

Innovation or Incrementalism: The Effectiveness of Conditional Bailout Programmes for German Local Governments

**- PhD-Thesis Outline -
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1. Introduction

In response to a long-standing crisis of municipal finance ten out of thirteen German territorial federal states (*“Länder”*) initiated conditional bailout programmes for their local governments. These programmes are designed as a “help for self help” offering conditional grants in return for local consolidation means (Junkernheinrich and Wagschal 2014, pp. 29–30). Estimations state that fifteen percent of German first tier local governments participate in such a programme (Ernst & Young GmbH 2013). At the first glance, these programmes seem to be an innovative approach. Local governments decide on the participation in the programmes and on specific municipal consolidation measures to fulfil the conditions. However, it is unclear whether these programmes are another case of up-scaling fiscal policies and strengthened fiscal rules or are an outstanding attempt to revitalize local autonomy. As similar programmes could diffuse into other multi-level systems it is necessary to know more about the concrete implementation at the local level. Does the mechanism of conditionality that receives harsh criticism in the European crisis policy work within national multi-level systems? What is the logic of conditionality? Do local governments just incrementally fulfil conditions to receive extra grants or do they use the opportunity to initiate innovative practises? As comparisons at the macro-level can give only preliminary answers, the research focus of my PhD thesis is the implementation of these programmes at the local level. I will provide case studies of independent cities which rely on an assessment of fiscal data, document analysis and guided interviews. The following questions should be answered:

- i) How effective are the conditional bailout programmes for local governments?
- ii) How can institutional factors, actor’s preferences or learning processes explain the effectiveness of conditionality?

I will clarify why I understand effectiveness as a multidimensional concept which consists of programme compliance, fiscal outcomes and administrative modernization. To explain differences in effectiveness or in different dimensions of effectiveness I will refer to the general framework of actor-centred institutionalism (Mayntz and Scharpf 1995a, p. 45, Scharpf 2006). Moreover, I will supplement this framework with three explanatory models of “conditionality”. The PhD-project evolved within the research project „REformability of POLitical Systems in times of crisis: The example of the financial consolidation in German and Greek municipalities (REPOS)“. Moreover, my research can assess previous work on the

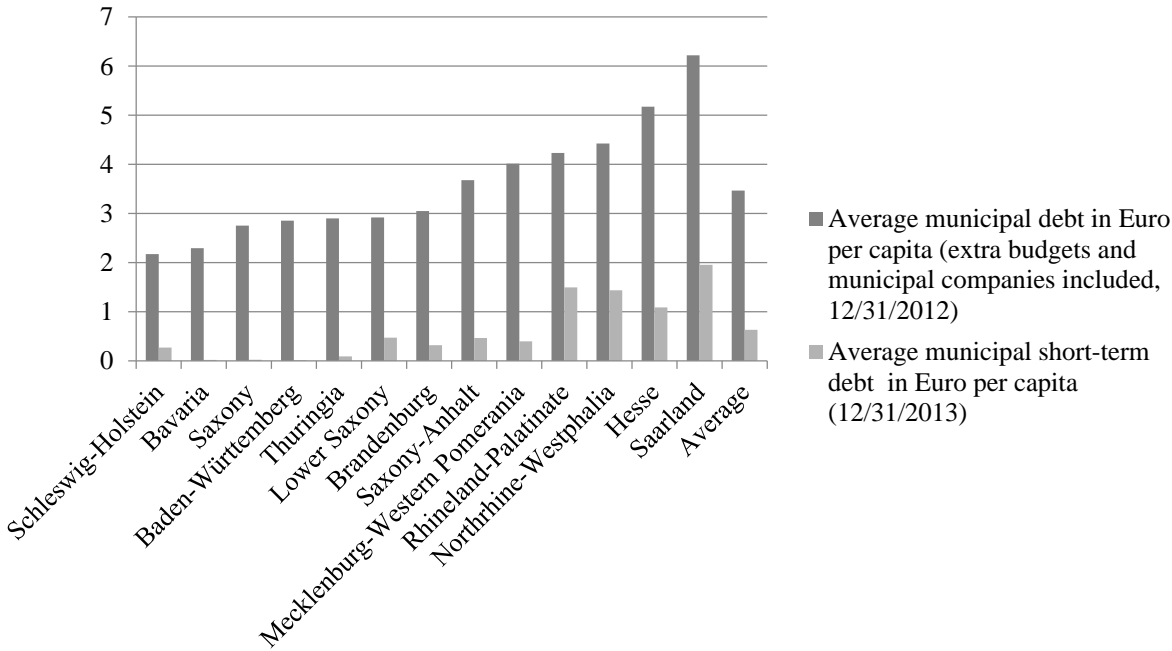
concrete design of conditional bailout programmes (Stolzenberg and Heinelt 2013, Heinelt and Stolzenberg 2014). My approach is a comparative case study of four independent cities in different German *Länder* (Wuppertal in North-Rhine Westphalia, Mainz in Rhineland-Palatinate, Kassel in Hesse and Magdeburg in Saxony-Anhalt).

