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POLICY COMMENTARY PAPER

State Responses to the Fiscal Crisis in Britain, Germany and The Netherlands.

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Introduction

How are governments, politicians and public administrations responding to the fiscal crisis? The current global financial, economic and fiscal crisis is undoubtedly one of the most important and urgent challenges that Western states face today. Remember that the previous worldwide economical and fiscal crisis, at the end of the 1970s, led to a major reform trend in virtually all Western states. Bluntly formulated, the oil crisis of 1974 led to an economic crisis and hence to economic recovery measures of governments. These two events together then led large public budget deficits, necessitating drastic budget cut-backs. A similar pattern seems to be developing now. Rescuing the banking system during the global financial crisis of 2008 through public investment led to increased state debts, the subsequent economic crisis of 2009 led governments to take economic recovery measures, whereupon the increasing debts and budget deficits together again led to the fiscal crisis in 2010 and necessitated drastic budget cut-backs. This pattern has taken place all over the Western world (OECD, 2009, 2011). The question about 'how states responded to the current financial, economic and fiscal crisis', seem therefore quite crucial. How can we explain for the different ways in which governments responded to the crisis? Of concern here are not only the financial-economic explanatory factors, but also the political-administrative factors. Finally, what are the effects of these government responses?

In this brief paper a first preliminary analysis will be presented about how the three countries (the UK, Germany and The Netherlands) responded to the crisis. The research questions above were explored by not only looking at the contents of the governmental responses, but also at the political and administrative aspects of the governmental decision-making process, and at the characteristics of the political systems, political ideology, the government system, the administrative system and budget procedures of each country. Finally the state responses were examined by looking at their financial-economic effects and also at the effects of the decision process in terms of fundamental priority-setting versus incrementalism, swift versus slow decisions, centralized versus decentralized decision-making, coherent systematical versus fragmented patchwork decisions, long term sustainable versus short term quick fixes (Peters et al, 2011).

The countries chosen were, first, the UK, as its political Whitehall system is potentially capable of swift and fundamental decision-making, the prime-minister is relatively powerful in cabinet, the current centre-right political ideology of the current Conservative coalition government, and the fact its economy is large and yet performed relatively badly in the economic crisis. Second, Germany was chosen as it has a consensus democracy and coalition cabinet, though with the Chancellor relatively powerful in cabinet, and as it is a large and leading country in the EU in monetary and financial problem solving. It also performed relatively well in the economic crisis. Finally, the Netherlands was chosen as a small consensual-corporatist state where decision-making is about 'eternal' deliberation, consultation and compromising.

Analysis

Let us draw some preliminary conclusions about the responses of the three states during the crisis. We first consider the external context of economics, finances and politics (some explanatory factors) and subsequently consider the decision-making processes in the three phases of the crisis. At the outset it must be emphasized that, due to the word limitation of this brief piece, empirical evidence is only presented in the form of illustrative text boxes.

> The crisis was managed in all three countries in three stages. First, the banking crisis, which in 2007 started in the United States and in 2008 led to a global financial crisis in which governments took various measures to save and support the banking system. Second, the economic crisis, which followed the financial crisis, causing governments in 2009 to take economic recovery measures. Third, the fiscal crisis of increasing state debts and budget deficits, which caused governments in 2010 to take fiscal cut-back measures.

Financial-economic context

Economic situation

The size and composition of governmental responses to the economic crisis varied between countries, depending on the severity of the economic crisis and their fiscal position prior to the crisis. The initial circumstances (economy, state debt and budget deficit) were worst in the UK. The financial and economic crisis severely hit all three countries though. Britain and Germany in 2009 experienced a severe economic decline, but the German economy recovered sooner and better than the British one. Dutch unemployment figures were relatively favourable.

Financial institutions

The measures taken by governments in 2008 to support the banking system and to restore confidence in the this sector followed a similar pattern all over the Western world (OECD, 2009): capital injections and nationalizations, guaranteeing state debt, isolating or buying bad assets, and increasing deposit assurance. The costs of these measures were highest in Britain. In The Netherlands the financial services sector was also relatively high and so were the costs of the banking crisis.

> The banking and financial crisis was severe in Britain. The UK has a relatively large banking and financial services sector. The 'economic miracle' in Britain of 1997-2007 (under the Labour government) was heavily dependent on the success of its banking and financial sector - and the symbolic importance of London as the financial capital of the world should not be

underestimated. The UK private property sector also was relatively large and, as in the US, vulnerable. Consequently the financial crisis hit Britain hard. The nine largest banks in the UK in 2007 together had a market capitalisation of £316 billion, which by 2009 had shrunk to £138 billion. Thousands of jobs in the financial services were also lost. Property prices have also fallen sharply. (Source: HCTC 2009a; interviews)

European situation

International (USA and Europe) pressure to take more actions (during the financial and economic crisis) was especially exerted on Germany. The euro crisis and initial 'bail-out' of Greece and later also of Ireland and Portugal led to major pressure on national domestic budgets. This influence was highest politically in Germany (which in the EU pays the largest 'bill').

