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Politics In and After Fiscal Squeeze

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Introduction

In Chapter 2, we examined what could be said about the politics of fiscal squeeze by comparing the available statistics on spending and revenue for the nine cases we have explored in this book and relating them to other more or less readily documented features of those cases, particularly their forms of government, the political parties involved in the 'squeeze' episodes and electoral outcomes. The nine chapters that followed took a more nuanced and in-depth look at the numbers and the politics behind them as seen by experts on each of those country cases of fiscal squeeze. So this chapter briefly puts together what answers to the questions about the politics of fiscal squeeze set out in Chapter 1 can be gleaned from combining the comparative statistical analysis of Chapter 2 with those qualitative case studies in Chapters 3 to 11. It then offers some reflections on the implications of this study for future studies of the politics of fiscal squeeze, and concludes by setting out some of the what-to-do policy conclusions that flow from this book.

We begin by repeating what was said in Chapter 1, that this is an exploratory study of the politics of fiscal squeeze, not a randomised controlled trial, and that it comprises insufficient cases for tests of statistical significance to be meaningful. That does not mean that such a study is of no value, far from it, but rather that we have to be careful in specifying what can be concluded from it. This sort of inquiry cannot be used to confirm a general hypothesis, and we do not claim to have done that, but it can be used for two very important purposes.

One is to *disconfirm* hypotheses about what is presumed to be always or usually the case—on the basis that (to take a rather hackneyed methods-textbook example used by philosophers at least since John Stuart Mill (1840: 204–6) and revived with the more recent appearance of 'black swan theory' (Taleb 2007)) we only need to identify one black swan to disconfirm the hypothesis that all swans are white. We shall develop that point in the next section because there are several greyish, if not black, swans that come out of this study.

The other use that can be made of this kind of study is to help develop theory, concepts and/or methodology, by framing better or clearer hypotheses informed by a limited in-depth study and thus establishing more clearly what 'we know we don't know'. After all, a key test of scientific progress is to be able to develop better or more precise questions about a subject of study, and to move from what has been called 'systemic' to 'parametric' uncertainty (Green, Tunstall & Fordham 1991: 228)—or in plainer language, made famous by former US Defense Secretary Donald Rumsfeld (2011)—move from what we don't know we don't know to 'known unknowns'.

Revisiting Our Opening Three Questions

In Chapter 1, we raised three main questions about the politics of fiscal squeeze, which the chapters exploring the triggers, processes and consequences of fiscal squeeze in the nine cases considered here were intended to illuminate. One was the idea that there is something inherently different about the politics of fiscal squeeze, as something especially challenging and difficult for political leadership in modern democracies. Another, closely related to the first, was the idea that fiscal squeeze presents incumbent political parties and leaders with high blame risks, particularly where squeezes are 'hard' and more or less endogenous. A third is the idea that fiscal squeezes are high-consequence, never-the-same-again events in democratic politics and government that leave a long shadow as a result of the changes they bring about. Chapter 2 examined what could be gleaned from aggregate statistical analysis about these questions, particularly the second one. Table 12.1 (in which, as in Chapter 2, 'hybrid' means a squeeze that is hard on one fiscal element (revenue or expenditure) but soft on the other) repeats some of the main conclusions from that chapter. What can the qualitative accounts add to—or subtract from—that analysis?

The Distinctiveness of Fiscal Squeeze Politics

A systematic answer to the question of whether there is something inherently different about the politics of fiscal squeeze as compared to periods of fiscal stasis or expansion—for example, whether it is indeed a nastier, less rewarding and more difficult environment for politicians in democracies—would need to be based on a careful comparison of those different financial circumstances, and this study has focused only on squeezes. Even so, these nine cases suffice

Table 12.1. Summary of conclusions from previous chapters.