2. Fiscal challenges of the local level in Germany

As an example of the „North and Middle European group” German local governments are supposed to fulfil tasks of service delivery effectively as well as act as an autonomous level of democratic decision-making (Hesse and Sharpe 1991, Haus 2014, p. 128). The German local level has a strong constitutional role but municipalities are subordinated to the *Länder*, which determine many aspects of local government finance. The municipalities levy business tax as well as real property tax and receive a share of income tax. Additionally, the municipalities obtain non-earmarked grants allocated by equalization schemes in the *Länder* and earmarked grants from upper levels. Municipalities fulfil voluntary tasks (e.g. culture or sports), implement many social policies as obligatory tasks (e.g. social welfare or childcare policies) and are responsible for about 60 percent of all public investments (Deutscher Städtetag 2013). Local government debt is unequally distributed between and within the federal states and in many affected local governments a vicious circle of budget deficits, high expenditures for social policies and economic weakness has evolved that paralyzes municipal leadership (Holtkamp 2010, p. 25, Junkernheinrich 2011, p. 44, Schäfer *et al.* 2013, p. 893). A comparison of types and sizes of local government shows that fiscal challenges are concentrated in independent cities with a population from 100.000 to 500.000 (Junkernheinrich and Wagschal 2014, p. 308). Furthermore, a remarkable share of local government debt consists of short-term borrowing (*‘Kassenkredite’* or *‘Liquiditätskredite’*) which is not related to asset values.¹ Moreover, a large share of local government debt is dedicated to municipal companies or off-budget funds. Since recently, public finance statistics capture all these different types of local government debt (see Figure 1).

¹ Long-term debt is relatively harmless when used for profitable investments which are useful for future generations (pay-as-you-use). In contrast, short-term borrowing or cash credit (*‘Kassenkredite’* or *‘Liquiditätskredite’*) should (according to regulations in the municipal codes) only compensate short-term variations of income. However, there is no doubt that German local governments misuse cash credit to finance structural deficits Herrmann (2011, p. 10).

Figure 1: Municipal debt in Euro per capita, according to types of debt and *Länder*



Source: Junkernheinrich and Wagschal 2014, p. 305

Research identified firstly exogenous reasons for fiscal problems, that local government can hardly influence (e.g. socio-economic conditions, task shifting of upper level governments, inadequately local government codes or fiscal rules), and secondly endogenous reasons which are provoked by local failures (e.g. party polarization, missing skills of political leaders, mal-investment, risky financial transactions)(Bogumil *et al.* 2014, Junkernheinrich and Wagschal 2014).

3. Conditionality: promises and limits of a mechanism

3.1. Selected Bailout Programmes in Germany

Before the bailout programmes diffused in Germany a comprehensive reform of the system of municipal finance was obstructed at the federal level. At the same time the economic and financial crisis raised doubts on the solvency of public debtors and caused consideration about stricter banking regulations. Under these conditions the *Länder* governments sought for new problem-solving strategies for the fiscal challenges of local governments that could prove the financial stability of the municipalities (Heinelt and Stolzenberg 2014). I use the term “bailout program” because this refers to the commonly used disciplinary language in economic and political science. However, municipalities participating in programmes are not necessarily “bankrupt” without the additional grants. The programmes aim to reduce short-term debt

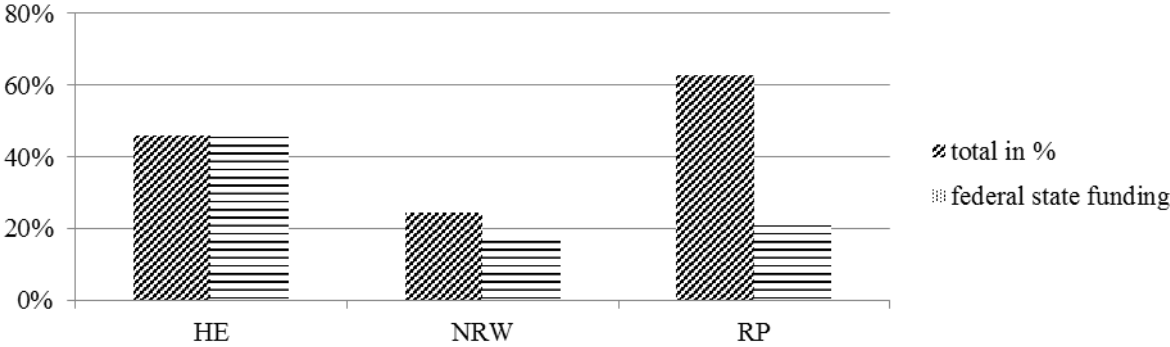
(Rhineland-Palatinate), long-term debt (Saxony-Anhalt) or total debt (Hesse), or they focus on balanced budgets of participating local governments in the long run (North Rhine Westphalia). Hence, the concrete conditions, the volumes and sources of funding differ (see Table 1and).

Table 1: funding of consolidation programmes

federal states	Consolidation program	benefits in total (in million euro)	funding period	sources (in million euro)		
				state	equalisation schemes and “solidarity funds” of the local level	own contribution
Rhineland-Palatinate	‘Kommunaler Entschuldungsfonds (KEF-RP)’	3,825	2012-2026	1,275	1,275	1,275
North Rhine-Westphalia	‘Stärkungspakt Stadtfinanzen’	5,76	2011-2020	3,995	1,762	-
Hesse	‘Kommunaler Schutzschirm’	3,200	-	3,200	-	-
Saxony-Anhalt	‘Stark II’	513	2010-2016	513	-	-

Sources: Ministerium für Inneres und Kommunales Nordrhein-Westfalen, Heinelt and Stolzenberg 2014, p. 8

Figure 2: funding in percentage of local government short-term debt



Source: Stolzenberg and Heinelt 2013, p. 469

The selection of local authorities and the allocation of additional state grants is based in all states on detailed fiscal criteria. However, the number of participating local governments varies considerably between the *Länder*. Furthermore, except some cities in North Rhine-Westphalia a decision of the local council is required to participate in the programmes. The councils of participating local governments decide on a consolidation treaty with the federal state or on a consolidation plan that has to be approved by the supervision. These contracts or

plans contain the concrete consolidation measures local governments chose to reach a balanced budget or to achieve a certain fiscal amount of consolidation. In periodic reports, local governments have to prove their compliance. If they do not stick to the agreed conditions, they face sanctions like the revocation of the contract or a reclaim of the financial support. North Rhine-Westphalia has comparatively strong fiscal rules for local governments (Holler 2013). Hence, the programme is combined with the threat of a state commissioner who takes over the tasks of mayor and council. In contrast to the time before the consolidation programme, the federal state is willing to implement the instrument of a commissioner at least in smaller municipalities (Holtkamp and Bathge 2014b, pp. 49–68). Hence, Holtkamp et al. characterize the programmes of North-Rhine Westphalia and Rhineland-Palatinate as opposite cases: the former, most restrictive one was underpinned by hard sanctions, whereas the latter left much room for local choices (Holtkamp and Bathge 2014b, p. 51).

