Economic and Political Instability and Dissatisfaction with Government

David Brady, Hoover Institution and Stanford University
Aldo Paparo, Hoover Institution and Stanford University

In 2012 in Project Syndicate, Michael Spence and David Brady argued that government paralysis in the West was at least partially the result of the fact that: "Government, business, financial, and academic elites are not trusted. Lack of trust in elites is probably healthy at some level, but numerous polls indicate that it is in rapid decline, which surely increases citizens' reluctance to delegate authority to navigate an uncertain global economic environment." Loss of trust probably has multiple causes, including analytical failure: central banks, regulators, market participants, rating agencies, and economists almost all failed to detect rising systemic risk in the years preceding the current crisis, much less to take appropriate corrective action. Clearly, this range of causes features economic variables, which makes sense, given that in low employment/high growth economies we would not expect to see dissatisfaction with government at high levels.

In order to determine the causes of distrust in government, we went to the Eurobarometer and found questions on trust in government and satisfaction with democracy going back to 1997. We were able to collect economic data: growth in GDP, levels of unemployment[1], and policy instability as measured by Baker et al. (2016), for six countries over the years 1997 to 2016 as a preliminary test of the argument[2]. The countries are the U.K., Spain, Netherlands, Italy, Germany and France We began by running O.L.S. regressions to determine which variables would directly affect peoples'

[1] Data on GDP growth and unemployment rates were extracted from the OECD statistical bank – harmonized unemployment rate (HUR) and Growth rate compared to Previous quarter, Seasonally Adjusted (GPSA).

[2] The Baker et al. measure of policy instability has been criticized because it essentially measures financial instability. However, for our purposes this is fine because if policy instability is financial it simply means that it is not under the control of any national government.

level of trust and satisfaction with democracy. Our suspicion was that the variable closest to peoples' well being, such as unemployment, would have the greatest effect.

We have constructed two separate datasets for our two main dependent variables – satisfaction with democracy and trust in government. We have constructed the database for only those points where trust in government and satisfaction with democracy are present, either separately or in common. Over the approximately twenty years period from 1997 to 2015, satisfaction was measured 27 times for an average of 1.5 per year with only 2008 missing. Trust in government was measured 34 times between 1997 and 2015 (almost twice a year), however there was no measurement in 1998 and 2000. Our strategy was not to include points in which the dependent variable was missing. The right hand side variables – GDP growth, unemployment, etc. – are measured as the average of the two quarters preceding the trust or satisfaction questions[3]. Thus the satisfaction has 27 observations over six countries while the trust variable has 34 observations over the six countries.

Table 1 shows, across all six countries, unemployment is the only variable that significantly affects satisfaction with democracy. Across all six countries a one percent increase in unemployment causes an almost three percent increase in dissatisfaction with democracy. Table 1 also shows the results of the same regressions separately performed on two groups of countries, characterized by different economic performances in recent years. As we can see, the three better economies (Germany, the UK, and the Netherlands) the effect of unemployment is less – 2.26 – but still extremely significant. In the worst economies (Italy, France, and Spain) the effect is higher – 2.89. We run all these regressions with a multi-level specification, allowing intercepts to randomly vary by country in order to model individual country variation. In short, different countries with different cultures and history can react differently to similar causes. These variables were significant, indicating that indeed countries have different levels of satisfaction given the same economic conditions.

[3] To be precise, we averaged across six monthly data points on variables measured on a monthly basis (policy instability and unemployment), and two quarterly points for GDP growth.

Table 1 – Satisfaction with Democracy by Economic Variables

	All six countries	Better economies	Worst economies
Satisfaction			
Policy uncertainty	-0.000827	0.00142	-0.00667
	(0.920)	(0.898)	(0.573)
Unemployment rate	-2.789***	-2.260***	-2.899***
	(0.000)	(0.000)	(0.000)
GDP growth	-0.893	-1.666	-1.145
	(0.458)	(0.357)	(0.471)
Consant	84.13***	82.14***	84.80***
	(0.000)	(0.000)	(0.000)
lns1_1_1			
Constant	2.413***	1.224**	2.752***
	(0.000)	(0.008)	(0.000)
lnsig_e			
Consant	1.635***	1.590***	1.652***
	(0.000)	(0.000)	(0.000)
N	*148*	*73*	*75*
R^2	*0.891*	*0.585*	*0.885*

