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Permanent Budget Surpluses as a Fiscal Regime

Lukas Haffert



European University Institute  
**Max Weber Programme**

## **Permanent Budget Surpluses as a Fiscal Regime**

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**Abstract**

This paper challenges the focus on budget deficits that permeates the literature on fiscal policy. It analyzes countries running budget surpluses and asks why some of them preserved these surpluses while others did not. Whereas several OECD members recorded surpluses for just a few years, balanced budgets became the norm in Australia, Canada, Denmark, Finland, New Zealand, and Sweden in the late 1990s. The paper compares the fiscal policy choices of both types of countries from a historical-institutionalist perspective. It argues that a path-dependent shift in the balance of power of fiscal policy interests explains why surpluses persisted in one group of countries but not in the other. This reconfiguration of interests was triggered by a deep fiscal crisis and an ensuing expenditure-led consolidation. It can be interpreted as creating a new “surplus regime”, in which fiscal policy became structured around the goals of balancing the budget and cutting taxes.

**Keywords**

Fiscal Policy, Budget Surpluses, Path Dependency, Austerity, Public Debt.

*Lukas Haffert*

*Max Weber Fellow, 2014-2015*



## Introduction: budget surpluses in OECD economies

*It is, of course, widely recognized that surpluses are unlikely to arise from deliberate policy action in a democratic political setting.*

James Buchanan, 1967: 8

The science of budget balances is a science of budget deficits. Internationally, news about fiscal policy is dominated by deficit crises, rating downgrades, debt ceiling disputes and other upheavals. The average indebtedness of OECD economies has more than doubled since the 1970s. Against this background, scholars of public finance have spent the last 40 years analyzing a “deficit bias” of representative democracies (Alesina & Tabellini, 1990; Buchanan & Wagner, 1977; Hallerberg, Strauch, & Von Hagen, 2009; T. Persson & Tabellini, 2003). The opposite case of budget surpluses received a short burst of attention in the late 1990s when the Clinton administration balanced the US budget for three consecutive years (Auerbach & Gale, 2000; Hassett & Hubbard, 1999; Posner & Gordon, 2001), but interest faded quickly when the US budget returned to a deficit in 2001. Apart from this brief exception, the literature has followed Buchanan’s lead and regarded budget surpluses as empirically unlikely to happen and—in case they happened nevertheless—as being of minor theoretical interest (Alesina, 2000).

This paper challenges the widespread neglect of budget surpluses. As Table 1 shows, this challenge can be justified empirically, as surpluses are a much more prevalent phenomenon than is widely assumed. To exclude one-off effects, I define a “surplus period” as a period of at least two years of continuing surpluses, which is interrupted by at most two deficits before the budget returns to surplus.<sup>1</sup> Applying this definition to the three decades from 1980 to 2009 results in 18 surplus periods in 13 different traditional OECD economies (five countries show up twice).<sup>2</sup> By contrast, only six traditional OECD economies (Austria, Belgium, France, Germany, Italy, and Portugal) recorded no surplus period over the entire three decades. While certainly less common than one would expect if budgets were balanced on average, surpluses are thus considerably more common than a Buchanan-inspired intuition would suggest.

Moreover, the challenge to the conventional focus can also be justified theoretically, as surpluses constitute “negative cases” (Emigh, 1997) which contradict dominant theories of fiscal policy. Specifically, they give rise to at least three different research questions: How they are created, how they are preserved, and how they are spent (on the latter see Haffert & Mehrrens, 2015). This paper will focus on the second question: how are surpluses preserved? This question has to be distinguished from the question how surpluses are created. Whereas surplus creation is a question of policy change—how to change fiscal policy to overcome a deficit?—, surplus preservation is a question of policy persistence, i.e. of non-change: how to prevent fiscal policy from changing again?

The issue of persistence is of particular importance because many observers believe that consolidation successes are persistently threatened by “consolidation fatigue” (Von Hagen, Hallett, & Strauch, 2002: 517). Furthermore, the process of balancing a budget has already been thoroughly analyzed by a large literature on fiscal consolidation (Alesina & Ardagna, 2009; Guichard, Kennedy, Wurzel, & André, 2007; Wagschal & Wenzelburger, 2008). About persistence, however, we know much less, because the consolidation literature is predominantly concerned with the process of consolidation itself and not with its aftermath. Those studies that explicitly investigate the sustainability of consolidation efforts restrict themselves to a two-year (Alesina & Ardagna, 2012) or,

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<sup>1</sup> Thus, New Zealand had a single surplus period from 1994–2008, despite small deficits in 1998 and 1999. The reason to allow for such brief interruptions is that budget balances only become clear ex post. Therefore, planned surpluses sometimes turn into deficits because of unexpected events.

<sup>2</sup> This is after excluding Ireland, Luxembourg, and Norway, which all recorded persistent budget surpluses. However, the Irish surplus was an artifact of an overheating economy (the cyclically adjusted balance was in deficit most of the 2000s), while Luxembourg and Norway benefit from unique geographical/geological circumstances.

at most, a three-year window (Wagschal & Wenzelburger, 2008) for defining sustainability. In contrast, this study will analyze persistence on a much longer scale.

<b>Country</b>	<b>Surplus Period</b>	<b>Length of Period</b>
<b>New Zealand</b>	1994–2008	15 years
<b>Canada</b>	1997–2007	11 years
<b>Finland</b>	1998–2008	11 years
<b>Sweden</b>	1998–2008	11 years
<b>Australia</b>	1998–2007	10 years
<b>Denmark</b>	1999–2008	10 years
<b>Japan</b>	1988–1992	5 years
<b>Denmark</b>	1986–1989	4 years
<b>Iceland</b>	2004–2007	4 years
<b>Sweden</b>	1987–1990	4 years
<b>Netherlands</b>	2006–2008	3 years
<b>Spain</b>	2005–2007	3 years
<b>United Kingdom</b>	1999–2001	3 years
<b>USA</b>	1998–2000	3 years
<b>Iceland</b>	1999–2000	2 years
<b>Netherlands</b>	1999–2000	2 years
<b>Finland</b>	1980*–1989	10 years
<b>Switzerland</b>	2006–2009*	4 years

**Table 1: Budget Surpluses in OECD Countries, 1980–2009; \* data is censored**

The issue of persistence is of particular importance because many observers believe that consolidation successes are persistently threatened by “consolidation fatigue” (Von Hagen, Hallett, & Strauch, 2002: 517). Furthermore, the process of balancing a budget has already been thoroughly analyzed by a large literature on fiscal consolidation (Alesina & Ardagna, 2009; Guichard, Kennedy, Wurzel, & André, 2007; Wagschal & Wenzelburger, 2008). About persistence, however, we know much less, because the consolidation literature is predominantly concerned with the process of consolidation itself and not with its aftermath. Those studies that explicitly investigate the sustainability of consolidation efforts restrict themselves to a two-year (Alesina & Ardagna, 2012) or, at most, a three-year window (Wagschal & Wenzelburger, 2008) for defining sustainability. In contrast, this study will analyze persistence on a much longer scale.

As Table 1 shows, the 18 surplus periods fall into two distinct groups with regard to their persistence. Six of them lasted for more than a decade (11.3 years on average). For want of a better term, I will call them “long” periods. These long surpluses developed largely in parallel in the mid- to late 1990s, and they all preserved their surpluses until the crisis of 2008. In contrast, in ten cases, surpluses were kept for a maximum of five years (and an average of 3.3 years). I will refer to these cases as “short” periods. These short surpluses are spread out over the entire period of investigation and correspond to peaks in the global business cycle.<sup>3</sup>

The paper aims to explain this gap between the two groups of cases. Why did balanced budgets develop into long surplus periods in some cases but not in others? Although this question asks

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<sup>3</sup> I exclude Finland in the 1980s and Switzerland from the following analyses. Finland had been running persistent surpluses already since the 1950s in order to finance a state-driven industrialization effort (Vartiainen, 2011: 60). This approach changed fundamentally after 1990. The Swiss surplus started in 2006 but did not end in 2009, making the data right censored.



about the differences between the groups, it does not put the same emphasis on both of them. Whereas the ten cases of short surpluses generally conform to the received wisdom, the six long periods constitute a puzzle for any theory positing a general deficit bias. The empirical analysis will therefore concentrate on explaining their distinctiveness.

