The Politics of Fiscal Responses to the Crisis of 2008–2009

KLAUS ARMINGEON*

The national fiscal responses to the economic crisis of 2008/2009 varied considerably. Some countries reacted with a strong demand stimulus, others intended to slash public expenditures, while a third group pursued mildly expansionary policies. There are strong reasons for governments to pursue a mildly expansionary policy. If governments depart from this default strategy in favor of a significant counter-cyclical policy, they must be able to swiftly make decisions. Therefore, effective use of counter-cyclical policy will be unlikely in cases where lengthy negotiations or significant compromises between governing parties with different views on economic and fiscal policy are likely. Therefore, a major determinant of the expansionary strategy is a unified government, usually in form of a one-party government. If governments opt for pro-cyclical policy in a major economic crisis, they do so because they have few other viable options. In this situation they tend to shift blame to international organizations.

Introduction

When the deepest recession since the 1930s (EU Commission 2009, 1) hit national economies in fall 2008, governments in democratic countries rapidly seemed to abandon the orthodoxies of economic policymaking that had been broadly accepted since the 1980s. These include trust in markets, maintaining low government deficits and debts, reducing intervention in the economy as far as possible, and rejecting the use of counter-cyclical fiscal policies. Versions of this orthodoxy include the "Washington Consensus" of 1989, which reflected the common views of World Bank and International Monetary Fund (IMF), or the basic ideas underlying the Maastricht treaty of the European Union (EU) and its Stability Pact in the 1990s. The pragmatic manifestation of this orthodoxy is the belief that counter-cyclical deficit spending (Keynesianism) ceased to work after the liberalization of capital markets, and that there were few reasons to expect the return of a Keynesian option for governments (Scharpf 1991, ch. 11, 12). Major government intervention, thus, should be limited to keeping inflation low through an appropriate monetary policy set by a preferably independent national or supranational central bank.

*Bern University

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When the problems of the financial sector had become obvious in 2007/2008, the first step of many governments was to support ailing financial institutions and large firms, while at the same time thinking about reforms to their financial institutions. The crisis of the financial sector led to declining industrial production and employment in the "real economy." When interest rates approached the zero line, monetary policy had reached its market-correcting limits. Having exhausted monetary policy options, most mature democracies turned to demand management as the second step of the anti-crisis measures. They devised major fiscal packages composed of tax reductions and increased state expenditures in order to stimulate the economy. The third step was taken in winter 2009–spring 2010 when economies recovered and some governments started exiting the expansionary fiscal strategy. Parallel to these measures, some governments used the crisis as an opportunity for reform and attempted to push through structural changes to their labor markets and social and environmental policies.

While national governments worked on their response to the economic crisis, four inter- and supranational organizations (the EU, the G20, the IMF, and the Organisation for Economic Co-operation and Development [OECD]) attempted to coordinate these national policies, with the EU and G20 claiming that they had been successful in their efforts.

In this article, I focus on the fiscal response strategies in late 2008 and 2009. While most observers have noted the commonalities—a general move from deficit containing policies to deficit spending—I am interested in the often overlooked variations between the responses. I describe the national fiscal stimuli, showing that coordination between countries was very limited. This contradicts the argument that national governments had very narrow maneuvering space on fiscal policy due a number of constraining factors including economic internationalization and capital market liberalization, the restrictions imposed by political institutions such as the monetary system of the EU, and the international coordination of economic policy in regimes such as the G20.

In explaining this variation, I argue that the default response strategy of governments was to pursue a severely limited expansionary budget. This reduced the danger of electoral punishment due to perceived passivity in macroeconomic policy during periods of crisis, as the government was able to signal to voters that it was actively addressing the economic problems. At the same time, this strategy reduced the dangers associated with huge increases in future debts, since spending increases were very limited. Several countries, however, departed from this default strategy: They either implemented a swift and significant shift to a strongly expansionary policy given the crucial condition that they had a unified government that could react quickly and consistently, or they opted for the pro-cyclical policy. Taking the restrictive pro-cyclical option was motivated by pressure and incentives from international organizations, whether this was driven by prior agreements made with the IMF or by the highly valued objective of entering the Euro zone or maintaining membership in the European Exchange Rate Mechanism as a precondition for entering the Euro zone.

In order to minimize the political costs of tough and electorally unfavorable policies, national governments could shift the blame to international organizations (IOs). For the countries following the default strategy, IOs were used to legitimate the lack of major anti-cyclical measures. For the countries following pro-cyclical fiscal policies, the IOs were likewise "blamed" for tying the hands of national governments and leaving them with no other viable options.

I provide evidence for this explanation in a comparative analysis of the fiscal policies of EU countries and mature non-EU democracies in 2008 and 2009. I do not include Cyprus, since Cyprus did not feel the full force of the economic crisis until fall 2009. I do include Greece and Bulgaria, although in spring 2010 it became clear that the previous reports on the fiscal situation of both countries were not true and that both countries did not implement their stated goals of a restrictive, pro-cyclical policy. However, for my argument it is important that both governments did not follow the default strategy but instead claimed to pursue pro-cyclical policies, which might have led to electoral punishment.

While there is no dispute that fiscal figures published for Greece and Bulgaria before 2010 were not reliable, we also cannot assume that data for other countries are without flaws. Some data on government finances for 2009 are still estimates, and even the data for earlier periods show considerable variation between respective statistical sources such as IMF or OECD. Even worse, this imprecision does not vary at random between countries; rather, some countries seem to report much more reliable data than others. Therefore statistical analyses assuming randomly distributed errors in the data have limited reliability and must be interpreted very cautiously. In drawing my conclusions, then, I will rely both on qualitative and quantitative data.

In the following section, I will present my argument. The third section will describe the fiscal response strategies. In the following section, I start by discussing standard explanations, and finally I will show that my argument is supported by the data.

The Argument

When a major shock such as the crisis of 2008/2009 hits a national economy, governments have three basic options for fiscal policy: (1) they significantly expand spending in order to introduce a demand stimulus to the economy, (2) they neither significantly expand nor restrict spending, or (3) they try to curb spending so that fiscal balances are not negative, notwithstanding negative economic growth. In addition to pursuing policies that are in line with the overall political goals of the relevant parties, each strategy has specific political costs and advantages that must be considered in regard to the chances for reelection.