Table 2 shows that in regard to trust in government, unemployment is again significantly related to trust in government across all the six countries. Policy instability has the right sign and is also slightly significant ($p<0.1$). A rise in unemployment of one percent causes trust in government to decrease by 2.5 percentage points, meaning that a ten percent level of unemployment decreases trust in government by 25 points. In the better economies the effect of unemployment is lower – 2.3 – than it is in the worst economies – 2.5 – but is extremely significant in both cases. As was the case for satisfaction, the analysis shows that different countries vary in their reaction to economic conditions.

Table 2 – Trust in government by Economic Variables

	All six countries	Better economies	Worst economies
Trust			
Policy uncertainty	-0.0170	-0.0225	-0.0128
	(0.099)	(0.126)	(0.374)
Unemployment rate	-2.478***	-2.327***	-2.503***
	(0.000)	(0.000)	(0.000)
GDP growth	-0.180	-0.722	0.335
	(0.846)	(0.549)	(0.816)
Consant	59.32***	58.23***	59.95***
	(0.000)	(0.000)	(0.000)
lns1_1_1			
Constant	2.196***	1.892***	2.373***
	(0.000)	(0.000)	(0.000)
lnsig_e			
Consant	1.985***	1.969***	1.998***
	(0.000)	(0.000)	(0.000)
N	*194*	*94*	*100*
R^2	*0.690*	*0.578*	*0.685*

The results of the preliminary analysis encourage us to go forward with the analysis. Our strategy is to run a structured equation analysis. The policy uncertainty variable of Baker et al. has recently been show to essentially measure financial instability; thus, for our purposes we view uncertainty as affecting GDP growth and unemployment. The idea is that because it measures financial instability it is outside the control of any one government to manage policy instability and is therefore more likely to be affecting economic variables and trust in government. We have run the analysis both ways, of course but prefer policy uncertainty as a left hand side variable.

We also include a measure of electoral instability. This is the total volatility index, which equals half of the sum across the absolute values in the changes in party vote shares across two consecutive general elections (Emanuele 2015). Obviously, national general elections are less frequent than the Eurobarometer surveys, so most observation have a missing value on the electoral instability measure[4]. The score of the volatility index encountered in a given country-election pertains to most immediate data point available for each of the alternative dependent variables – satisfaction with democracy and trust in government.