Specifically, it will argue that these countries preserved their surpluses because a fiscal crisis and a subsequent expenditure-led consolidation triggered a persistent shift in fiscal policy interests. This shift can be described as a change of “fiscal regime” which led to the establishment of a new “surplus regime.” This regime was further entrenched by a tight fiscal reaction to adverse macroeconomic developments and by a credible commitment to use surpluses for funding tax cuts.

In contrast, countries that did not preserve their surpluses followed a very different path: They did not experience a similar fiscal crisis, their consolidation relied much more on revenue increases and they reacted very differently to macroeconomic shocks. Surpluses were therefore not accompanied by a fundamental reconfiguration of fiscal interests and fiscal policy remained much more similar to that of countries with deficits.

By tracing these differences the paper will show that democratic fiscal policies are not necessarily subject to deficit bias. Instead, they are characterized by strong path dependencies which can potentially give rise to very diverse outcomes. One such outcome is the persistence of surpluses within a “surplus regime”. This regime describes a temporarily stable configuration of the societal conflict about taxing and spending, in which tax cuts, while arithmetically being in conflict with balanced budgets, serve as a political complement to fiscal discipline. For the analysis of fiscal policy more broadly, this suggests not looking at different sides of the budget in isolation but focusing on their interplay instead. Furthermore, it shows that an overly voluntaristic view of fiscal policymaking underestimates how much the political room for maneuver is restricted by earlier policy choices and by the structural constraints which they created.

The paper proceeds as follows: The next section compares a voluntaristic and a regime-based theoretical framework for analyzing fiscal policy and demonstrates how these approaches would conceptualize the persistence of surpluses. The empirical core of the paper then traces the differences between both groups through a multi-step process of fiscal crisis, fiscal consolidation, surplus persistence, and surplus spending. The final section concludes and discusses why it is justified to talk of a “surplus regime” in those countries where surpluses were preserved.

### **Theory: voluntaristic and regime-based approaches to surplus persistence**

Because surpluses have received little attention in the literature, there are so far no direct attempts to explain the differences between long and short surplus periods. However, it is clear that the dominant approach in the literature, while sufficient to explain short periods, has a hard time dealing with long surplus periods.

Most explanations of a deficit bias of representative democracies derive from the public choice tradition and rely on a conceptually individualistic and ultimately voluntaristic view of fiscal policymaking. In these models, policymakers face a certain set of incentives and try to maximize their own self-interest under this incentive structure.

In this framework, the prediction of a deficit bias follows straightforwardly: The dominant incentive for policymakers is that tax cuts are popular, and so is higher spending. Tax increases, on the other hand, are unpopular, and so are spending cuts. Therefore, balancing the budget is not in the self-interest of vote-seeking politicians. Specifically, fiscal policy can be plagued by a classical common pool problem, by problems of time inconsistency, by fiscal illusion, by the strategic use of debt to constrain future governments, by issues of intergenerational redistribution, by electoral cycles, and by many other problems which do not need to be reviewed in detail (for a recent summary see Alesina & Passalacqua, 2015).

Regardless of the details, such a framework indeed predicts fiscal policy to be dominated by deficits. These deficits arise out of policymakers’ unrestricted pursuit of their self-interest, or, in other words, because they have too much discretion. The suggested solution therefore is to restrict policymakers’ room for maneuver by reforms of the budgetary process. Accordingly, economists and political scientists have proposed a host of formal institutional reforms, such as the introduction of

expenditure rules (Ljungman, 2008), the creation of fiscal councils (Calmfors & Wren-Lewis, 2011), the centralization of the budgetary process (Hallerberg, 2004), or binding coalition agreements (Hallerberg et al., 2009).

Following this literature, countries that introduce such institutional reforms should be more likely to preserve their surpluses than countries that do not. However, this explanation begs the question why countries reform their institutional framework in the first place. Therefore, this literature is plagued by a perennial endogeneity problem (Debrun & Kumar, 2006). Very often, such reforms will be introduced by countries already committed to fiscal thriftiness. It is then unclear whether reforms are actually a cause or rather an effect of a fiscal policy change.

This study proposes to analyze the persistence of budget surpluses on a much broader canvas and challenges the assumption of wide political room for maneuver. Relying on historical institutionalist concepts like policy feedback and path dependency, it rather sees political discretion as heavily constrained by past decisions and their consequences. The stability and persistence of policy choices has been at the core of the research program of historical institutionalism at least since Rose (1990). Important explanatory mechanisms developed in this literature can therefore be fruitfully applied to the question of surplus persistence.

Specifically, a path-dependency approach to budget surpluses suggests looking for two crucial differences between the two groups of countries. Firstly, there must be a mechanism of surplus reproduction which keeps a country on its new path and developed in one group of countries but not in the others. And secondly, there must be a moment of change which sets a country onto this new path and which triggered the reproduction mechanism in some countries but not in others.

Concerning the mechanism, such an approach has to spell out which constraints on the political room for maneuver developed in long surplus countries, and why these constraints generated strong pressures for preserving balanced budgets. In doing so, it can follow in the footsteps of the most comprehensive analysis of fiscal policy in a historical institutionalist spirit, undertaken by Paul Pierson (2001). Pierson developed the concept of a “fiscal regime” which he defined as

“the configuration of political interests, institutions, and policy arrangements that structure conflicts over taxes and spending [...] In utilizing the concept of a fiscal regime, I want to stress the connectedness of different aspects of the policymaking environment in a particular historical configuration” (ibid: 56–57).

Following this approach, one can hypothesize that fiscal policy remained embedded in the existing fiscal regime in countries with short surpluses, while there was a change of fiscal regime in countries with long surpluses. Regime change is then a process in which transformations in one part of the regime are *reinforced* by transformations in other parts of the regime. For example, new ideas about the goals of fiscal policy trigger institutional reforms, these reforms feed back on the structure of political interests, political parties adapt their fiscal strategies to these new interests, and when they are in government, they introduce further institutional reforms. This process goes on until the crucial elements of the regime have reached a new structure of complementarities. By contrast, regime persistence is a process in which transformations in one part of the regime are *counteracted* by persistence in other parts of the regime and the preexisting complementarities remain in place.

As fiscal regimes are characterized by complementarities, such a perspective suggests an enormous stability of fiscal policy choices. For explaining a transformation from persistent deficits to persistent surpluses, it therefore has to be complemented by a mechanism of regime change. Following the extensive literature on critical junctures (Capocchia & Kelemen, 2007), this points to an important role for fiscal crises. A crisis may fundamentally question the established regime and thus create the “permissive conditions“ (Soifer, 2012) to overcome resistance against regime changing reforms.<sup>4</sup>

Whether a crisis indeed forms a critical juncture will have to do with the specific circumstances of the crisis itself. However, it will also depend on the reaction to the crisis. Fiscal crises will trigger fiscal consolidation everywhere, but not every budget consolidation is equivalent to

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<sup>4</sup> On the role of crises for economic policy reform see also Drazen and Grilli (1993); Rodrik (1996); Drazen and Easterly (2001). More generally, this argument follows in the footsteps of Peacock and Wiseman (1961) and the literature on punctuated equilibria (Baumgartner et al., 2009).

a fiscal regime change. Most consolidation is just an adjustment within an existing regime. Only a consolidation in which “political interests, institutions, and policy arrangements” are transformed will have the long-term consequences implied by the regime concept.

