

THE ART AND CRAFT OF BUDGETING: FISCAL POLICY IN THE EUROZONE

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ABSTRACT

In the past twenty-five years we have seen a growing body of literature on the determinants of fiscal policy as measured by analyzing cross-national data on budgetary deficits and public debts. The discussion is largely shaped by Jürgen von Hagen's work on the impact of both political and economic institutions. In this paper we will take a slightly different angle, looking at cultural variables. Taking Aaron Wildavsky's cultural theory of budgeting as point of departure, we assume that the budgetary strategy of the countries in the eurozone is related to their political culture or regime. Using empirical data provided by the European Union, we conclude that empirical support for the cultural theory of budgeting is concentrated at the extremes of the political spectrum. However, empirical support is much stronger if we differentiate to the economic situation. The outcome underscores, once again, that it is hard to maintain an anti-cyclical policy during an upswing of the economy.

1. INTRODUCTION

In the early 1990s the heads of state and government of the European member states gathered in the southern part of the Netherlands. The Maastricht Treaty not only established the European Union (EU), but also set the criteria for the qualification and participation in Economic and Monetary Union (EMU). In this paper I will focus on the budgetary criteria and procedures for the reduction of the budget deficit. The reason is twofold. The budget deficit has played a leading role

¹ The author would like to thank the editor of this special issue, two anonymous reviewers and the participants of the conference 'The Political and Economic Consequences of European Monetary Integration' for their comments on an earlier draft.

in the decision about qualification for and participation in EMU and has continued to play a role afterwards, whereas inflation and interest rates have lost relevance with the arrival of the common monetary policy (Italianer 1993: 17).

The reference value for the budget deficit was originally set at three per cent of Gross Domestic Product (GDP) at market prices, as deducted from the target for the public debt (Bini-Smaghi 1994: 30 fn.; Lubbers 1996)², though the relation has not played a decisive role in the choice of the reference values (Szász 1999: 159-160). It was later reinforced when the heads of state and government of the European member states committed themselves to reduce the budget deficit even further and to a medium term budgetary position of ‘... close to balance or in surplus’.³

The research question addressed in this paper is what constraints on the fiscal policy of European member states are induced by the new institutions of EMU? In particular, the paper examines the procedure for the reduction of excessive budget deficits. Taking Aaron Wildavsky’s *Cultural Theory of Budgeting* as point of departure, the paper explores the budgetary strategies of European Member States. It concentrates on the ‘policy mix’ that governments of the ‘old’ European member states have put together to meet the reference value of the budget deficit. The empirical data are mainly taken from the group of countries that were already part of the EU prior to the most recent enlargement towards Central and Eastern Europe, the so-called ‘EU-15’, that took place in 2004. In particular, it focuses on those countries that have already adopted the euro, often referred to as the ‘EU-12’ or the eurozone.

The article is structured as follows. In section 2 a non-comprehensive survey is given of the literature on fiscal policy, notably the impact of budgetary institutions on the size of the budget and the budget deficit. The essentials of Wildavsky’s cultural theory of budgeting are presented in section 3, arguing that the budgetary strategy (dependent variable) is directed by the political culture or regime (independent variable). In section 4 a description is given of the institutional framework, which articulates the point that having a common monetary policy requires fiscal coordination. Wildavsky’s cultural theory of budgeting presented in section 3 is put to a test in section 5. The test consists of combining statistical data, provided by Geert Hofstede for the political culture and by the European Commission with Eurostat for the budget deficit, notably the

² The public debt remains constant at a nominal growth of GDP of five per cent and a budgetary deficit of three per cent.

³ Note that the heads of state and government committed themselves to a balanced budget before the decision about the qualification for and participation in EMU was made.

structural balance. Although we find some evidence, support for Wildavky's cultural theory of budgeting is rather weak.

2. FISCAL POLICY

In the past twenty-five years we have seen a growing body of literature on political and economic variables of fiscal or budgetary policy as measured by analyzing cross-national data on budgetary deficits and public debts.⁴ Using Barro's 'tax smoothing' model as a benchmark, Alesina and Perotti (1995a) distinguish six political economic models for the analysis of budget deficits, at the heart of which are concepts such as 'fiscal illusion' and 'spending bias'. Wildavky's cultural theory of budgeting, used in this paper as a conceptual lens, is most related to the models that emphasize the effects of institutions (Zijderfeld 1998).

The literature on institutions may be further refined by making a distinction between two complementing subsets: 'electoral institutionalism' and 'fiscal institutionalism' (Hallerberg 2004: 9; Hallerberg and Von Hagen 1999: 210-211). The former looks at the impact of the electoral system, arguing that pluralist systems in which the winner takes all is doing better in terms of fiscal consolidation than systems with proportional representation which are typically characterized by coalition cabinets. The latter looks at the impact of budgetary institutions on the size of the budget. Borrowing from Alesina and Perotti (1995a: 21), budgetary institutions are defined here as all rules and regulations that influence the preparation, authorization and implementation of the budget.

The discussion about the impact of budgetary institutions on the outcome of fiscal policy is largely shaped by Jürgen von Hagen's work for the European Commission (Von Hagen 1992; Von Hagen and Harden 1994), testing two hypotheses.

1. The *structural* hypothesis: fiscal discipline is promoted by a strong prerogative of the prime minister or finance minister vis-à-vis the spending ministers, the limitation of amendments by parliament and a strict execution of the budget;

⁴ Not surprisingly, the publication of Barro's article coincided with the consequences of the oil crises. In recent years we have seen a shift from the countries who are a member of the Organisation for Economic Cooperation and Development (OECD) to the European Member States. This shift, due to the establishment of EMU and the Stability and Growth Pact, has created a fertile breeding ground for cross-national comparisons.

2. The *long-term constraint* hypothesis: the more budgetary decisions are tied to a multi-annual fiscal program, the greater the degree of fiscal stability.

Von Hagen (1992: 5) found support for the first, but not for the second. The relation between long-term fiscal constraints and fiscal discipline, while in most cases positive, was not significant (Von Hagen 1992: 54). For that reason, a coalition would not be able to carry out successful fiscal adjustments (Alesina and Perotti 1995b: 208). In addition they note that coalitions do not cause budget deficits per se, but coalitions delay fiscal adjustments (Alesina and Perotti 1999: 33).

In subsequent work Hallerberg and Von Hagen (1999: 216) concluded that delegation to a strong treasurer is more appropriate for a political party with a single party in office, whereas commitments to fiscal targets fit coalitions better. A reassessment by De Haan et al. confirms that budgetary institutions affect the outcome of fiscal policy, but the effect is quite small (De Haan, Moessen and Volkerink 1999: 284). However, we should be careful with the interpretation of these findings as they are based on the construction of indices and do not take into account the relative weight of the building blocks (Poterba and Von Hagen 1999: 4).