3.2. Economic Perspective on Conditionality and Fiscal Rules

From an economic perspective bailout grants enhance opportunistic behaviour of governments as they do not bear the full costs of their fiscal actions. Due to economic theories, the “soft budget constraint” of expected bailout grants causes overspending or under-taxing (Wildasin 1999, Rodden *et al.* 2003, pp. 5–6). Nevertheless, except the US and Switzerland, bailouts are quite common in multilevel systems. A bankruptcy of a public entity always raises doubts of creditors towards the solvency of other entities and upper level governments usually want to prevent spill-over effects. Moreover, German municipalities are responsible for the implementation of many federal policies and equal living conditions within the county, which are an important constitutional principle.

As upper level governments have a share of responsibility for the problems of municipal finance, they would risk to be blamed for bad service-delivery if they refused to pay bailout grants. To dissolve the dilemma of the risks of bailouts and the costs of no-bailout policy, upper level governments tried to combine bailout grants with strict conditions in the form of fiscal rules. However, it is disputed in research whether conditionality in form of fiscal rules could work to enhance fiscal performances or not. Moreover, there are important side-effects on questions like local autonomy, democracy and the quality of service delivery.

3.3. Conditionality: a Current State of Research on Conditionality

The mechanism of conditionality is not only a phenomena within states. It is also quite common in the credit policy of international financial organizations (International Monetary

Fund or World Bank), in the European crisis policy, in the EU-accession policy and also in multi-level fiscal policy. This research brought fruitful insights for the promises and limits of the “conditionality mechanism”. In credit policy and European crisis policy, conditionality is mostly evaluated negatively. Critics state that conditionality contravenes national sovereignty and ends in a dictatorship of creditors (Tetzlaff 1996, pp. 141–142). For them, neoliberal „evidence-based“ policies are provided as universal solutions without considering the specific challenges of the debtor. (Hagen and Dahlberg 2004, p. 21). Basically, the effectiveness of conditionality is perceived negatively for programme compliance as well as for economic outcomes (2005, p. 60). Moreover, side effects like increasing social inequality and worsened health services were observed (2005, pp. 60–62). To enhance legitimacy, the international financial institutions tried to strengthen the transparency of conditions and to foster consultations with governments and civil society. To focus on policy learning instead of pressure, the creditors tried to provide professional expertise to convince debtors of “better” policies and to create a sense of “ownership” of reforms (Hagen and Dahlberg 2004, p. 21, Gesmann-Nuissl *et al.* 2014, Konrad 2014, p. 246).

Research on conditional grants for sub-national governments provides some insights which are less critical on the legitimacy of conditionality but deliver different results for effectiveness. In contrast to the aforementioned mechanisms of conditionality in international or European policy, conditional bailout grants within nation-states focus merely on fiscal rules as conditions and do not prescribe a full reform agenda. These conditions – balanced budget rules, debt limits or a specific amount of fiscal consolidation – make the monitoring of the implementation of rules much easier. However, literature provides also different assessments of the impact of fiscal rules. The basic idea of rules is externalizing political responsibility to allow politicians to resist against demands from citizens and bureaucrats (Buchanan and Wagner 1977, Wagschal 2011, pp. 356–357). Although many economists are convinced on this mechanism, empirical studies show mixed impacts of rules on fiscal performance. For Swiss cantons and for US-states, research proves that strict fiscal rules cause a better performance in fiscal policies {Feld 2008 #775}{Bohn 1996 #888}. Moreover, an investigation of the implementation of the „debt drake“ in the *Länder* legislation indicated that a stricter clarification of the rule (e.g. the role of business cycle, degree of formalization) causes a more reluctant expenditure behaviour (Fiedler *et al.* 2014). Different fiscal rules for the German local level are also expected to influence fiscal performance. However, a systematic comparison of the impact of different rules on municipal fiscal policy misses up to now (Holler 2013, pp. 59–63, Bogumil *et al.* 2014, p. 643). Despite the call for more

strictness, there are rarely fundamental critics on fiscal rules in economic science (missing capabilities for stabilization policies and public investment (Bofinger and Horn 2009). Though, there is an emerging scepticism on fiscal rules in political science. Some authors argue that constraints lead to a “depoliticization” or “disciplination” of democracy. In this view rules are a cause or at least a mechanism to constrain elected politicians or to disable political debates and competition on policy choices (Burnham 2001, Pierson 2001, Flinders and Buller 2006, pp. 303–307, Roberts 2010, Streeck 2013, Sturm 2013, pp. 403–404). Moreover, missing policy alternatives and redistributive capabilities of governments could foster political apathy of underprivileged groups (Offe 2013, p. 181) but also of high-educated citizens (Häusermann *et al.* 2013). Some of the general concerns on conditionality and fiscal rules are only partly transferable to the bailout programmes. In contrast to international organisations, *Länder* governments have a direct legitimacy through elections and decide regularly on regulations for local governments. Furthermore, the “reversibility of rules” as the fundamental democratic principle is respected (Nullmeier 2012). Nevertheless, researchers on local government worry about an erosion of local democracy as conditions are too strict (Holtkamp 2013).