The proposition that the composition of a consolidation program affects its success and sustainability is a staple of the consolidation literature (e.g. Alesina & Ardagna, 2009, 2012). According to their results, consolidation relying on expenditure cuts is much more likely to succeed than consolidation relying on revenue increases. But why would expenditure-led consolidation be more likely to generate a change of fiscal regime?

Following war-of-attrition models of fiscal consolidation (Alesina & Drazen, 1991), fiscal policy can be conceptualized as a conflict between two policy coalitions, one calling for higher expenditure and the other one calling for lower taxes.<sup>5</sup> Expenditure coalitions will typically contain the beneficiaries of public redistribution and public services, but also their producers (i.e. public servants), and those domestically oriented sectors of the economy who benefit from an activist, anti-cyclical use of fiscal policy and who are comparatively sheltered from global tax competition. The partisan literature typically considers parties of the left as the political representatives of the call for higher expenditure (Franzese, 2002). By contrast, tax-cut coalitions will bring together the net-contributors to public redistribution, but also export-oriented sectors for whom deficit spending holds little promise but who see their fortunes threatened by international competitors who benefit from lower taxation in their home countries. Typically, parties of the right are considered to be the political representatives of lower taxes. A pivotal group, finally, are middle classes, which can potentially belong to both coalitions. In universalistic welfare states, they consume many public services and are therefore willing to support them. In more residual welfare states, however, they have to buy these services on the market and are therefore more supportive of tax cuts which increase their disposable income.

In this framework, the relative political weight of the two coalitions is affected very differently by different types of consolidation. An expenditure-driven consolidation will *weaken* spending coalitions by making the welfare state more residual, but will leave tax cut coalitions largely unaffected. Those who have always demanded lower taxes will keep doing so while those whose public services have been cut are induced to develop private alternatives and to rely less on the state. A revenue-driven consolidation, by contrast, leaves spending coalitions largely unaffected but *strengthens* tax-cut coalitions. Those who pay higher taxes will join the ranks of the tax-cut coalition while no one is induced to leave the spending coalition.

The political effects of revenue-led and expenditure-led consolidation are therefore highly asymmetric. Expenditure-driven consolidation will generate much stronger path dependencies and are much more likely to induce a fiscal regime change than revenue driven consolidation.

### **Empirics: from deficit crisis to surplus regime**

The regime-based argument developed in the previous section implies that long surplus countries and short surplus countries were already on very different paths when they first balanced their budgets. It thus invites a long-term perspective which does not start with the surpluses themselves but with the fiscal crises and the consolidation that created surpluses. It furthermore suggests looking at the reconfiguration of strategic and material interests which were triggered by these events. The following empirical comparison of the differences between both groups will therefore pay particular attention to how fiscal events affected the strength and cohesion of spending and tax cut coalitions in the medium- and long term.

The analysis starts with the fiscal conditions in the years preceding the surpluses. After that, it compares the consolidation efforts which balanced the budgets in both groups of countries. Thirdly, it looks at the institutional reforms undertaken during and after the consolidation. Fourthly, it compares the fiscal reaction to adverse macroeconomic developments, which were decisive for the preservation of surpluses. Finally, it looks at the evolution of tax policies during surplus years. The analysis of all five steps concentrates on the differences between and the commonalities within groups. Furthermore,

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<sup>5</sup> Barta (2011) argues that fundamental consolidation has to be understood exactly as such a rebalancing of societal forces. In its most general form, this argument goes back to Gourevitch (1986).

it focuses on countries with long surpluses, as they form the theoretically interesting “negative cases”. In doing so, the peculiar number of cases calls for a delicate balance between abstraction and detail. As the number of cases is too small for elaborate statistical tests, the section will focus on comparing group averages. At the same time, the number of cases is too big for a comprehensive treatment of all long surpluses. The discussion of group averages will therefore be illustrated by—necessarily selective—qualitative evidence which is not intended to give a full account of the development in all six countries, but rather to highlight the main mechanisms driving the observed results.

### ***Long surplus countries experience financial market pressures***

All six countries where surpluses would later be preserved experienced unique fiscal and macroeconomic difficulties in the late 1980s and early 1990s (Schwartz, 1994). They had all reacted to the macroeconomic upheavals of the 1970s with big public investment programs. These interventions, however, failed to produce the intended results but increasingly exhausted the fiscal capacity of the state. This led to serious fiscal crises in the late 1980s or early 1990s.<sup>6</sup>

One symptom of these crises were high budget deficits and rising debt-to-GDP-ratios. Yet, deficits also grew in many other countries and headline numbers were even worse in Belgium, Italy, or Japan. What distinguished countries with long surpluses was not the absolute size of their problems but the rapid deterioration of their situation. They all started from a very strong fiscal position (the debt of all six countries was rated AAA in the early 1980s) and all lost the trust of financial markets during the crisis.

<b>Country</b>	<b>Downgrade by Standard&amp;Poor's</b>	<b>2<math>\sigma</math> hike of interest rate spreads</b>
<b>Australia</b>	02.12.1986: AAA to AA+ 24.10.1989: AA+ to AA (neg)	1986–87 1989
<b>Canada</b>	14.10.1992: AAA to AA+	1990
<b>Denmark</b>	06.01.1983: AAA to AA+ 07.03.1985: AA+ to AA	1982
<b>Finland</b>	03.03.1992: AAA to AA+ 11.03.1993: AA+ to AA-	1990 1992
<b>New Zealand</b>	29.04.1983: AAA to AA+ 02.11.1986: AA+ to AA 22.01.1991: AA to AA-	1985 1986 1987
<b>Sweden</b>	22.03.1993: AAA to AA+	1990
<b>Other OECD members</b>	/	/

**Table 2: Rating Downgrades and Interest Rate Spreads in OECD Countries, 1980–2000; source: Baldacci, Petrova, Belhocine, Dobrescu, and Mazraani (2011); Standard&Poor's (2011)**

This can be seen from two indicators of financial market pressure, namely credit ratings and interest rates on government bonds (Table 2). All countries where surpluses were preserved were downgraded in this period, and some of them several times. In contrast, no other OECD members were

<sup>6</sup> These crises also show that persistent surpluses can hardly be attributed to a deep-seated cultural aversion to debt. Such a cultural argument cannot account either for the particularly strong increase of private debt in countries with permanent surpluses in the buildup of the 2008 financial crisis (Mc Kinsey Global Institute, 2015).

downgraded between 1980 and 2000 (Japan was downgraded in 2001).<sup>7</sup> Furthermore, pressure did also arise from investors directly. Baldacci et al. (2011) define a fiscal crisis as a situation in which the spread between the interest rate on a country's debt and the interest rate on US treasuries deviates by more than two standard deviations from its long-term average. With this operationalization, they identify a fiscal crisis in just six OECD economies between 1980 and 2007, which are exactly the six later surplus countries.

While some countries with short surpluses also experienced deep fiscal troubles, in particular the Netherlands, financial market pressure did not become as acute in any of them. Rating downgrades and interest rate pressures thus provide an important first distinction between the two groups of cases. The existence of a fiscal crisis alone, however, does not yet explain why crisis countries would later preserve their surpluses.

This, instead, has a lot to do with the psychological and political dimensions of the crises, which questioned the social and economic models of these countries fundamentally, in particular in the social democratic welfare states of Scandinavia (Lindbeck, 1997). The economic troubles caused a deep feeling of national crisis both among the population (Benner & Vad, 2000; Lewis, 2003; Nannestad & Green-Pedersen, 2008) and among economic and political elites (Fortin, 1996; G. Persson, 1996; Steinmo, 2002; Wenzelburger, 2010). This intense feeling of crisis was heightened by memorable moments in which the crisis culminated symbolically. These were sometimes economic events, for example when the Swedish central bank increased the overnight lending rate to 500 percent (sic!) to defend the exchange rate of the Krona (Mehrtens, 2014) or when a Canadian bond auction almost failed to attract the necessary demand (Palmer & Egan, 2011). More often, though, these were rhetoric moments which captured the crisis mood in a single, powerful image. Paul Keating's diagnosis of Australia being in danger of becoming a "banana republic" (Schwartz, 1994), David Lange's comparison of New Zealand's economy to a "Polish shipyard" (Goldfinch & Malpass, 2007), or the Wall Street Journal's description of Canada as an "honorary member of the third world" (Courchene, 2002: 23) are still quoted regularly today.