				Political context at start of squeeze		Short-term political consequences	
Case study[a]	Type of squeeze (policy mix)	Type of trigger	Estimated political effort	Strong government	Veto points	Planners lost office	Implementers lost office
USA 1838–43	Single (expenditure) hard squeeze	Exogenous	High	No	Yes	Yes (1840) Yes (1844)	Yes (1840) Yes (1844)
UK 1923–25		Endogenous	High	Yes	Yes	Yes (1923)	Yes (1923) Yes (1924)
Netherlands 1983–89	Double soft squeeze[b]	Endogenous	Medium	Yes	Yes	Yes (1986)	Yes (1986) No (1989)
Sweden 1993–2000		Endogenous	Medium	No	Yes	Yes (1994)	Yes (1994) No (1998)
New Zealand 1992–97	Hybrid squeeze (soft tax/hard spending)	Endogenous	High	Yes	No	No (1993) Partly (1996)	No (1993) Partly (1996)
Ireland 1987–89		Endogenous	High	Yes	Yes	Yes (1987)	Partly (1989)
Germany 1996–2000		Endogenous	Medium	Yes	Yes	Yes (1998) No (2002)	Yes (1998) No (2002)
Canada 1993–97		Endogenous	High	Yes	No	No (1997)	No (1997)
Argentina 2003[c]	Double hard squeeze	Exogenous	1999–2002: Medium/High; 2003: Low	Yes	Yes	Yes (1999)	n/a

[a] For more details on the periodisation of the squeeze episodes, see Chapter 2, pp. 28–33.
[b] As shown in Chapter 2, the categorisation of the Swedish case depends on the time period chosen; it is a hybrid squeeze (soft tax, hard spending) for the period 1996–97.
[c] Conclusions in columns 4, 7 and 8 are based on outcomes for the qualitatively defined episode (1999–2003) rather than just the quantitative (2003), as they differ. The incumbents in 2003 were an interim government appointed in 2002.

to show that fiscal squeeze in a democracy is not invariably prompted by external *force majeure*, does not automatically reflect a standard set of economic and financial conditions (as we showed in Chapter 2), does not necessarily produce deep political crisis or political violence, and is not necessarily marked by political turning-points in the form of the 'Nixon-goes-to-China' phenomenon that we noted in Chapter 1. We have at least one 'black swan' to show for each of these propositions.

First, the idea that we referred to in Chapter 1, that modern democracy is an environment that leads inexorably to long-term public spending growth unless the irresistible political force of pressures for extra spending meets an immovable object in the form of constitutional, legal or other obligations to balance budgets, by no means fits all the cases considered here, as Table 12.1 indicates. Of course the degree of 'exogeneity' is contestable in many cases, given that those who want to change fiscal course can always play up threats of crisis, as plainly happened in Canada after the Mexican peso crisis. Nevertheless, there are several cases in our collection for which it could not plausibly be said that fiscal squeeze was a response to an immediate threat to the currency or an inability to borrow on international capital markets. The Netherlands in the 1980s, which repositioned itself from a Scandinavian-type to a Northern European-type fiscal profile by holding back public spending while GDP grew, is perhaps the blackest swan in our set for the idea that democratic governments only practise fiscal squeeze when the international markets force them to do so.

A second possible element of political distinctiveness is the idea that fiscal squeeze is likely to remove the financial glue that holds societies and political systems together and thus is likely to produce political crisis in some form and even to cause politics to shift from peaceful debate to violence. Such an idea is far from implausible, and indeed was part of the background for the IMF's '1 per cent a year' rule of thumb for the practical limits of fiscal squeeze that we mentioned in the opening chapter, but the cases in our set suggest that those effects by no means occur in all cases of fiscal squeeze. If political crisis is reflected by developments such as abrupt changes in leadership, sudden collapse of governments, suspension of normal institutional or constitutional rules and at a deeper level by a significant descent into political violence, such effects occurred to a marked degree in only a minority of the episodes considered here (notably the United States and Argentina). Post-unification Germany's fiscal squeeze is just one of several distinctly 'black swans' for that proposition.