Expansionary budgets are a powerful signal to voters that the government is doing something to ameliorate the impact of an economic crisis. The beneficial economic effects of these strategies are dependant on a number of variables, such as the ability to time the implementation of the measures and the economic openness of a country precisely. Regarding the timing of the measures, the fiscal stimulus must follow very shortly after the fall in economic output in order to be efficient. Very open countries—and this applies in particular to small nations—risk that their demand stimulus expenditures trickle away from their domestic economies, since some of the expenditures will be used to buy from abroad. Unless there is a firm contract between nations to coordinate their fiscal policies, the economic success of such stimulus packages is uncertain and conditional on the size of import shares and/or the willingness of other governments to expand their budget in a similar way. Expansive fiscal packages also carry intrinsic costs, including increased debt levels that must be covered in the future, inflationary pressures, and the danger of capital flight. Finally, size matters. Small nations that are well integrated into world markets are fully exposed to the ups and downs of the world economy, but due to their small size they are unable to influence the global market through their own fiscal policies. Given this, they have much less incentive to enter the risky business of demand management than do large nations, in particular if their domestic market is large in comparison to their world market exposure.

The opposite option is a strategy of radical budget cuts during a recession. This strategy has a number of advantages, especially in that it avoids all of the dangers of the counter-cyclical policies. However, governments run the risk that their pro-cyclical policies will increase unemployment and further decrease economic growth. This hurts the programmatic goals of nearly all governing parties. In addition, austerity strategies tend to cut resources in areas such as education, social policy transfers, and services. Given the fact that most citizens strongly support the welfare state, these policies are electorally dangerous and may reduce the likelihood of incumbent reelection (Pierson 1994).

In most cases, both strong pro- and counter-cyclical strategies constitute a radical shift from precrisis fiscal policies. During the past 30 years, the broadly accepted benchmark for good fiscal policy in the OECD is prudent policy based on a foundation of little or even no deficit spending. Many governments, however, failed to adhere to this standard. The literature gives a long list of plausible hypotheses on why, contrary to expectations, governments have in fact engaged in considerable deficit spending. These hypotheses include arguments related to the electoral competition of politicians elected in single-member electoral districts, the tendency of parliaments to overspend, the tendency to offer compensation during compromises with coalition partners, the weakness of the finance minister, or the number of spending ministers (see the literature discussion in Franzese 2010; Hallerberg 2004; Hallerberg and Hagen 1999; Hallerberg, Strauch, and Hagen 2009; Hallerberg and Ylaeoutinen 2010; Wehner 2010). Furthermore, time-invariant political institutions create what are arguably country-specific levels of deficits. In the Euro zone, this deficit should not exceed the 3% level—measured as percentage of gross domestic product (GDP)—during "normal times" according to the Maastricht rules. In a major recession such as in 2008/2009, this level of deficits is shifted upward. This is due to decreased tax revenues and increased social security spending (in particular for unemployment insurance) affecting the nominator. In addition, if the denominator (GDP) decreases, the share of deficits in GDP will increase, all other things being equal.

There are good reasons for governments not to deviate too much from precrisis deficit levels. First, the increased debt burden resulting from the deficit increase will be hard to tackle once the crisis is over. It is also unclear whether increased spending will lower domestic unemployment, as the counter-cyclical effects of the spending are conditional on the timely implementation of the stimulus package and the extent to which the expenditures remain in the domestic economy. Given these conditions, the logical fiscal response for most countries is to increase spending by a marginal amount with the intention of alleviating the worst of the labor market strains and signaling to the voter that government is actively trying to fight the crisis. I assume, therefore, that this is the default fiscal policy response to the crisis, as it carries the least risk in economic and electoral terms and does not require a significant shift from the status quo, but is still open to possible positive spillover effects from other import countries stimulating their own economies.

The other two options available to governments (strong deficit spending or pro-cyclical policy) both require a significant shift from the fiscal status quo. Governments must be both willing and able to bring about this shift in a short period. Unified governments—that is, governments that have little internal programmatic conflict over fiscal policy—that have no obligation to negotiate with opposition parties have a higher likelihood of deviating from previous prudence-oriented fiscal policies (this argument draws heavily on Spolaore 2004). Being a unified government is a necessary but not a sufficient condition for dramatic fiscal policy change toward fiscal expansion during economic crisis, as there may be many ideological or economic reasons not to deviate from the default strategy. One of the most pressing economic reasons is the soundness of the precrisis fiscal policy in a country. It is much less problematic for countries with a balanced budget and low debts to stimulate the economy by increasing demand through increased spending than it is for countries with high debts and deficits (see Egert 2010; IMF 2010c).

This argument can explain why some governments opt for a significant fiscal stimulus. But why should governments decide to take the electoral risk of a significant pro-cyclical policy during a severe crisis? The answer could be that this strategy will pay off either through substantial gains in other areas that can offset the blame for increased unemployment, or through the avoidance of substantial punishment. Both these substantial gains and punishments can be offered by international organizations. Potential membership in the Euro zone may be a substantial gain for former postcommunist countries, while the avoidance of dramatic economic breakdowns by accepting the obligations of IMF loans is another example.

Fiscal Policy Change 2008/2009

In this section, I describe the 2008/2009 fiscal policy changes in the 34 countries under study. I combine various types of information. First, I consider the development of deficits in 2008/2009 compared to the previous period. I consider both nominal and cyclically adjusted (so-called "structural") deficits. During an economic crisis, tax revenue decreases and social security spending increases. These so-called automatic stabilizers both create demand in the economy independent of political action and increase the nominal deficit. Automatic stabilizers vary by country depending on the generosity of certain social policies—in particular unemployment benefits—and on the elasticity of various taxes. The cyclically adjusted deficits indicate the size of the deficits as if there were no revenue loss and spending increase due to the crises. Hence, it is an indicator for discretionary fiscal policy choices. Data about deficits (in percent of GDP) are of limited reliability. Recent adjustments of figures for Greece and Bulgaria illustrate the problem. Hence, a cautious strategy is to avoid the interpretation of small changes, instead focusing only on the large differences. Since countries tend to have nation-specific levels of deficits, it makes sense to take the previous level of deficits into account. Regressing the average deficits in 2008 and 2009 on the average deficit in 2006 and 2007 yields positive and significant coefficients for unadjusted and adjusted deficits. This supports findings of institutional determination of deficit levels and is also in accordance with research showing that there are country-specific patterns of fiscal policy use during booms and recessions (Egert 2010). For the countries under consideration, the average deficit increased from +0.4% (2006/2007) to –3.7% (unadjusted deficits) (2008/2009) and from –0.7% (2006/2007) to –3.2% (adjusted deficits) (2008/2009) (see also Table 1).