One immediate expression of this crisis feeling were political upheavals. Sweden and Canada experienced so-called "earthquake elections" in which old parties demised and new parties rose (Arter, 2012; Brede & Schultze, 2008). Furthermore, the continued existence of the Canadian federation was questioned by the Quebec referendum in 1995. New Zealand, in response to widespread voter discontent with the established parties, even fundamentally reformed its electoral system and replaced majoritarian voting by a German-inspired version of PR.<sup>8</sup> While these upheavals had many causes, economic calamities played an important role, as cash-strapped governments were increasingly unable to use public funds to stabilize existing political alignments (Vowles, Aimer, Catt, Lamare, & Miller, 1995; Weaver, 1992).

These crises therefore triggered a fundamental reshaping of economic and fiscal priorities in all six countries. They clearly demonstrated that short-term adjustments of specific policies would not be enough and that fundamental reforms were necessary (Lewis, 2003; Mehrtens, 2014). Such reforms did not only fight the deficits but also created a new durable fiscal policy context in which the later surplus policies were made.

### ***Consolidation in long surplus countries is expenditure-driven***

In reaction to their fiscal crises, countries with long surpluses engaged in massive consolidation programs to reduce deficits and win back the trust of financial markets. Yet countries with short surpluses also undertook consolidation efforts that—while not being imposed by financial markets—were sometimes quite sizeable. However, the composition of consolidation programs differed considerably between both groups.

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<sup>7</sup> Market confidence in Belgium and Italy had always been shaky, so these countries did not lose confidence they had enjoyed before.

<sup>8</sup> A reform that theoretically should have made the preservation of surpluses less likely.

As Figure 1 shows, budget consolidation in countries with long surpluses focused almost entirely on the expenditure side of the budget.<sup>9</sup> In contrast, countries with short surpluses relied much more on increasing revenue. This is the case both when looking at the three years directly preceding the surplus and when looking at the entire consolidation, defined as the entire period in which budget balances improved. In addition, there was almost no difference with regard to economic growth in the three years preceding the surplus. While growth rates were generally high in both groups, they contribute very little to distinguishing preservation from non-preservation. Thus, countries with a long surplus did not simply enjoy highly beneficial circumstances.

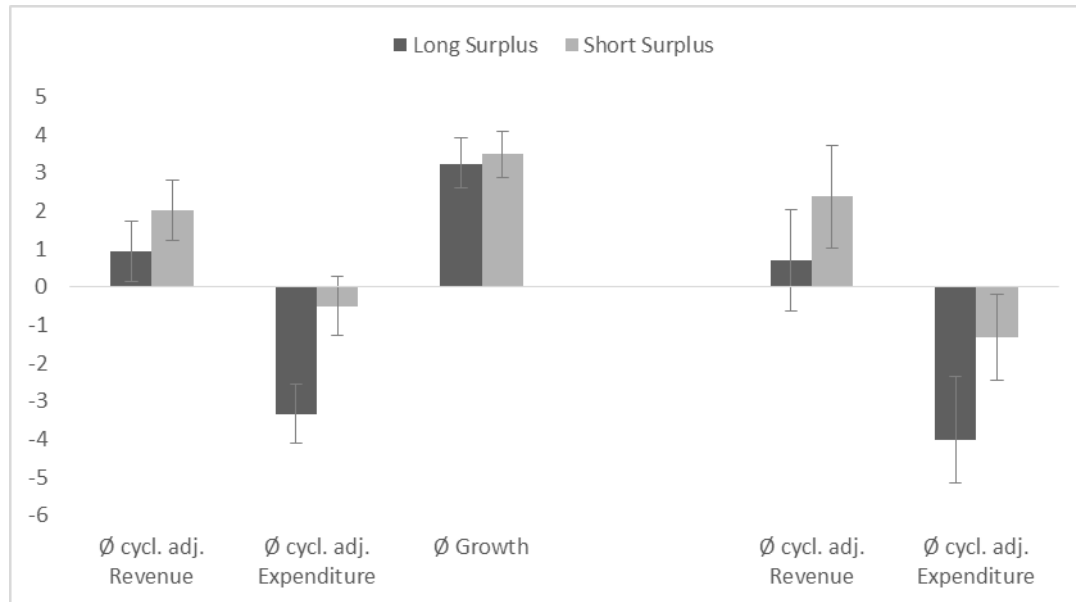


Figure 1: Composition of consolidation preceding budget surpluses<sup>10</sup>

That consolidation programs in long surplus countries focused on the expenditure side of the budget had important political consequences. In particular, spending cuts weakened those interest groups that had traditionally fought for an activist state. This happened on two levels: Firstly, concerning the supply of public services, the state considerably reduced the number of its public servants. Public sector unions, a traditional stronghold of the labor movement, thus lost political influence. Between 1990 and 2000, the share of public sector employees among all employees declined from 22% to 16% in Australia, from 23% to 19% in Canada, from 37% to 31% in Sweden and from 21% to 12% (sic!) in New Zealand (ILO, 2013). Only in Finland, it did hover constantly between 26% and 28% (no data for Denmark available). By contrast, the share of public employees remained constant in the US, whereas it first decreased and then increased again in the UK.

Secondly, demand for public services was also seriously affected by the privatization of these services. Privatization could mean completely abolishing the public provision of certain goods and services or—more often—privatizing their production though not their financing. In this case, the state still paid for the service that was delivered by private suppliers. In both cases, however, supporters of a strong service state were weakened as public services acquired a more residual character and no longer included all social groups.

The effects of such reforms are particularly visible in Sweden, which had always been regarded as the epitome of the social democratic service state (Huber & Stephens, 2000). In fields like elderly care, education, health, and child care, a substantial part of services is today delivered by

<sup>9</sup> The narrative method of DeVries, Guajardo, Leigh, and Pescatori (2011) confirms this result for Australia, Canada, Finland, and Sweden. New Zealand is not part of their dataset, and the Danish case is somewhat ambiguous. According to their data, almost all consolidation efforts in Denmark happened in the 1980s (see below).

<sup>10</sup> Because of the small number of cases I show 90% confidence intervals.

private providers though financed by the state (Gingrich, 2011; Mehrrens, 2014). In a process of layering (Streeck & Thelen, 2005), these private structures have increasingly replaced classical state-provided public services. Thereby, they allowed important constituencies to “exit” the public system and leave it and its problems behind (Schwartz, 1994: 530). Before the privatizations, these constituencies had to use “voice” to demand a political reaction to their discontent. Accordingly, increasing polarization about the goals of public education, as Fladmoe (2012) documents for Finland and Sweden, leads to more exit into private schools instead of a voice-based strengthening of the public system.

Crisis and consolidation thus triggered a kind of self-fulfilling prophecy: They led citizens to expect cuts to public programs and thus to rely less on the state. For example, in a 1997 survey the large majority of Swedes expected that the public pension would not guarantee an acceptable standard of living and would have to be complemented with private insurance (Edlund, 2006: 399). The fact that citizens then invested in alternatives to state provision, in turn, made the expected cuts politically viable (Lewis, 2003: 162). Ex post, cuts then seemed to confirm how prescient it was not to rely on the state.

