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MPIfG Discussion Paper 04/2

Financial Policy in the Netherlands 1977–2002

The Effects of Fiscal Contracts

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Max Planck Institute for the Study of Societies Cologne
March 2004

MPIfG Discussion Paper | ISSN 0944-2073

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Abstract

The paper analyses the course of Dutch financial policy since the demise of Keynesian full employment. How did the public expenditure ratio, the tax burden, and the deficit develop in the last twenty-five years? Why did the government lose control over public spending in the period between 1977 and 1982, even though it proved possible to reduce spending continuously thereafter? Important explanatory variables in this context are economic growth and the ideological orientation of the government. In the 1990s, however, a literature on the common pool resource problem of public budgets developed which emphasizes the impact of the number of actors involved in financial policy-making as well as the institutional design of the budget process for public spending. Combining process tracing and intertemporal comparison, the study demonstrates how fiscal contracts were made and how they were stabilized through the working of the party system. It concludes that if other relevant variables are allowed for, fiscal contracts did have a moderating impact on public spending.

Zusammenfassung

In dem Papier wird die Finanzpolitik der Niederlande seit dem Ende der keynesianischen Vollbeschäftigungsphase analysiert. Wie haben sich die Staatsquote, die Abgabenquote und das Defizit in den vergangenen 25 Jahren entwickelt? Warum sind die Staatsausgaben in der Phase von 1977 bis 1982 praktisch unkontrolliert gewachsen, wenn es danach gelang, diese kontinuierlich zurück zu führen? Wichtige Erklärungsvariablen sind in diesem Zusammenhang natürlich das Wirtschaftswachstum und die ideologische Ausrichtung der Regierung. In den Neunzigerjahren hat sich eine Literatur zum Allmendeproblem des öffentlichen Haushaltes entwickelt, die zur Erklärung der Entwicklung der Staatsausgaben vor allem auf die Zahl der finanzpolitischen Akteure und die institutionelle Ausgestaltung des Haushaltsprozesses abstellt. Durch eine Kombination von Prozessanalyse und intertemporalen Vergleich wird gezeigt, wie finanzpolitische Vereinbarungen zu Stande kamen und wie sie durch die Funktionsweise des Parteiensystems stabilisiert wurden. Schließlich wird belegt, dass die in Koalitionsabkommen niedergelegten finanzpolitischen Absprachen unter Kontrolle anderer wichtiger Erklärungsvariablen einen mäßigenden Einfluss auf die Entwicklung der Staatsquote hatten.

Contents

1 Introduction

In the post-war period, Keynesian fiscal policy stabilized full employment. In return, increasing wages made for a steady flow of taxes that sufficed to fund the growing Keynesian welfare state. This equilibrium disintegrated in the mid-seventies. The Netherlands – like many other industrial nations – began to suffer from structural unemployment that could not successfully be dealt with by Keynesian policies alone. As a consequence public outlays and deficits increased. At the same time a paradigmatic shift occurred in academic economics. New theories recommended public expenditure restraint. How did Dutch financial policy respond to these intellectual and economic challenges?

In the adjustment process two distinctive periods can be distinguished: In the first period up to the early 1980s public outlays, taxes and deficits clearly got out of control. The years 1982/83 brought a trend reversal. In the following two decades public expenditures decreased rapidly. Today, the share of public spending in GDP is lower than in 1977, the budget is structurally consolidated, and full employment has been at least temporarily regained. Why is it that public finances went out of control in the late 1970s? And why did budget consolidation prove to be possible thereafter?

In the 1990s a literature arose that tries to explain financial policy outcomes with reference to the common pool resource (CPR) problem of public budgets. According to this school of thought, public expenditures will increase unduly unless access to the budget is restricted by an effective fiscal contract or hierarchical institutions such as a strong minister of finance. Research with this approach has produced substantial insights with an important impact on the real world. However, some problems are still unresolved: First, there are few studies which show how co-operation can evolve under the conditions of the commons problem. Second, how can these fiscal agreements be stabilized? Third, in spite of numerous regression analyses there is currently no agreement about the effects of budget institutions.

The purpose of this paper is twofold: First, I want to shed some light on the empirical puzzle of the Dutch public expenditure ratio. Second, I think that this analysis will yield some answers to the problems in the literature. With regard to the development of the public expenditure ratio I will argue that it cannot be explained by economic factors alone. Instead we have to take the role of the CPR problem and fiscal contracts

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I am heavily indebted to the Max Planck Institute for the Study of Societies in Cologne and in particular to director emeritus Fritz W. Scharpf for generous support. Furthermore, I have to thank the participants of a seminar at the MPIfG and Hendrik Zorn for sharing his data. It would have been impossible to finish this paper without the support of the Department of Political Science, University of Cologne. Final drafts of the paper benefited greatly from comments by André Kaiser and the untiring work of our research assistants. Siebo Jansen helped me with useful information on Belgium. Finally, I would like to thank the two referees Imke Kruse and Philip Manow for their useful suggestions and Cynthia Lehmann for help with the English language.

into account. During the first period (1977–82) public expenditures soared because there was no fiscal contract to contain the commons problem. By contrast, all governments during the second period (1983–2002) concluded fiscal agreements during coalition formation. Hence, various ministers of finance managed to keep the CPR problem at bay and eventually reduced the public expenditure ratio.

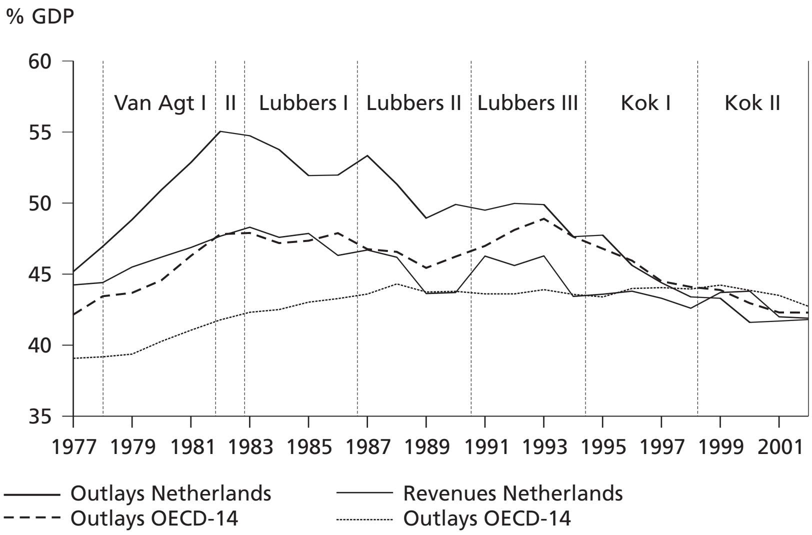
With reference to the problems in the literature I will advance the following hypotheses: First, it is easier to negotiate a fiscal contract if the "distributional dimension" (Who gets what?) of the CPR problem is separated from the production dimension (How much aggregate spending?). Second, the Dutch party system stabilizes these contracts as long as the chance to participate in government does not primarily depend on votes but on the relationship between the parties. Third, fiscal contracts have a moderating effect on public spending if one controls for economic growth and the actor constellation. The paper has six sections: First, I describe the development of the public expenditure ratio in the Netherlands, i.e. the dependent variable. Second, I review the literature using the CPR approach and identify some of its problems. Third, I present my analytical framework, which is based on elements from Scharpf's actor-centered institutionalism and the CPR approach. The fourth section settles the questions of whether the CPR problem is prevalent in the Dutch parliamentary system and whether the institutional framework can offer a solution. In the fifth section I employ my analytical framework to analyze Dutch fiscal policy, and finally I draw conclusions.

2 The fiscal performance of the Netherlands 1977–2002

How did Dutch public expenditure and revenues develop during the successive government terms between 1977 and 2002? Figure 1 shows public outlays and revenues as a share of gross domestic product for the Netherlands and the average of 14 OECD countries. The difference between outlays and revenues equals the deficit or surplus in that particular year. The reader should note that the average only serves as a benchmark against which Dutch fiscal performance can be judged. It does not imply that this paper aims to explain the variance in fiscal performance between the Netherlands and the benchmark since this would require a much larger study. It includes wealthy parliamentary democracies only.[1]

1 The countries included are Australia, Austria, Belgium, Canada, Denmark, Germany, Great Britain, Ireland, Italy, Japan, Netherlands, New Zealand, Norway and Sweden. Finland, France, and Switzerland are excluded because they are often classified as semi-presidential or non-parliamentary forms of government. The conclusions from the comparisons are, however, quite robust and do not depend on the inclusion or exclusion of one or two countries.