A thrifty chancellor was what the German people wanted, especially in the context of the Greek debt crisis and bail-out actions. Most Germans believed that Greece was in trouble because of its own over-spending and that German taxpayers should not pay the price. Chancellor Merkel was aware of a voters' backlash if she risked German taxpayers' money, which actually happened in regional elections. Chancellor Merkel had also long resisted aid for Greece and only gave in to a combined IMF and EU rescue plan for Greece in April 2010 after the (lost) regional elections. At subsequent stages of the euro-crisis ,when Ireland and Portugal, and Greece again, also required support, chancellor Merkel long refused to let Germany pay the checks for failing euro-members, though eventually relented. (Source: interviews, newspapers)

Political context

Political system

The UK government single-party government system and the power of the prime-minister should have enabled swifter and more fundamental decision-making than elsewhere in Europe - even in the post-2010 Conservative coalition government. However this is at odds with the actual process.

The Cameron-Clegg cabinet was formed within one weekend after the May 2010 elections and severe retrenchments were announced speedily. These were, however, just the first announcements, with the details being laid out in the June 'emergency budget', though still only as a framework, and finally in the October 'spending review'. In sum the process took more than five months to arrive at a specified stage, about the same time it took in the consensual multi-party Dutch case. (Source: HCTC 2010; interviews)

The German Chancellor is relatively powerful, but is restrained by a certain degree of ministerial autonomy. The centralization of power in the hands of the Chancellor (in close cooperation with her Finance minister) during the 2008 banking crisis continued in the 2009 economic crisis and 2010 fiscal crisis. During the economic crisis other ministers were also involved. Moreover the federal and consensual political system of Germany forces governments to actively involve non-coalition parties and other stakeholders.

In German governmental decision-making, the so-called 'Koalitionsausschuss' (coalition committee) traditionally plays a prominent role in mediation between government and parliament. It consists of the Chancellor, the Vice-chancellor (from the coalition party), the chairmen of the parliamentary parties and the political party chairmen. The coalition committee met in October 2008 (first Konjunkturpaket) and January 2009 (second Konjunkturpaket) to coordinate the government response to the economic crisis. (Source: Fleisher and Parrado, 2010; interviews)

The Dutch prime-minister is legally only 'primus inter pares', that is, chairman of the Friday cabinet meetings, and only played a secondary role in the 2008 banking crisis. The (Social-democrat) Finance minister dominated this decision process, especially in public appearances where he was seconded by the (Christian-Democrat) prime-minister and the president of the National Bank. In the 2009 economic recovery program, which was explicitly politicized, the prime-minister did play a central coordinating role. The fiscal cut-back measures in 2010 were the outcome of the coalition formation (a multi-party deliberation process) and therefore a 'patch-work' of political compromises.

Political ideology

In Britain the first two stages of the crisis were handled by the Labour-government headed by prime minister Gordon Brown. The third stage of the fiscal crisis and cut-backs was handled in 2010 by the new incoming Conservative coalition. The Conservative Party political profile in the 2010 election campaign was about swift and severe cut-backs and the subsequent fiscal consolidation measures in Britain were drastic.

The retrenchment package that Britain announced in the October 2010 'spending review' amounted to £81 billion. The Conservative coalition government announced a 34 % cut in the costs of the Whitehall administration and its agencies, plus cut-backs for local government. Official estimates were that 490.000 jobs in the public sector would be lost, whilst other commentators later estimated an additional 0.5 million loss in associated private sector jobs. (Source: HCTC 2010; interviews)

In Germany the banking and economic crisis were handled by the Christian-Social-Democrat coalition. Cooperation between CDU-chancellor Merkel and SPD-Finance minister Steinbrück was close, until the upcoming September 2009 elections caused party competition. The subsequent fiscal crisis was handled by the new Christian-Liberal coalition (see below).

In The Netherlands the banking and economic crisis were handled by the Christian-Social democrat coalition. Cut-back decisions were delayed over the election period, as in Britain and Germany. In 2010 a Liberal-Christian-Democrat coalition was formed, with support of the right-populist Freedom Party. The conservative Liberals together with this right-populist party then pushed through a severe cut-back program with substantial cuts in public administration.