In this paper we will take a slightly different angle. First, we assume that the budgetary strategy of the EU-15, notably the EU-12, is influenced by their respective political culture. In so doing, we expect that the effectiveness of budgetary institutions in reducing the

deficit bias depends on the general political setting of a country (Poterba and Von Hagen 1999: 12). Following Wildavsky, for each country a political culture is made up by a combination of two variables, i.e. the number of prescriptions ('grid') and the degree of individualism as opposed to collectivism ('group strength').⁵ Second, we focus on the budgetary deficit (or to be more precise the structural balance, excluding interest payments) rather than the accumulation of the debt. The reason for making this choice is that our main purpose is to test Wildavsky's cultural theory of budgeting instead of providing an explanation of the budgetary strategy or fiscal policy of individual European member states. In their analysis of the budget deficit in the OECD-countries Roubini and Sachs (1989b) conclude that the size of the budget deficit is related to political as well as economic characteristics of countries:

⁵ A culture is, as such, a broader concept than an institution as it is referring to rules and regulations as well as beliefs, norms, traditions and values.

‘Budget reduction requires political consensus, at least among the members of government. We noted that such a consensus was harder to achieve in multi-party coalition governments’ (Roubini and Sachs 1989b: 126).

Third, we look at the size as well as at the composition of the budget deficit, which is often neglected in the literature on fiscal policy (Alesina and Perotti 1995b: 208; Alesina and Perotti 1999: 21). In their work on the budgetary deficit in OECD-countries they find that there are almost no changes in the rate of taxation in years of economic expansion and, if any, that mainly transfers and wages in the public sector increase during an upswing of the economy. In addition, they find that there are virtually no changes in spending in years of economic contraction and that public investment suffers most during a downturn of the economy. A successful adjustment of a budgetary deficit, ‘does not raise taxes, but, rather, cuts transfer programmes and government wages and employment’ (Alesina and Perotti 1995: 240-241).

The data taken from the Annual Macro-Economic Database (AMECO) provided by the Directorate-General on Economic and Financial Affairs (DG ECFIN, formerly known as DG II) were updated on December 1, 2005. Contrary to the budgetary criteria used in EMU, the Stability and Growth Pact (SGP) and the Excessive Deficit Procedure (EDP) we focus on the adjusted primary deficit or the *structural* balance instead of net borrowing (+) or net lending (-) as percentage of GDP at market prices for the same reasons as Buti et al. did in their analysis of the budgetary policies during recessions. The adjustment for the cycle does not cover all the changes in the environment such as fluctuations in inflation and interest rates. Taking interest payments out provides a rough indication of how a government is pursuing a budgetary strategy towards fiscal consolidation (Buti, Franco and Ongena 1997: 7).

The analysis covers two periods of six years each. The first period, focused on the budgetary convergence, starts in 1993 assuming that the Member States anticipated the ratification of the Treaty of the European Union (TEU) later that year and ends with the decision about the qualification for EMU in 1998. The second period is marked by the SGP that had been established a year before at the Amsterdam Summit (1997) and geared to fiscal stability. It ends with the decision of the Council of Ministers of Economic and Financial Affairs (ECOFIN) in November 2003 to suspend the EDP in the case of France and Germany, notably not to move to the next steps of the EDP (which would have brought the pecuniary sanctions closer). Additionally, some information is provided for the third period that starts in 2003.

3. A CULTURAL THEORY OF BUDGETING

The appeal of Valdimer Key for a budgetary theory denotes the interest in public budgeting in the contemporary period. He clearly referred to a *normative* theory, raising the question: ‘on what basis shall it be decided to allocate X dollars to activity A instead of activity B?’ (Key, quoted in Hyde and Shafritz 1978: 20). Efforts to develop such a theory failed until Aaron Wildavsky took the baton. The first edition of his seminal *The Politics of the Budgetary Process* changed the budgetary landscape. He argued that the allocation of scarce resources is not a matter of arithmetic or calculation, but a matter of power. Budgeting is politics.

In the mid 1980s Aaron Wildavsky, influenced by Mary Douglas’ work, turned to culture as the main explanation for the way in which a government will respond to a situation of fiscal stress (Caiden 1995: 49), arguing that political culture or regime can be assessed and classified into two categories:

1. Grid, referring to the number of prescriptions or rules that constrain discretionary behaviour of individuals and/or organizations.
2. Group strength, referring to the customary distinction between individualism and collectivism.

The combination of these two categories leads to four logical positions or in Aaron Wildavsky’s words ‘primary colors’.

Group Strength	Weak	Strong
Prescriptions		
Many	F	H
Few	M	E

Source: Wildavsky (1986).

Figure 1. A Classification of Political Cultures or Regimes.

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The main hypothesis of Wildavsky’s cultural theory of budgeting is that the government of each political culture or regime (as independent variable) will

pursue its own budgetary strategy (as dependent variable), being shaped by the degree of control over revenues and expenditures:

1. A hierarchy (H), also referred to as collectivism, can manage revenues, but not expenditures because of the many echelons between the top to the bottom where the spending takes place;
2. A sect that is driven by egalitarianism (E) can control expenditures, but cannot manage revenues because it lacks the internal authority to make large demands on the members;
3. A fatalistic system (F), being subordinate, can manage neither expenditures nor revenues and, therefore, suffers from apathy. Consequently, the government will 'do nothing';
4. A market (M), characterized by individualism can manage both revenues and expenditures (at low levels). The state is kept poor by making only resources available for collective goods leading to reduction of both revenues and expenditures.

In reality, there are all kinds of alliances or hybrids.⁶ The combination of a hierarchy and the market is so common that Aaron Wildavsky calls this political regime the *establishment* (E).⁷ Political cultures disagree on the ideal size of government, while a hierarchy prefers a large and the market a small government. The compromise will be a medium level of taxing and spending. A mix of a hierarchy and an egalitarian regime is called a *social democracy* which is supposed to pursue a strategy that consists of an increase of both revenues and expenditures. He argues that all Western democracies are pluralists (P) being a combination of a hierarchy, the markets and a sect (see triangle in figure 1).⁸ Consequently, the budgetary strategy will vary depending on the respective strength of each culture. The stronger the hierarchical element, the more both revenue and expenditure go up. The stronger the market forces, the lower the taxing and spending and the stronger the sectarian regime, the higher the spending and the lower the taxation. Strangely, the combination of raising taxes and spending cuts is not mentioned by Wildavsky, though it seems to be the most adequate strategy to reduce a budget deficit.