A third possible element of political distinctiveness about fiscal squeeze, as discussed in Chapter 1, is the idea that such circumstances are likely to provoke political turning-points and political cross-dressing, notably in Nixon-goes-to-China moments where policy reversals are championed by leaders previously opposed to spending cuts and/or tax increases. In most of the nine cases considered here, there was indeed some evidence of such effects, for example when the Social Democrats implemented the spending squeeze initiated by the (centre-right) Moderates in Sweden or when Fianna Fáil implemented the squeeze planned by Fine Gael in Ireland. Moreover, there were numerous instances of parties who had opposed major new taxes in opposition continuing with those taxes when in government, as with the Goods and Services Tax in Canada. New Zealand—whose 1990s fiscal squeeze was both planned and implemented by a right-wing government—is perhaps the blackest swan in this set for the idea that fiscal squeeze will always lead to policy switches of that type (though even there the Bolger/Richardson squeeze involved jettisoning the National Party's election pledge to scrap the politically salient superannuation tax imposed by its predecessor).

Fiscal Squeeze as a Blame Trap or Credit Magnet

A second issue about the politics of fiscal squeeze raised in Chapter 1, closely related to the first, was the idea that fiscal squeeze presents incumbent political parties and leaders with high blame risks, particularly where squeezes are 'hard' and more or less endogenous, and therefore likely to pose a severe test of political blame-avoidance skills.

Chapter 2 showed that parties planning or implementing expenditure squeezes lost office in subsequent elections in over half of our cases, but we cannot say from this analysis how such a casualty rate relates to that applying to non-fiscal squeeze politics. The argument of Alberto Alesina and his colleagues, to which we referred in Chapter 1, that parties in government can improve economic conditions by expenditure-led fiscal adjustments linked with changes in regulation designed to improve competitiveness, which may in turn lead to electoral credit rather than blame, may well apply to some of the cases considered here (Canada and Argentina might be seen as examples). However, those who planned spending cuts wholly or partly lost the subsequent elections nine times out of twelve in the cases considered here.

Within this set of cases there is some hint that the casualty rate of parties implementing fiscal squeezes planned by their predecessors might be lower than that of parties who both plan and implement fiscal squeezes (two out of four as against seven out of ten, as calculated using Table 12.1), in line with the 'inertia politics' analysis we referred to in Chapter 1. But we cannot rate it as more than a hint, and certainly the tactic of avoiding electoral blame for a squeeze by pinning responsibility onto an earlier government was not invariably successful for avoiding loss of office. The blackest swan in this collection for the idea that planning and executing expenditure-led fiscal squeeze is a short route to electoral perdition is that of Canada, in the very peculiar political circumstances described by Donald J. Savoie in his account of the famous Program Review. Clearly fiscal squeeze is not invariably a 'blame magnet' for incumbents and at least in that instance it may have served as a credit-claiming opportunity, following Alesina's analysis.

Three other propositions about the link between fiscal squeeze and political blame can be shown to be contingent rather than universal even from this set of nine cases. One is the apparently common-sense hypothesis that we tentatively sketched out in the opening chapter, that blame would tend to stick to incumbents when squeezes are unambiguously triggered by endogenous factors or are 'hard' in terms of expenditure and/or taxation. That remains broadly plausible, but even then such squeezes do not seem to be an automatic route to electoral annihilation. After all, the New Zealand National Party managed to squeak back into office (admittedly by a hair's breadth) in 1993, and the UK Conservative Party, co-planner of the 'Geddes Axe' expenditure squeeze and subsequent implementer, seems to have suffered only short-term electoral damage in 1923, in sharp contrast to the Liberal Party, its coalition partner at the time the cuts were planned.

A second is a variant of the proposition put forward by Alesina and others that expenditure-led fiscal adjustments are always less costly than tax-led adjustments. By that such commentators mean that the economic costs incurred are lower, but if we consider the proposition that fiscal squeezes that were purely or largely expenditure-based invariably have lower political costs (in terms of avoidance of loss of office at subsequent elections) than fiscal squeezes that were a hybrid of tax rises and spending cuts, that does not seem to apply in these cases. The black swan here is the UK in 1923 (and possibly the USA, for the federal-level counterpart of the state-level fiscal squeezes analysed by Alasdair Roberts), where incumbents lost office after implementing expenditure-only squeezes. For the corollary, that costs would be higher for fiscal squeezes putting more emphasis on tax increases, the black swans are Canada and New Zealand, where incumbents retained office after planning and implementing hybrid tax-expenditure squeezes.