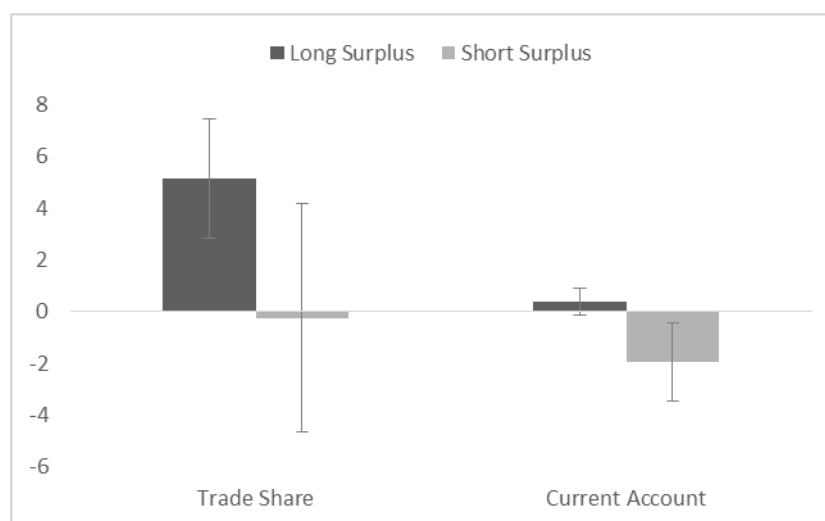
The fact that citizens relied less on the state, however, did not mean that public programs became less popular in general. In some countries, the welfare state today is even more popular than before the crisis (Goul Andersen, 2008; Svallfors, 2011). To the confusion of scientific observers (Leigh, 2006), however, this popularity has not been translated into expansionary policies. This, again, points to the difference between policy change and policy preservation. While this popularity ensures that open retrenchment is almost impossible except in times of severe crisis, protection from retrenchment and support for expansion are two entirely different questions. After consolidation had succeeded, the debate in long surplus countries moved from retrenchment to selective expansion. Such an expansion, however, would have required an active support coalition, which is very different from a passive defense coalition that protects the welfare state. But this active coalition had lost large parts of its organizational capacities and its political clout during the consolidation (Lewis, 2003: 105f.; Schwartz, 1994: 530; Svallfors, 2015).

Another important facet of the decline of expenditure coalitions in long surplus countries was that consolidation measures were pursued with the consent of all major parties, be it because governments depended on the support of the opposition (in Sweden and Denmark), because government changed hands during the consolidation (in Sweden, Finland and New Zealand), or because consolidation efforts of the central state were replicated by provincial governments of all stripes (in Australia and Canada). For example, the Swedish bourgeois government and the oppositional Social Democrats already agreed on several savings measures in 1992. From 1994 onwards, the new Social Democratic minority government then relied on the support of the left party in some cases and on the agrarian center party in others. In Canada, the federal budget consolidation was pursued by a Liberal government while the opposition parties enacted very similar programs in Ontario (Progressive Conservatives), Alberta (Reform Party), and Saskatchewan (New Democrats) (MacKinnon, 2003).

As a consequence, almost all countries had governments which strongly defined themselves through the consolidation efforts. In Sweden and Finland, governments had been explicitly elected on the promise of consolidation; and in Canada, Australia, and New Zealand, consolidation had quickly become their most important political project. Moreover, opposition parties could not credibly attack the governing parties for being too austere. Instead, they generally opted for a strategy of “difference minimization” and tried to present themselves as offering even greater fiscal responsibility (Battin, 2002; Haffert & Mehrrens, 2014). This was particularly so when the main opposition party could be blamed for the financial troubles preceding the consolidation, as was the case in Australia or Sweden.

Finally, expenditure-led consolidation efforts were also associated with a shift in the growth model of the respective economies. As many analysts have pointed out, successful consolidation benefitted enormously from increased export demand which cushioned the contractionary effects of expenditure cuts (e.g. Perotti, 2011). As Figure 2 shows, the cumulated share of imports and exports increased by more than 5% over the three years preceding the surplus in countries with long surpluses,

while it remained constant in the other countries. Moreover, the current account balance improved by 0.4% in long surplus countries, whereas it declined by almost 2% in countries with short surpluses.



**Figure 2: Development of trade share in GDP during the consolidation.**

The export boom did not only help the economies of long surplus countries to deal with the consolidation, it also strengthened the political clout of export sectors. In these small open economies, export interests had always held a certain sway over fiscal policies. This sectoral cross-class coalition between capital and labor was now reinforced (Schwartz, 1994). Its members supported policies geared to increasing the economy's international competitiveness, in particular by cutting taxes. In contrast, the biggest economies with surpluses—the USA, Japan, and the UK—, in which export interests played a smaller role, and in which tight fiscal policies are generally more difficult because of their bigger contractionary effects (Buti & Pench, 2004), all failed to preserve their surpluses. This, however, is also true of several small economies with surpluses, suggesting that the size of the economy is only one among several elements of the explanation.

One long surplus country where this sequence of crisis and consolidation differed slightly is Denmark. The Danish crisis culminated already in the early to mid-1980s. Denmark then managed to run budget surpluses from 1986 to 1989, thereby inspiring the literature on expansionary fiscal consolidation (Giavazzi & Pagano, 1990), but did not preserve them (Nannestad & Green-Pedersen, 2008). The reason was that these surpluses were not created by cuts to public expenditure but by revenue increases due to an economic boom. This boom, however, was driven by low interest rates and the wealth effects of rising house prices, but not accompanied by an expansion of the economy's productive capacity. The OECD estimates economic output to have been four per cent of GDP above potential in 1986 (OECD, 2012).

When the government introduced contractionary measures, referred to as a “potato cure”, the boom collapsed and the Danish economy entered a long phase of stagnation, from 1987 to 1993, during which the deficit again ballooned to almost four per cent of GDP. Thus, the surplus of the 1980s is best seen as an element of an unfolding crisis sequence rather than an expression of fiscal policy success. Only the consolidation efforts of the 1990s, constructed around a set of “activating” labor market reforms (Benner & Vad, 2000: 450; Gaard & Kieler, 2005), managed to turn Danish public finances onto a more sustainable path.

### ***Budgetary institutions are reformed after consolidation succeeded***

As pointed out above, when public choice interpretations of fiscal policy look for tools to reign in democracy's deficit bias, they typically recommend reforms of the budgetary process. And indeed, many such reforms were introduced in countries where surpluses persevered. Table 3 is based on a recent IMF study (Budina, Kinda, Schaechter, & Weber, 2012) which catalogued four types of fiscal rules, namely balanced budget rules (BBR), debt rules (DR), expenditure rules (ER) and revenue rules



(RR). Unfortunately, this study only covers explicit rules and no other types of institutional reforms but it is the best comparative effort available.<sup>11</sup> It shows a huge number of reforms in countries with long surpluses and a much smaller number in countries with short surpluses. Furthermore, the table distinguishes whether a rule was introduced before or after the budget was first balanced.<sup>12</sup> Reforms in countries with long surpluses happened mostly after surpluses had already been achieved. In contrast, reforms in countries with short surpluses usually preceded the surpluses.

On a first look, this strong correlation between institutional reforms and surplus preservation seems to confirm the public choice recommendation. Nevertheless, there are at least four reasons to be skeptical about a causal interpretation of this finding. Firstly, while the institutional reforms certainly point to a difference between both groups, this difference is likely to lie deeper, so that the reforms are its consequence and not its cause. This interpretation is supported by the timing of the reforms in long surplus countries. If anything, their effect was not to bring about a consolidation, but to codify an already achieved success. This distinguishes them from earlier attempts to fight deficits through institutional reforms. Neither the “expenditure framework” introduced by Denmark in 1984 (Christiansen, 2008: 154), nor the Canadian “Spending Control Act” of 1991 (Blöndal, 2001), or the Finnish expenditure rules of the early 1990s (European Commission, 2003: 252) had been particularly successful. In contrast, governments generally complied with the rules of the late 1990s and early 2000s.