In Germany well-known examples for conditional bailout grants are the funds of debts relief for two *Länder* (1994-2004) and the consolidation grants for five *Länder* (2011-2020) as a part of the implementation of the debt brakes. The grants for debts reliefs are evaluated negatively as the *Länder* fulfilled conditions while budget deficits and debts further increased. For the consolidation grants an assessment is too early. There are stricter conditions (yearly reduction of new borrowing by 10 percent) and a clear monitoring but sanctions are limited to blaming and cancelling grants (Konrad 2014, pp. 119–120). Bailout grants for local governments are also not a new invention. Many German *Länder* governments allocated “special needs transfers” (Fehlbedarfszuweisungen) to their local governments before the new programmes were enacted. These grants are provided for local governments which did not cause their fiscal challenges on their own, exhausted their tax base and have an approved list of consolidation means. Compared to the new conditional bailout programmes, these criteria are very vague and the amount as well as the duration of the transfers are much smaller (Rehm and Matern-Rehm 2010, p. 177, Schwarting 2011, p. 138). Therefore, empirical assessments of the special need transfers are rare. At least for Hesse, a quantitative study proves that municipalities which receive special grants comply with the conditions, implement cutbacks as well as increase taxes and decrease budget deficits and debt (Baskaran

2014). Hence, the federal state seems to be able to effectively enforce conditions which could also apply for the obligations of local governments in the bailout programmes.

4. How to Operationalize the Effectiveness of Conditional Bailout Programmes?

There are different approaches to define the “success” or the “effectiveness” of fiscal consolidation. They depend on a varying evaluation of data validity as well as on different normative considerations. The easiest way to estimate the effectiveness of conditional bailout programmes would be to assess *programme compliance*. This could be done by analysing monitoring reports of the *Länder* governments. The question would be whether local governments fulfilled the conditions and fiscal rules of the bailout programmes or not. Basically, input- and output/outcome-conditions as well as procedural conditions can be differentiated (Konrad 2014, pp. 244–245). Procedural conditions set specific rules for decision-making processes like the involvement of municipal councils or procedures for grant applications. Input conditions oblige local governments to take specific actions, e.g. to increase local government taxes or to decide on a municipal consolidation plan. In contrast to that, output/outcome-conditions bind local governments to reach certain policy goals like a balanced budget or a reduction of municipal debt. The advantage of input conditions is a relatively easy monitoring because there is a clear causal relation between local government actions and the fulfilment of conditions. In contrast to that, the accomplishment of output/outcome-conditions depends also on many external factors beyond local government influence (e.g. economic growth, socio-economic development). The concrete conditions differ between the programmes. Additionally, some refused to include output/outcome-conditions. In a first step it seems to be useful to consider the compliance to the specific policy conditions and policy goals of each programme. Nevertheless, an empirical study that would only assess compliance could produce affirmative results which cannot compare effectiveness between federal states as well as between the selected cases. Hence, I will select own indicators, which make a comparative assessment of *fiscal outcomes* possible. Basically, I will refer to the development of budgetary results and different types of municipal debt. For German local governments, the introduction of different business-like accounting systems in the *Länder* challenges the comparison. Therefore the selection of concrete indicators is mainly influenced by data availability. Like output/outcome conditions, fiscal outcomes have the problem of external factors which local government cannot influence. Furthermore, there will be some overlaps between the two dimensions that I will have to consider. Moreover, the possible time period for the investigation whether fiscal outcome is really sustainable or not,

is too short to find out. Hence, I will ask whether municipal consolidation is associated with long-term *administrative modernization*. I will follow the recommendation to rely not only on short term quantitative indicators because such an approach tends to hide long-term side-effects of consolidation policy (Geißler 2011, p. 279). Especially “voluntary” tasks (sports, culture), investments and maintenance are affected by fiscal consolidation which could remarkably worsen the attractiveness and competitiveness of a municipality. Therefore, after many years of fiscal consolidation the potential of incremental (or ‘decremental’) approaches, (also called “cheese slicing” or “across the board cuts”) which aim to maintain or minimize the public sector, seem to be exhausted (Pollitt 2010, p. 21, Weiß 2014a, p. 3). On the one hand, these approaches seem to lower decision-making and transaction costs because the “pain” of fiscal consolidation is equally distributed and only limited cognitive capacities are necessary. On the other hand, these approaches fade out political priorities and do not recognize different needs in specific policies, which could lead to a loss of service quality. Moreover, administrative units which already work efficiently are penalised. Consequently, this will which cause disincentives in the long run (Raudla *et al.* 2013, p. 8). As the crisis of local government finance is a longstanding crisis, municipalities should *“reposition their service portfolio to focus resources on the high-priority programmes”* instead of concentrating on short-term approaches and reactive policies (Meneguzzo *et al.* 2013, p. 462). A concrete assessment of the impacts of administrative modernisation in the cases is not possible, but I will try to categorize the means of fiscal consolidation in the four cases. Different classifications of measures are available in the literature Pollitt 2010, pp. 172–186, Overmans, J. F. A. (Tom) and Noordegraaf 2014, Hastings *et al.* 2015. For an overview, see Raudla *et al.* 2013, pp. 5–7. I tried to adjust these classifications for the investigation of German local governments. Generally, I will differentiate between incremental/ decremental measures and strategic measures, which I consider as a contribution to administrative modernization.

Table 2: fiscal consolidation means and administrative modernisation

	strategic measures		incremental measures	
	efficiency gains/innovation	priorization	horizontal cut-backs	tax increases
approach	organisational	fiscal	fiscal	fiscal
time span	long-term	long-term	short-term	short-term
decision-making costs	high	high	low	low
long-term effectiveness	high	high	low	low
typical measures	process optimization, E-government, co-production	cutbacks of non-prioritized	control of expenses, across-the-board cut-	increase of business and real

of citizenry, intercommunal cooperation	services	backs, recruitment stops	property tax, skimming of profits of municipal companies
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To sum up, I will consider three dimensions of effectiveness: programme compliance, fiscal outcomes and administrative modernization (see Table 3). This assessment might be complex but a multi-dimensional approach has the advantage to combine different disciplinary perceptions on conditionality, fiscal rules and consolidation. Obviously, there might be trade-offs between the different dimensions, but this possibly enables me to provide some new insights to ongoing debates on the relation between fiscal consolidation and administrative modernization (Bozeman 2010, Pollitt 2010, Di Mascio and Natalini 2014).