Finally, if fiscal squeeze is expected to be electorally toxic, we might expect the process of implementing such squeezes to be dominated by blame-avoidance strategies, and here the accounts given of those processes in the case-study chapters provide important evidence. If blame-avoidance strategies dominated the process, we might expect fiscal squeeze politics to emphasise the following: presentational strategies such as pinning the blame on the profligacy or incompetence of predecessors in office or on implacable market forces; agency strategies such as delegation of unpopular choices to technocrats, bureaucrats or lower-level governments; policy strategies such as grand coalitions; and the sort of cheese-paring approaches that cut spending or raise taxes by technical or small-print changes that make it harder for opponents to draw a line in the sand and mount last-ditch defences of the status quo that will command public sympathy.

The preceding nine chapters indeed showed examples of many of those processes accompanying the politics of applying fiscal squeeze, and the rhetoric of irresistible market forces does seem to have been a widespread tactic used by the squeezers. It does not seem to have invariably been the case that cutbacks were imposed disproportionately on lower-level governments (the UK in the 1920s is again a 'black swan' for that proposition) or that the poisoned chalice of deciding what to cut was handed over to technocrats (indeed, that seems to have been fairly rare). From the accounts given in the preceding country chapters, cheese-paring seems to have been widespread, for instance in public service salary cuts or freezes which invariably seemed to accompany fiscal squeeze. However, in some cases major 'cliff-edge' cutbacks were made, for instance in the abolition of transport subsidies in Canada and the scrapping of plans for the extension of post-14 education in the UK. None of the cases involved a formal grand coalition of all the major political parties. Trying to dodge the blame may be a universal in politics, but it does not seem to have played out in the same way in all of the cases considered here.

The Consequentiality of Fiscal Squeeze: Never the Same Again?

The third issue about the politics of fiscal squeeze raised in Chapter 1 concerned its consequentiality or otherwise. Consequentiality could mean that the changes made during periods of fiscal squeeze tend to be irreversible or at least highly 'sticky' in the medium term: for example, that new taxes or higher tax rates once imposed as part of a fiscal squeeze tend to become a fixture, or that old subsidies or other spending items once removed or reduced tend to be gone for good. It could mean that fiscal squeeze has palpable and clear-cut effects on the working of government and politics, as a once-and-for-all 'critical juncture' that disrupts path dependence and, possibly irreversibly, reshapes institutional and policy development. Examples include reshaping the state or altering the relative power of major political and institutional players (such as lower levels of government relative to federal or central governments). Even more broadly—as the high-consequentiality rhetoric of fiscal squeeze politics tends to imply, for example with claims that it will lead to a 'lost generation'—fiscal squeeze could have palpable consequences for the society more broadly.

Table 12.2. The consequentiality of fiscal squeeze.

Case study	Fiscal and economic effects	Constitutional and institutional effects	Effects on location of effective power	Effects on societal values	Effects on social order	Overall: was it a critical juncture?
USA 1838–43	**H:** introduction of new taxes and a shift towards financing state expenditure from taxes rather than loans and land sales	**H:** balanced budget rules in state constitutions remain in place 18 decades later	**H:** strengthened federal power, particularly at the executive level	**H:** contributed to continuing suspicion of big government after phase of entrepreneurial state government led to defaults	**H:** extensive rioting, the incidence of which contributed to the establishment of bureaucratic policing	Yes: enduring legacy in reliance on constitutional limitations and emphasis of state-level self-sufficiency
UK 1923–25	**M:** fiscal squeeze was part of policy outlook that led to ill-fated return to the gold standard in 1925			**M:** halt in post-WWI reconstruction policies may have contributed to disillusionment of key voters		No: other events in the interwar period had more important legacies
New Zealand 1992–97	**H:** led to a decade of strong fiscal performance protected by transparency reforms but effects on economic perfor-mance less clear	**H:** likely to have contributed to the introduction of MMP, reducing chances of single-party majority in unicameral parliament	**M:** offsetting effects of strengthening Treasury's reputation and policy control yet electoral system led to coalition-forming deals	**H:** may have contributed (along with demographic change) to weakening of egalitarian values and policy shift to market-based policies		Yes: pioneering welfare state leads move to smaller state (neo-liberal) policies
Netherlands 1983–88	**M:** tighter fiscal control continued, OECD public expenditure/GDP ranking henceforth lower		**L:** seems to have been associated with increased role of technocrats and managers at local level	**L:** may have contributed to populist challenges to technocratic and managerial policymaking		(Yes): led to lasting change in spending/GDP ratio; may have helped to spark new populist/right politics
Ireland 1987–89	**H:** misleadingly became the poster child for 'expansion-ary fiscal contrac-tion'. Celtic Tiger period led to real economic gains but spectacular crash later			**L:** significant changes in Irish society not attributed to fiscal squeeze, more to decline in religious affiliation, and to effects of immigra-tion and emigration		No: represented a missed opportunity to address issues that would have to be addressed in the later fiscal squeeze after 2008