As a sensible strategy for gauging the stimulus levels during the crisis, I calculated the difference between the average deficits in 2008/2009 and in 2006/2007, both for the adjusted and unadjusted time series. These differences vary considerably between countries with coefficients of variation of 0.9 (increases of levels of unadjusted deficits) and 1.4 (increases of levels of adjusted deficits). Nation-specific deficit changes are depicted in columns 2 and 3 of Table 1.

TABLE 1
Fiscal Responses to the Economic Crisis 2008/2009

	Average Deficit 2008/2009 Minus Average Deficit 2006/2007 (Unadjusted)	Average Deficit 2008/2009 Minus Average Deficit 2006/2007 (Cyclically Adjusted)	Fiscal Package	Type of Response
Australia	–3.4	–2.8	–5.4	Strongly counter-cyclical
Austria	–0.9	–0.8	–1.2	Slightly counter-cyclical
Belgium	–3.6	–2	–1.4	Slightly counter-cyclical
Bulgaria	–3	–2.0	None	Pro-cyclical
Canada	–4.3	–3	–4.1	Strongly counter-cyclical
Czech Republic	–2.6	–1.5	–2.8	Slightly counter-cyclical
Denmark	–4.6	–2.6	–3.3	Slightly counter-cyclical
Estonia	–4.7	–1.3	None	Pro-cyclical
Finland	–3.8	–1.9	–3.2	Slightly counter-cyclical
France	–2.9	–2	–0.7	Slightly counter-cyclical
Germany	–0.8	0.1	–3.2	Slightly counter-cyclical
Greece	–6.1	–5.4	0.8	Pro-cyclical
Hungary	3.2	5.4	7.7	Pro-cyclical
Iceland	–17.6	–15.8	7.3	Pro-cyclical
Ireland	–12.2	–8.6	8.3	Pro-cyclical
Italy	–1.6	0.3	0	Slightly counter-cyclical
Japan	–2.6	–1.4	–4.7	Slightly counter-cyclical
Latvia	–6.8	—	—	Pro-cyclical
Lithuania	–5.6	–2.9	—	Pro-cyclical
Luxembourg	–1.4	–0.1	–3.9	Slightly counter-cyclical
Malta	–1.8	–1.7	(–1.0)	Slightly counter-cyclical
Netherlands	–2.7	–2.9	–2.5	Slightly counter-cyclical
New Zealand	–6.2	–4.6	–3.7	Strongly counter-cyclical
Norway	–3.5	–1.3	–1.2	Slightly counter-cyclical
Poland	–2.5	–2.1	–1.2	Slightly counter-cyclical
Portugal	–2.7	–2.0	–0.8	Slightly counter-cyclical
Romania	–4.8	–3.1	—	Pro-cyclical
Slovak Republic	–2.5	–1.1	–1.3	Slightly counter-cyclical
Slovenia	–3.2	–1.9	(–2.1)	Slightly counter-cyclical
Spain	–9.6	–7.7	–3.9	Strongly counter-cyclical
Sweden	–2.4	0.9	–3.3	Slightly counter-cyclical
Switzerland	0.5	0.9	–0.5	Slightly counter-cyclical
United Kingdom	–5.1	–3.5	–1.9	Strongly counter-cyclical
United States	–6.3	–4.7	–5.6	Strongly counter-cyclical

Sources: Deficits: OECD (2010a); Eurostat (downloaded March 2011). Adjusted deficits for Bulgaria, Estonia Lithuania, Malta, Romania, Slovak Republic, and Slovenia from IMF (2010a, 120) and from IMF Country reports on Malta and Estonia. Fiscal Package: OECD (2009a, table 1.7, 63, update July 3, 2009. Retrieved on April 6, 2011, http://dx.doi.org/10.1787/658647186571). Malta: IMF (2009b, 11), Slovenia: IMF (2009c).

Notes: Column 2 and 3: Unadjusted/cyclically adjusted deficits 2008 and 2009 minus unadjusted/cyclically adjusted deficits 2006 and 2007, divided by 2. Since deficits are indicated by a negative sign, the increase has a negative sign as well.

Column 4: Fiscal package: 2008–2010 net effect of fiscal package on fiscal balance. In brackets: Data from IMF with limited comparability to OECD data.

Column 5: Strongly counter-cyclical: if fiscal policy program is at least size of the United Kingdom (–1.9%) and corresponds empirically to the increase of the level of deficits in Australia (–3.4 unadjusted, –2.8 adjusted). Pro-cyclical: if government claimed to pursue a restrictive fiscal policy. Slightly counter-cyclical: all remaining cases.

The obvious problem concerns the interpretation of the differences between the previous deficit level and the deficit level during the crisis. Even the adjusted deficits do not necessarily reflect deliberate fiscal response strategies. They are based on assumptions about potential GDP as denominator. They also capture such things as variations in the impact of the crisis, spending decisions made before the onset of the crisis, or time-invariant schemes that have some cost dynamics. Increasing health-care costs due to demographic change would be an example. Furthermore, they also depend on the cost of one-shot bailouts and similar crisis interventions. These latter measures were not intended to create lasting additional demand.

To overcome these shortcomings, we need information about the magnitude of the fiscal packages that were expressly intended to stimulate the economy by creating additional demand. The respective national governments, the OECD (OECD 2009c); the EU (EU Commission 2009), the European Trade Union Institute (Watt 2009), and the IMF in its surveillance reports have reported information on the scope of these fiscal packages. However, the data vary considerably depending on the source. The major explanation for this is that some governments labeled spending decisions that were taken before the crisis as elements of the crisis package (Watt 2009, 12), and other governments labeled EU means as part of the national fiscal package.