Figure 1
Public outlays and revenues



Note: Caretaker governments are treated as part of their predecessors.
Source: OECD Fiscal Positions and Business Cycle Data Base, own calculations.

What is striking is the sharp increase in public expenditures during the Van Agt governments. In fact, the share of public outlays in GDP increased by almost ten percentage points in only five years. The increase, which was mainly financed through deficits, is more pronounced than in other comparable nations at the time. In just three years, from 1978 to 1980, the public expenditure ratio went up by 5.8 percentage points. During the transition to the first Lubbers government, however, a trend reversal emerges. The share of public outlays in GDP starts to decrease even faster than in other parliamentary democracies. In the three years between 1988 and 1990 the public expenditure ratio fell by 3.9 percentage points. Even during the recession of the early nineties when outlays rose quickly in other parliamentary democracies, the public expenditure ratio in the Netherlands remained almost stable. In fact, the increase in the three-year period between 1991 and 1993 was limited to only half a percentage point. During Wim Kok's terms of office, public outlays decreased further. In the years between 1996 and 1998 the ratio of public expenditures to national product dropped by 4.3 percentage points. This was even faster than in the second half of the eighties. During the second Kok government we can even observe budget surpluses due to the fact that the tax burden decreased slower than outlays. In the current recession the surpluses have vanished again. From this brief sketch of Dutch fiscal performance the empirical puzzle of this paper arises: Why is it that public expenditures went out of control during the Van Agt governments? And why was it possible to cut spending during the Lubbers and Kok governments? In the following section, I will review the literature which applies the CPR approach to public budgeting.

3 The CPR approach and some methodological remarks

The common pool resource (CPR) approach took hold in the political-economic literature after the path breaking studies by Roubini and Sachs (Roubini/Sachs 1989a, 1989b) and von Hagen (von Hagen 1992; von Hagen/Harden 1994). It is based on the simple idea that public benefits are concentrated on certain constituencies while the costs of public policies have to be borne by all taxpayers. This means that the price in terms of taxation actually paid by the user is much lower than the "production costs" of the benefit. Hence, demand will also be higher in comparison to a situation where the user has to pay the full costs. Without a fiscal contract or hierarchical institutions such as a strong minister of finance, outlays will soon consist of the sum of individual claims. Thus, under such conditions public spending and the associated taxes and deficits are always higher than can be reconciled with common welfare.

The CPR approach has inspired a vast amount of empirical research that tries to estimate the effects of political, institutional and economic variables on the development of deficits, public debt, and government outlays (Borelli/Royed 1995; De Haan/Sturm 1997; De Haan/Sturm/Beekhuis 1999; Kontopoulos/Perotti 1999; Volkerink 1999; Volkerink/de Haan 2001). Most of these studies apply regression analysis to cross-national time-series. This methodology has several obvious advantages: First, researchers can quantify the effects of factors such as the number of actors involved in the budget process and the impact of various institutional designs on budgetary outcomes. At the same time, they can control for a large number of intervening variables. Second, in contrast to case studies, statistical analysis is supposed to yield generalizable results. In fact, research in this tradition has produced substantial results with important impact on the real world. The Swedish government, for example, has redesigned its budget process as a reaction to the findings of von Hagen (Molander 2000).

In spite of these successes, there are still some blind spots and unresolved problems in the literature.[2] First, there are no studies which show how co-operation can evolve under the conditions of the commons problem. This is far from trivial, given that the actors are caught in the "negotiator's dilemma" (Scharpf 1997: 124), i.e. they have to solve a "production problem" (Which level of spending is in accordance with the common good?) and a "distributional problem" (Who gets what?) at the same time. The answer to the "production problem" requires creativity, co-operation and trust between actors. By contrast, successful actors in the distributional struggle have to be opportunistic. In real-world situations these two dimensions can hardly be separated. Arguments about a collectively optimal level of spending, for example, may well have distributional implications. This can easily lead to mistrust and complicate things even further. It is fairly obvious that quantitative studies are not suited to shed more light on this issue.

2 I will only review the empirical studies which include the Netherlands and deal with the CPR problem *and* budget institutions.

The second blind spot concerns the way in which fiscal agreements can be made binding. This is a serious problem since it is unlikely that all actors will stick to the terms of the contract voluntarily. To my knowledge the only research conducted on this important question is by Marc Hallerberg and Jürgen von Hagen (Hallerberg 2001; Hallerberg/von Hagen 1999). These studies found that the stability of fiscal agreements depends on the party system. Once again it is clear that qualitative methods are required to trace the strategic interactions between parties and ministers involved in the budget process.

Finally, there is currently no agreement with regard to the effects of budget institutions in general and fiscal agreements in particular. In addition, the impact of the latter on fiscal policies pursued has hardly been studied. In his pioneering study, Jürgen von Hagen (von Hagen 1992) uses rank correlations, non-parametric tests and simple regression analysis to test whether a "structural index" and a "long-term constraint" have an impact on public debt, net lending, and primary net lending.[3] He finds that a structural index which includes a measure of the strength of the minister of finance generally has a strong and significant effect on fiscal variables. By contrast, his "long-term constraint" which can be interpreted as a proxy for fiscal agreements, has hardly any significant impact on lending and public debt.

In a more recent study for the Dutch Ministry of Finance (Hallerberg/Strauch/von Hagen 2001), Hallerberg and his collaborators find that various aspects of the strength of budget institutions have an impact on the development of real expenditures in fifteen EU countries. At the same time they do not find any important impact on the "fiscal stance" in their multivariate regression.

De Haan and Sturm (De Haan/Sturm 1994) use von Hagen's (von Hagen 1992) data in a pooled time-series regression of the EC countries between 1982 and 1992. The estimation results indicate that budgetary procedures are a relevant variable in explaining cross-national differences in the development of public debt in GDP. However, they do not reveal any effects of the budgetary process on government expenditures. The same is true for other factors such as the ideological orientation of the government or trade dependence. Unfortunately, the authors do not investigate the role of fiscal agreements in a more detailed manner. In a later study, De Haan, Moessen and Volkerink (De Haan/Moessen/Volkerink 1999) conclude again that budget institutions matter but that the effects are quite small. This time De Haan and his collaborators go into detail about the various aspects of budgetary institutions and find that "binding constraints" have a significant effect.

Why are the estimated effects so small and uneven? While this may be attributed to differences in operationalization and "samples," I suspect that there also might be

3 Primary net lending is net lending minus interest payments.

methodological reasons. First, it is impossible for quantitative studies to take the fiscal policy goals of the various governments into account. Second, in order to apply regression analysis, complex and widely varying institutional arrangements have to be reduced to simple indices. This makes it difficult to interpret the results for practical purposes in a meaningful way. These rather simple methodological remarks are not meant to deny the value of quantitative analysis in political science or to belittle the achievements of von Hagen, De Haan and their collaborators. Instead the point here is to show that they must be complemented by qualitative case studies to extend our knowledge about budget institutions and fiscal agreements.[4]

In this paper I use the combination of a case study and an intertemporal comparison to investigate Dutch fiscal policy in the last 25 years. This makes it possible to study the evolution of co-operation under the conditions of the CPR problem of public budgets. Furthermore, process tracing enables me to examine the way in which fiscal agreements are stabilized. With regard to the effects of fiscal contracts I first examine whether they made a difference in the yearly budget process. This method makes it possible to take the beliefs of actors and the contents of fiscal contracts into account. Thus I can compare collectively intended expenditures with fiscal outcomes. If actual spending is higher than originally intended, this indicates a CPR problem. In addition to process tracing, I compare a period without fiscal agreement to a phase with an effective fiscal contract. This allows me to control for several other factors and to examine whether fiscal contracts have an effect on aggregate spending. There are also drawbacks to this method, however. While it is possible to estimate the direction of the effects of fiscal agreements on public spending, I cannot exactly quantify them. Finally, one can object that no generalizable knowledge can be generated by means of a case study. It is certainly true that the findings produced with qualitative methods cannot be applied independent of time and space, but this does not preclude their being able to generate useful insights which can be applied in similar settings. After all, it is questionable whether the results of pooled time-series are strictly generalizable. In fact, the time-series analyzed are not random samples at all, but should also be regarded as the population. Nevertheless the insights gained can be practically and theoretically relevant. The next section deals with my analytical framework for the study of Dutch fiscal policy.