Germany 1996–2000	**H:** in aftermath of unification (e.g. fiscal transfers to new eastern Länder), 'internal devaluation' made Germany super-competitive within the Eurozone	**M:** highly symbolic constitutional reforms in debt brake, being echoed at Länder level, designed to lock in benefits of period of fiscal squeeze	**L:** continuing Federal leadership of the federation, with countervailing Länder influence via the Bundesrat	**L:** fiercely competitive party system but two big parties often operating on shared societal values		(No): critical juncture was unification in 1990. However, allegedly inflexible political system showed agility in negotiating reforms
Sweden 1993–2000	**H:** economic recovery helped by crisis being standalone, by devaluation and later protected by status outside Eurozone; strong fiscal performance backed by transparency			**L:** continuing acceptance of welfare state and big government; has avoided collapse of trust in government. Capacity of governments and oppositions to compromise on fiscal measures and pension reform		(Yes): public expenditure/GDP ratio is now less detached at the top of OECD rankings. Decline of the once-dominant Social Democrats
Canada 1993–97	**M:** continued efforts in terms of maintaining trends in revenue and expenditure; consolidated Goods and Services Tax		**M:** Shift of greater fiscal responsibility to provinces, through unfunded or partially funded mandates			No: though it gave Canada 'poster child' status elsewhere after 2008
Argentina 2003	**M:** devaluation in 2002 led to rapid rise in GDP and consequent growth. Tax reforms instituted in early 2000s helped revenue increase				**H:** protests linked to economic crisis of 1999–2002 and consequent political effort to squeeze	No: contributed to remarkable recovery after 1999–2002 crisis, but fiscal improvement was not sustained

Notes: The evidence base for judgements is Chapter 2 and the relevant country chapter.
L = Low, M = Medium and H = High, the scale relating to the strength of the effect rather than directly to the quality of supporting evidence. Blank cells indicate that the study has produced no relevant evidence. Brackets around coding in the final column indicate weaker statements.

As we noted in Chapter 1 and as the nine case studies have shown, such questions are easier to ask than to answer, even for country experts with the benefit of hindsight. Table 12.2 attempts to sum up what consequences can be attributed to the nine fiscal squeezes discussed in this book on five aspects of politics and society, with an overall 'critical juncture' column on the right of the table. Each country case is a row and the five analytic items and the summary judgement are the columns. These categories are drawn from the literature discussed in Chapter 1 and the scores come from the comparative analysis of Chapter 2 and the editors' interpretation of the evidence presented in the nine case studies. Where effects have been identified, they are scored as Low (L), Medium (M) or High (H). Where no evidence is presented in this book, the cell is left blank. This scoring of effects in Table 12.2 is to be distinguished from the scoring of political effort devoted to fiscal squeeze in Table 12.1. The final column then indicates whether the fiscal squeeze episodes should be regarded as critical junctures: the scoring options are Yes, (Yes), (No) and No, bracketing indicating a more qualified response. That scoring is an overall qualitative judgement, not based on counting Ls, Ms and Hs.