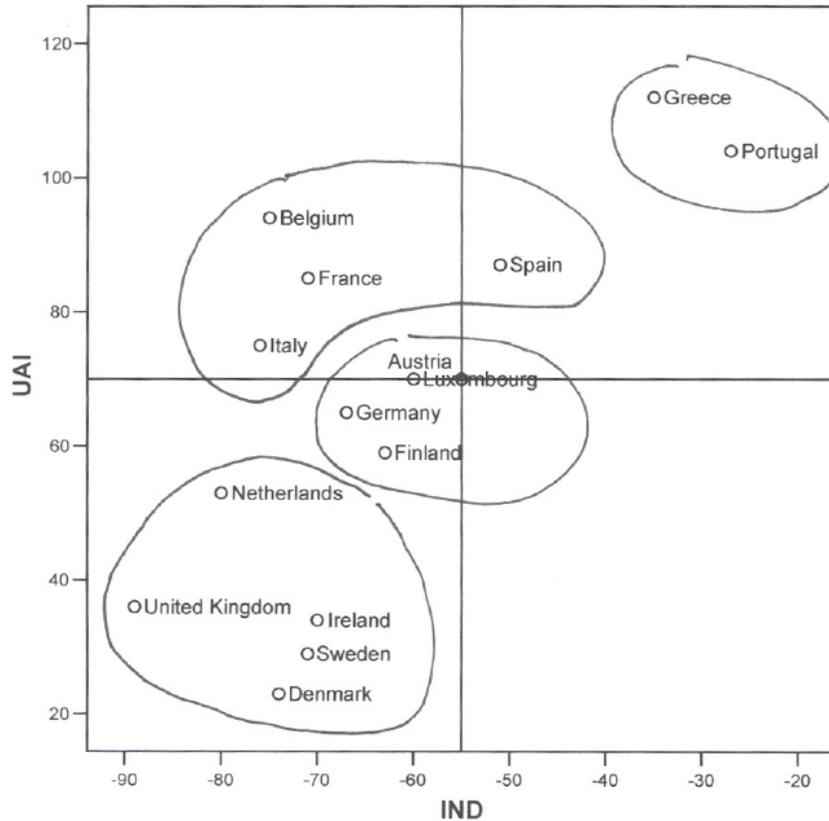
⁶ Apathetic regimes (fatalism) are often excluded at the institutional level (Mamadouh 1997: 21) and, therefore, left out as well as the combination of apathetic regime with one of the other regimes (authoritarianism and totalitarianism).

⁷ He does not provide a label for the other diagonal, i.e. a combination between an egalitarian and fatalistic regime, probably because such a hybrid is not viable.

⁸ A pluralistic regime should not be confused with the so-called 'hermit' i.e. a person who is deliberately withdrawing from social involvement (Mamadouh 1997: 19).

A couple of comments should be made. First, it is hard to classify the political culture or regime of the EU-15 since the dimensions are not operational in spite of Aaron Wildavsky's assertion to the contrary (Wildavsky 1986: 336-337). A useful alternative is provided by the dataset that Geert Hofstede has put together to 'measure' the impact of culture in forty countries, using four and later five indicators (Annex I and II). The uncertainty avoidance index (UAI) focuses on the level of tolerance for ambiguity and uncertainty within a society. A high score indicates a rule-oriented society that institutes laws, rules, regulations, and controls in order to reduce the amount of uncertainty and is matching, as such, the number of prescriptions to maintain the status quo. The inverse of the indicator Individualism (IDV) may be used as a proxy for group strength as a low score typifies societies of a more collectivist nature with close ties between individuals.

A scatter diagram, using the dataset provided by Geert Hofstede's on his website, shows that the EU-15 might be positioned along the diagonal between a hierarchy (upper right corner) and a market (lower left corner), reflecting the establishment.



Comment [bfg2]: You may consider to add circles' around the clusters.

Figure 2. A Classification of the Political Culture of the EU-15.

The correlation between the two dimensions is significant at the 0.01 level, i.e. the number of prescriptions (UAI) goes along with group strength (IND). In addition, one may argue that a political culture is not bi-dimensional, but multi-dimensional. A dendrogram (see Annex III) shows that the EU-15 should be clustered into roughly three groups, one being divided in two subsets, roughly matching Loughlin and Peters' classification of state traditions described as 'sets of institutions and cultural practices that constitute a set of expectations about behaviour' (Loughlin and Peters 1997: 45-48).⁹

⁹ A classification on the basis of a distinction between, on the one hand, a unitary state vs. a federation and, on the other hand, the level of centralization/decentralization is provided by

- Cluster I: Greece and Portugal
- Cluster IIa: Belgium, France, Italy and Spain
- Cluster IIb: Austria, Finland, Germany and Luxembourg
- Cluster III: Denmark, Ireland, The Netherlands, Sweden and the UK

On the basis of Wildavsky's cultural theory of budgeting we assume that all European member states have put together a 'policy mix' of measures of both revenues and expenditures in order to meet the reference value for the budget deficit (net borrowing/lending) which is set at three per cent of GDP at market prices. They have basically three choices to reduce a budget deficit and to balance the budget.¹⁰

1. The introduction of new taxes and/or an increase of existing rates to enable a high level of spending;
2. A reduction of expenditures, for instance by the postponement of investments and/or spending cuts;
3. The promotion of economic growth as the budget deficit will disappear when the economy expands.

In this paper we focus on the first two options as is illustrated in figure 3. In line with Roubini and Sachs' analysis of government spending and budget deficits in the OECD-countries we do not attempt to explain government investment (Roubini and Sachs 1989: 111). The outcome will be a combination of revenues and expenditures as all European member states can be considered pluralistic regimes.

Arend Lijphart in his work on democracies (Lijphart 1984; 1999; Van Aabel and Van Nispen 2002).

¹⁰ In addition, the member states that do not participate in the third stage of EMU – Denmark, Sweden and the UK – may pursue their own monetary policy, manipulating the internal as well as the external value of their currency. In practice they follow the common monetary policy of the EU-12.

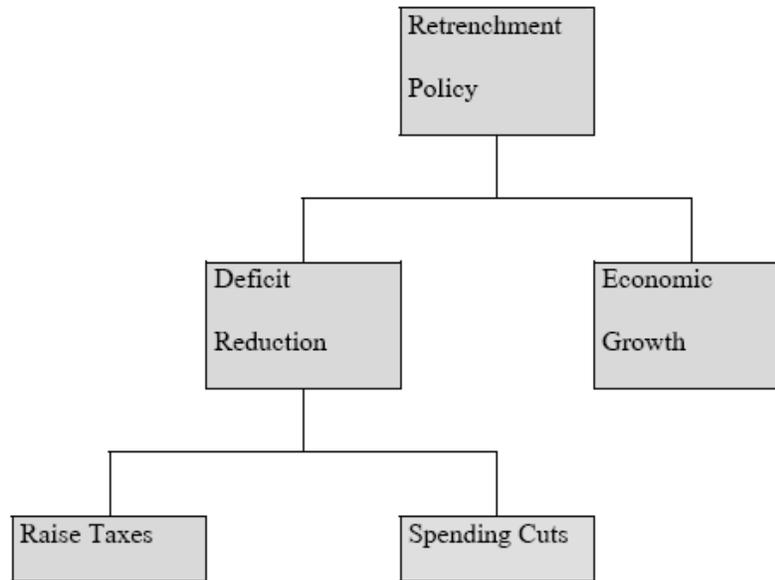


Figure 3. Analytical Framework.