4 Actually, the authors have recognized this need and at times supplemented their regression analysis with short case studies. Furthermore, there are some detailed case studies for Germany, Belgium, and Italy (Hallerberg 1999; von Hagen/Strauch 1999).

4 Analytical framework

My explanatory framework draws on the literature on the CPR problem of public budgets and on elements of Scharpf and Mayntz's actor-centered institutionalism (Mayntz/Scharpf 1995; Scharpf 1997). The most important independent variables are economic growth, the actor constellation, and the institutional framework. It is obvious that economic growth has a substantial impact on financial policy: The higher economic growth is, the lower public outlays and the higher revenues will be. Given that public budgeting always involves planning, future economic growth has to be estimated. Therefore what really matters to governments that want to achieve their budgetary targets is whether economic growth turns out to be above or below expectations. This, of course, gives the government some leeway to conceal budgetary problems and thereby avoid awkward decisions.

This brings us to the role of actors in budgetary decision-making. In the budgetary process certain actors have to decide on the public share in national product and how it should be distributed. With regard to the question of distribution, I presume that parliamentary parties and ministers are guided by their egoistic interests. Each actor strives for as big a share of the public budget as possible in order to endow his or her portfolio properly. At the same time, I presume that actors involved in financial policy have notions about an appropriate level of the public share in the economy. On the one hand, these are grand *political-economic ideologies;* on the other, they are hands-on *economic policy ideas.* In reality, however, left or right ideologies as well the various schools of thought in academic economic policy are always interwoven with distributional interests. Nevertheless there seems to be a core in all these notions that deals with the impact of the size of the public sector on common welfare. Right-wing ideologies hold that the public sector should be small because the market will maximize welfare. Leftist ideologies, by contrast, argue that the market responds to effective demand but does not necessarily meet people's needs. With respect to schools of thought in economic policy we have to distinguish between Keynesian and neoclassical theories. The first approve a fiscal policy that stabilizes the economy through active demand management. By contrast, the latter call for a reduction of public outlays, taxes, and deficits in order to promote employment through lower labor costs and additional investment. All relevant theories consider some limit for the public sector to be necessary, because they want to maintain the free market.

Given a sufficient number of actors, this combination of ideas about common welfare and egoistic interests results in a problem that has often been analyzed in the social sciences under the labels of the Tragedy of the Commons (Hardin 1968) or the common pool resource problem (Ostrom 1990). This actor constellation is hallmarked by the fact that public benefits can be privatized while the costs are widely spread. With respect to the budget this means that parliamentary parties and ministers involved in the budget process have a systematic incentive to endow their portfolios as well as possible and to disregard the impact on total spending. The reason is that the benefits accrue at the clientele of the minister or her party, while the costs including the deadweight losses of taxation have to be borne by taxpayers and consumers of *private* goods. The price actually paid by the consumer of public goods is therefore much lower than their real costs. Therefore demand will also be higher than in a situation where the user has to pay the full price of the public benefit. Thus, the budget will end up being the sum of the egotistical demands of spending ministers, and it will inevitably be bigger than any single minister or parliamentary party wishes. As a consequence, taxes and deficits that cover spending will also be higher than collectively desired, which means that such a budget will be inconsistent with common welfare. Note that the CPR problem is not one that results from irrational behavior. Rather, it is a dilemma that prevents perfectly rational actors from achieving their common goals. If the number of actors in the budget process increases it becomes therefore less likely that one minister or parliamentary party will make a sacrifice for the collective interest. Instead everyone hopes that the others will abstain from their claims for the sake of the common good, i.e. lower spending and taxation. Hence, it will become impossible to keep spending under control even if everybody agrees on the desired aggregate spending level. The common pool resource problem is the most fundamental dilemma of public budgeting. To make things worse, it extends over time, so that co-operative behavior is additionally complicated. Of course, one can object that budgeting does not take place in the midst of anarchy, but rather within the institutional framework of a parliamentary democracy. While this certainly does not clear the common pool problem out of the way, it makes sense to ask whether and how institutions can help to solve it.

Institutions can mitigate the common pool resource problem by creating roles and the necessary competencies in order to safeguard the collective interest vis-à-vis individual interests. How does this work in a budget process? Usually three stages can be distinguished in the budget process:

1. Budget initiative of the government.
2. Debate and adoption of the budget bill by parliament.
3. Execution of the budget by the government.

The common pool resource problem looms primarily during the first two stages. In contrast the execution of the budget depends primarily on an efficient administration or once again on the institutional position of the minister of finance. During the budget initiative spending ministers hand their claims in. The prime minister has the responsibility to lead the government as a whole. Therefore, one cannot expect him to tolerate special interests of spending ministers. It will be easier for the prime minister to fulfill his duty if he has got the competencies to instruct his ministers or even to appoint and dismiss them. The minister of finance will be expected by the public as well as his colleagues to prevent increases in public expenditures which are inconsistent with the collective interest. Legal or even constitutional prerogatives vis-à-vis spending ministers will help him to counter their claims. His position is strong if conflicts over budgetary issues are solved in a cabinet committee where he and the prime minister dominate. Decision-making rules in the cabinet are also important. If unanimity is required, this constitutes a disadvantage for the minister of finance because spending ministers can insist on their claims. By contrast, the minister of finance has an institutional advantage if he alone possesses a veto in budgetary issues.

When the budget bill is debated in parliament it is the government that has to prevent the parliamentary parties from making additional demands on the budget. The cabinet has a strong position in relation to parliament if members of parliament cannot submit their own bill and if only one house of parliament can decide on the budget bill. Furthermore, it is advantageous for the government if parliament can only pass or reject the bill but not amend it. If the prime minister and the minister of finance are in a strong position vis-à-vis the cabinet, and parliament is weak in relation to the government, then we should expect aggregate public spending to be in accordance with collective interest. What happens if the budget process is not hierarchically designed? Then the CPR problem reappears or the politicians involved in the budget process manage to negotiate a fiscal contract.

Following Elinor Ostrom (Ostrom 1990: 42–45) three requirements have to be met for a voluntary agreement to become a viable solution for a common pool resource problem:

1. An agreement has to be negotiated that provides a set of rules which determine the level of public spending and the distribution of financial resources.
2. The agreement has to be monitored by somebody.
3. Finally, all actors have to commit themselves to the contract over an extended period of time.

If these three conditions are fulfilled, contracts are at least theoretically a viable alternative to the hierarchical solution (e.g. strong minister of finance or prime minister) and can therefore overcome the common pool resource problem of public budgets. If there is no hierarchy and no contract, collectively unwanted increases in spending will be the consequence. In the next section I will examine whether the parliamentary system in the Netherlands fosters a hierarchical or contractual solution to the CPR problem.

5 The parliamentary system of the Netherlands

In this section, I will assess the extent to which the features of the Dutch parliamentary system favor or attenuate the common pool resource problem. First, I deal with the party system. Then I investigate the institutional position of the prime minister and the minister of finance as well as the relation between cabinet and parliament in an international perspective. Finally, I show that fiscal contracts are favored by the procedures of government formation and that the party system promotes the stability of these agreements.

What is the structure of the party system in the Netherlands? How many parties and ministers participate in government? The four major parties in the Netherlands are the Christian democratic CDA, the social democratic PvdA, the conservative VVD, and the left-leaning liberal D'66. The party system has two cleavages. Christians are represented by the CDA, while all other parties can be considered secular. The VVD represents the interests of the higher-income brackets and homeowners. Therefore it takes a position on the far right on the socio-economic axis. The CDA is the party for religious people of all strata and therefore in the middle. The D'66 was founded as a progressive party that aims to reform the political system. It is a liberal party that has long been in a close alliance with the social democrats. Hence, it can be placed to the left of the CDA, while the PvdA is clearly the most left-wing of the four major parties. Tables 1 and 2 show that the two cleavages in Dutch society and the strictly proportional electoral system combine to produce a comparatively high number of effective parties in parliament and government.