The cases of the Austrian and German fiscal packages are instructive in this regard: Austria introduced two programs in spring and September 2008. Neither was closely linked to the economic crisis following the financial crisis. Rather, they were part of a policy bundle that aimed to increase real household income in times of increasing inflation and was enacted just before a national election. Although inflation was reduced substantially in late 2008, these measures remained in force. They amounted to 30% of the total fiscal stimulus in the period between 2009 and 2010. In October and November 2008, two further fiscal programs were launched. In February 2009 an eco premium was introduced to encourage households to buy new cars. Finally in March 2009, a personal tax reform was decided on and enacted retrospectively to January 2009. This reform was decided upon earlier, though, and it is difficult to classify it as a clearly counter-cyclical policy (OECD 2009b, 31–34; Watt 2009, Table 2, footnote). The OECD calculates that the fiscal stimulus was in the range of 1.5–1.8% annually of GDP for the years between 2009 and 2013 (OECD 2009b, 32). Between 84% and 95% of this stimulus in the period 2009–2013 came through the spring 2008 program, the September 2008 program, and the tax reform, none of which were deliberate anti-crisis programs. In a certain sense, the Austrian government had decided on a solution (a fiscal impulse) some time before the problem (the crisis of the real economy) actually emerged.

Germany's fiscal stimulus consisted of four programs. The first program was decided on October 5, 2008 and included a temporary cut in unemployment insurance contributions and increases in child benefits and tax allowance for children. Two additional packages were adopted in November 2008 and January 2009. The January package was the largest. It amounted to 2.1% of GDP to be spent during 2009 and 2010, that is, about 1% of GDP p.a. A very popular element was a government subsidy of €2,500 if consumers bought a new car while scrapping their old car (> 9 years of age). The November 2008 package was much smaller, with a fiscal impulse of 0.2% of GDP in 2008 and 0.3% of GDP in 2009. The estimates for the extent of the fiscal stimulus in Germany vary. According to the OECD, the packages equaled €77 billion, that is, 3% of the 2008 GDP. Since these measures covered two to three years, the total average annual stimulus was 1.5% (OECD 2010b, 63–64). The IMF is more conservative; it estimated that the impulse was 1.5% of GDP in 2009 and 0.7% of GDP in 2010 (IMF 2010b, 16). An additional stimulus is due to rulings of the Federal Constitutional Court, which reduced government revenue annually by about 0.8% of GDP due to a change of the commuter tax allowance (*Pendlerpauschale*) and to a change of tax deductibility of social security contributions (Zohlnhöfer 2011). Hence, about two-thirds of the "gross" stimulus was not due to a crisis-related political choice but resulted independently from economic circumstances.

Combining data from the OECD on fiscal packages with the data on differences of the unadjusted and the structural deficits can help to classify countries, though. In addition to the quantitative data, I also checked qualitative data from newspaper reports, the OECD Economic Outlook, the OECD Economic Surveys, the IMF Staff Reports and Reports from Article IV consultations, and IMF country reports and related materials, for whether there is strong evidence that the national government expanded the budget in order to create significant additional demand or whether governments deliberately opted for a restrictive fiscal policy.

Given these restrictions, I classified the national fiscal response in the following way (see last column of Table 1). If a government explicitly rejected the idea of a stimulus program and aimed at a restrictive fiscal policy, this was considered a pro-cyclical fiscal policy. This applies even if the outcome was expensive, such as in countries that were hit very hard by the crisis (e.g., Ireland or Iceland). Here, the deficits were not a result of deliberate government action. Rather, they resulted, for instance, from the loss of tax revenue due to declining economic activity combined with spending obligations due to social policy programs, which obviated efforts by governments to contain deficits. Such a deliberate restrictive course was intended in nine countries, according to OECD and IMF sources. These are Bulgaria, Estonia, Greece, Hungary, Iceland, Ireland, Latvia, Lithuania, and Romania. In some of these nations—in particular, Greece and Bulgaria—governments failed to stick to their own fiscal programs. But again, that expansive course was not due to an intentional macroeconomic program, but rather it was a consequence of lacking fiscal discipline.

A response was classified as "counter-cyclical" if governments committed themselves to substantial deficit spending. This implies a deliberate choice to stimulate the economy by spending increases and tax cuts, and the willingness and capability to implement this policy. Hence, we expect substantial fiscal packages, which imply a substantial increase in deficits. How can we measure a substantial fiscal stimulus package? I set the lower threshold at the country that sees its own policies as being clearly "Keynesian" while having the smallest fiscal package among all nations that do not deny following an explicitly expansionary strategy. This is the case of the United Kingdom, with its fiscal package of 1.9% of GDP. According to former U.K. cabinet member Ed Balls, the British government was ". . . the only government in post-war British history which—faced with recession and deflation—had both the will and the means to fight it through a classic Keynesian response" (http://labourlist.org/2010/08/the-growth-deniers-ed-balls-full-speech/, July 2011). And it was the U.K. government—together with the U.S. administration—that called for a coordinated expansive fiscal response at the G20 meetings in London and Pittsburgh, while both France and Germany bluntly rejected the idea of a massive stimulus program.

Published plans for a stimulus do not necessarily translate into policies, though. Some governments had numerically dramatic programs—such as the German—but these did not lead to considerably higher deficits. Hence, in order to classify a case as being strongly counter-cyclical, it must have a substantial fiscal package (according to the self-definition by the government) that must also lead to a substantial increase of deficits. I define the threshold for a substantial increase of deficits based on the countries that were unquestionably those that engaged in counter-cyclical policy (Australia, Canada, United States, New Zealand; see OECD 2009c). Of those four countries, the increase in deficits in Australia was lowest, both with regard to adjusted and unadjusted deficits. Therefore, I take the Australian figures for increases of deficit levels as a benchmark. The operational rule then is that in order to be classified as "strongly counter-cyclical," a government needs to have a fiscal package of at least the size of the United Kingdom and an increase of both adjusted and unadjusted deficits that are at least the size of the increase in Australia (–3.4 percentage points for unadjusted and –2.8 percentage points for adjusted deficits). This gives six countries that pursued a counter-cyclical fiscal policy: Australia, Canada, New Zealand, Spain, the United Kingdom, and the United States.

Nineteen countries neither embarked on a restrictive fiscal policy nor took the counter-cyclical option. Rather, they chose the default strategy of a slight fiscal stimulus.

