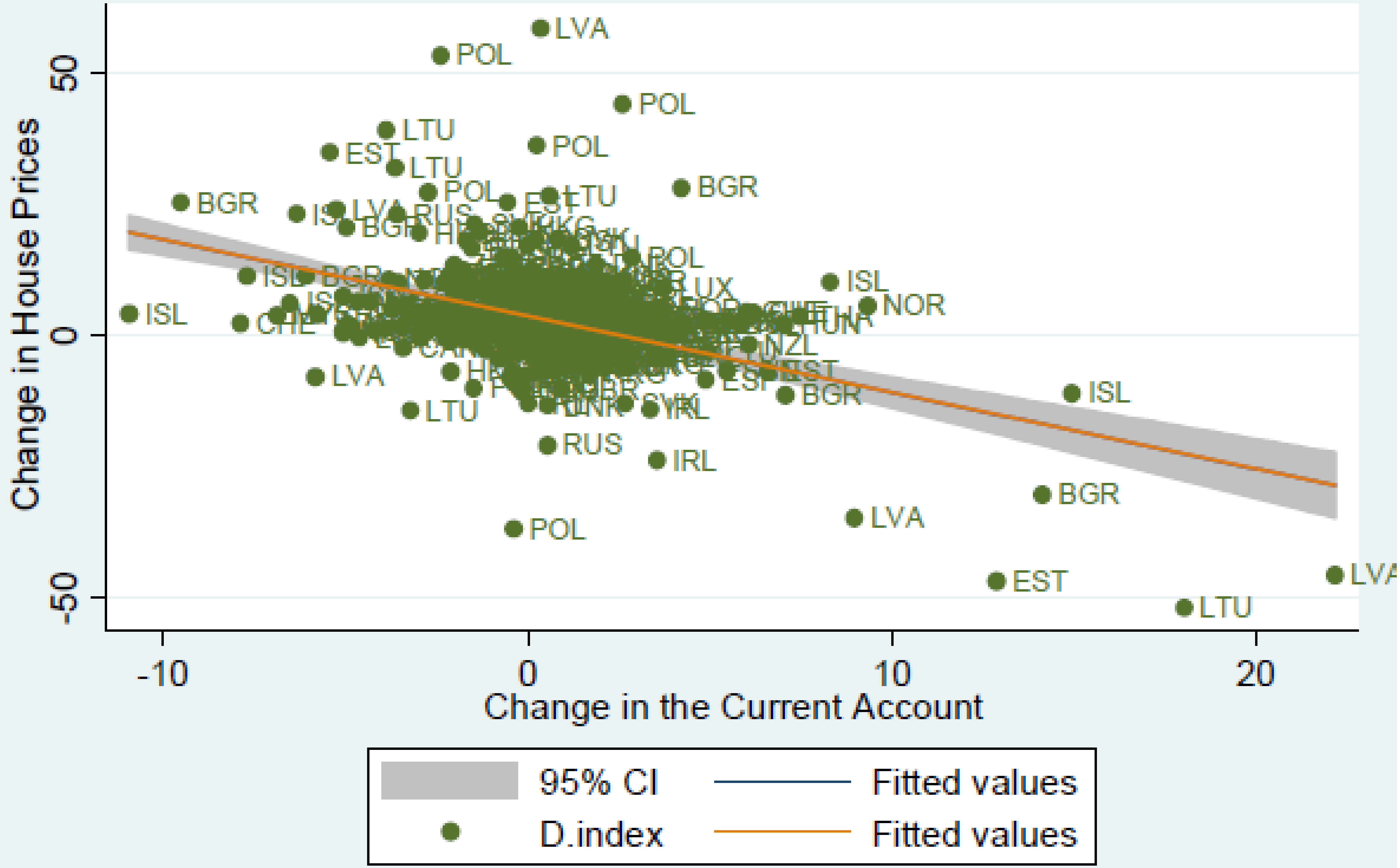
- There are distinct patterns to home prices that reflect the forces of global capital markets
  - Home (and other asset) prices tend to appreciate where foreign capital is flowing in, driving down real interest rates and fueling the expansion of domestic credit
  - Home prices typically fall where capital outflows increase real interest rates and contract domestic mortgage lending

HOUSE PRICES AND "CAPITAL INFLOW BONANZAS"



46 countries, 1960-2011

Figure 5: House Price Changes and the Current Account, 2000-2011



coef = -1.46, (robust) se = 0.25, t = -5.88, R-squared = 0.20

POLICY PREFERENCES

- We examine citizens from 29 countries in the 2009 ISSP, which asks a question directly tapping citizens' home equity
- We analyze preferences over tax rates and redistributive policies
- Citizens with higher home equity are systematically less supportive of taxes and spending
- Homeowners also less supportive of taxation in countries with housing booms