Secondly, none of these reforms included explicit sanctioning mechanisms. In many cases, reforms were not even codified. And where they were, as in New Zealand’s “Fiscal Responsibility Act” and Australia’s “Charter of Budget Honesty”, they did not contain enforcement mechanisms for punishing deviations from fiscal targets. Moreover, the targets themselves were defined in rather abstract terms like “reducing public debt to prudent levels” (Janssen, 2001). The specific operationalization of these targets was left to the government. These reforms were thus mainly political declarations which focused on transparency and accountability towards voters. In a public choice framework it is not clear why politicians should obey such a weak rule or why voters should punish them for not doing so.

Thirdly, all surplus countries regularly beat their institutional targets. Hence, these targets did not really force political choices that would otherwise not have been made. To the contrary, governments sometimes pursued policies even tighter than demanded by the rules: “In practice, Sweden seems to have targeted a structural surplus of 2 percent of GDP which is an even tougher rule” (IMF, 2002: 4). The first conflict between Sweden’s new “Fiscal Council”, introduced in 2007, and the government arose about the fiscal reaction to the great financial crisis (Calmfors & Wren-Lewis, 2011), when the council, remarkably, did not criticize the government for being too expansionary but rather for being too austere (Haffert & Mehrtens, 2015).

Fourthly and finally, the single most important change in the budgetary process was not formalized at all, namely a tendency to base the budget on very pessimistic assumptions. Empirically, Frankel and Schragger (2013) find that most countries tend to make systematically over-optimistic forecasts of budgetary developments. As their data also show, however, the opposite is the case in long surplus countries, which systematically underestimated their surpluses.<sup>13</sup> This persistent underestimation was no accidental result of positive macroeconomic surprises but was clearly intended (Janssen, 2001: 13; Kelly, 2002: 77; O’Neill, 2005). At the same time, it was emphatically not the consequence of any formalized pressure on governments. Quite the contrary, the literature generally assumes that institutional rules will induce over-optimism in official forecasting (Frankel & Schreger, 2013).

Taken together, these objections suggest that institutional reforms were not the exogenous cause of a fiscal policy change, but one of its endogenous elements. They expressed a consensus that

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<sup>11</sup> The European Commission provides a “fiscal rule strength index” but only for EU member countries.

<sup>12</sup> Admittedly a rough measure, as there is often a lag between the decision about a rule and its actual implementation.

<sup>13</sup> I thank Jeffrey Frankel and Jesse Schragger for sharing their data with me.

had already formed among key actors as a result of the crisis and consolidation experiences of the previous decade. When introducing institutional reforms to their national parliaments, ministers of

Long Surpluses			Short Surpluses		
Country	Rules before	Rules during	Country	Rules before	Rules during
<b>Australia</b> (surplus since 1998)		BBR 1998 DR 1998 RR 1998	<b>Denmark</b> (1986)		
<b>Canada</b> (1997)		BBR 1998 DR 1998 ER 1998	<b>Iceland</b> (1999)		
<b>Denmark</b> (1999)	BBR 1992 ER 1994	RR 2001 BBR 2007 ER 2007	<b>Iceland</b> (2004)		ER 2004
<b>Finland</b> (1998)	DR 1995	BBR 1999 ER 2003	<b>Japan</b> (1988)		
<b>New Zealand</b> (1994)		BBR 1994 DR 1994	<b>Netherlands</b> (1999)	ER 1994 RR 1994	
<b>Sweden</b> (1998)		ER 1997 BBR 2000	<b>Netherlands</b> (2006)		
			<b>Spain</b> (2005)	BBR 2003	BBR 2006
			<b>Sweden</b> (1987)		
			<b>United Kingdom</b> (1999)	BBR 1997 DR 1997	
			<b>USA</b> (1998)	ER 1990	

**Table 3: Institutional Reforms in Countries with Budget Surpluses**

finance made it very explicit that these reforms were a response to the preceding experience of crisis (Costello, 1996; Richardson, 1994). And also in countries where reforms were not legally codified, budgetary reforms seem to have been heavily influenced by the crises (Ljungman, 2008: 47).

This does not mean that institutional reforms were irrelevant for the persistence of surpluses: They were important signaling devices which demonstrated a government's determination to stay the fiscal course. Furthermore, they created focal points which defined success and failure and thereby structured the political debate. They certainly contributed to keeping fiscal policy on a new path, but they had not set it on this new path.

### ***A tight reaction to macroeconomic shocks ensures the persistence of surpluses***

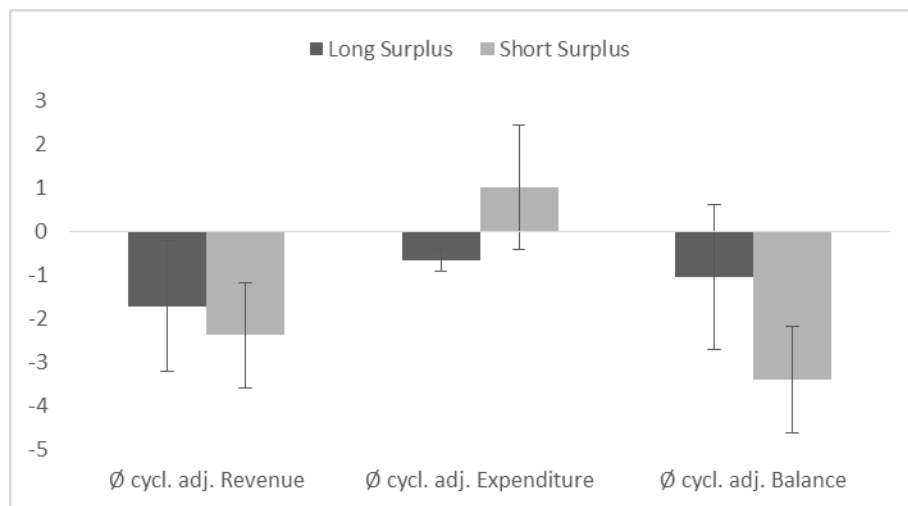
The first years of budget surpluses were a time of good economic performance in all 16 cases under investigation. Tax revenue increased as the economy grew while welfare state expenditure declined as unemployment rates fell. Things began to change, however, when the economic booms, from which

the surpluses had benefitted so much, ran out of steam. Confronted with adverse macroeconomic developments, some countries managed to preserve their surpluses while others returned to a status of permanent deficits. While they had already been on different political paths, now their fiscal paths diverged as well.

Unfortunately, the empirical analysis of this divergence is complicated by the fact that different shocks affect countries differently at different times. I will therefore not try to compare policy responses to different shocks over time. Instead, I analyze only one macroeconomic shock, which is the global downturn of 2001–03 in the aftermath of the bursting of the IT bubble. This unfortunately reduces the number of comparison cases to just four: Iceland, the Netherlands, the US and the UK.

Figure 3 shows the development of cyclically adjusted revenue and expenditure in these four short and the six long periods between 2001 and 2003. It shows a clear difference in the discretionary fiscal reaction to the downturn. Countries with long periods were more reluctant to cut taxes and much more reluctant to increase expenditure. Adding up changes on the revenue and on the expenditure side, the fiscal stimulus provided by countries with short surpluses was more than three times as big as the stimulus provided by long surplus countries.

Thus, only the former opted for explicitly expansionary fiscal policies. For the US government in particular, the recession even provided a welcome opportunity to repackage long since planned policies as necessary macroeconomic interventions (Morgan, 2009). By contrast, countries with long surpluses let automatic stabilizers do their work, but did not use discretionary measures to stabilize their economies. Where they introduced discretionary measures, these were often contractionary and designed to protect the surplus (Costello, 2008: 174; Lindh & Ljungman, 2007: 43).