In view of the facts presented in Tables 1 and 2, it seems likely that the common pool problem is of relevance in the Dutch case even if one considers that the number of ministers in the cabinet is clearly below the international average. Is the budget process hierarchically designed?

The main problem in comparing the strength of institutional positions is the question of how to define institutions. On the one hand, it is impossible to rely on formal and written rules only. Consider the case of Great Britain and New Zealand, which do not have a written constitution. Nevertheless, conventions make their prime ministers extremely powerful. On the other hand, when one sets out to assess the actual power of the prime minister or minister of finance, the term "institution" becomes meaningless. Since there is no good solution to this dilemma in my opinion, I will not base any strong conclusions on this analysis.

Table 3 shows that the position of the Dutch prime minister vis-à-vis the cabinet is rather weak in comparative perspective. Nine of the fourteen prime ministers are in a stronger position. The Dutch premier can formally neither instruct nor dismiss individual ministers. Hence, he is quite weak when compared for example with the German chancellor or the Anglo-Saxon prime ministers. The institutional position of the minister of finance is laid down in simple legislation. Important budgetary issues are decided in an inner cabinet where the minister of finance has considerable influence. The official quorum for decisions in the cabinet is the majority rule, but the prime minister's vote decides in case of a tie. Table 4 shows, on the one hand, that the British chancellor of the exchequer as well as the German minister of finance are in a much

Table 1
Number of effective parties in parliament, 1970–2002

Period	Australia	Austria	Belgium	Canada	Denmark
1970–1979	2.5	2.2	5.7	2.4	5.0
1980–1989	2.4	2.4	7.2	2.1	5.2
1990–1999	2.4	3.2	8.0	2.5	4.6
2000–2002	2.5	3.4	5.6	2.7	4.6
Period	Germany	Great Britain	Ireland	Italy	Japan
1970–1979	2.3	2.2	2.5	3.4	2.8
1980–1989	2.6	2.1	2.6	3.9	2.8
1990–1999	2.8	2.2	3.2	5.9	3.3
2000–2002	2.9	2.1	3.0	5.7	3.1
Period	Netherlands	New Zealand	Norway	Sweden	OECD-14
1970–1979	5.6	1.9	3.5	3.3	3.2
1980–1989	3.8	2.0	3.1	3.4	3.3
1990–1999	4.6	2.5	4.2	3.5	3.8
2000–2002	5.1	3.5	4.8	4.3	3.8

Notes: The number of effective parties (N) is computed as follows: $N = 1/\sum s_i^2$ in which s_i is the share of seats of the i-th party.
Sources: Data for 1970–2001 are from Hendrik Zorn, election results for 2002 were taken from IFES (electionguide.org), own computations.

Table 2
Number of parties in government and type of government, 1970–2002

Period	Australia	Austria	Belgium	Canada	Denmark
1970–1979	1.7	1.0 *m*	4.3 *o, m*	1.0 *m*	1.1 *m*
1980–1989	1.3	1.7	2.2 *o*	1.0 *m*	3.2 *m*
1990–1999	1.3	2.0	4.3	1.0	2.6 *m*
2000–2002	2.0	2.0	6.0 *o*	1.0	2.0 *m*
Period	Germany	Great Britain	Ireland	Italy	Japan
1970–1979	2.0	1.0 *m*	1.3	2.7 *o, m*	1.0 *m*
1980–1989	2.0	1.0	1.5 *m*	4.6 *m*	1.3 *m, o*
1990–1999	2.0	1.0	2.3 *m*	4.6 *m*	2.2 *m, o*
2000–2002	2.0	1.0	1.8	6.3 *o*	3.0 *o*
Period	Netherlands	New Zealand	Norway	Sweden	OECD-14
1970–1979	4.3 *o*	1.0	1.4 *m*	1.8 *m*	1.8
1980–1989	2.2 *o*	1.0	1.6 *m*	1.4 *m*	1.9
1990–1999	2.5 *o*	1.3 *m*	1.6 *m*	2.3 *m*	2.2
2000–2002	3.0 *o*	2.0 *m*	1.9 *m*	1.0 *m*	2.5

Notes: In this table "m" indicates a minority government and "o" an oversized coalition. Caretaker governments are not accounted for because definitions vary between countries.
Sources: The figures from the number of parties in government during the period 1970–1979 are from Lane/McKay/Newton (1997: 126–130), the other data are from Woldendorp/Keman/Budge (2000: Chapters 4 to 49), Kaiser (2002), Archiv der Gegenwart, various internet sources, and own computations.

Table 3
Position of prime minister in 14 parliamentary democracies

Country	Position
Australia	strong
Austria	intermediate
Belgium	weak
Canada	strong
Denmark	intermediate
Germany	strong
Great Britain	strong
Ireland	strong
Italy	weak
Japan	weak
Netherlands	weak
New Zealand	strong
Norway	weak
Sweden	intermediate

Note: This table provides an overview of the prime minister's position vis-à-vis other ministers. If the prime minister can instruct as well as appoint and dismiss her ministers she has a strong position. In those cases where the prime minister can only instruct or appoint/dismiss his ministers he is in an intermediate position. Otherwise he or she is in a weak position.

Source: Own diagram on the basis of a literature review.

better position. On the other hand, it is also clear that the position of the minister of finance in Norway is even weaker. It therefore seems safe to conclude that the Dutch minister of finance has comparatively few hierarchical competencies vis-à-vis his colleagues. Table 5 displays indicators for the relation between the cabinet and parliament in the budget process in my sample of parliamentary democracies.

Dutch members of parliament cannot submit their own budget bill, and the *Eerste Kamer*[5] has practically no say in budgetary issues, but the *Tweede Kamer* can amend the budget bill as it sees fit. There is, however, the unwritten rule that amendments have to include a proposal on how to finance it. Even though parliament has even more extensive powers in Belgium and Norway, it is clear that the *Tweede Kamer* is in a strong position in comparison to the *Bundestag* or the lower house in the Anglo-Saxon democracies. Although the parliaments in Belgium and Norway have even more influence in the budget process, it is clear that Dutch parliament is strong in

5 The *Eerste Kamer* is the upper house, the *Tweede Kamer* is the lower house of parliament.

comparative perspective. In short, the Netherlands are characterized by a combination of a pronounced common pool problem and a collegial design of the budget process. Therefore the question arises as to whether the parliamentary system of the Netherlands is conducive to the conclusion of binding fiscal contracts.

Table 4
Position of minister of finance in 14 parliamentary democracies

Country	Legal basis	Decision in case of conflict	Mode of decision
Australia	Ordinary law	Prime minister	Cabinet decisions are confidential, dominant position of prime minister
Austria	Federal constitution	Cabinet	Unanimous decision
Belgium	Ordinary law and standing orders	Coalition committee	Practically delegated to the high council of finance
Canada	Ordinary law	Ministers don't know details of the budget proposal	Prime minister and minister of finance decide
Denmark	Conventions	Decisions are made in the economic committee chaired by the minister of finance	Unanimous decision
Germany	Ordinary law and standing orders of the government	Negotiations between spending minister and minister of finance plus chancellor	Minister of finance can only be outvoted by a majority including the chancellor
Great Britain	Conventions and standing orders	Confidential, chief secretary dominates spending side	Chancellor of the exchequer and prime minister dictate revenue side and thereby the total amount of spending
Ireland	Ordinary law and standing orders	Confidential, no information	Cabinet decisions are confidential, dominant position of prime minister
Italy	Ordinary law	Cabinet	No exceptional position of minister of finance
Japan	Ordinary law	No conflict in cabinet	Unanimous
Netherlands	Ordinary law	Prime minister can mediate, core cabinet	Majority, in case of a tie the vote of the prime minister decides
New Zealand	Ordinary law	Until 1996 prime minister, thereafter coalition committee	Confidential, dominant position of prime minister
Norway	Ordinary law	Minister of finance collects claims of spending ministers	Unanimous, government submits a proposal to parliament that makes the final decision
Sweden	Ordinary law and standing orders	Spending ministers receive little information on the budget proposal	In practice the prime minister and minister of finance on the basis of multi-annual plans

Sources: Own diagram on the basis of information from homepages of ministries of finance, inquiries at ministries of finance, and a literature review.