REGRESSION RESULTS

Table 1: House Prices and Preferences over Tax Policy

	(1) All	(2) Low Income	(3) High Income	(4) All	(5) Low Income	(6) High Income
House Equity	-0.046**	-0.054***	-0.031	-0.054***	-0.041*	-0.056**
	(0.019)	(0.020)	(0.023)	(0.018)	(0.022)	(0.022)

Table 2: House Prices and Preferences over Redistribution

	(1) All	(2) Low Income	(3) High Income	(4) All	(5) Low Income	(6) High Income
House Equity	-0.065***	-0.065**	-0.053*	-0.028	-0.043***	-0.013
	(0.025)	(0.026)	(0.030)	(0.019)	(0.016)	(0.026)

MULTILEVEL MODEL

	(1) Tax Opinion	(2) Tax Country	(3) Redistribution	(4) Aid to Poor
House Price Change (5 Year)	0.097	0.182	1.302***	0.251
	(0.562)	(0.414)	(0.487)	(0.236)
Homeowner	-0.009	-0.049	-0.113	-0.018
	(0.112)	(0.072)	(0.103)	(0.068)
Homeowner X House Price Change	-0.428**	-0.447**	-0.123	-0.198
	(0.173)	(0.200)	(0.157)	(0.183)

Some evidence that homeowners in high price appreciation countries became less supportive of taxation.