Using the combined figures for deficit increases and size of fiscal packages leads to the classification of some countries as "slight stimulus," although they are rather close to the strongly expansionary governments. This applies in particular to Denmark, Finland, and the Netherlands.[1] For statistical tests, I refined the 3-point scale (pro-cyclical, slightly counter-cyclical, strongly counter-cyclical) to a 4-point scale by adding the category of "almost strongly counter-cyclical" and putting these three countries in this new category. In all regression analyses, I estimated models with the dependent variable as a 3-point scale and a 4-point scale. Since this yielded substantially similar results, I report only the results for the 3-point scale. The 4-point-scale was also used for a fuzzy set analysis. For this variable, I gave numerical values (0, 0.33, 0.67, 1.00) in the sense of calibration necessary for a fuzzy set analysis (Ragin 2008).

This descriptive finding of strong variations in crisis responses is interesting in itself. According to major theories on globalization, the notion of the iron fist of liberalized capital markets, or the wordy claims of successful coordination by G20, IMF, or the EU Commission, we would have expected a strong congruence among the crisis responses. This clearly did not happen.

Explanations

How can we explain this variation in crisis responses? There are a number of very plausible economic arguments that may explain some, but probably not the most important, determinants of government action during the crisis. For example, countries differ with regard to their automatic stabilizers. These dampen fluctuations in GDP without any explicit government intervention. Examples of this automatic process include shrinking tax revenues and increased state expenditures due to unemployment compensation during an economic downturn. The larger these automatic stabilizers, the less is the need for additional fiscal stimuli. The OECD provided data on the size of these stabilizers, which I use as a control variable. These figures indicate the change of the budget balance as a percent of GDP for a 1% change in GDP (Girouard and Andre 2005, 22). Policy options may also depend on fiscal maneuvering room, which is significantly larger if a nation entered the crisis period with low debts and deficits. Therefore, the levels of deficits (average 2006 and 2007) and debt in 2007 need to be controlled for. The data for this come from the OECD (2010a) and the Web site of Eurostat. Finally, the fiscal reaction may be explained by the severity of the crisis. Countries that are hit hard have stronger incentives to react. Measuring the impact of the crisis before the fiscal packages could take effect is difficult. In the countries under study, the real growth rates started to decline in the fourth quarter of 2007. Between fall 2007 and the end of 2008, policymakers experienced declining economic activity before the fiscal packages—which were mostly decided upon in the last two months of 2008 and the first half of 2009—could have any effect. Therefore, I calculated the average quarterly real growth rate from the fourth quarter of 2007 to the fourth quarter of 2008, and deducted it from the average quarterly growth from the first quarter of 2006 to the third quarter of 2007 (Source OECDstat, downloaded Mach 14, 2011). This is a measure that does not suffer from endogeneity but also does not take account of the severity of the crisis after fall 2008. Therefore, I checked regression results by using an alternative measure: the worst quarterly growth rate in the period 2008 until the end of 2009. Both variables are closely correlated (0.77) and lead to substantially similar results. In the following, I present the models with the differenced growth rates, since they do not suffer from endogeneity.

In addition to these economic constraints and incentives, there is a classic collective action problem (Olson 1965). Countries that pursue Keynesian demand management and that are highly integrated in the world market need to have strong confidence that other nations will pursue similar policies. In the absence of coordination, a country that attempts to strongly stimulate demand through an expansive budget risks financing the economic recovery in the other countries (from which citizens import goods and services) while carrying the cost of this measure domestically. Small countries in particular have little incentive to contribute to such a global effort in fiscal stimulation, since they know that their own effort will be negligible toward the collective good of a recovered global economy. From the small country's perspective, it makes strategic sense to allow the governments of large countries to carry the burden.

Finally, politics may play a role. In the past, social-democratic parties showed a stronger inclination to use deficits spending than did liberal or conservative parties (Cusack 2001). I calculated an indicator for the presence of social-democratic and other left parties (social-democratic and other left members of cabinet as a percentage of total cabinet posts, weighted by days (source: updates of Armingeon, Careja, et al. 2010; Armingeon, Engler, et al. 2010, based on the *Political Data Yearbook of the European Journal of Political Research*).

Combining all the independent variables in one robust model is difficult, given the low number of cases. In particular, data for the size of the automatic stabilizers are available only for 25 of the 34 countries. In addition, the outcome variable is ordered, and therefore the ordered logit model is usually the appropriate choice. But in this application, we only have 34 (or 25) data points. We know the properties of the maximum likelihood estimator (consistency, normality, and efficiency) in large samples, but unfortunately we do not know the small sample properties of maximum likelihood estimators. Therefore, we might abstain from employing ordered model (ML) estimators when the sample size is too small (Long 1997, 53). The question is whether we want to use an ML that requires enough observations or a linear model that requires the outcome to be on an interval scale and that also suffers—although to a lesser degree—from small n's. Both solutions will force us to violate one assumption. I opted for the linear regression model. Table 2 reports the results of the regression analyses. Regressions have been done for the 3-point scale (3 = strongly counter-cyclical, 2 = slightly countercyclical, 1 = pro-cyclical) and for the operationalization of the dependent variable

TABLE 2
Regression Models. Dependent Variable: Fiscal Response Strategies

Independent Variables	Model 1	Model 2	Model 3	Model 4	Model 5
Extent of shock	0.01	0.07		0.00	
	(0.12)	*(1.92)*		*(0.24)*	
Level of deficits	0.04	0.04		0.02	
(2006/2007)	*(2.0)*	*(1.49)*		*(1.17)*	
Gross debt 2007	–0.01**	–0.00	–0.00	–0.01**	–0.01**
	(–3.33)	*(–0.66)*	*(–0.65)*	*(–2.99)*	*(–2.97)*
Import and export	0.00	0.00		0.00	
(% GDP 2008)	*(0.24)*	*(0.05)*		*(0.56)*	
Population (2008) (log)	0.33**	0.22*	0.21**	0.13*	0.10*
	(3.81)	*(2.35)*	*(2.82)*	*(2.03)*	*(2.45)*
Automatic stabilizers	–2.35				
	(–2.01)				
Left government	0.00	0.00		0.00*	0.00*
(2008 & 2009)	*(–0.05)*	*(0.72)*		*(2.39)*	*(2.68)*
One-party government				0.53**	0.49**
				(3.63)	*(2.94)*
IMF conditionality, candidate euro or European exchange rate mechanism, Ireland				–1.01**	–1.09**
				(–9.20)	*(–14.47)*
Constant	2.88**	1.62**	1.55**	1.83**	2.02**
	(4.65)	*(2.98)*	*(7.40)*	*(8.22)*	*(29.93)*
N	25	34	34	34	34
Prob > F	0.00	0.02	0.02	0.00	0.00
R2adj	0.52	0.26	0.17	0.85	0.83

Sources: See Table 1 and text. In brackets and italics: *t*-values. *$p < 0.05$; **$p < 0.01$.

as a 4-point scale. Since data for automatic stabilizers are available only for 25 countries, models were estimated with and without this variable. Two types of models were estimated. Models 1, 2, and 4 were run with all of the independent variables. Models 3 and 5 contain only variables that had significant coefficients in the models with the entire set of independent variables. All models are free from multicollinearity.