Table 3: effectiveness of conditional bailout programmes

programme compliance	fulfilment of input-, output- and procedural conditions
fiscal outcomes	budget surpluses, reduced local government debt
administrative modernization	importance of strategic vs. incremental/decremental consolidation means

5. How to explain the effectiveness of conditional bailout programmes?

5.1. Actor-centred Institutionalism as General Framework

There are no theoretical models which explicitly try to explain the results of conditional bailout programmes. Therefore, I will base on the general framework of actor-centred institutionalism established by Mayntz and Scharpf (Mayntz and Scharpf 1995a, p. 45, Scharpf 2006). This approach seems to fit for the investigation of conditional bailout grants as it avoids the narrowed perspective of a “legislator” and considers the role of the addressees of legislation (Mayntz and Scharpf 1995a, p. 44). Moreover, the origins of the approach in the debate on “political steering” and associated “steering problems” (motivation -, information - and implementation problems) makes it suitable to investigate the chances and limits of conditionality (Mayntz 1987, pp. 95–100, Scharpf 2006, pp. 386–399). I decided to choose the approach because other actor-centred institutionalisms are either oversimplified like the two-filter model (Elster 1979, p. 113) or too elaborated for my research like the Institutional Analysis and Development Framework (IAD-framework, see Ostrom *et al.* 1994). In contrast to the IAD Framework the actor-centred institutionalism explicitly resign to establish a formal categorization of rules (position-, boundary-, authority-, aggregation- and information rules

see (Ostrom 2011, pp. 19–21). However, Mayntz and Scharpf use a similar narrower definition of institutions that focuses on rules and excludes practices or cultural aspects. In contrast to classical institutional approaches they assume that institutions enable or restrict the leeway of actors without determining actions (Mayntz and Scharpf 1995a, pp. 43–47). Due to actor-centred institutionalism preferences or motivational orientations like rational self-interests (autonomy, budget maximization or vote-maximization), role expectations as well as social norms and identities influence behaviour (Scharpf 2006, pp. 116–122). Moreover, problem perceptions or cognitive orientations of actors are key factors (Mayntz and Scharpf 1995a, p. 53). As unilateral actions are rare in political life I have to analyse the actor constellation which describes the interrelation between the different actors, e.g. between the council and the administration, between the council fractions or between the mayor and the treasurer (Mayntz and Scharpf 1995b, p. 60, Scharpf 2006, p. 87). The actor-centred institutionalism is a general filter framework for my research but I will try to concretize it for the implementation of conditional bailout programmes. Firstly, I will try to specify the institutional and non-institutional factors which could affect fiscal policies. Secondly, I will present more concrete models for actor-related influences towards the effectiveness of conditional bailout programmes.

5.2. The Role of Institutions in Municipal Fiscal Policy

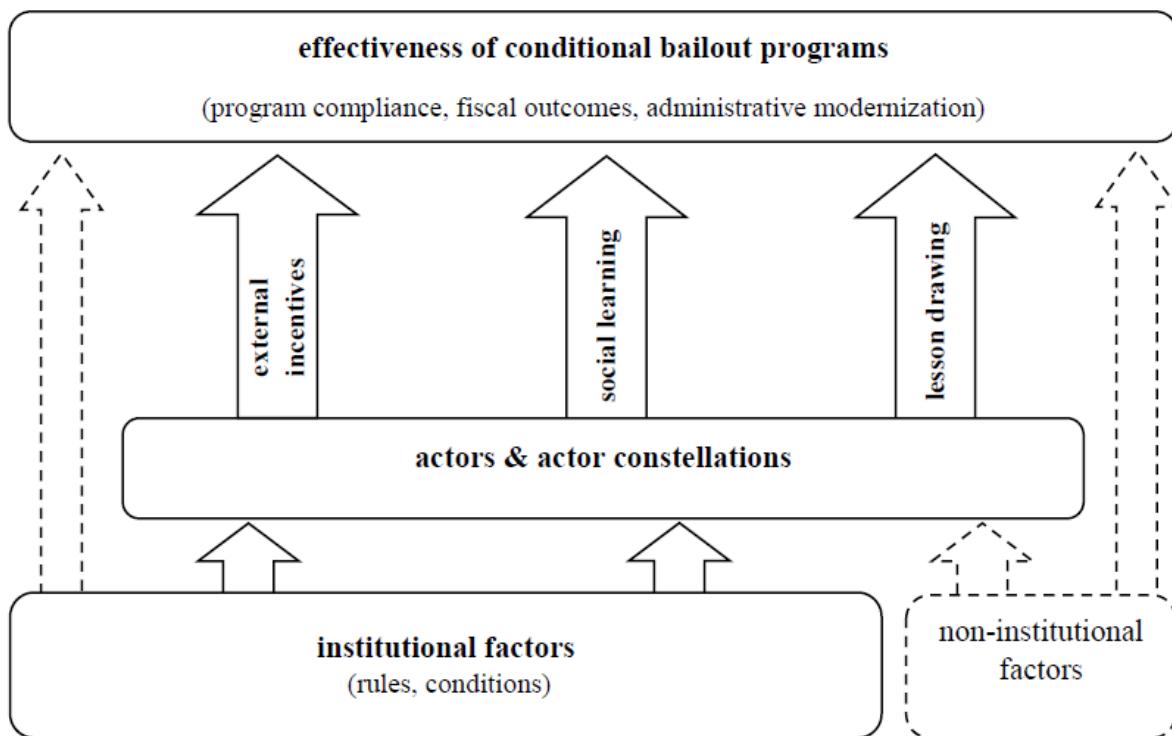
Recent research includes various institutional factors which could influence municipal fiscal policy. Although the German local level experienced a longstanding harmonization of different local government systems (primarily the diffusion of directly elected mayors) some differences remained. In the *Länder* of the four cities under research the “strong-mayor”/“executive mayor” in Rhineland-Palatinate, Saxony Anhalt and North Rhine Westphalia and the “collective mayor”/“collegiate leader” in Hesse (Kassel) can be found (Mouritzen and Svara 2002, pp. 55–56, Heinelt and Hlepas 2006, p. 36). Moreover, the level of decentralization varies within in the *Länder* (Freitag 2008, pp. 195–220, Burth *et al.* 2013, pp. 50–52). These institutional differences (especially the varying institutional strength of mayors) are investigated in “Large-N” studies on municipal fiscal policy which had different findings towards their importance (Kunz and Zapf-Schramm 1989, Bogumil *et al.* 2014, Junkernheinrich and Wagschal 2014, p. 313). I will keep these institutional differences in my mind but I do not think they are a prior factor in explaining the results of the conditional bailout programmes. Qualitative research showed that even before local government systems in Germany converged the mechanisms of decision-making could be very similar in