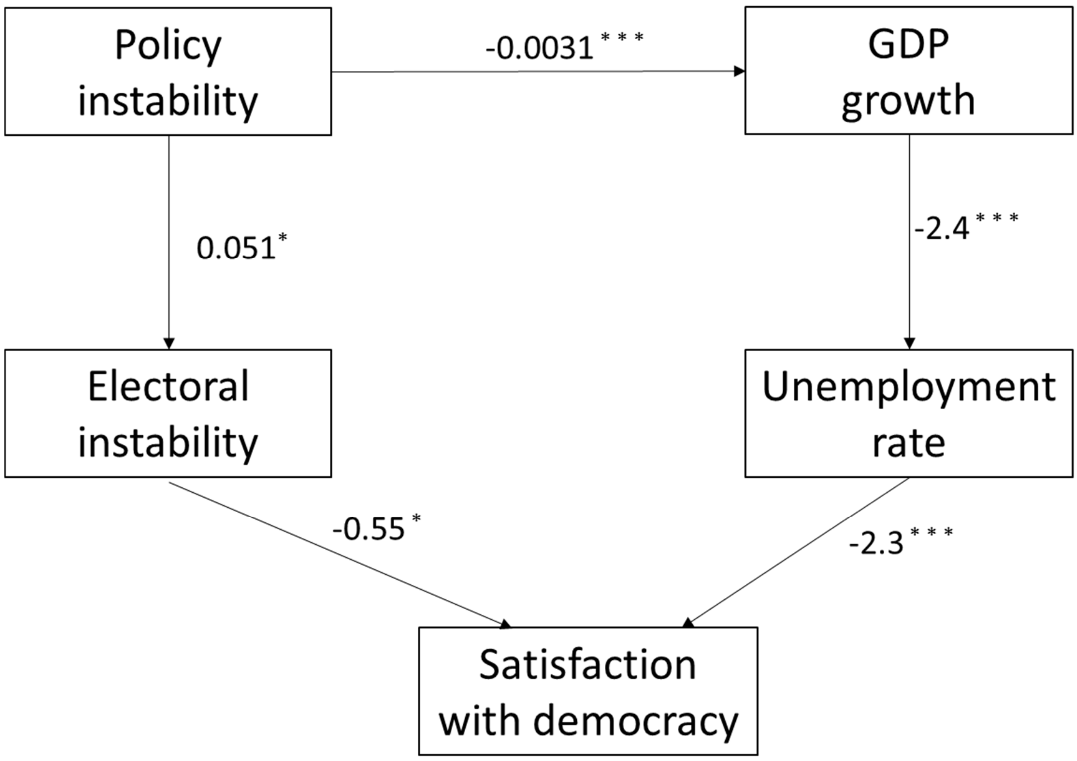
Roughly, the argument is that policy uncertainty and GDP growth while not significant in the OLS regressions have some effect on both unemployment and political stability, which we believe affects satisfaction and trust. Table 3 shows the results for satisfaction with democracy and trust in government for all six countries while Figure 1 shows the picture for the satisfaction model. Coordinating Figure 1 and Table 3, we can see first that policy instability has a significant effect on electoral instability and also that policy instability affects GDP growth. In turn GDP growth is significantly related to unemployment levels and then that unemployment has a direct significant effect on satisfaction with democracy, which confirms the results of the OLS analysis. Electoral instability is also related to satisfaction, but has a less significant effect. It is also the case that the exogenous unmeasured variables affect the results.

[4] This is also the reason why we use a maximum likelihood with missing values estimating technique, in order to exploit all of our data and be able to estimate all the effects of interest.

Table 3 – Structural equation models for satisfaction and trust in all six countries