Models 1 to 3 consistently show that the level of debt and the size of the population are important predictors of fiscal responses. The higher debts are before the crisis, the less the likelihood that governments opt for a strategy that increases this debt further in the very near future. Small countries are more reluctant than large countries to choose the risky strategy of Keynesian demand management due to the considerable danger that the stimulus expenditures will trickle out of the country (since citizens buy abroad) and since the small amount of additional demand is incapable of significantly influencing the world market.

A larger set of plausible explanations is not supported by the empirical evidence from this analysis. The extent of the shock is not an important and significant predictor, and neither is trade dependence, the size of automatic stabilizers, or the strength of the left.[2] All coefficients (with the exception of the coefficient for imports and exports) have the theoretically expected direction. However, the explained variance in the full models is very small.

The conclusion from models 1–5 is that economic constraints, the partisan composition of national governments, and their rational economic cost–benefit calculations impact fiscal policy decisions, even if the criteria of statistical significance are not always met. But they do still leave much room for national variation in choosing a policy response. Therefore, we have to focus on further politico-institutional determinants of fiscal policy, assuming that ". . . economic policy-making is a quintessentially political process. Even in a field where the correct choice of policies depends heavily on expertise and the instruments for policy implementation, policy is driven by a dynamic that is as much political as economic" (Hall 1986, 229).

My argument is very simple and straightforward. It starts from the assumption that governments need to be able to make swift and significant fiscal policy changes. This requires that governments can act quickly and do not need to engage in time-consuming negotiations with coalition partners. This is a necessary condition for a significant fiscal policy change toward an expansionary strategy in the years 2008/2009. Hence, we expect one-party governments to react stronger and more expeditiously than coalition governments. In fact, all six governments that pursued a pronounced expansionary policy were one-party governments (Australia, Canada, New Zealand, Spain, United Kingdom, United States).[3]

In almost all other countries that did not pursue a significant anticyclical policy, the government was a coalition composed of two or even more parties. The only exceptions are the one-party governments of France, Greece, Japan, and Malta that pursued the default strategy or—in the Greek case—that claimed to follow a pro-cyclical policy. There are good explanations for why one-party government is a necessary, but not sufficient, condition for the outcome "strong counter-cyclical policy." For example, the Maltese government implemented a stimulus package in 2009 amounting to 1.5% of GDP, two-thirds of which was financed by EU grants. A larger stimulus package would have been hard to legitimize, given Malta's inflation problem and the previous policy of fiscal consolidation pursued by the reelected bourgeois government (IMF 2009b, 11). Hence, these four cases do not invalidate the argument, which is about necessary conditions. In order to depart from the default strategy, executives must be willing and able to change the course of fiscal policy dramatically in the short term. It would be a much more critical blow against my argument if there were coalition governments composed of governing parties that held very different views on taxation and spending that also deviated from the default response in favor of an expansionary policy, but there are no such cases.

The German and Swiss cases are good examples for the logic of the default strategy. Both countries were hit by the crisis, governments in both nations have a strong concern for fiscal sustainability, both were very skeptical about the effectiveness of demand-side management, and both feared that they would help other countries more than themselves when stimulating their strongly internationally integrated economies. In both countries, governing parties disagreed about adequate means and goals of intervention in the economy, arguably more so in Switzerland than in Germany. Outside of limited and immediate interventions into the financial sector and the electorally motivated very visible and self-explaining "focused" policies, such as the wrecking premium in Germany, the coalition governments in both countries necessitated extensive negotiation and compromise over broader fiscal policy. This took time, and initial proposals were significantly scaled back. What emerged was low risk and limited in nature, such as the plan to relabel previously accepted expansive policies as "stimulus" (Watt 2009), or to finance stimuli by EU transfers or by the simultaneous introduction of taxes to finance the expansive package, such as occurred in Italy.

Another strategy of low-risk electorally favorable crisis intervention was the shifting of blame and virtual resources to international organizations. During the three G20 meetings that dealt with the economic crisis (Washington, D.C., November 2008; London, April 2009; Pittsburgh, September 2009), the U.S. administration—together with the British government—tried to motivate European governments to stimulate the economy to an extent comparable to that in the United States. The answer was a very clear "no" by the German and French governments and the European Commission, all of which were able to free-ride on the Anglo-Saxon demand management. The solution agreed upon by most governments was the reinvigoration of the IMF, mainly through trebling its resources. This increase was not brought about by transfers of real funds, but rather by an increase in the credit lines of the member states. As far as these resources were needed, they were channeled in particular to the European members of the IMF (Woods 2010). Since far-reaching reforms of the internal structure of the IMF failed, the old rich democracies kept their dominance of the IMF. The IMF imposed tough austerity measures in Latvia, Hungary, Iceland, and Romania, which otherwise would have been hard to defend domestically without the existence of IMF conditionality. This outsourcing of competences to the IMF showed electorates that the government was doing something about the economic crisis, in particular if the domestic crisis packages were small.

At the same time, the EU pursed policies similar to the domestic default strategy. It relabeled expenditures as fiscal packages (such as an energy and technology program) and cautioned against any further, risky expansionary strategies.