municipalities of different *Länder* Derlien 1976 and very different within the same *Land* Voigt 1992. Even the particularity of a directly-elected “collective mayor” in Hesse will probably affect decision-making only in specific situations (e.g. phases of cohabitations, Dreßler 2010, p. 175). Therefore, I will concentrate on the different conditions within the bailout programmes or other institutional settings which directly affect fiscal policies. Moreover, I will consider possible sanctions for non-compliance to the programmes (infringement, suspension or reclaiming of financial support) (Heinelt and Stolzenberg 2014)

5.3. Actors, Actor Constellations and three Models of Conditionality

As the constitutional status and the financial autonomy of the local level in Germany is comparatively high the consolidation programmes formulate merely general fiscal rules as conditions without determining specific consolidations means. At least theoretically the German local government system provides many feasible options and strategies to consolidate a municipal budget. Local government can increase municipal taxes and fees, reform their administration, reduce some municipal tasks, enhance regional cooperation and privatise assets or services (Schwartzing 2011, Junkernheinrich and Wagschal 2014, p. 322). The influence the local level exerts over expenditure depends on the type of tasks. Voluntary tasks (10 to 15 per cent of the budget) but also many compulsory task including some social transfers can be affected by local governments (Weiß 2014b). Hence, various research studies proved that although institutional and non-institutional factors (socio-economic conditions) are quite important in explaining the results of municipal fiscal policy endogenous mainly actors-centred factors like the skills, beliefs and cooperation abilities of municipal leaders do also play a role (Geißler 2011, Timm-Arnold 2011). I agree that it is useful to consider ideal typical preferences of actor types like mayors, treasurers or bureaucrats according to public choice theory (see for example Geißler 2011). However, to stop at this point would mean to refer to traditional or even “*naive institutionalism*” (Roberts 2010) that pretends to anticipate the behaviour of actors. Therefore, I will refer to three models which try to explain how actors can deal with conditionality. These models are inspired by the accessibility policy of the European Union (Tiebout 1956, pp. 671–672) but are also used to explain the performance of conditionality within the European crisis policy (Hansmann). Hence, I believe that these models are epistemologically more innovative than traditional explanatory approaches for fiscal policies but also fit into the context of the conditional bailout programmes.

Figure 3: explaining the effectiveness of bailout programmes



Source: own illustration

5.3.1. “External Incentives Model”

The first explanatory model is the “external incentives model” which bases on bargaining of rational actors. This model is still very similar to public choice approaches. In this model governments calculate if the internal adaption costs of the implementation of conditions are higher or lower compared to the prospective benefits (Tiebout 1956, pp. 671–672)). The outcomes of bargaining depend on the relative power of actors which bases on asymmetrical information and the benefits of agreements compared to alternative outcomes (2005, p. 10). In the case of the bailout programmes local governments will accept and fulfil conditions if their costs to implement these obligations (e.g. loss of votes, autonomy or service quality) are lower than the rewards of additional grants or possible sanctions. In the Europeanization literature the costs to fulfil conditions depend on the domestic status quo and its “fit” or “misfit” to European rules (2005, p. 11). In my case the costs are related the current fiscal situation of a municipality and the “fit” or “misfit” compared with the requirements for the bailout programmes. For example the necessary efforts of a municipality to comply with the condition of a balanced budget in two years depend on their current balance.

Within the “external incentives model” Schimmelpfennig and Sedelmeyer identified three different mechanisms of reinforcement for EU-accession policy: *reinforcement by reward*,

reinforcement by punishment and reinforcement by support (2005, p. 11). Reinforcement by reward means in my case that the *Länder* governments pay bailout grants if local governments comply with the conditions and withhold grants if they do not. Reinforcement by punishment would mean to raise extra costs in the case of non-compliance. In my case the use of supervisory mechanisms, especially the delegation of a state-commissioner who assumes the tasks of the council and the mayor, would be the most impressive example of such a punishment. Reinforcement by support would be the most implausible mechanism. Local governments which fail to comply would receive again additional grants. However, as this would enhance the problem of opportunistic behaviour (see paragraph 3.2) technical assistance in fiscal consolidation is more likely. The basic hypothesis of the external incentives model for my research field would be:

H1: *Conditional bailout programmes are effective if the benefits for local actors are higher than their internal adoption costs.*

To specify possible benefits and possible costs I will explain some advanced assumptions of the model. In theory conditionality affects domestic decision-making through *intergovernmental bargaining* and through *differential empowerment of domestic actors* (2005, p. 11). In intergovernmental bargaining the described direct calculation of domestic or municipal adaptations costs and benefits takes place and conditionality is enforced top down by the EU or in my case by *Länder* governments. Moreover, the research on EU-accession policy assumes that some domestic actors gain more benefits from compliance than others, but do not have the power to enforce their preferences without external conditionality (2005, p. 11). This could also refer to the conditional bailout programmes as they tend to strengthen the mayor or the treasurer, who represent the municipality in bargaining processes with the *Länder* level. Multi-level bargaining tends to shift power from the head of an organization (the mayor and the council) to the interface between different levels of government (the treasurer) (Grande 2000, pp. 18–19, Geißler 2011, p. 140). Especially treasurers could build coalitions with actors from the *Länder* level who ideal typical share the preference of “fiscal discipline”.

