Ifo Viewpoint

Munich, 3 May 2016

No. 172
Preparing for Crises – A “Legacy” for States*

A proposal put forward by the German Federal Ministry of Finance has given a boost to the negotiations between Greece, the EU Commission and the IMF. These parties could not agree on the volume of the fiscal consolidation package needed to enable Greece to meet the budget goals set by the Troika. It is not only difficult to calculate the costs of the refugee crisis. The future revenue and spending of the crisis-afflicted country are difficult to predict in any case. This led to a proposal from Berlin to approve consolidation measures in advance, which would only take effect if Greek government spending were to exceed forecasts.

Although this idea may seem fairly insignificant at first glance, we think that it has the potential to play a key role in crisis management in the Eurozone, beyond the special case of Greece. In addition to taking annual budgetary decisions, member states could also commit to approving a crisis budget that would cover 90 percent of expenditure, for example, and potentially provide for measures to increase revenues.

Should a crisis strike suddenly, a government could resort to these emergency decisions without any further involvement on the part of parliament and cut spending. The emergency plans that have to be submitted by banks could act as a role model. Should a bank get into a crisis, such a “legacy” would describe the smooth liquidation of the financial institute. Although states cannot be liquidated, they have to be restructured.

Recent years have shown why, especially in the crisis countries in southern Europe, a legacy for states may be attractive. In many cases an economic crisis was followed by a political crisis, which led to a parliamentary blockade and subsequently to new elections. Since the outbreak of the most recent crisis the Prime Minister has changed five times in Greece, three times in Italy, and there has been a deadlock in Spain since the elections last autumn. Under the time and psychological strain of implementing restructuring and reform measures, governments often break down. In times at which a country needs a strong government capable of action, that government is lacking.

This reflects how difficult it is for democracies to distribute the burden of adjustment during crises in a way that is perceived as fair by the majority. If government spending is cut, the recipients of pensions and transfers, subsidised branches, as well as state officials and civil servants tend to suffer. Each group has huge incentives to mobilise all of its members to remain protected from cuts and to saddle others with the burden.

The story is a very similar one with tax increases. The political system and the country become incapable of taking decisions, and the crisis intensifies. Precautionary measures do not preclude protests and resistance against cuts or additional burdens. They merely prevent such protests from blocking adjustment measures needed to deal with the crisis.

Such measures carry a whiff of state-of-emergency legislation. Even if parliament no longer has to be consulted in the case of a crisis, however, advance resolutions do not usurp democracy. They are passed by parliament before the crisis, and it is possible to make constructive changes to them at any point. In other words, if parliaments can agree to alternative savings measures, the latter should take priority, provided that the change is revenue neutral. Only blocking should no longer be possible.

Advance resolutions ensure that governments remain able to act in times of crisis and that crises are not unnecessarily intensified. In normal times they also show voters what is at stake and thus increase the pressure on governments to avoid crises in the first place. The definition of what constitutes a crisis situation is naturally crucial; and this could be linked in the Eurozone to participation in an ESM programme.

Advance resolutions do not prevent the election of governments that wish to revoke or thwart agreements with the Euro Group and the IMF. In the agreement between the Troika and Greece advance resolutions therefore also have another function: they aim to deny Greece scope for renegotiation – or at least to make it more difficult.

* Published in German under the title “Krisenhaushalt auf Vorrat” (Crisis Budget in Reserve), *Handelsblatt*, 3 May 2016, p. 48 (with Johannes Becker).

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