Table 5 Parliament and budget

Country	Australia	Belgium	Denmark	Germany	Great Britain	Ireland	Italy
Which houses of parliament decide?	House of Representatives & Senate	De Kamer	Folketing	Bundestag	House of Commons	Dail Eireann	Camera dei Deputati & Senato della Repubblica
Budget bill from members of parliament?	No	Yes	No	No	No	No	No
Amendments?	No	Yes	Yes	Yes	In practice none	No	Yes
Limitations?	Parliament can only pass or reject the bill	No limitation	No limitation	Proposals that increase spending or reduce revenues can only be debated if they include a plan on how to fund the resulting gap. Federal government can veto amendments. The veto cannot be overruled by parliament. If parliament and cabinet cannot agree the government can continue on the basis of emergency budgets.	In practice parliament can only pass or reject the bill. Officially it can reduce spending.	Parliament can only reject or pass the bill.	Parliament cannot increase the deficit
Country	**Japan**	**Canada**	**Netherlands**	**New Zealand**	**Norway**	**Austria**	**Sweden**
Which houses of parliament decide?	House of Representatives	House of Commons	Tweede Kamer	House of Representatives	Storting	Nationalrat	Riksdag
Budget bill from members of parliament?	No	No	No	No	Government only makes a proposal and parliament decides	Theoretically yes, if federal government fails to submit the budget proposal in time	Yes
Amendments?	Yes	No	Yes	Yes	Yes	Yes	Yes
Limitations?	There is no clear demarcation between an amendment and a budget bill of parliament. A conflict between cabinet and parliament can therefore lead to stalemate.	Parliament can only pass or reject the bill.	According to an unwritten rule amendments have to include a proposal for funding	Until 1996 parliament could only pass or reject the bill. Ever since the government can veto amendments. Parliament cannot overrule these amendments. This can result in a stalemate.	No limitation	No limitation	No limitation

Sources: Homepages of parliaments, national codes of law, information from civil servants in Belgium, Japan, New Zealand, Norway, and Austria as well as a literature review (Hallerberg/Strauch/von Hagen 2001; Sturm 1989; von Hagen/Harden 1994).

In fact the Dutch parliamentary system has many features that favor fiscal agreements. In the Netherlands, societal cleavages result in a high number of parties, which makes coalition governments and compromises necessary. In the course of the last century procedures of government formation have been developed (Andeweg/Van der Tak/ Dittrich 1980) that foster compromises through the extensive use of "neutral" expert knowledge. The most important advisory bodies in the area of financial policy are the Central Planning Bureau (CPB), the Central Economic Commission (CEC), and the Study Group on the Budget Margin. Especially since the late 1960s compromises on financial policy have been laid down in ever more detailed coalition agreements. Ministers and parliamentary parties have to commit themselves to these agreements, which have developed more and more into full-fledged government programs (Bovend'Eert 1988; Van Raalte/Bovend'Eert/Kummeling 1991). Over time, government formations turned into a central policy-making arena (Timmermans 1998). Hence, supplying fiscal contracts does not seem to pose a major problem.

Though the minister of finance has only limited hierarchical competencies vis-à-vis his colleagues, he has still sufficient information on all financial issues to monitor the implementation of a fiscal contract. Furthermore, a close look at Table 2 reveals that the Netherlands belong to the small group of nations that do not have minority governments but do tend to have oversized coalitions. The high number of parties in government is therefore not a direct consequence of the electoral system but rather a result of a desire for broad majorities. A party's chance of participating in a governing coalition depends therefore less on its share of the vote than on its relationship to other parties. Under these conditions it does not pay for a party to break an agreement with another party, because it loses its reputation as a reliable coalition partner, which in turn reduces its chances to participate in future coalitions. Given that the share of votes is not the only determinant of the chance to participate in government, electoral competition is eased somewhat. This reduces the incentive for parties to turn populist and break an agreement just before the elections in order to increase their share of the vote. This should strengthen commitment to the fiscal contract.[1] To what extent can the budgetary performance of the Netherlands be traced to the common pool problem and fiscal contracts?

1 The argument presented here is a variation of a theme discovered by Hillebrand and Irwin (1999); Hallerberg and von Hagen (1999) even argue that countries with multi-party systems (but without a dominant party) deliberately choose the fiscal contracts as a solution for the common pool problem.

6 The financial policy of the Van Agt, Lubbers and Kok governments

In this section I analyze the financial policy of all cabinets in the last twenty-five years in a theoretically informed manner. In each case, I first evaluate the importance of the election for government formation. Second, I analyze the process of government formation and the coalition agreement. Third, I sketch financial policy during the term and finally I check whether the cabinet has reached its own financial targets. Before I turn to the various cabinets, however, some remarks have to be made about the change from Keynesian to supply-side financial policy.

In the 1960s the Netherlands introduced Keynesian fiscal policy in order to stabilize effective demand and to ensure full employment. Labor costs were not a big issue at the time. There were two ideas behind the so-called Zijlstra norm, which was introduced in 1961. First, central government's budget was supposed to act as an automatic stabilizer for the economy. The second goal of Minister of Finance Zijlstra was more political in nature. The norm was intended to force parliament to appreciate the benefit of additional outlays and the resulting costs in terms of increased taxation (Diamond 1977; Kertzman 1972/73). During the 1960s the norm worked satisfactorily. Public finances were in good shape, and at the same time the Dutch experienced full employment. In the recession of the mid-seventies, however, Keynesian fiscal policy proved to be inadequate. The consequences were increasing unemployment and a steep rise in public outlays. Minister of Finance Wim Duisenberg tried to counteract both problems with his "one-percent norm," which aimed to reduce the increase of taxation in national income to one percentage point per year. At the same time, the Netherlands' Bureau for Economic Policy Analysis established the so-called "labor cost theory" through the use of its new simulation program VINTAF II. This heralded the end of the Keynesian era in the Netherlands and led to a new view of the role of financial policy in relation to the labor market. The major actors in financial policy now believed that unemployment could only be reduced if the growth of the tax burden was curbed and the deficit was at least kept stable. In this perspective cuts in public spending served *common welfare* and the central question was whether it would prove possible to implement them against the resistance of *special interests.* The Den Uyl government only partly managed to implement the measures associated with the "one-percent norm."

The elections of 1977 were an impressive victory for the social democrats. They increased their share of the vote considerably and became the biggest parliamentary party in the Tweede Kamer in Dutch history up to that point. In the government formation that followed, the social democrats experienced for the first time the so-called "trauma of defeat in victory." The government formation lasted 208 days and in the end, a center-right coalition of Christian democrats and conservatives was sworn in (Andeweg et al. 1978). The coalition agreement mirrored the economic ideas of VINTAF II and consequently aimed at dampening the rise in the tax burden in order to reduce structural unemployment. To this end the new Van Agt government wanted to continue the "one-percent" policy. The part of the coalition agreement that dealt with financial policy was quite vague and was based on far too optimistic assumptions regarding economic growth. Real growth during the term averaged only 1.3 percent but in the first three years between 1978 and 1980, it was at 1.9 percent. The cabinet was therefore under pressure to substantiate its plans. The result was a paper known as "Blueprint '81". The purpose of the new plan was to prevent the deficit and the tax burden from becoming a larger share of national income, thus stabilizing the public share in the economy. Despite new forecasts by the CPB, "Blueprint '81" stuck to far too optimistic assumptions about economic growth and contained no specific plans for cuts in public outlays. Hard decisions were postponed until decisions were made on the 1979 budget.