**Figure 3: Fiscal reaction to the recession of 2001–2003; \* Iceland, the Netherlands, UK, US**

Whether this tight approach was successful in economic terms is a disputed point. At least, it was certainly not dictated by fiscal necessities. If anything, these countries were in an even stronger fiscal position than the more interventionist countries with short surpluses: Several studies show that the six countries with long surpluses have comparatively low risks to fiscal sustainability (European Commission, 2006: 66; Ostry, Ghosh, Kim, & Qureshi, 2010), while pressures from the ageing of their societies are not larger than in other OECD economies (Merola & Sutherland, 2012; OECD, 2011). Thus, a more activist approach would have doubtless been affordable.

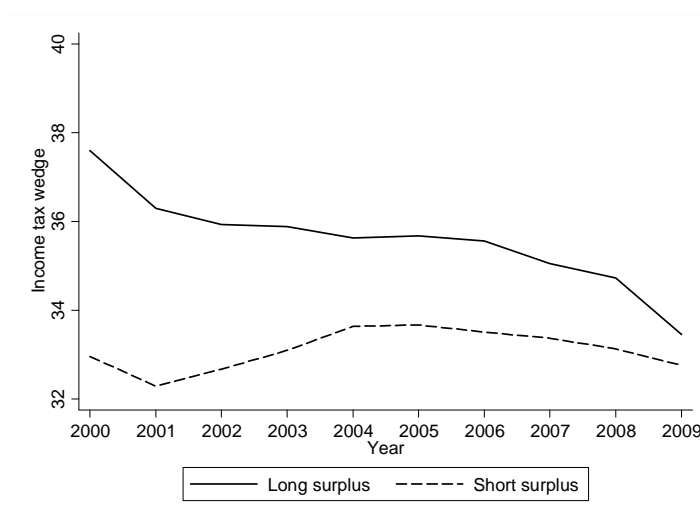
Politically, however, the tight approach chosen was a big success. All six countries were able to overcome the recession in relatively good shape. For example, unemployment increased much less than expected. Thus, government politicians quickly claimed that their prudent fiscal approach had been responsible for the mildness of the recession (e.g. Goodale, 2004). In their rhetoric, surpluses turned from being an outcome of economic growth to being a precondition for economic growth. This redefinition, of course, could not happen in countries with short surpluses: Claiming that surpluses

were an engine of growth would have been a most damning verdict on their own expansionary fiscal policies.

### Surpluses are used for cutting taxes

After the recession of 2001–03 had been overcome, the years before the world financial crisis were characterized by a strong macroeconomic environment in surplus countries which further strengthened their public finances. These beneficial economic conditions were underwritten by a resource boom in Canada, Australia, New Zealand, and, to a lesser extent, in Denmark, which caused a strong growth in tax revenues. As these countries had already preserved their surpluses through the recession of 2001–03, a period of generally low resource prices, the resource boom increased surpluses, but did not cause them. Nevertheless, it gave an increased importance to the question of how the surpluses were to be spent.

Progressive politicians had promised to use surpluses to increase public consumption and, more importantly, public investment. However, they failed to deliver on this promise. Instead, surpluses were mainly used for cutting taxes, independent of government partisanship (Haffert & Mehrtens, 2015).



**Figure 4: Development of tax wedges in surplus countries; source: OECD (2014); \* Iceland, the Netherlands, UK, US**

Figure 4 shows the development of the average tax wedge for singles with an income of 100% of the average in both groups of countries (no data prior to 2000 available).<sup>14</sup> Long surplus countries reduced their tax wedge by almost four percentage points between 2000 and 2009. This corresponded with a substantial decline in total tax revenue which fell from 41.2% of GDP in 2000 to 38.4% in 2008 of GDP (cyclically adjusted revenue declined by 1.9% of GDP). By contrast, short surplus countries kept their income tax rates almost constant over the entire decade. As the preceding section has shown, these countries had enacted extensive tax cuts during the first years of surplus. After returning to deficits in the recession of 2001–03, however, they could no longer afford further tax cuts.

To some extent, tax cuts were an economic strategy to raise the competitiveness of long surplus countries. As small open economies, they could benefit from international tax competition, as the ratio of lost revenue on the existing tax base to new revenue generated by increasing the tax base through attracting new investors was particularly favorable (Genschel & Schwarz, 2011). Furthermore, the consolidation had been accompanied by an increase in the economic importance of export sectors and thus of competitiveness concerns.

<sup>14</sup> This wedge measures the difference between the gross wage that an employer pays and the net wage that an employee receives.

These concerns about competitiveness mainly inspired reductions of corporate taxes and income taxes. Cuts of the former were seen as attracting investors from abroad, but also as inducing increasingly footloose national companies to stay. For example, both the Swedish technology company Ericsson and the Finnish cellphone giant Nokia threatened to move their headquarters out of the country if taxes were not reduced (Helsingin Sanomat, 2001; *The Economist*, 2000). Similarly, income tax cuts were intended to prevent a “brain drain” of highly educated individuals. Consequently, official documents frequently highlighted the need for income tax rates that could compete with neighboring countries (Department of Finance Canada, 2004: 208; New Zealand Treasury, 2006: 44; OECD, 2000: 132).

Even more important than these economic concerns were the political benefits of cutting taxes. Tax cuts were important for generating persistent support for continuing surpluses. The sheer existence of surpluses seemed to signal that citizens were overtaxed and deserved tax relief: In the wake of massive expenditure cuts, citizens paid more or less the same taxes as before but received substantially reduced public services. Against this background, governments typically argued that taxpayers paid for the surplus and thus had every right to share in its benefits. As Australian minister of finance Peter Costello put it succinctly: “Australian taxpayers are shareholders in Australia and they will benefit through income tax cuts as government debt is eliminated” (Gittins, 1999).

Surpluses and tax cuts, while being arithmetic rivals—money that is used to balance the budget cannot be returned to taxpayers—were thus political complements. Persistent budget surpluses allowed politicians to credibly commit to future tax cuts because they guaranteed that such tax cuts could indeed be financed. At the same time, this promise to invest any surpluses in tax cuts ensured the support of those political interests which had been strengthened by the consolidation. Had they demanded bigger tax cuts in the present, this could have easily derailed the surplus policy. The promise of even bigger tax cuts in the future thus bought off their support for continued surpluses.

The crucial question, of course, was the credibility of such a promise. How could politicians credibly commit to using surpluses for tax cuts in the future? As surpluses can only be spent for tax cuts or for expenditure increases, a commitment to cut taxes is equivalent to a commitment not to increase expenditure. And this commitment was made possible by the reconfiguration of political interests that had been triggered by the privatizations and expenditure cuts of the consolidation. Faced with a shrinking clout of spending coalitions, even parties of the left increasingly advocated for tax cuts. Political conflict between the major parties focused more and more on the composition of tax cuts and not so much on whether to cut taxes at all.

Furthermore, the new budgetary rules acquired a surprising importance in this context. Instead of being the primary cause for the preservation of surpluses, their main effect was to influence the use of surpluses and to channel them into tax cuts. This is particularly clear in the case of expenditure ceilings, which prohibited the use of unexpected revenue for anything other than tax cuts or paying down the debt. Denmark even legislated a “tax freeze”, a legal ban on tax increases both in real and nominal terms, which ensured that measures to protect the surplus would always be undertaken on the expenditure side (Ministry of Finance Denmark, 2002). Canada went even further and introduced a “tax-back guarantee act” in 2007, which stipulated: “The Government of Canada shall apply any imputed interest savings resulting from reductions of federal debt to measures that provide tax relief for individuals” (Statutes of Canada, 2007). Continued surpluses would thus lead to automatic tax cuts by reducing the interest burden.