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Taking the diagonal from lower left corner to the upper right corner of the scatter diagram as a regression line, we assume that the countries in cluster I (hierarchy) focused on an increase of revenues, though mitigated by an increase of expenditures. Besides, we expect that the countries in cluster II (establishment) raised taxes and cut back on spending with group A having a preference for an increase of revenues and group B for a decrease of expenditures. Finally, we suppose that the countries in cluster III (market) had a preference for a decrease of expenditures inducing a decrease in revenues.

4. THE INSTITUTIONAL FRAMEWORK

The treaty of Maastricht creating the European Union established a number of new institutions, foremost the criteria for the qualification for and participation in Economic and Monetary Union (EMU) later followed the Stability and Growth Pact (SGP) that, among other things, speed up and clarified the Excessive Deficit Procedure (EDP) already contained in the Maastricht treaty. Consequently, the European member states are not completely free to pursue their own budgetary

strategy as they are subject to benchmarking, coordination and monitoring or surveillance under the before-mentioned agreements.

The budgetary policy of the European member states is more or less directed by the reference value of the budget deficit that was agreed upon at the Maastricht summit (1991).¹¹ The rules prohibit a budget deficit exceeding 3 per cent of GDP at market prices (except under exceptional and temporary circumstances). The reference value for the budget deficit was set at 3 per cent of GDP at market prices. The Amsterdam summit (1997) reinforced and strengthened this commitment when the heads of state dedicated themselves to a budgetary position close to balance or in surplus.¹²

The governments of the European member states are still in charge of the composition of the 'policy mix' to keep the budget deficit as well as the public debt below their reference value. However, they have to submit a convergence or stability report every year that, *inter alia*, assesses the state of the economy and the measures that they have been taken to keep the budget deficit and public debt below the reference value.¹³ An early warning, (to use a soccer analogy) the so-called 'yellow card' – is issued when the budget deficit comes close to the reference value. In case of a break of the reference value the EDP might come into operation – the so-called 'red card' – but that requires a decision by the ECOFIN that a European member state is in derogation.¹⁴

Finally, the budgetary policy is subject to coordination through the Broad Economic Policy Guidelines (BEPGs) that may be seen as a form of open coordination 'avant la lettre'. A major difference with the EDP is that these are only political 'commitments' that cannot be legally enforced. The link between budgetary and economic coordination is recently reinforced by the decision to integrate the Broad Economic Policy Guidelines and the Employment Guidelines as the centrepiece of the relaunch of the Lisbon Strategy.

¹¹ The budgetary policy is further directed by the reference value for the public debt that is set at 60 per cent of GDP at market prices.

¹² The reference values are put in a protocol and are, therefore, easier to change than the treaty.

¹³ The main difference is in the monetary policy. The European member states that do not participate in (final stage of) EMU pursue their own monetary policy and, therefore, should provide information about inflation and interest rates in addition to the state of the budget. The participants in EMU have to provide information only about the state of the budget since the (common) monetary policy is left in the hand of the European Central Bank (ECB) that is located in Frankfurt, Germany.

¹⁴ A qualified majority is needed of all votes including the European member state in derogation. It allows ECOFIN to make recommendations. In the end, the procedure may lead to financial sanctions against those who fail to comply. The decision is made by a two-third majority of the votes whereby the European member state in derogation is left out.

The authority of the European Union to coordinate the budgetary policy has been challenged by the French minister of Finance, Francis Mer, claiming that the responsibility for the fiscal policy belongs to the exclusive domain of individual European member states:

‘Nous sommes encore dans une Europe où la politique budgétaire et la politique tout court d’un Etat restent sous son contrôle.’ (Mer 2002).

He refused, supported by his German colleague, to reduce his budget deficit below the reference value. Motivated by electoral reasons, he issued a package of measures to accomplish tax relief instead of deficit reduction, arguing that the SGP is not alone about stability but also about growth. The argument he made was that the budgetary deficit would disappear as the economy recovers. Unfortunately, the outcome of this strategy will be only visible in the long run.

The decision of the ECOFIN has been brought before the European Court of Justice by the former commissioner for Economic and Financial Affairs, Pedro Solbes Mira, backed unofficially by the Dutch government. The court has ruled that the decision of the ECOFIN is illegal and, therefore, it has to reconsider its position, implicitly underscoring that there is no distinction between big and small states. The outcome of this case has changed the intended meaning of the original agreements. The reference value of the budget deficit is saved, but the damage is unmistakably done. A more flexible interpretation of the EDP is the outcome or the price that has been paid for this rescue operation. The ministers of finance could take into account the local economic situation, notably economic cycle and the size of the public debt. In addition, coherence is required between the budgetary and economic policy objectives as part of the Lisbon Strategy. As compensation, the European member state should pursue a more restrictive budgetary or fiscal policy in time of economic growth. The alternative is to adjust net lending or net borrowing for the cycle and to look at the *structural* balance, taking the so-called ‘output gap’ into account.¹⁵

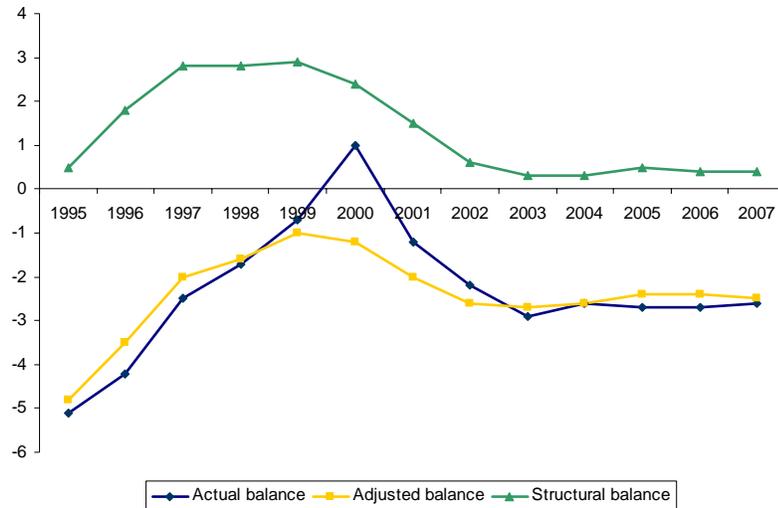
5. FISCAL COORDINATION

¹⁵ The output gap is the difference between the actual and potential growth of the economy. We would like to note that there is no agreement among experts about the calculation of the output-gap, because it is not clear what constitutes the potential growth of the economy. The structural balance should be treated therefore with prudence.

In the spring of 1998 ECOFIN met in Brussels to decide on the starting date of EMU that had been reinforced and strengthened just before at the Amsterdam summit. All but one, notably Greece, passed the test, though it later became clear that the then government had manipulated the statistics. Only three out of fifteen EMU member states stayed out of the third stage of EMU and, therefore, the single currency.¹⁶ However, it should be noted that many did not meet the reference value for the public debt. With a public debt of more than 100 per cent of GDP, some countries like Belgium, Greece and Italy were far from close to meeting the reference value for public debt. The price for economic stability, i.e. the risk of political instability, turned out to be too high.