The consequences of this rather vague declaration of intent were soon felt. Growth was lower than assumed by the government and consequently even more savings were necessary in order to reach the targets. At the same time, "Blueprint '81" provided no leverage for the minister of finance since it contained no specific measures he could demand from the spending ministers. Thus, "Blueprint '81" remained a vague plan even after the negotiations for the 1979 budget (Toirkens 1988). Spending ministers skillfully avoided clear-cut decisions by way of non-binding accords and short-term measures that did nothing to solve the problem. These measures only postponed hard decisions. If the cabinet could not agree, it decided, for example, to cut compensation to the various ministries for the increase in prices. On paper the ministries therefore had less money to spend. In reality, however, no decision was made where the cuts should be implemented. To the spending ministers this meant a further adjournment. Another measure was to declare a temporary moratorium on spending. This stopped the rise in expenditures and the deficit only temporarily because claims were once again voiced after the end of the moratorium. Ministers were, however, not generally opposed to savings. They only objected to savings that pertained to their own budgets. The attitude of the minister of education Païs (VVD) was a typical case in point. In a whole series of cabinet meetings he delivered extensive economic speeches on the necessity of cuts in all areas of public spending – except education, of course. Since the conduct of his colleagues was hardly more cooperative, Minister of Finance Andriessen (CDA) achieved very little in the almost uninterrupted budgetary negotiations of these years. The main reason for the steep increase in outlays was the indexation of social benefits and salaries in the public sector to the development of private sector wages. The latter were in turn indexed to prices. As a consequence a dangerous wage-price spiral developed during the second oil-crisis. Nevertheless, the minister of social affairs was not prepared to abolish indexation unilaterally because he wanted an amicable solution with the unions (Visser/Hemerijck 1998). Finally, Andriessen resigned because he was defeated in the conflicts with the minister of social affairs. In a statement to the press the minister of finance judged the cabinet's financial policy harshly by Dutch standards: "The cabinet's policy of austerity and moderation is less than it appears to be. It is not enough of anything and this is exactly what this country is continuously suffering from." [2]

His successor Van der Stee was no more successful. In order to hide the whole extent of budgetary problems, the cabinet started to fund outlays outside the regular budget. Moreover, the Netherlands's own huge natural gas reserves and the Dutch state had substantial ownership in the gas producing industry. When energy prices skyrocketed and profits increased quickly, the government could finance an increasing share of its growing budget from gas revenues without resorting to additional taxation. In spite of these revenues and the use of accounting gimmicks, the cabinet Van Agt I did not reach a single one of its own financial targets at the end of its term.

In the 1981 elections the social democratic party lost a substantial share (Brants/Kok/van Praag 1981) of its vote, but without them no government could be formed. The election result ensured that the governing coalition could not continue. Finally, an oversized coalition of Christian democrats, social democrats, and liberals was formed. Within this center-left-left coalition, considerable disagreements on economic policy persisted especially between the CDA and PvdA. While Christian democrats wanted to reduce the budget deficit, the social democrats insisted on a generous public works program. The coalition agreement did not settle this issue but rather concealed it by the use of vague formulations. After only one month the cabinet collapsed for the first time because of conflicts over the interpretation of the financial part of the coalition agreement. This time, however, the Queen appointed new *informateurs*[3] who managed to bridge the gap. In the months that followed the economic situation deteriorated even further. Finally, there was almost no money left for the social democrats' public works program. In May 1982 the cabinet fell over the resulting tensions. Dutch public finances were obviously in a state of crisis. Expenditures increased unchecked, the deficit passed 10 percent of national income in spite of the rising tax burden. This devastating picture was still sugarcoated by the substantial but extremely unreliable gas revenues.

Minister of Finance Van der Stee reacted to this crisis by asking the Study Group on the Budget Margin to investigate the controllability of public finances and to generate recommendations. The expert committee at the ministry of finance regarded the prisoner's dilemma of the budget as the key problem for the controllability of public finances. The Study Group recommended concluding multi-annual fiscal contracts during government formation. According to the experts, coalition agreements should be based on a cautious scenario and include not only simple targets for the tax burden and the deficit but also tangible savings and precisely defined measures. This was to help the minister of finance assert his claims. Furthermore, the advisors alerted the leading politicians of the upcoming government to the perils of programs with unlim-

2 Translation by the author, cited from the Dutch CD-rom version of Keesings Historical Archive (Keesings Historisch Archief, 2001).

3 Informateurs are appointed by the Queen during government formations.

ited appropriations which are especially difficult to control since they are not subject to the scrutiny of the budgetary process. Unlimited appropriations are common practice in social insurance, for example. Finally, they advised against indexation of social benefits and salaries in the public sector (Tweede Kamer 1982–1983).

In the 1982 elections, the social democrats gained votes and became the biggest party, but this time the election result permitted a coalition of CDA and VVD. Given the salience of economic policy at the beginning of the eighties and the extreme position of the social democrats on this issue, they were not seriously taken into consideration during government formation. By contrast, the liberals were asked twice whether they were willing to enter government in spite of the fact that CDA and VVD held a majority in the Tweede Kamer. Finally, a center-right coalition with fourteen ministers under Prime Minister Lubbers was formed. Although once again the relation between the parties had been a decisive factor for government formation, it emerged clearly that the social democrat's polarization strategy had created blocs of left- and right-wing parties after the strategy had failed. In the long run, this development gave increasing weight to electoral fortunes.

The cabinet also embraced the view of the Central Economic Commission, which held that the reduction of the deficit at a stable tax burden has to be regarded as a prerequisite for investments and a lasting improvement of the labor market. In order to achieve the necessary savings, it adopted a considerable share of the recommendations of the Study Group in its coalition agreement. Hence, the agreement not only defined targets for the tax burden and steps for the reduction of the deficit but also substantiated savings in particular policy areas which were deemed necessary to reach the targets during the term. It was agreed to abolish indexation of social benefits to wages in the private sector in order to dampen the development of the so-called "price component" of social expenditures. Furthermore, the coalition agreement specified structural reforms in social insurance which would cut the number of beneficiaries. The assumptions about economic growth on which the simulations of the coalition agreement were based proved to be realistic. Therefore it seems justified to consider this a full-blown fiscal contract. This agreement had a substantial impact on the budget process. The minister of finance insisted on the provisions of the contract and was supported by the prime minister most of the time. Although the minister of finance did not always prevail, he succeeded often enough to cause spending ministers to complain about the strict terms of the coalition agreement. After all, the cabinet managed to achieve the volume of economies agreed in the coalition agreement. In spite of the recovery more savings had to be found in order to reach the targets for the tax burden and the deficit. Once again, this involved painstaking negotiations. Nevertheless it can be maintained that the fiscal contract helped to mitigate the common pool resource problem. Where deviations from the financial part of the coalition agreement can be detected, they involved such aspects as the way spending cuts were arrived at and how the money saved was actually used, but they did involve expenditure overruns. Cuts were mainly achieved by the manipulation of the "price component" of public expenditures. Measures which cut the "volume-component" i.e. the number of beneficiaries were not implemented. Finally, it turned out to be difficult for the cabinet to meet the timetable for the reduction of the deficit because the savings were mainly realized in social insurance and had therefore no direct effect on the financial balance. At the same time, cabinet wanted to reduce the tax burden in order to facilitate wage moderation. As a result, the first Lubbers cabinet reduced the tax burden quickly although the coalition agreement foresaw only stabilization.

The parties considered their collaboration to be successful and decided to continue if the election results permitted. Such a statement declaring the party with which one intends to form a coalition is a rather unusual step in Dutch politics. Obviously, this made the upcoming elections even more important (Van der Eijk/Irwin 1986) and thereby endangered the stability of coalition agreements. The coalition parties won a majority in the Tweede Kamer again since the losses of the VVD were made up by the gains of the CDA. Since the election results determined the composition of the future cabinet, government formation was mainly about policy. Generally, the parties wanted to continue financial policy of their first term. To this end they specified once again budgetary targets for the whole term, which amounted to a stabilization of the tax burden and a stepwise reduction of the deficit. In addition, the coalition agreement laid down strict budgetary rules which stated that additional tax revenues could not be used to fund spending overruns (Regeerakkoord Tweede Kabinet-Lubbers 1986).