Although the model is labelled as “actor-centred” it includes also institutional factors which make it easy to incorporate it into the general framework of actor-centred institutionalism. One of these factors is the *determinacy of conditions* or the clarity and formality of conditions which enhances the likelihood of compliance (2005, pp. 12–13). At the first

glance, conditions in fiscal policies are much clearer than in other policy fields. However, supposed clear numeric rules provide enough opportunities for circumvention by creative bookkeeping or by interpretation of vague legal terms (e.g. “investments” or “cyclical fluctuation”). Another aspect which influences actor behaviour in the external incentives model is the *size and speed of rewards* (2005, p. 13). The amount of additional grants differs remarkably between the different bailout programmes. Moreover, the rewards will be received timely, but it varies if local governments receive one or various tranches. Furthermore, the *credibility of conditionality* matters for EU-accession policy. The open question is the likelihood of the rewards in case of compliance and the likelihood of the suspension of rewards or sanctions in the case of non-compliance. In contrast to the EU the credibility of the *Länder* governments to pay the promised grants seems to be not questionable. Though, this does not necessarily refer to the credibility in the case of non-compliance. In most of the *Länder* fiscal supervision is responsible for the enforcement of the conditions of the bailout programmes. Although there is a trend to strengthen fiscal rules for local governments (Geißler 2011, p. 63) there is an ongoing critics of a “laissez-faire attitude” towards local governments (Gröpl *et al.* 2010, pp. 186–188, Herrmann 2011, p. 10). As part of vertical party political networks between the local and the *Länder* level and as part of the *Länder* administrations supervisions risk to be blamed as co-responsible for fiscal problems. Moreover, due to litigation risks sanctions like the state commissioner were only used temporarily in a few small municipalities (Duve 2008, Holtkamp 2014). However, the practises of supervision differ within Germany (Wegrich 2006, pp. 217–243, Junkernheinrich *et al.* 2011, p. 79) and the experiences with the “special needs transfers” (see paragraph 3.3) proves that supervisions are not necessarily unable to enforce conditionality. Another factor which domestic actors consider in their calculation of adaptations costs are *veto-players*. The rational choice approach implies that there are always adaptations costs otherwise conditionality is needless to reach the intended policy goals. The model refers to the veto-player theory and assumes that the effectiveness of conditionality decreases with the number of veto-players and the distance of their preferences ((Tsebelis 2002, p. 37, 2002, p. 37) quoted in: (2005, p. 16). At the local level the importance of veto-players depends on the local government system and the concrete actor constellation. Possible veto-player are collegiate governing bodies (in Hesse), the councils or citizens through referenda.² The external incentives model has the

² Referenda on budget plans including tax rates and fees are legally excluded. However, it is disputed if this restriction also concerns decisions which are not part of the budget plan but directly affect the budget (e.g. municipal consolidation plan or treaties, Wessels and Mutius, Albert von von (2013, pp. 310–333)).

advantage of analytical clarity but its explanatory power focuses merely on “programme compliance”. It is probably not sufficient to explain the other more far reaching aspects of effectiveness that I would like to explain (fiscal outcomes and administrative modernization). The model relies primarily on adaption and force whereas policy learning is excluded. The weakness of this approach is that it takes the existence of stable preferences for granted and leaves no room for the evolution of preferences. Therefore, the analytical clarity could lead to oversimplification of actor’s behaviour.

5.3.2. Social Learning Model

The “social learning model” assumes that actors are motivated by identities, values and norms. In the approach of Schimmelfennig the “social learning model” is subordinated to the rational choice model (2005). This constructivist approach implies that actors have to be persuaded and not forced to fulfil conditions. For EU-accession policy the EU is perceived as a community with shared collective values. Within this approach conditionality is effective if domestic actors think that EU-rules are appropriate. In contrast to the “external incentives model” this approach considers the possibility of complex learning instead of pure adaption (Tiebout 1956, pp. 675–676). For the case of the consolidation programmes the basic hypothesis derived from the social learning model is:

H2: Conditional bailout programmes are effective if local actors perceive the conditions as appropriate and legitimated.

Three factors shape these perceptions. The first factor refers to the ***legitimacy of rules and processes***. Hence, EU accession-candidates will rather adopt rules if they were involved in the formulation of rules. In contrast to dictated conditions deliberative processes could enhance the sense of “ownership” 2005, p. 19. Moreover, the acceptance of conditions is enhanced if there is a consensus on rules among the member states and among other international organizations 2005, p. 19. For the conditional bailout programmes it is also obvious that the process of agenda-setting and decision-making at the *Länder* level differed in respect to the involvement of local government actors. In some cases local government associations were only involved in legally obligated consultations whereas in other cases local governments were the agenda-setters or their associations committed themselves to support the

programmes. Furthermore, it could be an important difference that some municipalities were obligated to participate whereas others participate voluntarily. The second factor of the model is *identity* which implies that accession candidates effectively adopt EU-rules if they want to be part of the “European collective identity”. In my view it makes no sense to incorporate this factor in to my study. It is doubtful if German *Länder* have a “collective identity” and it is even more doubtful if this identity would increase the commitment to fiscal conditions. The third factor of the “social learning model” is *resonance*. In accession policy this comprises domestic aspects that increase or decrease the domestic openness towards new rules. On the one hand the absence or deligitimation of domestic rules through policy failures could enhance the likelihood to adopt EU-rules. On the other hand domestic actors will probably resist to fulfil conditions if own rules are perceived positively (2005, p. 20). As the bailout programmes usually do not replace municipal (domestic) fiscal rules but supplement existing *Länder* rules, this factor is also not adoptable on a one-for-one basis. However, the factor of resonance seem to be similar to the idea of “policy dissatisfaction” in the lesson drawing model.