The development of the *actual* balance shows the budgetary position is first underestimated (1995-1998), later overestimated (1998-2003) and seems to stabilize from 2003 onwards, though close to the reference value (Annex IV). The average deficit of the EU-15 was even turned into a surplus for a short period at the beginning of the millennium, but that is partly due to the countries that for various reasons do not participate in EMU (Denmark, Sweden and the United Kingdom). The findings suggest that fiscal coordination through the SGP and the EDP has been successful, also taking into consideration the time lag needed for implementation. In addition, the impact of the cycle seems to have diminished indicating that the budget situation is more or less under control. Besides, the structural deficit is moving in the same direction though in surplus.

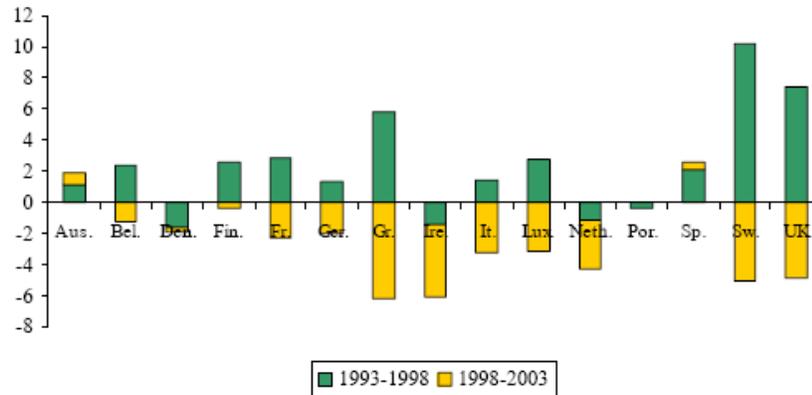
¹⁶ Greece became part of EMU on 1 January 2001.



Source: European Commission (2006). The data for FY 1993 and FY 1994 are not available.

Figure 4. Budgetary Performance EU-15 (FY 1995-2007).

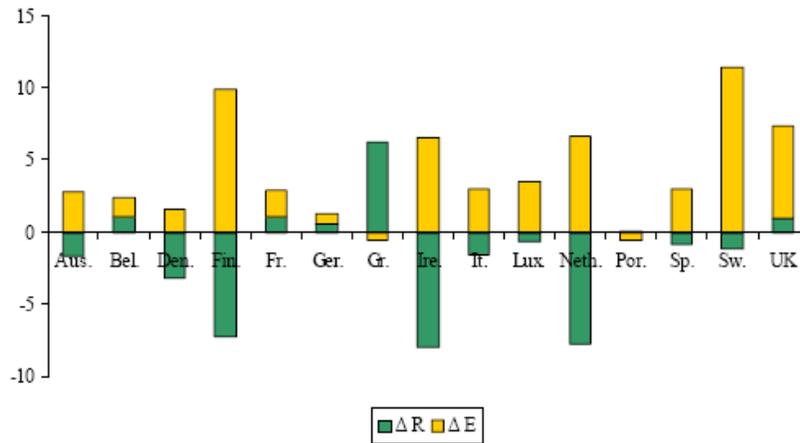
At first value the structural balance of the EU-15 worsened over time (0.2 per cent), but a closer look reveals that the structural balance improved in the first period and worsened in the second period, when most countries featured an upswing in their economy (Annex V). A breakdown per country for both periods shows a wide variety, diverging from 5.2 per cent in the case of Sweden to -6.1 per cent for Ireland over the entire period (Annex VI).



Source: European Commission (2006).

Figure 5. The Development of the Structural Balance of the EU-15 (FY 1993-2003).

The fiscal coordination in the first period was focused on budgetary convergence, reducing the *actual* balance below the reference value. The *structural* balance improved in 9 of the EU-12 (11 of the EU-15) with Sweden as the front-runner (10.2 per cent) and the UK as the runner-up (7.4 per cent), followed by Greece (5.8 per cent).



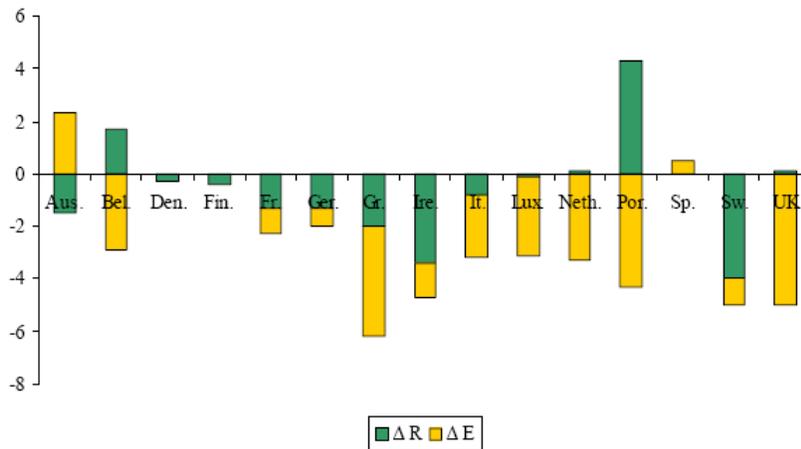
Note: A positive sign indicates a decrease, a negative sign an increase of the deficit.

Source: European Commission (2006).

Figure 6. The Composition of the Structural Balance, FY 1993-1998.

The adjustment of the structural balance in the first period is mainly due to a decrease of expenditures. By increasing revenues and expenditures, Greece and Portugal were the exception. Note that spending cuts in four countries – the big countries plus Belgium – were supported by an increase of revenues and in nine countries they were mitigated by a decrease of revenues.

The gains in the first period were completely ‘reversed’ in the second period which can be characterized by a combination of tax relief and extra spending, thus creating a budget deficit rather than a budget surplus. In sum, the structural balance worsened in nine countries of the EU-12 with Greece in the worst position (6.2 per cent). In one country – Portugal – the increase of revenues compensated for the increase of expenditures and in two countries – Austria and Spain – we see a modest improvement of the structural balance. The dominant path taken by most governments was an increase of expenditures, fuelled by a decrease of revenues. However, expenditures were kept at the same level in two countries – Denmark and Finland – whereas the empirical data for two other countries – Austria and Spain – reveal a decrease of expenditures.



Note: A positive sign indicates a decrease; a negative sign indicates an increase of the deficit.

Source: European Commission (2006).

Figure 7. The Composition of the Structural Balance, FY 1998-2003.

Looking at the budgetary strategy reveals that Wildavky's cultural theory of budgeting better accounts for the situation in the first period than in the second period (Annex VII). A closer inspection of the first period shows that Wildavky's

cultural theory of budgeting is doing relatively well for cluster I as both Greece and Portugal increased both revenues and expenditures with the increase of revenues exceeded by the increase of expenditures. The empirical data for cluster II do not support the assumption of Wildavky's cultural theory of budgeting as all but Belgium issued tax relief in combination with spending cuts, whereas Germany kept its expenditures at the same level. The evidence points to a path that is leading via extra spending for investments (in order to stimulate economic growth and employment) to a reduction of the budget deficit (increasing the nominator of the deficit/GDP-ratio). The findings for cluster III are more or less in line with the assumption of Wildavky's cultural theory of budgeting with the clear exception being the UK who increased rather than decreased revenues.