The picture presented in Table 12.2 and the case study chapters also suggests black or at least greyish swans for the idea that fiscal squeeze is clearly and invariably a high-consequentiality affair, in terms of irreversibility of tax and spending changes; for long-term political impact, in terms of major party-system upsets or constitutional change; and for lasting social effects of a broader kind. Taking those in reverse order, Canada appears to be the blackest swan in our set for the idea that fiscal squeeze invariably prompts major social change of a 'lost generation' kind. As for the middle item, in most cases our country experts detected some evidence of fiscal squeeze having non-trivial impacts on party politics in the short or medium term, but only in one or two cases were there constitutional or major institutional changes (for example, in the balance between local and central government) that are unambiguously attributable to fiscal squeeze. As for the first item (irreversible change), we see evidence in several cases of fiscal squeeze introducing or serving to consolidate new unpopular taxes (such as the Goods and Services Tax in Canada), reflecting Peacock & Wiseman's (1961) famous comment that 'it is harder to get the saddle on the horse than to keep it there'. However, Argentina appears to be the blackest swan in our collection for the idea that expenditure cuts invariably tend to be once-and-for-all, and it is notable how temporary was the slimming effect on the Canadian federal bureaucracy of the much-lauded-at-the-time Program Review.

Where To From Here?

This book takes a step towards a fuller analysis of the politics of fiscal squeeze, but there is of course further to travel. At least three new questions arising from this study demand some attention in future analyses of this phenomenon.

As we have shown, the politics of fiscal squeeze is not readily reflected in the numbers reported in cross-national economic datasets. Political pressure, the central element in our definition of fiscal squeeze, is not necessarily reflected by reported changes in primary balances, yet it is the latter that the dominant literature tends to concentrate on. Moreover, the political impact of fiscal squeeze will include 'announcement effects' as well as the effects of enacted changes in tax and spending, yet it is the latter that most quantitative studies focus on. Outcome-based economic data can therefore be distracting as well as illuminating. Measurement, even conceptualisation, of 'political pressure' is in its infancy, and though Chapter 1 developed an indicative scheme, the analysis here relies heavily on qualitative judgement. So how can we get closer to assessing or measuring the 'political effort' going into fiscal squeeze? Must it remain one of those 'known unknowns', such as would be needed to disconfirm the Second Law of Thermodynamics (which can be stated but still not measured)?

Second, as we said in Chapter 1, our nine fiscal squeeze cases can only serve to disconfirm propositions about what might be claimed to apply to all cases of fiscal squeeze, and as we have shown in the previous section, numerous 'black swans' emerge from this study. Those who believe (for instance) that democratic governments will never cut spending unless faced with strong external pressure, that fiscal squeeze will always produce political crises, that it will invariably lead to annihilation of incumbents at the polls or have deep and irreversible consequences, will find this study suggests otherwise. But if we want to turn from disconfirmation to the more positive task of confirming what might be distinctive about fiscal squeeze politics, we need both more cases (for example, by combining country comparisons with over-time comparisons) and a comparative strategy that matches cases of fiscal squeeze with control cases of 'unsqueezed' politics.

Third, this study has only covered a sub-set of all the possible kinds of fiscal squeeze in democracies. We began by defining fiscal squeeze as political effort put into reining in public spending and/or raising taxes, and that means fiscal squeeze can vary in the relative emphasis placed on cutting spending as against raising taxes. Table 12.3, developing Table 2.1 in Chapter 2, classifies the nine country case studies according to 16 possible combinations of revenue/spending and hard/soft introduced earlier. The nine cases cluster into 4 out of the 16 cells representing all the possible combinations of revenue

Table 12.3. Types of fiscal squeeze.

	Expenditure			
Revenue	No fall	Fall only in constant prices	Fall only as % of GDP[a]	Fall as % of GDP and in real terms
No rise	1 No squeeze	2 Single (expenditure) soft squeeze	3 Single (expenditure) soft squeeze	4 Single (expenditure) hard squeeze **Cases: USA, UK**
Rise only in constant price terms	5 Single (revenue) soft squeeze	6 Double soft squeeze	7 Double soft squeeze **Cases: Netherlands, Sweden**[b]	8 Hybrid squeeze **Cases: New Zealand, Ireland, Germany, Canada**
Rise only as % of GDP[c]	9 Single (revenue) soft squeeze	10 Double soft squeeze	11 Double soft squeeze	12 Hybrid squeeze
Rise as % of GDP and in real terms	13 Single (revenue) hard squeeze	14 Hybrid soft/ hard squeeze	15 Hybrid soft/ hard squeeze	16 Double hard squeeze **Case: Argentina**