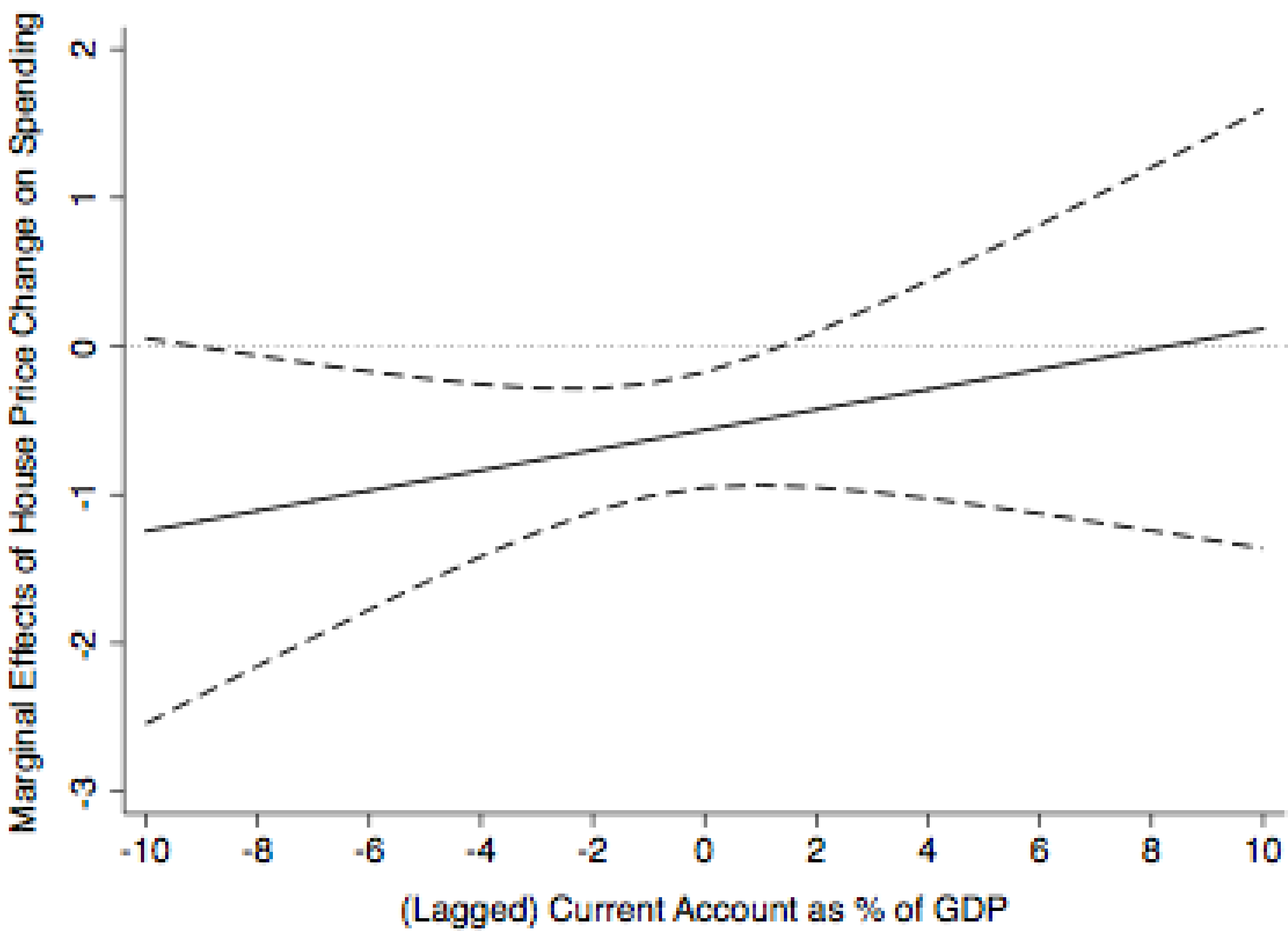
POLICY OUTCOMES

- Rising house prices seem to produce reduced demand for taxes and spending. *How do politicians respond?*
- We expect housing booms, especially during capital inflow bonanzas, to produce reduced spending
- Partisan effect: this should be amplified for right-wing parties who represent homeowners

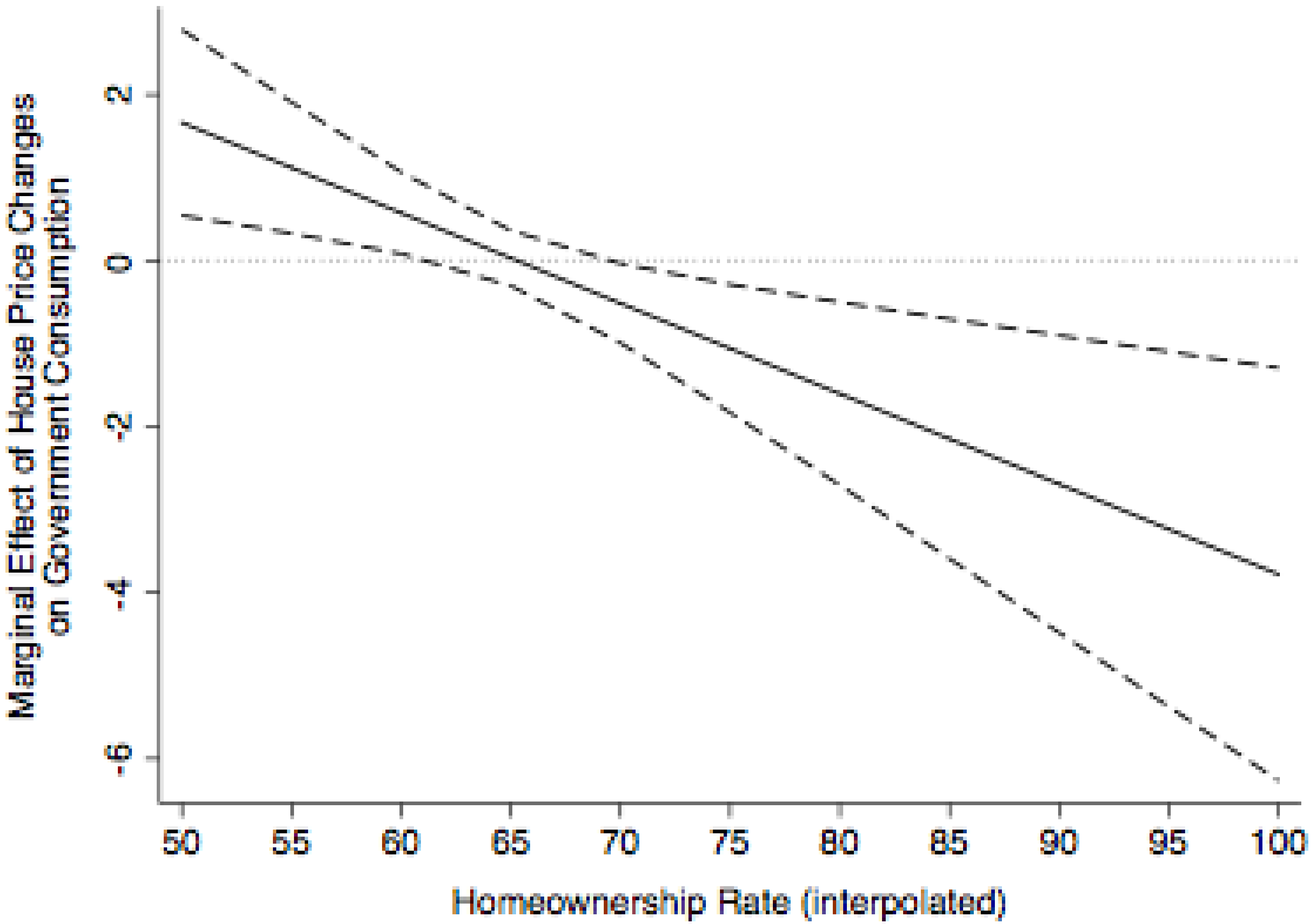
ANALYSIS

- TSCS data for 43 countries over 1960-2011.
- Evidence of strong negative impact of rising house prices on government consumption
- Effect appears stronger for countries experiencing capital inflows or with higher homeownership
- Partisan effect: right-wing parties with rising house prices leads to cuts, left-wing parties leads to increases