In the second period we only found evidence for Portugal who increased both revenues and expenditures, counterbalancing each other with the outcome being null. The number of hits is increasing substantially if we adopt an additional hypothesis and take the economic situation into account. The second period features an economic upswing, taking the pressure off the reduction of the budget deficit. The dominant strategy is exactly the opposite of the hypothesis deduced from Wildavsky's cultural theory of budgeting, i.e. a mix of tax relief and additional spending, once again underscoring that it is harder to pursue an anti-cyclical policy during an upswing than a downturn of the economy.¹⁷

6. CONCLUSION

In this paper we have applied Aaron Wildavky's cultural theory of budgeting to the EU-15. We have found some evidence supporting the theory, but mainly at the extremes of the political spectrum. A breakdown per cycle provides some additional evidence for the cluster in the middle of the political spectrum (cluster II), but the evidence is rather weak. We have found a match for only three of the eight countries in that group (Belgium, France and Germany) pursuing a budgetary strategy composed of an increase of revenues and a decrease of expenditures. The remaining five countries in that group pursued a budgetary strategy that is associated with the market, making the combination of tax relief and spending cuts the dominant budgetary strategy in the first period. A mix of tax relief and extra spending characterizes the main budgetary strategy in the second period and was geared more towards fiscal consolidation. Consequently,

¹⁷ The SGP has been revised exactly because of that reason. The countries in the eurozone must enhance budgetary discipline now in good times to create a buffer for bad times.

both actual and structural deficit balances declined in all but three countries (Austria, Portugal and Spain). Besides, we have found no match at all between the budgetary strategy and the empirical data at all, with the exception of Portugal, which increased both revenues and expenditures as predicted.

A number of explanations come to mind for the lack of support for Wildavsky's cultural theory of budgeting. First, the main hypothesis of Wildavsky's cultural theory is that the budgetary strategy is directed by the political culture may, of course, be wrong. Indeed, that may be possible, but it is still too early to draw that conclusion. On the positive side, the hypothesis served as a heuristic device, revealing that a decrease of revenues and expenditures dominates in a period of budgetary convergence and a decrease of revenues and an increase of expenditures prevail in times of fiscal consolidation.

In addition, the hypothesis may be blurred by, for instance, interfering variables. The first thing that comes to mind is a change in the political ideology of the political party in office, as left-wing governments are supposed to have a preference for spending (De Haan and Sturm 1994: 168), but Hahm et al. did not find much support for that hypothesis (Hahm, Kamlet and Mowery 1996: 68).¹⁸ The budgetary strategy may have suffered from elections as is illustrated by the French case. The former government had issued a package of measures leading to tax relief, whereas a tax increase would have been appropriate to reduce the deficit that hit the ceiling of the reference value for the third time in a row.

Besides, the economic situation may have forced the government in office to pursue another budgetary strategy than predicted by Wildavsky's cultural theory of budgeting. We have to take into account that European member states were not on equal footing at the time they agreed on the criteria for the participation in EMU (i.e. at the Maastricht Summit in December 1991). Countries, like Ireland, Luxembourg and the Netherlands were already in a good shape regarding their budgetary deficits (in terms of their performance relative to the reference value), but other countries like Greece, Italy and Sweden had to reduce considerably as they were running large budgetary deficits of more than 10 per cent of GDP. In a relatively short period they reversed the trend. Only two had difficulties: Greece overshot the reference value, whereas Portugal hit the ceiling. However, they had to pay a price in the form of a rising debt and, therefore, higher interest payments.

A second explanation for the mismatch between the political culture and the budgetary strategy may have to do with the indicators used for the independent and dependent variables. To start with the independent variable, one may argue

¹⁸. The same is true for Roubini and Sachs hypothesis about the relationship between the strength of the political party in office and (the size of) the budget deficit (Hahm et al. 1996: 68; De Haan and Sturm 1997: 749).

that to characterization of political culture is too simple. In the theory it is characterized by only two variables - the number of prescriptions and the degree of individualism vs. collectivism – even though that worked in anthropology for small groups. However, the outcome of the clustering is in line with other classifications that use more than two variables to measure political culture.

A similar argument can be made regarding the dependent variable: it is perhaps too simple to argue that the budgetary strategy is shaped only by changes in revenues and expenditures. A closer look at the spending side, notably the change in expenditures for investments and employment, is needed to find out if governments focus on the denominator rather than the numerator of the deficit/GDP ratio. After all, the deficit should disappear when the economy recovers. In addition, public debt and interest payments could be reduced as European member states with a high debt/GDP-ratio give priority to a reducing their debt.

Third, the empirical data may prove to be wrong. After all, the statistical data regarding the independent variable were collected for another purpose, i.e. to show international differences in work-related values, notably in the private sector (Hofstede 1984). One may argue that Wildavsky's cultural theory does not account for the dynamics of political regimes¹⁹ and, therefore, does not reflect the current state of affairs in European member states. Since, most European member states have gone through a process of deregulation and privatization both affecting Hofstede's indicator. However, he claims that 'culture' is stable over decades²⁰. Unfortunately, the empirical data needed to test Wildavsky's cultural theory of budgeting in a more dynamic way are not available.

The data regarding the dependent variable is collected and provided by individual European member states and may be biased and subject to interpretation as is shown by the Greek case. In addition, the statistical data not only reflect the budgetary strategy, but also the impact of other variables as an unpredicted growth in the demand for entitlement. A more refined analysis of the expenditures, that analyzes benefits and transfers (Alesina and Perotti 1995b), may provide better insight. However, the figures are checked and verified by Eurostat and then combined into a single format and can, as such, be considered as authoritative, reliable and valid.²¹

¹⁹ The cultural theory can be used dynamically though, as Gunnar Grendstad has shown (Grenstad 1999).

²⁰ A culture is, as such, even harder to change than an institution (see Von Hagen 1992: 2; Alesina and Perotti 1995a: 23; Alesina and Perotti 1999: 15).

²¹ In addition, the data are adjusted for the cycle by DG ECFIN in charge of the monitoring of budgetary position of European member states.

Last but not least, a more sophisticated method of inquiry may produce better results, though the degrees of freedom constitute a problem (Alesina and Perotti 1999: 31). Expanding the time horizon may add to the test of Wildavsky's cultural theory of budgeting. Additionally, the enlargement of the European Union to Central and Eastern Europe is promising as the number of test cases currently is too small for a more sophisticated method of inquiry. A first group of new European member states has applied for participation in EMU, but it will take years before that data may be included in the analysis of the 'policy mix' that European member states have put together to reduce their budget deficits below the reference value and then to consolidate their budgetary position.