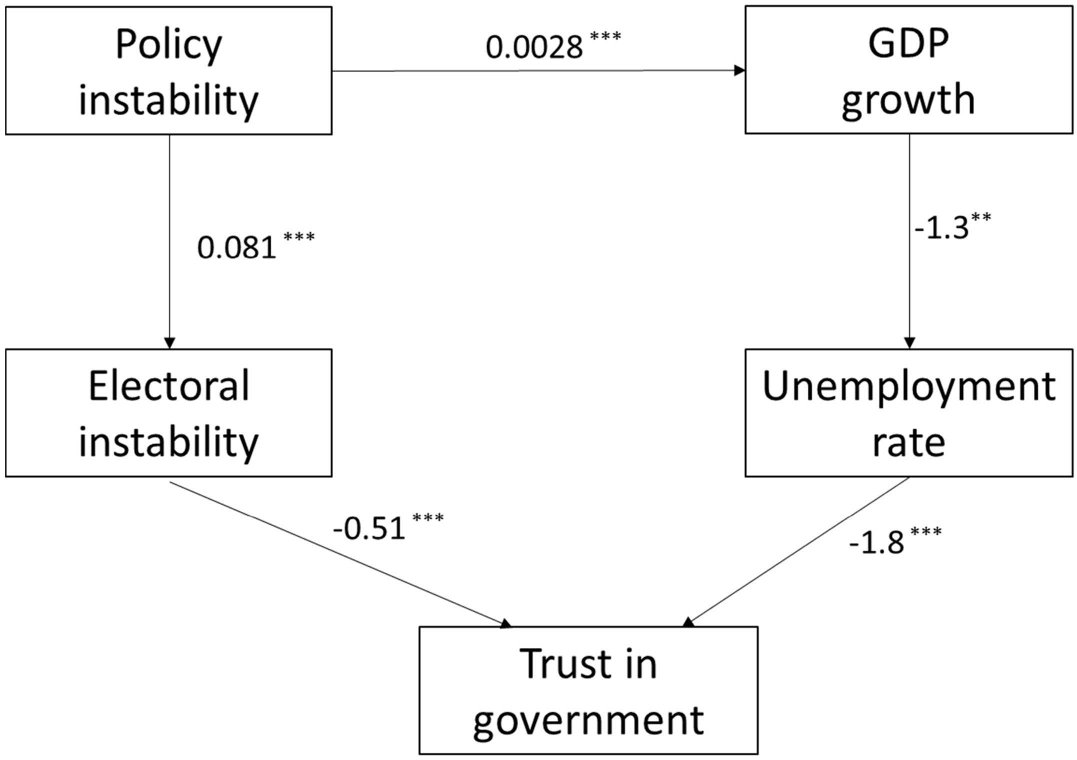
	Satisfaction		Trust	
Electoral_Instability				
Policy_Instability_t	0.0514*	(0.013)	0.0810***	(0.000)
Constant	9.474***	(0.001)	6.235*	(0.020)
GDP_t				
Policy_Instability_t	-0.00314***	(0.000)	-0.00279***	(0.000)
Constant	0.772***	(0.000)	0.600***	(0.000)
Unemployment				
GDP_t	-2.398***	(0.000)	-1.269**	(0.005)
Constant	9.772***	(0.000)	8.746***	(0.000)
Satisfaction / Trust				
Electoral_Instability	-0.546*	(0.017)	-0.515***	(0.000)
Unemployment	-2.349***	(0.000)	-1.810***	(0.000)
Constant	91.30***	(0.000)	61.57***	(0.000)
mean(Policy_Instability_t)				
Constant	117.1***	(0.000)	118.2***	(0.000)
var(e.Electoral_Instability)				
Constant	58.09***	(0.000)	55.39***	(0.000)
var(e.GDP_t)				
_cons	0.203***	(0.000)	0.376***	(0.000)
var(e.Unemployment)				
_cons	20.15***	(0.000)	18.96***	(0.000)
var(e.Satisfaction)				
_cons	169.8***	(0.000)	125.1***	(0.000)
var(Policy_Instability_t)				
_cons	3607.9***	(0.000)	3220.4***	(0.000)
N	*189*		*238*	

Figure 1 – Satisfaction with democracy model



The trust in government model (Table 3 and Figure 2) shows that the overall pattern of significant effects shown for satisfaction is replicated. Policy instability is significantly related to electoral instability and GDP growth. In turn, GDP growth has a significant effect on unemployment level. Trust in government is directly affected by both electoral instability and unemployment, at roughly the same levels shown for satisfaction with democracy. These results confirm the original findings that trust in government is to a large extent the result of the state of the economy and that high levels of unemployment and political instability bring down trust in government. As was the case with satisfaction, there are significant effects of exogenous unmeasured variables on the measured variables of interest.

Figure 2 – Trust in government model



The preliminary results we have presented here indicate that trust in and satisfaction with institutions varies over time with the state of the economy. Globalization affects how many and what type of jobs are available in a given country. The overall loss of industrial jobs to automation and then to exportation has in large part contributed to the current levels of dissatisfaction found in OECD countries. Dissatisfaction is not limited to governmental institutions, but also includes businesses, banking, the press, the legal system, and democracy itself. Our intention is to add other institutions to our analysis to better assess the effect of economic variables on trust and satisfaction with functioning of contemporary democratic systems. Any look at survey results shows great unhappiness with the very institutions, which will ultimately have to solve the problems created by the transformations of the world economy.

References

Baker, Scott R., Nicholas Bloom, and Steven J. Davis. (2016), *Measuring Economic Policy Uncertainty*. http://www.policyuncertainty.com/media/EPU_BBD_Mar2016.pdf

Emanuele, V. (2015), *Dataset of Electoral Volatility and its internal components in Western Europe (1945-2015)*, Rome: Italian Center for Electoral Studies, http://dx.doi.org/10.7802/1112

Spence, Michael, and David Brady (2012), *Why Are Governments Paralyzed?*, Project Syndicate. https://www.project-syndicate.org/commentary/why-are-governments-paralyzed-by-michael-spence-and-david-brady?barrier=true