The Dutch Rutte-government in its October 2010 'coalition agreement' announced a 18 billion retrenchment package. Savings were announced of up to 1,5 billion euro in national administration and another 1,1 billion euro cuts in provincial and municipal incomes, plus a range of other measures making up a huge 6,1 billion euro cuts in administrative expenditures.
(Source: coalition agreement, September 2010)

The three retrenchment packages also contained measures that were rather symbolic and rhetoric rather than specific and realistic - for example, the political rhetoric in Britain about the ‘Big Society’ where citizens and civil organisations should take more responsibilities for themselves and each other (at the same time as swingeing cuts in support to these organisations). The UK government rhetoric about ‘localising’ public tasks also implied a decentralisation of central government tasks to municipalities, although again this was in the context of severe cuts in local government funding from central government. The Dutch coalition announced a budget-cut in the performing arts sector, which is financially small but symbolically representative of the right-populist aversion against ‘high-brow leftists’.

2.3. Decision-making process

Financial crisis

In all three countries the decision-making during the banking crisis in 2008 was typical of political ‘crisis-management’ (Boin et al., 2005). A very small group of key-players (Prime-minister, Finance minister, president National Bank, few top-officials) took very significant decisions in very short time, often at evenings and weekends. The financial crisis came as a complete surprise to the financial-economic authorities, which were unprepared, and so uncertainty was high. External consultants and experts like investment bankers, lawyers and accountants were hired in all three countries to assist in taking-over banks, in checking banks’ balances and books, and in determining the price of banks’ ‘bad assets’. Consequently most elected politicians and parliamentary bodies hardly played a role.

> The transition to Brown from Blair as labour prime minster in the UK in 2007 had an uneasy start. Brown did not possess the ‘easy charisma’ that Blair could show. The financial crisis in 2008 was the ‘finest hour’ for Brown, though, as he was a financial-economic expert having served at the Treasury for a decade. He was subsequently able to show statesmanship, at home and abroad. He played a prominent role on the international, and especially, European stage during the 2008 banking crisis, whilst the ultimate policies of the nationalisation of the failing banks coincided with his Social-Democratic principles. (Source: interviews, newspapers)

Economic crisis

In all three countries the decision-making in 2009 about the economic recovery packages was politicized. Ministries of Economic Affairs, Social Affairs, Education, Housing, and Health were all involved in the preparation of the stimulus packages. Further, parliaments and a broader group of politicians were now playing an active role, as were employer and employee organisations and other interest organisations.

In Germany the decision-making was still relatively centralized in the hands of the Chancellor and the Finance minister, supported by a few top officials. Due to the upcoming elections the process also became influenced by political party competition. Finally the so-called ‘coalition committee’ played an important role in mediation between the government and parliament in order to arrive at the first and second ‘Konjunkturpaket’ (see above).

In The Netherlands the decision-making was explicitly politicized. The 2009 economic recovery programme was considered as a revision of the 2007 coalition agreement, so the prime-minister coordinated extensive multi-party deliberations and consultations with employee and employer organisations. From a financial-economic viewpoint the economic recovery program was primarily about postponing planned cut-backs and advancing already planned investments. The main issue in this case was not so much extra money for economic recovery (as presented by politicians), but rather budget discipline and deficit reduction. The political and financial viewpoints thus apparently differed.

Fiscal crisis

The decision-making in the third stage of the crisis was politically more sensitive as it involved major cut-backs. In all three countries governments postponed the cut-back decisions till after their respective elections.

Although the alleged speed of the British decision-making process can be doubted (see above), the UK government did enhance fundamental priority-setting by creating the so-called 'star chamber' approach.

> A new form of cabinet decision-making was announced by chancellor Osborne in June 2010 and termed the 'star chamber'. In the 'star chamber' all Whitehall spending decisions were to be fundamentally scrutinised. Ccabinet ministers were required to justify their departmental spending plans before a scrutiny panel of senior politicians and public servants. Cabinet ministers only became member of the 'star chamber' once they had settled their departmental allocation with the Treasury. The Dutch cabinet in 2009 by contrast also installed 'working-groups' to scrutinise spending decisions but these consisted of public officials alone, thus shifting the responsibility for this fundamental priority-setting to the bureaucracy. Subsequently the proposals of these working-groups were disregarded in the subsequent election campaign and can hardly be recognised in the October 2010 coalition agreement. (Source: HCTC 2010; interviews; reconsideration reports, April 2010).

In Germany the July 2010 'Sparpaket' was devised by Chancellor Merkel in close cooperation with Finance minister Schäuble (also CDU). The coalition partners FDP and CSU were informed and consulted, but lacked the power to resist a drastic cutback package. Centralisation of power in the hands of the Chancellor from the earlier phases of the crisis continued.