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- Hofstede: <http://www.geert-hofstede.com>

ANNEX I: GEERT HOFSTEDE'S DATASET

Country	PDI	IDV	MAS	UAI	LTO
Austria	11	55	79	70	
Belgium	65	75	54	94	
Denmark	18	74	16	23	
Finland	33	63	26	59	
France	68	71	43	86	
Germany	35	67	66	65	31
Greece	60	35	57	112	
Ireland	28	70	68	35	
Italy	50	76	70	75	
Luxembourg*	40	60	50	70	
The Netherlands	38	80	14	53	44
Portugal	63	27	31	104	
Spain	57	51	42	86	
Sweden	31	71	5	29	33
United Kingdom	35	89	66	35	25

* Proxy on the basis of a cross-national comparison.

EXPLANATION

PDI: Power Distance Index
 IDV: Individualism
 MAS: Masculinity
 UAI: Uncertainty Avoidance Index
 LTO: Long Term Orientation

ANNEX II: GEERT HOFSTEDE'S INDICATORS

1. Power Distance Index (PDI) focuses on the degree of equality, or inequality, between people in the country's society. A High Power Distance ranking indicates that inequalities of power and wealth have been allowed to grow within the society. These societies are more likely to follow a caste system that does not allow significant upward mobility of its citizens. A Low Power Distance ranking indicates the society de-emphasizes the differences between citizen's power and wealth. In these societies equality and opportunity for everyone is stressed.
2. Individualism (IDV) focuses on the degree the society reinforces individual or collective achievement and interpersonal relationships. A High Individualism ranking indicates that individuality and individual rights are paramount within the society. Individuals in these societies may tend to form a larger number of looser relationships. A Low Individualism ranking typifies societies of a more collectivist nature with close ties between individuals. These cultures reinforce extended families and collectives where everyone takes responsibility for fellow members of their group.
3. Masculinity (MAS) focuses on the degree the society reinforces, or does not reinforce, the traditional masculine work role model of male achievement, control, and power. A High Masculinity ranking indicates the country experiences a high degree of gender differentiation. In these cultures, males dominate a significant portion of the society and power structure, with females being controlled by male domination. A Low Masculinity ranking indicates the country has a low level of differentiation and discrimination between genders. In these cultures, females are treated equally to males in all aspects of the society.
4. Uncertainty Avoidance Index (UAI) focuses on the level of tolerance for uncertainty and ambiguity within the society - i.e. unstructured situations. A High Uncertainty Avoidance ranking indicates the country has a low tolerance for uncertainty and ambiguity. This creates a rule-oriented society that institutes laws, rules, regulations, and controls in order to reduce the amount of uncertainty. A Low Uncertainty Avoidance ranking indicates the country has less concern about ambiguity and uncertainty and has more tolerance for a variety of opinions. This is reflected in a society that is less rule-oriented, more readily accepts change, and takes more and greater risks.
5. Long-Term Orientation (LTO) focuses on the degree the society embraces, or does not embrace, long-term devotion to traditional, forward thinking values. High Long-Term Orientation ranking indicates the country prescribes to the values of long-term commitments and respect for tradition.

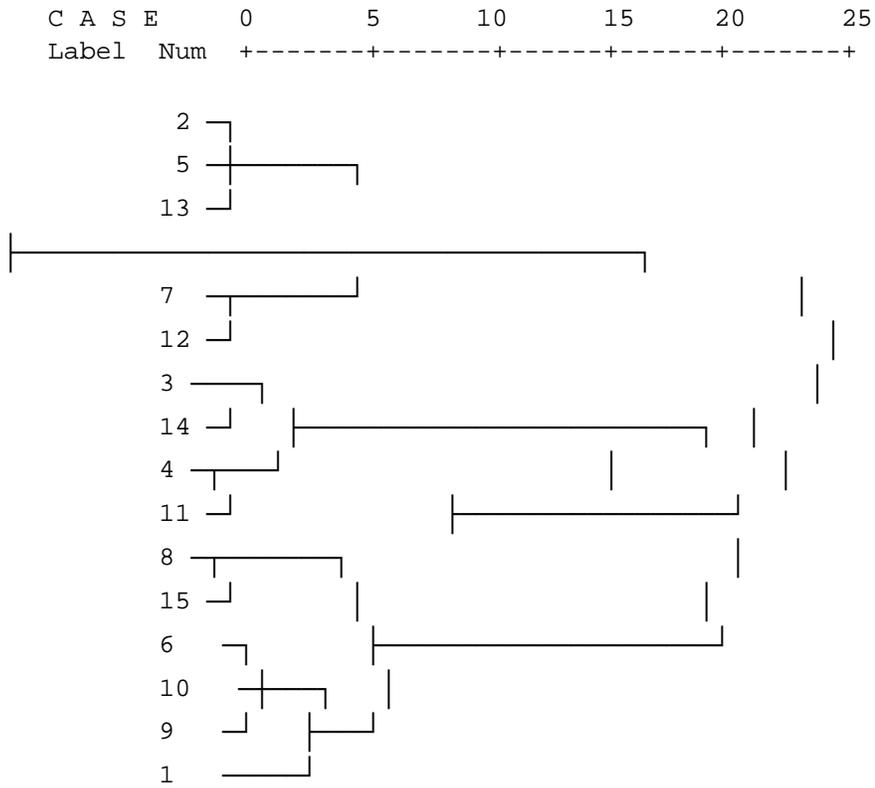
This is thought to support a strong work ethic where long-term rewards are expected as a result of today's hard work. However, business may take longer to develop in this society, particularly for an "outsider". A Low Long-Term Orientation ranking indicates the country does not reinforce the concept of long-term, traditional orientation. In this culture, change can occur more rapidly as long-term traditions and commitments do not become impediments to change.

ANNEX III: DENDROGRAM USING WARD METHOD

*** HIERARCHICAL CLUSTER
ANALYSIS ***

Rescaled Distance Cluster Combine

Comment [F.K.M.4]: Note that the dendrogram is mutilated. See original.



EXPLANATION

1. Austria
2. Belgium
3. Denmark
4. Finland
5. France
6. Germany
7. Greece
8. Ireland
9. Italy
10. Luxembourg

11. The Netherlands
12. Portugal
13. Spain
14. Sweden
15. United Kingdom

**ANNEX IV: BREAK-DOWN OF THE BUDGET DEFICIT
(NET BORROWING/NET LENDING)**

Deficit/ Surplus	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Actual Balance	NA	NA	-5,1	-4,2	-2,5	-1,7	-0,7	1	-1,2	-2,2	-2,9	-2,6	-2,7	-2,7	-2,6
Cycle	NA	NA	-0,3	-0,7	-0,5	-0,1	0,3	2,2	0,8	0,4	-0,2	0	-0,3	-0,3	-0,1
Adjusted Balance	NA	NA	-4,8	-3,5	-2	-1,6	-1	-1,2	-2	-2,6	-2,7	-2,6	-2,4	-2,4	-2,5
Interest	NA	NA	-5,3	-5,3	-4,8	-4,4	-3,9	-3,6	-3,5	-3,2	-3	-2,9	-2,9	-2,8	-2,9
Structural Balance	NA	NA	0,5	1,8	2,8	2,8	2,9	2,4	1,5	0,6	0,3	0,3	0,5	0,4	0,4