To twist Margaret Levi’s famous argument (Levi, 1988), this can be seen as a “reverse fiscal contract”. Levi had argued that generating revenue was easier for governments who could credibly promise to use revenues for financing public goods. The promise of future returns in the form of higher spending would make citizens comply with taxes in the present. In a similar but reversed fashion, the promise of future returns in the form of lower taxes generated support for lower spending (i.e. continuing surpluses) in the present in surplus countries.

## **Conclusion**

What Levi’s concept of a fiscal contract points to, is the deep political connection between fiscal decisions in the present and in the future. This interconnectedness between taxing, spending, and

budget balances is also what justifies speaking of a “surplus regime” in countries with long surpluses. Both how surpluses were spent as well as how they were created had an important impact on their preservation. Only countries that could credibly commit their surpluses to future tax cuts were able to preserve them. And only countries that generated surpluses through expenditure cuts were able to make such a commitment.

In these long surplus countries, the coalition of interests that coalesces around the goal of lower taxes had been strengthened by a fiscal crisis and the following expenditure-led consolidation. It was therefore able to permanently shift the burden of fiscal adjustment onto the coalition that coalesces around the goal of higher expenditure, which had been weakened by the very same sequence of crisis and consolidation. “Political interests, institutions, and policy arrangements” (Pierson, 2001) thus became structured around the double-goal of balancing the budget and cutting taxes.

Countries with short surpluses, by contrast, remained stuck in a deficit regime. In these countries, there was no similar crisis and only a much less fundamental consolidation. Consequently, the underlying societal conflict between both coalitions was temporarily alleviated by surprisingly strong revenue growth, but was never really solved. As soon as the underlying economic boom ended, the conflict arose again and deficits returned.

This regime-based approach has implications not only for the analysis of budget surpluses but for the study of fiscal policy more broadly. It calls for attention to the specific historical circumstances in which fiscal policies are made and questions the validity of sweeping generalizations, including the prediction of a permanent “deficit bias”. In particular, such an approach shows the limits of a voluntaristic conception of fiscal policy in which policymakers are essentially free to pursue their individual interests and in which their room for maneuver has to be restricted by formal institutional barriers. As I have argued, both the creation and the efficacy of such barriers crucially depend on the underlying fiscal interests which support them.

Moreover, while institutional reforms are endogenous with regard to underlying fiscal interests, these interests themselves are shaped by prior fiscal policy choices in a path-dependent fashion. As the analysis has demonstrated, the specific composition of consolidation programs set in motion a realignment of interest structures. Thus, fiscal policy is not just an outcome but also a source of the relative strength of different coalitions. Accordingly, the analysis of fiscal policy should not just take into account how interest structures restrict the political room for maneuver, but also how fiscal decisions feed back on the content and weight of specific interests.

This is of particular importance at those junctures where established fiscal policy regimes get into trouble and the topography of fiscal interests begins to shift. The most recent example of such a juncture, of course, is the fiscal response to the great financial crisis and, in particular, the euro crisis. Many analyses of these crises focus on the more immediate questions of fighting deficits, reassuring financial markets and restarting economic growth. The theoretical framework adopted in this paper, however, suggests that the long-term consequences of different policy options are as important as their immediate effects. The decisions taken in response to the crisis are likely to define the path for fiscal policy for many years to come. What the specific feedback effects of different policy choices will be, however, is difficult to foretell. Future research should therefore analyze path dependencies in fiscal policy on a much more systematic scale, in order not just to identify them *ex post* but also to anticipate them *ex ante*.

## Appendix: Development of Fiscal Indicators in Long Surplus Countries as Percent of GDP

Figure A.1: Budget Balance

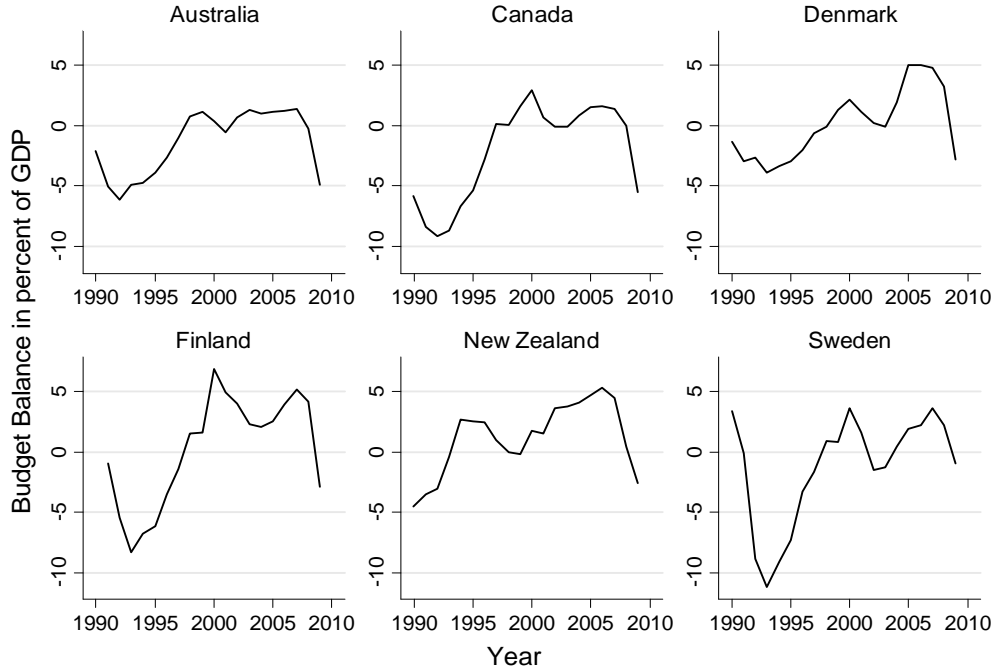
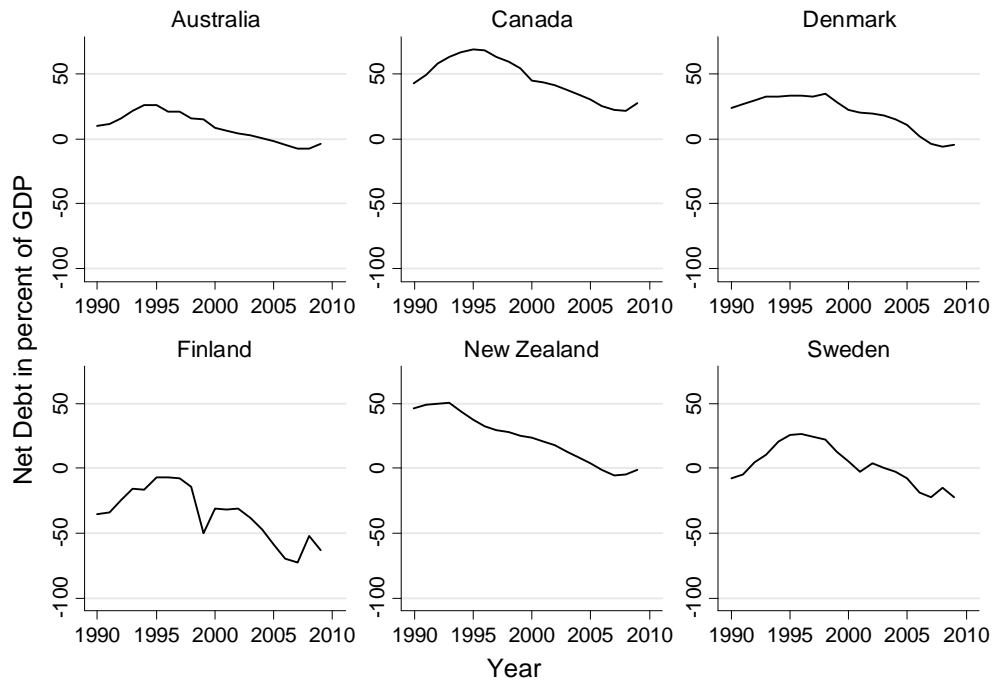


Figure A.2: Net Public Debt



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