But how can we explain that some governments (Bulgaria, Latvia, Lithuania, Estonia, Greece, Hungary, Iceland, Ireland, and Romania) opted for pro-cyclical policies, thereby risking to aggravate further the economic crisis? Clearly, coalition governments were able to introduce these measures despite their unpopularity and the subsequent inherent risks of electoral defeat. The simplest answer is that these governments did not have much choice. The Baltic nations, Ireland (IMF 2009a), and Iceland were arguably hit hardest by the crisis due to their specific reliance on international finance. Hungary, Romania, Iceland, and Latvia chose to ask for IMF loans, thereby accepting the policy goals of financial sustainability. In addition, the Baltic States and Bulgaria (which intended to enter the European Exchange Rate Mechanism II as a pre-stage of Euro zone membership) were the next candidates for membership in the Euro zone. Hence, for these countries, a counter-cyclical policy could endanger the future Euro membership. Arguably, this membership is more important both for governments and electorates than the potential short-term improvements in growth and employment that a counter-cyclical policy might bring. Therefore, the respective governments did not have much choice given their relationships with either the EU or the IMF.[4] In the case of Ireland, deficits increased massively due to lowered tax revenues and the extraordinary fiscal burden of providing financial support to banks. Hence, the Irish government hardly had any other choice but to design a pro-cyclical fiscal policy package (IMF 2009a). This does not imply that governments were always successful in cutting back expenditures. As the Bulgarian and Greece examples show, the administrations did not adhere to their published austerity programs—but they also did not opt for Keynesian measures. Rather, the soaring deficits may be explained by administrative inefficiency and lack of fiscal discipline among politicians. In the case of Greece, the EU and the IMF intervened effectively shortly after the end of the period under study.

The last two columns of Table 2 show the results when dummy variables for one-party governments and IMF credits/candidate status for European Exchange Rate Mechanism II or Euro zone membership/Ireland are entered in the model.[5] Obviously, these two variables are highly significant, and the explanatory power of the models with these two dummy variables is about twice as high as those of models 1–3.

An alternative technique to demonstrate the impact of these two variables on fiscal response decisions is qualitative comparative analysis (QCA; see Ragin 1987, 2008; for an application in the field of political science, see Schneider and Wagemann 2006; for an application in the field of comparative policy analysis, see Rizova 2011). Judged by the standard criteria of this type of analysis, the solutions for "strong counter-cyclical" and "pro-cyclical policy" are very good. Consistency for one-party government as a necessary condition for the outcome "strong counter-cyclical response" is 100% with a coverage of 60%. The consistency for IMF conditionality/Euro/ERMII/Ireland as a necessary condition for pro-cyclical policy is 88% with a coverage of 100%.[6]

However, one could argue that configurations with sufficient conditions might be identified that are both highly consistent and covering a very large number of cases. Hence, they may be at least as good as the explanation resting on necessary conditions. I tested for this possibility with a fuzzy set analysis both for the 3-point (now calibrated 0, 0.53, 1) and 4-point (calibrated 0, 0.33, 0.67, 1) scales of fiscal response. For the dependent variables, I used the calibration technique that rank orders the variable and then standardizes this ranking to range from 0 to 1. I could not identify solutions with reasonably high consistency and coverages. The best I could find were total coverages up to 0.38 and solution consistencies of 0.90. Hence, the argument with the necessary conditions is empirically better founded than any other explanation with these sufficient conditions.

Thus, the statistical analyses based on both a regression model and the logics of fuzzy set analysis corroborate the findings from the qualitative analysis: Certainly, economic and fiscal variables were important for governments when they designed their fiscal responses to the crisis of 2008/2009. The most important factor was whether these governments could react swiftly enough to deliver a sufficiently strong stimulus to the economy. The other main factors are the political constraints that leave governments no choice but to pursue a fiscal policy, which in all likelihood will contribute to a worsening of the crisis in the fields of growth and employment.

Conclusions

The fiscal response to the economic crisis of 2008/2009 varied considerably among the 34 democracies that belong either to the OECD or the EU. The countries can be assigned to three groups: A group of six nations reacted with a significant demand stimulus that resulted in a considerable increase in public deficit levels. I classify this response as strongly countercyclical fiscal policy. The United States is the most prominent member of this group. A group of nine countries chose the opposite strategy. They designed fiscal policies intended to scale down public expenditure, though in several cases this did not result in a reduction of the overall deficit. I classify this response as clearly pro-cyclical. Hungary is a case in point. A third group of 19 countries opted for a slightly expansionary policy strategy, in which the respective governments, including Switzerland and Germany, pursued low-risk and largely symbolic stimulus measures. These measures, however, were dwarfed by the magnitude of the crisis and by the magnitude of the fiscal stimulus undertaken by the strong counter-cyclical governments.

I argued that there are strong economic and electoral reasons for governments to pursue a mildly expansionary policy such as the one taken by the 19 countries of the second group. These governments minimize the risks of accruing public debt and funding the economic recovery of other countries as their stimulus expenditures trickle away to their trading partners. They also manage electoral dangers, as their policies allow them to claim to their electorate that they are actively trying to turn around their economies. Furthermore, in becoming active on the international level, they shift competencies to international organizations (the IMF in particular). In doing this, they are also able to deflect blame for a very moderate fiscal stimulus to the international organizations by claiming to their electorate that the IMF is doing the job and that their hands were tied.

If governments depart from this default strategy in favor of a significant counter-cyclical policy, they must be able to make risky decisions swiftly. This is possible only where leaders do not need to engage in lengthy negotiations with coalition partners that may hold different views on economic and fiscal policy. Therefore, a major and necessary condition of the expansionary strategy is the presence of a unified government, usually in the form of a one-party government.

If governments opt for pro-cyclical policy in a major economic crisis, they do so because they have little other choice. They are either under IMF conditionality (Hungary, Iceland, Romania, Latvia), or they have a more highly valued goal on the horizon, such as membership in the Euro zone, that would be endangered by an expansionary fiscal policy (in the Baltics, for example). In both cases, domestic governments are able to shift the blame to international organizations for not being able to do more about the current crisis.

My findings are in accordance with many works on fiscal consolidation that show that this process depends critically on the distribution of interests and power in governments (Franzese 2010; Hallerberg 2004; Hallerberg and Ylaeoutinen 2010; Spolaore 2004). The major difference between most of this literature and my analysis concerns the goals: In the absence of an imminent crisis, governments are concerned with fiscal consolidation. During an economic crisis and if monetary means are exhausted, governmental goals may change toward expansionary fiscal policy.