ANNEX V: STRUCTURAL BALANCE, FY 1993-2007

Country	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Austria	0,2	-0,8	-1,5	0,2	2,4	1,3	0,8	0,7	3,2	2,8	2,1	2	1,2	1,2	1,4
Belgium	4,5	4,7	4,9	5,5	5,9	7	6,2	5,7	6,5	5,6	5,8	4,8	4,7	4,1	3,6
Denmark	6,3	4,1	3,9	4,3	4,6	4,9	5,5	5,2	4,8	4,5	4,8	6,1	6,2	5	4,4
Finland	1,8	1,9	2,7	3,2	3,1	4,3	4,2	8	7,1	6,1	4,3	3,5	4	3,7	3,5
France	-1,7	-1,3	-1,2	0,8	1,5	1,1	1,3	0,6	0,5	-0,8	-1,1	-0,9	-0,3	-0,4	-0,7
Germany	0,1	0,6	0,1	0,5	1,1	1,4	1,7	1,1	-0,6	-1	-0,5	-0,5	-0,4	-0,3	0
Greece	-0,1	5,3	3,3	5,4	5,6	5,8	5,6	4,2	0,5	1,2	-0,4	-1,7	1,1	0,8	0,6
Ireland	6,6	7,3	5	5,9	5,1	5,3	3,3	4,3	0,5	-0,7	0,6	2,3	0,8	1	1,1
Italy	3,9	3	4,1	4,8	6,9	5,3	5,1	3,8	2,4	2,6	2,1	1,8	1,1	0,8	0,4
Luxembourg	1,3	3,2	4,8	5,3	4,6	4,1	3,1	4,1	5,8	2,3	1	-0,6	-1,8	-1,6	-2
Netherlands	4,3	3,3	2,5	4,4	4,1	3,2	3,5	3,1	1,3	0,2	0	1	1,9	1,9	2
Portugal	0,5	0,6	1,9	1,6	1,1	0	-0,4	-1,6	-2,6	-0,9	0	-0,3	-2,9	-1,8	-1,7
Spain	NA	NA	-0,5	1,5	2,5	1,6	2,2	1,5	1,7	2	2,1	1,8	2,1	2	1,7
Sweden	-2,5	-1,2	0,2	4,8	6,3	7,8	6,4	7,5	5	2,5	2,7	3,3	3,2	2,4	2,6
United Kingdom	-4,4	-3,8	-2,6	-0,9	1	3	3,3	3,1	2,2	-0,2	-1,8	-1,9	-1,3	-1,1	-1

EU-12	NA	NA	0,9	2	2,9	2,5	2,6	2	1,1	0,6	0,6	0,6	0,7	0,6	0,5
EU-15	NA	NA	0,5	1,8	2,8	2,8	2,9	2,4	1,5	0,6	0,3	0,3	0,5	0,4	0,4
EU-25	NA	NA	NA	NA	NA	NA	NA	2,3	1,4	0,5	0,2	0,3	0,4	0,3	0,3

ANNEX VI: ADJUSTMENT OF STRUCTURAL BALANCE PER COUNTRY AND PERIOD

	FY 1993-1998			FY 1998-2003			FY 1993-2003		
	ΔR	ΔE	$\Delta R-\Delta E$	ΔR	ΔE	$\Delta R-\Delta E$	ΔR	ΔE	$\Delta R-\Delta E$
Austria	-1,7	-2,8	1,1	-1,5	-2,3	0,8	-3,2	-5,1	1,9
Belgium	1,1	-1,3	2,4	1,7	2,9	-1,2	2,8	1,6	1,2
Denmark	-3,2	-1,6	-1,6	-0,3	0	-0,3	-3,5	-1,6	-1,9
Finland	-7,3	-9,9	2,6	-0,4	0	-0,4	-7,7	-9,9	2,2
France	1,1	-1,8	2,9	-1,3	1	-2,3	-0,2	-0,8	0,6
Germany	0,6	-0,7	1,3	-1,3	0,7	-2	-0,7	0	-0,7
Greece	6,3	0,5	5,8	-2	4,2	-6,2	4,3	4,7	-0,4
Ireland	-8	-6,6	-1,4	-3,4	1,3	-4,7	-11,4	-5,3	-6,1
Italy	-1,6	-3	1,4	-0,8	2,4	-3,2	-2,4	-0,6	-1,8
Luxembourg	-0,7	-3,5	2,8	-0,1	3	-3,1	-0,8	-0,5	-0,3
Netherlands	-7,8	-6,7	-1,1	0,1	3,3	-3,2	-7,7	-3,4	-4,3
Portugal	0,1	0,5	-0,4	4,3	4,3	0	4,4	4,8	-0,4
Spain	-0,9	-3	2,1	0	-0,5	0,5	-0,9	-3,5	2,6
Sweden	-1,2	-11,4	10,2	-4	1	-5	-5,2	-10,4	5,2
United Kingdom	1	-6,4	7,4	0,1	5	-4,9	1,1	-1,4	2,5
EU-12	0,4	-1,3	1,7	-1	0,9	-1,9	-0,6	-0,4	-0,2
EU-15	0,2	-2,1	2,3	-0,9	1,6	-2,5	-0,7	-0,5	-0,2
EU-25	NA	NA	NA	NA	NA	NA	NA	NA	NA

ANNEX VII: BUDGETARY STRATEGY PER CLUSTER

	FY 1993-1998			FY 1998-2003		
	ΔR	ΔE	ΔSB	ΔR	ΔE	ΔSB
Cluster I						
Greece	I	I	D	D	I	I
Portugal	I	I	I	I	I	B
Cluster IIA						
	ΔR	ΔE	ΔSB	ΔR	ΔE	ΔSB
Belgium	I	D	D	I	I	I
France	I	D	D	D	I	I
Italy	D	D	D	D	I	I
Spain	D	D	D	B	D	D
Cluster IIB						
	ΔR	ΔE	ΔSB	ΔR	ΔE	ΔSB
Austria	D	D	D	D	I	D
Finland	D	D	D	D	B	I

Germany	I	D	D	D	I	I
Luxembourg	D	D	D	D	I	I

Annex VII. (Continued)

	FY 1993-1998			FY 1998-2003		
	ΔR	ΔE	ΔSB	ΔR	ΔE	ΔSB
Cluster III	ΔR	ΔE	ΔSB	ΔR	ΔE	ΔSB
Denmark	D	D	I	D	B	I
Ireland	D	D	I	D	I	I
Netherlands	D	D	I	I	I	I
Sweden	D	D	D	D	I	I
United Kingdom	I	D	D	I	I	I

Explanation: ΔR = Change Revenues, ΔE = Change Expenditures; ΔSB = Change Structural Balance; B = Balance, D = Decrease, I = Increase

	Indicates match
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