The assumptions about economic growth, however, turned out to be far too pessimistic. Therefore, the second Lubbers cabinet had to deal with entirely different problems than the first. Programs that operated on the basis of unlimited appropriations created large spending overruns. At the same time, the booming economy in the second half of the eighties produced substantial additional tax revenues. Politicians were therefore tempted to break budgetary rules and use windfall revenues to fund permanent overruns. In this situation it proved to be decisive that the declining popularity of the cabinet caused the parliamentary parties to worry increasingly about votes. The VVD feared that voters would hold it responsible for the austerity policies of the government and that the CDA could then switch to the social democrats after the elections. Christian democrats were also hardly prepared to cut back on programs which benefited their supporters. Both parties strived to increase their share of the vote by way of gifts to their voters at the expense of the other party and budgetary discipline. Thus, Prime Minister Lubbers was forced to compromise if he wanted his government to stay in power. Budgetary rules were shelved so as to finance the claims of both parties, and cyclical tax revenues were used to fund the resulting additional outlays. In a time of sharp competition between the two governing parties, Minister of Finance Ruding was as powerless as Andriessen during the first Van Agt cabinet. Finally, the populist attempts of the VVD to increase its share of the vote led to the fall of the second Lubbers government (NRC Handelsblad, 1 May 1989: 1).

Although the structural balance of the budget worsened considerably during its term, Lubbers II reached all its fiscal targets due to the booming economy. Furthermore, consolidation was only achieved by way of reducing the price of public benefits. By contrast, the volume of public benefits, i.e. the number of beneficiaries, decreased at best cyclically. The development of the disability pension which threatened to pass the threshold of one million claimants is especially telling in this respect. These budgetary sins became a burden for the following cabinet.

The fall of the government made early new elections in 1989 necessary, which brought the Netherlands once again closer to consensual democracy (Narud/Irwin 1994; Wolinetz 1990). During the campaign the CDA did not commit itself to any coalition after the elections. Under their new leader Wim Kok, the social democrats pursued a new strategy. They adopted a more consensual attitude towards the other parties and thereby lent themselves to the Christian democrats as a potential coalition partner. The leadership of the PvdA was even prepared to accept vote losses in return for a better chance to participate in office (Hillebrand/Irwin 1999: 124–125). The VVD hoped to win enough votes to revitalize the coalition with the Christian democrats. Although the election results permitted such a coalition and the social democrats had lost votes, a center-left coalition consisting of CDA and PvdA was formed. The most important effect of the elections on the party composition of the government was the fact that the biggest party participated in cabinet. Therefore one could expect the parties to strictly adhere to the provisions of the coalition agreement.

The fourteen ministers of the cabinet Lubbers III and the parliamentary parties committed themselves to the coalition agreement and thereby to a fiscal contract that included targets for the tax burden and the deficit. As in earlier terms the government aimed at stabilizing the share of taxes in national income and reducing the deficit each year. At the same time, the cabinet wanted to restore indexation of public benefits and wages to pay increases in the private sector. Structural problems in social insurance were to be dealt with through a strategy that was applied to the volume component of public spending. Next to some substantiated cuts the coalition agreement foresaw mainly preventive measures in the area of disability pensions to achieve this goal. In sharp contrast to the previous term, the assumptions about economic growth used in the coalition period proved to be far too optimistic. Economic growth during the cabinet's term averaged only 2.1 percent, and in the first three years between 1991 and 1993 it amounted to a meager 1.7 percent.

Hence, the coalition encountered financial difficulties. Instead of "reaping the fruits of the reforms" as Lubbers had indicated during the election campaign, his new Minister of Finance Wim Kok had to pinch and scrape. As had been the case during Van Agt I, the coalition agreement had to be supplemented by a so-called "mid-term review" in order to reach the targets in spite of the slump (Tweede Kamer 1990–1991). The PvdA lost dramatically at the polls. Nevertheless the social democratic minister of finance had to stick to the provisions of the coalition agreement because otherwise the social democrats would have lost their reputation as a coalition partner *and* suffered a severe defeat in the elections. The "mid-term review" foresaw cuts in all areas of the public sector including disability pensions. It did not, however, specify how the number of disability pensioners could be reduced. The reason was that this program was more important to the PvdA than to the Christian democrats. In countless negotiations during which the cabinet was always on the verge of breakdown, it proved possible to assert the volume policy in social insurance. The continuous procyclical austerity policies led the government to doubt whether it made sense to keep the targets. Towards the end of the term, it was finally agreed to drop the target marks for 1994. Instead the cabinet gradually adopted a policy which backed the so-called "activating" labor market policy by way of a reduction of the tax wedge for low-income workers. All the same, the targets of the coalition agreement were met to an astonishing degree.

As a result of the problems brought about by the policy of rigid targets in changing economic circumstances, the minister of finance charged the Study Group on the Budget Margin to draw lessons from these difficulties and to advise on possible solutions. In their report the experts recommended a new fiscal norm which included elements of the "Zijlstra norm" of the 1960s. The central tenets of the norm were: First, conservative assumptions about economic growth ("cautious scenario") and second a fixed, cyclically independent upper limit for real public spending (Kraan 2001; Van Ewijck / Reininga / ter Rele 1999). These rules effectively separated the spending side from the revenue side of the budget. It was hoped that the new norm would prevent procyclical financial policies in the future and avoid continuous negotiations over cutbacks outside the regular budget cycle. Once again, a report of the Study Group on the Budget Margin had an enormous impact on financial policy of the following cabinet.

The difficulties of the third Lubbers government had lasting consequences for future financial policy by discrediting the policy of fixed targets. Furthermore, the political struggles around the disability pensions caused a landslide in the following elections. Both coalition parties lost heavily. Due to infighting the CDA lost even more votes than the PvdA which made the social democrats by a small margin the largest actor in a party system dominated by four parties of almost equal size. Each combination of at least three parties had a majority in the Tweede Kamer (Hippe / Lucardie / Voerman 1995). After a government formation that lasted a hundred days a new cabinet led by Wim Kok was sworn in. It was based on a coalition of PvdA, D'66, and VVD. In fact this was the first government since 1917 without a Christian party. Many political observers expected the coalition of two left-wing parties (PvdA, D'66) and one right-wing party (VVD) to have a short lifetime. The new Minister of Finance Gerrit Zalm, however, argued that the cabinet would be very stable because no party could afford to defect from the coalition agreement. Any party doing so would be ignored during the next government formation (Het Financieele Dagblad, 21 Sept. 1994: 15).

The coalition agreement largely followed the recommendations of the Study Group. The fiscal contract, the so-called "Zalm norm," was based on cautious assumptions about economic growth which proved to be very conservative indeed. Real economic growth during the term averaged 3.4 percent. In the three years between 1996 and 1998 growth was on average as high as 3.7 percent. For each budget year a ceiling for real spending was laid down. In addition a number of spending cuts were proposed in order to ensure that real public spending would decrease during the government's term. If economic growth turned out higher than expected, additional tax revenues would have to be spent on the reduction of the deficit or the tax burden. If economic growth proved to be lower than expected, outlays could still be financed as long as the yearly limit of the deficit was not exceeded. With this coalition agreement the new cabinet wanted to decrease public spending in a smooth way in order to reduce the tax wedge on low-wage labor and create new jobs. Moreover, the government wanted to reduce the deficit in order to lower interest payments and to meet the Maastricht criteria.

The strong recovery in the years from 1995 to 1998 and the Zalm norm made for a smooth budget process. Once a year there were separate negotiations on the spending and the revenue side of the budget rather than continuous struggles for cutbacks. The spending limits laid down in the coalition agreement could easily be kept. The impact of the fiscal contract was also evident in the way the financial surplus created by economic growth was spent.

The VVD rejected the social democrat's claims for additional spending with reference to the Zalm norm. In accordance with the preferences of the VVD, windfall gains provoked by the Zalm norm in combination with the booming economy were utilized to reduce the deficit. High economic growth, however, also creates margins on the spending side of the budget because of decreasing unemployment. The social democrats could therefore spend more money than originally foreseen on health care without violating the terms of the coalition agreement. Furthermore, the PvdA asserted targeted tax reductions for low-income workers which also benefited their supporters. In the end, the first Kok government achieved all its budget targets. Unemployment was falling and at the same time employment grew rapidly. The Zalm norm proved to be a success for the coalition.