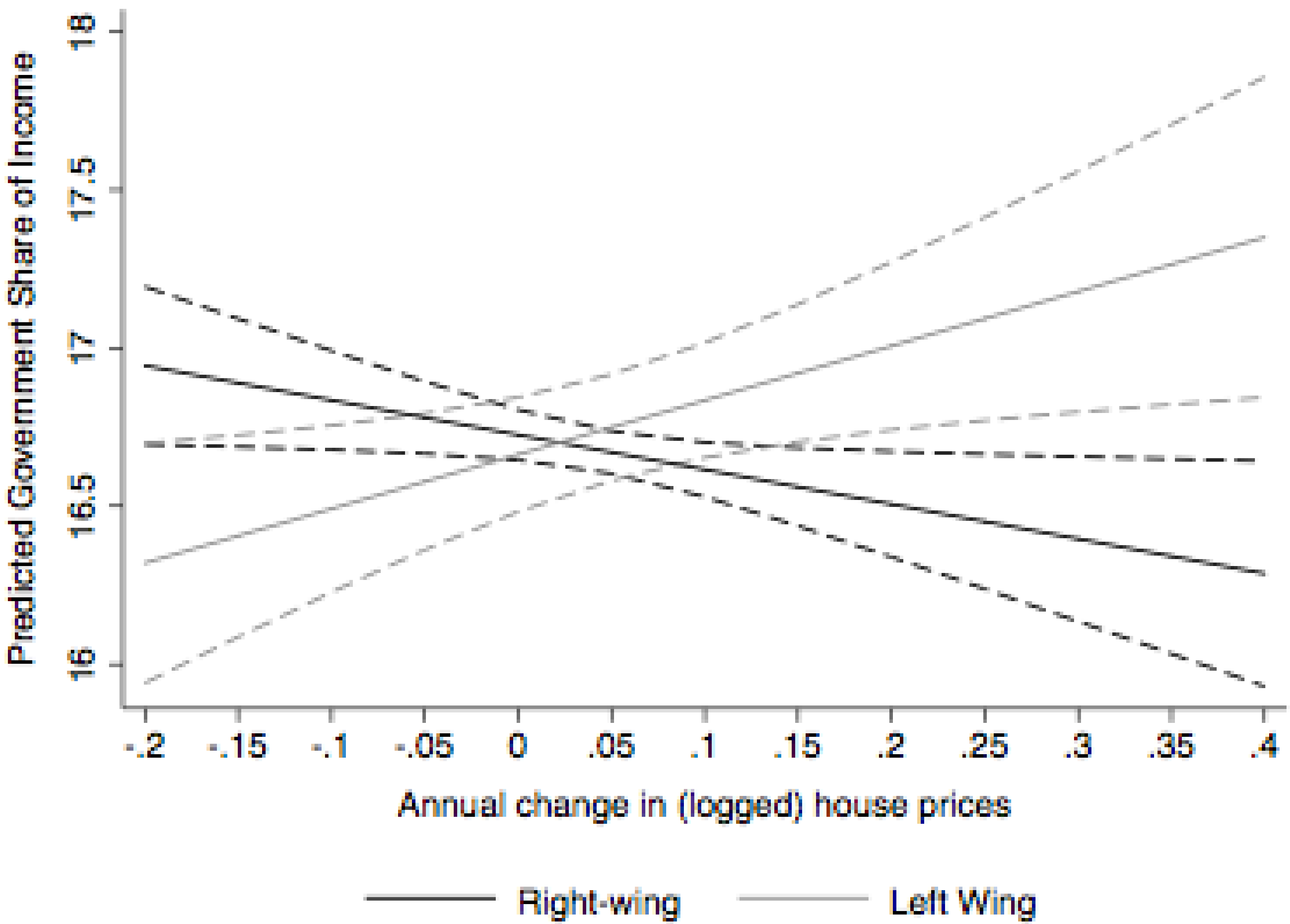
CURRENT ACCOUNT



HOMEOWNERSHIP



PARTISANSHIP



STEPS FORWARD

- How to think about impact of globalization on the welfare state in an era of asset markets?
- Case studies of European periphery – Ireland, Estonia, Spain – which experienced dramatic upward and downward shocks to capital inflows and housing prices
- Further develop multilevel analysis of preference formation