Two potentially powerful explanations were not tested here because they do not help us in understanding fiscal responses during the 2008/2009 crisis. The first is federalism (Rodden and Wibbels 2010): State governments have an incentive to save money in periods of expansive federal budgets, and hence they tend to turn the counter-cyclical central budget in a pro-cyclical direction. However, with the United States, Canada, Australia, and quasi-federalist Spain among the most counter-cyclical governments, this effect obviously did not have a powerful influence during the last two years. The significant correlation between federalism and fiscal response, then, is in the theoretically unexpected direction, as federal systems had a higher likelihood of embarking on an expansive strategy. The second explanation concerns the electoral cycle. One can assume that governments at the end of their term would be particularly willing to accept strongly expansionary policies, so long as they are viewed favorably by the electorate. However, despite facing a general election, the German government disregarded the many demands for a more aggressive fiscal policy, while the outgoing and the incoming U.S. presidents both launched their program of economic stimuli shortly before or after the 2008 election. A simple statistical analysis supports the notion that national elections were not a significant determinant of policy, as correlating the fiscal response with the latest year in which a general election was held in the period up to and including 2008 yields an insignificant coefficient.

If I am right, who is wrong? (1) My descriptive analysis contradicts arguments according to which the option of substantially different fiscal strategies is gone after capital market liberalization and monetary EU integration. (2) Economic variables—such as previous levels of debt or deficits, the size of the automatic stabilizers, the size of the domestic market, and the likelihood that the fiscal stimulus will be exported to other countries—have limited explanatory power. Economic variables certainly constrain governments, but in the end fiscal policy is about politics. (3) Partisan politics explain little of the variation of spontaneous fiscal reaction to economic crisis. This contradicts analyses that show that left parties are more in favor of counter-cyclical and bourgeois parties (Cusack 2001). One has to add, however, that my findings may be valid only for the second most dramatic economic crisis after the crisis of the 1930s—that is, during truly extraordinary circumstances (EU Commission 2009). Cusack's (2001) findings concern the broader period of 1961 to 1994. (4) My findings are not in accordance with many accounts that emphasize the constraining functions of institutions such as central banks or federalism. In hard times, politicians are obviously able to stretch considerably the institutionally defined corridor for political action. What seems to count in the end above all else is simply politics, such as the logic of one-party versus coalition government. (5) We have little evidence for the claims by international organizations that the EU, OECD, or IMF had a sufficiently large capacity to steer and coordinate fiscal policies across countries. Even in economically densely integrated societies, fiscal policy is still mainly framed by the domestic political actors.

Some qualifications are in order: Even the default strategy of a small fiscal stimulus contributed to strongly rising public debts in most countries; "default" strategy does not mean that these governments did not have to cope with major fiscal problems after the crisis. In addition, my argument does not claim to explain the policies of exiting the expansionary strategies and of reducing the public debt, though there are very good reasons to believe that this process will be strongly conditioned by the variables that have shown themselves to be powerful in explaining fiscal consolidation in the past. Rather, with regard to choosing between various fiscal policies, this comparative analysis showed that in the global crisis of 2008/2009, a swift and significant departure from the standard patterns of fiscal policies toward a major demand stimulus required the presence of governments that are able to make decisions without lengthy negotiation or compromises. It is difficult to gauge whether these policies really worked in terms of avoiding even worse outcomes in the areas of growth and employment. And it is even more difficult to gauge whether the advantages of a consistent counter-cyclical policy are not offset by the problems facing the public household once the crisis is over.

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Notes

1. In theory, a fiscal stimulus may be highly successful in increasing growth immediately so that the fiscal position of the country is not seriously damaged. Hence, there does necessarily not need to be a major deficit if a country pursues a significant counter-cyclical policy. Although this theoretical possibility is in practice unlikely, Sweden could be such a case (Lindvall 2011). Therefore in doing robustness tests, I coded Sweden also as "almost strongly counter-cyclical." This did not alter the substantive findings of the regression analyses.
2. The strength of left parties is significant in models 4 and 5, though. This significant result, however, could be obtained only when robust standard errors in regressions with dummy variables were estimated and when the dependent variable was the 3-point scale. It lost its significance when the dependent variable was the 4-point scale. In addition, the magnitude of the coefficient is relatively modest. A shift from 0 to 100% left party government leads to an estimated increase of just 0.3 points in the dependent variable (ranging from 1 to 3).
3. This classification refers to the period fall 2008 until December 2009. The classification of New Zealand as one-party government is a borderline case. On the one hand, National's John Key negotiated support agreements with the very small Maori Party, Act Party, and the United Future Party. On the other hand, it insisted that it is a one-party minority government (see Edwards 2009, 1064–1065). In the regression model (Table 2), substantive results were not altered when New Zealand was reclassified as a coalition government.
4. One could argue that those countries that had unsound public finances in the years preceding the crises were forced to ask for IMF support given the impact of the crisis. Hence, the fiscal situation in 2006/2007 could explain both the fiscal policy in 2008/2009 and IMF loans. This is not true, though. Among the four EU countries (Greece, Italy, Hungary, and Portugal) that had public debt > 60% in 2007 and a deficit of > 3% of GDP either in 2006 or 2007, only Hungary was under IMF conditionality in 2008/2009.

5. There is a statistical problem, since my argument is about necessary conditions, while the model underlying the regression model is a linear model of probabilities. In order to account for the character as a necessary condition (and the ensuing heteroscedasticity), the models were estimated with robust standard errors (Huber-White variance estimator). The optimal solution for the models with the two dummy variables would be a regression analysis with multiplicative heteroscedasticity. However, this is not feasible due to the small number of cases, since the estimation technique is maximum likelihood.
6. The analysis was done with "fuzzy," a suite of tools in STATA 11 (StataCorp 2009) that performs qualitative comparative analyses. In case of necessary conditions, "*consistency* assesses the degree to which instances of an outcome agree in displaying the causal condition thought to be necessary, while *coverage* assesses the relevance of the necessary condition—the degree to which instances of the condition are paired with instances of the outcome. . . . Consistency, like significance, signals whether an empirical connection merits the close attention of the investigator. . . . Coverage, like strength, indicates the empirical relevance or importance of a set-theoretic connection" (Ragin 2008, 44–45).

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