[a] Fall as of % GDP: cut-off points as defined for Table 2.1.
[b] For period defined in Chapter 2: Sweden is a case of hybrid squeeze for the period 1996–97.
[c] Rise as % of GDP: cut-off points as defined for Table 2.1.

rises and spending falls. Two of our specimens are single (spending-only) ‘hard’ squeezes (USA and UK in cell 4). One (Argentina, 16) is a double hard squeeze (revenue plus spending), while the other six cases bunch into ‘hybrid’ cell (8) and one double soft squeeze cell (7). Developing the study of the politics of fiscal squeeze requires both comparing more cases within those populated cells (in particular the double hard squeeze category) and exploring the unpopulated cells in Table 12.3, in particular the revenue-only type of hard squeeze. How rare are those unpopulated cells and what political effects do they have?

What Should Policymakers Take Away from this Study?

Flashforward—The Next Great Crash

Picture the scene, at some indefinite point in the future. The global economy has recovered after the previous financial crash. Pressures on public finances have eased, with governments in many developed countries able to run primary surpluses and to congratulate themselves on the political effort they have put into the future sustainability of their public finances. Social tensions linked to unemployment and increased inequality have been contained in most countries, despite warnings about the effects of increased income inequality on the social fabric and on economic performance (Dorling 2011; OECD 2011). The narrative of 'strivers and shirkers' has proved its electoral value as heresthetic in many countries and (in spite of a few dogged dissenters in highbrow, low-circulation blogs and publications) blame for the 2008 financial crisis has been pinned squarely on the excessive welfare spending and incompetent financial regulation of feckless governments during the decade prior to the 2008 crisis. The banking and financial sectors have boomed to new heights, and international agencies such as the IMF and OECD have concluded that prudential regulation is now well designed and effective.

Then comes the next Great Crash. One Sunday evening, out of the blue, the US president personally telephones the leaders of all G8 countries to warn them that Wall Street will be closed on Monday until further notice. Massive US financial institutions are being declared bankrupt, ahead of liquidation. The crisis has been sparked by rogue trading, false accounting, bad investments in property, outright corruption in several countries and massive exposure to misunderstood risks in others. The scale of defaults means that many financial institutions across the world are likely to be brought down on Monday by counterparty risk. After these tense phone calls, the president attends a specially convened meeting of his Council of Economic Advisers, to consider what fiscal and monetary steps to take in these bleak circumstances, and equivalent what-to-do discussions are about to start across much of the rest of the world.

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We do not claim any gifts of prophecy. Economists have been defined as people who can tell you tomorrow why yesterday's prophecy failed to fit today's events (McCloskey 1985: xix) and political science is also littered with failures to foresee the future. However, if anything like the scenario painted above comes about, what lessons can policymakers take from this comparative study of historical cases of fiscal squeeze?

First, on the basis of past experience, those who have to grapple with the next generation of fiscal squeeze decisions are likely to be struggling with problematic economic and fiscal data, possibly exacerbated by measures to cut costs in previous fiscal squeezes. Reflecting on the contribution which public finances had made to country vulnerability in 2008, the IMF (2012) stressed the role of inadequate data quality and weak fiscal transparency in contributing to policy errors. In grappling with the data, these future fiscal squeezers will encounter some more or less technical problems arising from more fragmented public services delivery (complicating the scoring of public spending) and the effects on the economy of globalisation, financialisation and electronic transactions (recording GDP, including estimation of the shadow economy). They are also likely to face data problems that are more behavioural in origin, for example where governments have restrained measured public expenditure by the use of policy instruments (such as off-balance sheet Public–Private Partnerships and government guarantees) that do not show up in reported numbers (Heald 2012). When engaged in cross-national comparisons, they are likely to struggle to reconcile budgetary and financial reporting data, since government accounting practices vary across countries in a way that private sector practices no longer do. Simply being able to establish the current position, and what happened even in the recent past, is more fraught than many decision-makers realise.