> In Germany, the Liberal party (FDP) had promised tax cuts during the election campaign, and both the Liberal FDP-leader Westerwelle and the Southern Christian-Democrat CSU-leader Seehofer wanted less and slower cutbacks. Finance minister Schäuble (CDU), though, supported by chancellor Merkel, managed to push through a drastic cutback package. The political position of the Liberal party (FDP) in this case was relatively weak and early elections could have wiped out the party – recent regional elections had resulted in important losses for the CSU. Both parties were hence in a relatively powerless position. (Source: interviews, newspapers)

A marked difference between both the UK and German decision-processes on the one hand and the Dutch on the other, was that the first two took place *after* both governments were formed, so that the process resulting in the fiscal retrenchment package was orchestrated, coordinated and lead by an already installed and functioning government, while in The Netherlands by contrast the decision-process *coincided* with the coalition formation. Coalition formation is, inevitably, a hectic political 'circus' of multi-party compromises and consensus making where fundamental political priority-setting is hardly possible. Moreover cut-backs were not the only political hot issue to resolve.

During the Dutch coalition formation the financial negotiations were highly influenced by the Christian-Democratic representative De Jager, who was Finance minister of the outgoing cabinet and became Finance minister of the new incoming cabinet. Officials of the Ministry of Finance were also influential behind the screens. Although the Dutch cut-back package seems on the surface an incoherent patch-work of political compromises, from a financial-economic viewpoint the main issue was that the budgetary framework was predetermined and maintained *during* the coalition negotiations. This was a case where the political and financial viewpoints of politicians and Treasury officials differed and collided.

A regular procedure in the Netherland is that before national elections a 'study group on budgeting' produces an advisory report. This study group consists of top-officials from various ministries, the Central Planning Bureau and the National Bank, and is headed by the Treasury-general of the Ministry of Finance. The study group works without interference from politics, and cabinet sends the study group's advice to parliament without adding any commentary. This advice was a major financial-economic input for the coalition deliberations after the elections. The April 2010 report of the study group contained major retrenchment proposals.

Another regular procedure before elections is that the Central Planning Bureau publishes its economic forecast (an input for the above study group on budgeting). This forecast was that the budget deficit would on the long term rise to 29 billion euro. Notwithstanding the enormity of this amount, this figure came to be widely accepted. All political parties (except the left-socialist and the right-populist party) in their party programs used this long-term figure, which thus became leading in the political debate on cut-backs. All party programmes before elections are economically 'checked' by the Central Planning Bureau, and this Bureau also economically checks the financial elements and forecasts of the coalition agreement. (Source: interviews, official documents)

Apparently, then, the relationships between politicians and bureaucrats, and especially the role of financial-economical institutions (Hallenberg et al, 2009) can have a substantial influence on fiscal decisions. Budget discipline and tight budget procedures are their preferred 'modus operandi'.

In Germany the fiscal crisis led Finance minister Schäuble to reverse the annual budget preparation procedure. The prior situation was that politicians had the first say, then external independent experts were consulted, then the ministry of Economic Affairs would present an economic forecast, and subsequently the Finance Ministry would transform these discussions into budget proposals - which were then debated and decided upon in parliament. The new 'top-down' procedure announced in 2010, however, was to be that the Finance Ministry would annually start by presenting a financial framework, and that ministries would subsequently make their estimates and plan their budgets within that predetermined framework. The fiscal crisis thus led to a tightening of the German budget procedure. (Source: interviews, official documents)

3. Conclusions

In this brief paper only a few preliminary conclusions are presented. An more extensive international comparative study of state responses to the fiscal crisis is currently being prepared in the setting of the EU-subsidized research program COCOPS, in collaboration with Randma-Liiv of Tallinn University of Technology.

The preliminary three-country case study presented here has illustrated that the recent global financial crisis was managed in three stages, and that governmental responses in these three stages differed. *The banking crisis* resulted in the centralization of decision-making in the hands of prime-minister and Finance ministers across the three nations, though the extent of prime-ministerial power differed between the countries. The subsequent stages of the crisis involved many more ministries, parliaments, politicians, parties, and social partners in deliberation and decision making. *Economic recovery* required further more politicized decision-making, and *fiscal cut-backs* even more so.

The type and degree of politicization differed between countries, however, the Netherlands being the clearest case of multi-party compromise and consensus. The type of decision-making (fundamental priority-setting, speed, coherence, centralization) further differed between countries. Although The Netherlands seemed at first glance to be an example of incremental, slow, fragmented, political decision-making, in reality another set of financial-economic institutions existed which actually predetermined and maintained the budgetary process and outcomes. In Germany the euro-crisis and Greek 'bail-out' led to further pressure to tighten budget restraint. A preliminary conclusion therefore is that the global fiscal crisis is also having an impact on government and governance, particularly on budgetary decision-making. Further research is now needed to test out this conclusion with deeper and more comparative evidence.

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