Given that the incumbent cabinet was as successful as it was popular, a large share of the electorate as well as politicians from the governing parties wanted to continue the coalition. The Democrats'66 was the only party that could not profit from the popularity of the government. Since the two other parties regarded D'66 as necessary for the functioning of the government, however, they did not oppose D'66. This was their strategy for avoiding an election disaster and a resignation of the liberals from government. Although PvdA and VVD finally won a majority in the Tweede Kamer, the old coalition including the liberals was continued. It is fairly obvious that the elections had at best a limited impact on this government formation (De Boer et al. 1999).

Minister of Finance Zalm successfully asserted his norm as the basis for the financial part of the coalition agreement (Tweede Kamer 1997–1998). In the first half of the term the "cautious scenario" estimated by the Central Planning Bureau once again proved to be very conservative. Thereafter, however, it turned out to be rather realistic.

Initially, the coalition continued the successful budget policy of its first term. Ironically, full employment disclosed a constructional flaw of the norm which in turn led to internal strife in the coalition. The reason was the asymmetric impact of the Zalm norm which continuously produced "unexpected" additional revenues and lower than budgeted outlays. Additional revenues soon turned out to be very high indeed. In contrast, "unexpected" savings were rather modest, because at full employment spending for the unemployed could hardly decline any further. This meant that no additional funds could be raised for financially suffering policy areas such as health care which were of great importance to the social democrats and the liberals. This led to considerable tensions because the VVD was more interested in a high budget surplus and tax reductions. PvdA and D'66 even threatened to shelve the Zalm norm. Minister of Finance Zalm and his party stated unmistakably that they were not prepared to abolish the norm, and that any attempt to do so would result in a fall of the cabinet. The PvdA put the screws on the minister of finance to exploit all the financial resources available under the terms of the coalition agreement. Prime Minister Kok wanted to sustain his cabinet and therefore tolerated the behavior of his parliamentary party, but at the same time supported the maintenance of the Zalm norm. In the second half of the government's term this problem vanished as the budget surplus disappeared when the current recession set in. During the period of declining economic activity, the advantages of the Zalm norm were reconfirmed. In spite of reduced tax revenues, the targets of the coalition agreement were reached without hectic cutbacks.

7 Conclusion

What conclusions can be drawn from this comparison? First, in the analysis of the coalition talks of the cabinets Lubbers I and Kok I, I showed how co-operation can evolve under the conditions of the common pool resource problem. The Dutch political landscape – its multi-party system, its lack of a strong prime minister or minister of finance, and the strong position of parliament vis-à-vis cabinet – makes a fiscal contract a prerequisite to a financial policy in accordance with the common interest. At the same time, the political system is very conducive to fiscal contracts: It was the analyses of the Central Economic Commission on the basis of the CPB's macroeconomic model VINTAF II that led to the insight that cuts in public spending were necessary to restore full employment. Hence, cuts in public spending were a *common good* and therefore the only question was how to defend it against *special interests*. The Study Group on the Budget Margin gained considerable influence on the course of financial policy of the Netherlands at two junctures. Its first report on institutional aspects of the budget process in 1983 allowed parties to state their intentions in an appropriate and exhaustive fiscal contract. This was a decisive step towards a new course in financial policy. A decade later the Study Group paved the way for the Zalm norm, which has shaped Dutch economic and social policies in the recent years. Since the advisors coped with the "production problem" and the politicians dealt with the "distributional problem," the two dimensions were effectively separated. The involvement of "neutral" expertise thus helped to overcome the negotiators' dilemma and to foster the creation of fiscal contracts.

Moreover, the multi-party system also stabilized the coalition agreement because the chance to participate in government depended more on the relationship between the parties than the share of votes a party won at the polls. If the party's chance of participating in government depends very much on its relations to other parties, then each party will be anxious not to violate the terms of the coalition agreement. In fact, a party that openly breaks a fiscal contract would run the risk of being excluded from government formation even though it may have won additional seats in the elections. If votes gain importance, however, parties will tend to break an agreement in order to enhance their chances at the polls. This can be shown with the help of Table 6.

The years from 1988 to 1990 and 1996 to 1998 were periods of high economic growth. Given that tax revenues were buoyant, politicians perceived fiscal contracts as restrictive in both time spans. In the first period budget discipline slipped in spite of the conservative ideological orientation of the second Lubbers cabinet because each party tried to please its constituency. Each coalition party tried to emphasize its own strengths at the expense of the others. Competition for votes thereby led to higher spending in violation of the terms of the coalition agreement. Finally, the cabinet fell. In contrast, the cabinet Kok I, which was only one possible coalition among others, had comparatively little problems with budgetary discipline. As Gerrit Zalm correctly pointed out, no party could afford to break the coalition agreement. Consequently, the share of government outlays in GDP declined somewhat more quickly than during the reference period. This hypothesis has, of course, implications from the point of view of democratic theory since coalition agreements are only stable as long as political competition is reduced. In fact, Dutch voters unsatisfied with their lack of influence on the composition of government have in the past turned to parties like D'66, which in 1967 promised a more "democratic" political system with a directly elected prime minister (Andeweg/Irwin 2002). Also the success of Pim Fortuyn can be traced to his populist critique of the "political cartel in The Hague" (Pennings/Keman 2002).

Another comparison of the periods from 1978–80 and 1991–93 shows that fiscal contracts had a moderating effect on public spending. In both phases economic growth and other explanatory variables were almost equal or yielded results that run counter to my hypotheses. Because the election of 1977 had little impact on the composition of the government, everybody could be expected to adhere to the coalition agreement. Poli-

Table 6 Dutch government terms in comparison, 1978–2002

	Van Agt I (1978–1981)	Van Agt II (1982)	Lubbers I (1983–1986)	Lubbers II (1987–1990)	Lubbers III (1991–1994)	Kok I (1995–1998)	Kok II (1999–2002)
Budget results							
Targets reached?	No	No	Yes	Yes	Yes	Yes	Yes
Public outlays in % of GDP	+7.7 (78–80: +5.8)	+2.2	−3.1	−2.6 (88–90: −3.9)	−1.8 (91–93: +0.5)	−4.3 (96–98: −4.4)	−1.5
Economic growth							
% of GDP	+1.3 (78–80: +1.9)	−1.2	+2.7	+3.2 (88–90: +3.8)	+2.1 (91–93: +1.7)	+3.4 (96–98: +3.7)	+2.4
Assumed/real growth	Blueprint 1981 3% / −0.3% NI	No information given	3% / 3.7% WT	2.3% / 3.1 NI	2.25% / 1.95% NI	2% / 3.4% GDP	2.25% / 2.4% GDP
Actors and actor constellation							
Ideol. orientation	Center-right	Center-left-left	Center-right	Center-right	Center-left	Left-left-right	Left-left-right
Economic policy idea	Lower taxes for more jobs	Disagreement	Deficit reduction or more jobs	Lower taxes for more jobs	Lower taxes for more jobs	Lower taxes for more jobs	Lower taxes for more jobs
CPR problem?	Yes	Disagreement	Yes	Yes	Yes	Yes	Yes
Ministers/parties	16/2	15/3	14/2	14/2	14/3	14/3	14/3
Fiscal contracts							
Type	Declaration of intent		Fixed targets			Zalm norm	
Relationship between share of votes and composition of government	Weak association	Weak association	Weak association but increasing	Relatively strong association, declaration before election regarding party with which coalition is planned	Weak association	Weak association	Weak association
Level of spending/specific cuts?	Hardly any details, changing targets	No specific deal	Specific details on both issues	Specific details on both issues	Specific details on both issues	Fixed real spending/specific cuts	Fixed real spending/specific cuts

NI = national income WT = world trade

Source: Own diagram, economic data from OECD (2002).

ticians had gained the insight that the growth of public expenditures had to be curbed in order to reduce unemployment. What lacked, however, was technical support to generate an effective fiscal contract. This only became available through the Study Group's report on the controllability of public finances. During the third Lubbers cabinet, however, parties were tied to an effective fiscal contract. The result was, that the share of public outlays in GDP increased by 5.8 percentage points in the years between 1978 and 1980 while the reference period in the nineties witnessed only a minor rise of 0.5 percentage points. This demonstrates that if one controls for a range of other factors, fiscal contracts helped to avoid unwanted public spending. It is therefore possible to explain a substantial part of the empirical puzzle which provided the starting point of this paper: the development of public spending in the Netherlands, in terms of the absence or presence of fiscal contracts.

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