Second, on the basis of past experience, policymakers in the next set of fiscal squeezes are likely to find themselves grappling with those difficult data problems within a highly compressed time period. Policymakers rarely have the luxury of a lengthy period of reflection before they have to implement fiscal squeeze measures. When crises hit, decision-making time can be minimal, leading to policy errors. There is not likely to be a 'level playing field', either in terms of how markets react (note that Argentina's default came when it would have met the Maastricht deficit criteria) or of how international/supranational institutions respond to countries in fiscal difficulties (for example, Ireland was severely criticised by the European Commission in 2002 for breaching the Excessive Deficit Procedure, whereas the rules were rewritten when they were later breached by France and Germany).

Third, in the middle of grappling with problematic data under extreme time pressure, policymakers will find themselves having to assess the policy panaceas that are on offer to show what they should do. These proposals are often put forward by key actors from previous crises proclaiming their success and generalising from highly contingent circumstances; such actors from New Zealand, Canada and Sweden were prominent after 2008. Our country chapters make it clear that judgements about success, even in these celebrated cases, have to be nuanced, but under the kind of pressures noted above often are not. Cartwright & Hardie (2012) stress the crucial difference between 'Did it work *somewhere?*' and 'Will it work *here?*', and policymakers will find themselves struggling to decide how much to discount claims of 'transferability' and 'best practice' where contextual factors are uncertain. Of course they will not be passive actors in the process: academic and other experts aim to influence the course of public policy, but policymakers will also find themselves shopping for those research results that buttress their preferred choices.[1]

[1] In his defence of Reinhart & Rogoff (2010) (after criticism that they had made data errors), Summers (2013) squarely put the blame on policymakers shopping for evidence.

Fourth, a key aspect of the judgements about context that these future decision-makers in the next generation of fiscal squeezes will need to make concerns the state of the world economy, and particularly whether major trading partners have comparable fiscal difficulties. That element is often neglected in accounts of economic recovery after periods of fiscal squeeze. For example, the 'success stories' of Ireland in the 1980s and Canada and Sweden in the 1990s were all cases where fiscal squeeze took place in a far more buoyant international economy or with policy instruments that were not available to the Eurozone countries in the 2010s.

Fifth, the dog that did not bark is the absence of revenue-led fiscal squeezes. The three revenue squeeze cells (5, 9 and 13) in Table 12.3 are all unpopulated. There are several possible explanations that invite future research. This result might have technical origins, in that however hard governments work on raising tax rates and expanding tax bases, the trajectory of GDP prevents revenue increasing either in real terms or as a percentage of GDP (the automatic stabilisers playing a role). However, possible deeper causes are that such a result is a characteristic of capitalist democracies and an indication of the effects of globalisation on the tax-revenue-generating capacities of their economies. A pragmatic lesson is that governments should fix their tax systems, particularly their tax bases, during periods of prosperity: Argentina and Ireland stand out in the way they demonstrate the fiscal risks attached to a narrow tax base in general and to heavy reliance on transaction taxes in particular.

Finally, future policymakers grappling with the next round of fiscal squeezes are likely to be making decisions whose consequences they may not be able to foresee. At the time when decisions have to be taken, it can be unclear whether a critical juncture has been reached and, if so, what would be the direction of change. The 2008 global financial crisis, which some commentators had expected to mark the end of neo-liberalism (Crouch 2011), might alternatively lead to intensification. As the preceding discussion of consequentiality showed, not all fiscal squeezes seem to have high long-term consequentiality, but some certainly do. For example, the US states' constitutional provisions that followed the 1830s state defaults may possibly have contributed to less government growth than elsewhere, but have certainly accentuated the marked pro-cyclicality of sub-national public expenditure in the United States. New Zealand's change of electoral system in the 1990s seems to have been motivated in part by a reaction against strong governments imposing far-reaching institutional and fiscal changes without serious challenge. Of course in many cases the consequences of fiscal squeeze are likely to be subtle and contestable, such as in changes in the relative power of central and sub-national governments (more likely in unitary states than in federations), and in the consequences of substituting technocratic expertise for the legitimacy of democracy (Barber 2011).

Whenever the next set of major pressures on government spending and revenues comes, such decisions—about problematic data, uncertain consequences, contestable lessons, and perplexing contextual judgements, all made under severe time pressure—are likely to be as central to the politics of the next fiscal squeeze as they have been in the past.

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