5.3.3. Lesson Drawing Model

Lesson drawing refers to an approach initially developed by Rose (1991). In this model conditionality works if domestic actors are dissatisfied with the status quo and expect better solutions from policy transfer (Tiebout 1956, p. 676). Two variants of the model can be distinguished. In the rationalist version of the model domestic actors receive new information which leads to “simple learning” and an adjustment of means. In contrast to that the constructivist version implies “complex learning” and a change of policy goals. In EU-accession policy conditionality could allow for varying EU-compatible solutions. Therefore, the accession candidates can look out for different solutions in EU-member states and choose the one they perceive as most appropriately for their own country. Moreover, this explains the need of this model. The external incentives model may explain the degree of programme compliance but it cannot explain the choice out of different feasible options (2005, pp. 21–22). The logic of the conditional bailout programmes is similar. Conditions are general fiscal rules like balanced budgets or debt limits but the *Länder* governments usually do not specify the concrete means. So it is up to the local governments how they reach these targets. Municipal actors decide if they adopt incremental consolidation means or if they focus on strategic means to modernize the municipal administration.

H2: *Conditional bailout programmes are effective if local actors are unsatisfied with the status quo of municipal fiscal policy and expect new rules to solve the fiscal challenges of the municipality.*

The pre-condition for learning in the rationalist and the constructivist version of the model is ***policy dissatisfaction***. In the rationalist approach actors fear of the domestic costs of failures whereas in the constructivist version domestic ideas and values might be discredited (2005, p. 22). As municipal finances in Germany are heavily interwoven with other political levels there is a clear lack of accountability. Therefore, actors usually have the opportunity of blame avoidance instead of declaring policy failure. However, there are a plenty of local governments whose mismanagement of public money (e.g. exploding costs for investments or risky financial transactions) is obvious. In these cases local governments probably have to recognize their responsibility for failures and have to find new policy means or even new policy goals. Another important factor in the policy learning model is the existence of ***epistemic communities*** or professional contacts across institutional and geographic boundaries. For municipalities the local government associations, think tanks (e.g. the Communal Joint Office for Administrative Management/"Kommunale Gemeinschaftsstelle für Verwaltungsmanagement"), academic experts and external consultants could strengthen epistemic communities in municipal fiscal policy. The third factor in lesson drawing is the ***transferability*** of solutions. In EU-accession policy domestic institutional settings (e.g. constitutional rules), socio-economic factors or different standards of political acceptability may limit transferability. Although the socio-economic, party political or institutional variance within Germany is not as strong as between EU-accession candidates and member states there are relevant differences. Some means, especially measures for administrative modernization, may require specific professional knowledge which is not available in each municipality. Different standards for municipal tasks in the *Länder* could restrict possibilities for cutbacks. Moreover, the ability to increase taxes could be limited because of lower tax rates of neighbouring municipalities. This again justifies to consider learning processes as it enables me to show how actors take city-specific factors into account.

6. Case study approach

6.1. Opportunities of the Comparative Case Study Approach

The complex understanding of the effectiveness of conditional bailout programmes and the detailed explanatory approach can only be conducted in a case study approach. Programme compliance and fiscal outcomes can also be evaluated at a macro level with many cases. However, to categorize concrete measures, to assess the degree of administrative modernization and to consider possible side-effects of fiscal consolidation is only possible in a research design with few cases. Moreover, previous attempts with quantifiable actor-centred factors (party differences or professional expertise of mayors) helped to exclude some explanatory approaches but could not deliver advanced explanations for the outcomes of municipal fiscal policies in Germany (Kunz 2000, Freier and Thomasius 2012, Bogumil *et al.* 2014, p. 643). The approach of the PhD-thesis is a “comparative case study” (Jahn 2013, pp. 344–353) or a “structured, focused comparison” (George and Bennett 2005, pp. 67–72). “Structured” means that each case study focuses on the same research questions and hypotheses to ensure a standardised empirical approach and data collection in each case study. Moreover, it is focussed as it is concentrated on selected aspects derived from theory while others are faded out (George and Bennett 2005, pp. 67–72).

According to my research design I will merely disregard many factors that could influence fiscal policy (e.g. party politics, socio-economic indicators or political culture) and focus on the specific role of selected institutional and actor-centred influences. Hence, my approach is different from purely descriptive or exploratory case studies that operate in a “theoretical vacuum” or are more interested in a specific case than in theory (Lijphart 1971, pp. 691–692). It is merely explanatory or nomothetic as I assume to find causal relations (Jahn 2007, 2013, pp. 341–350). Nevertheless, the case study focuses on a holistic explanation of effectiveness as dependent variable and not is interested to assess the influence of one specific independent variable.³ The advantage of case studies is that they allow to identify or test “causal mechanisms” which emphasise the difference between causality versus sheer correlation (Muno 2009, p. 123). In my research design the relevant mechanisms are especially the three models of conditionality” and I expect that my independent variables (e.g. institutional or non-institutional factors) influence the dependent variable (“effectiveness”) through these or political or social processes. However to disclose these processes, especially the complex

³ Ganghof differentiates between „Y-centred” and “X-centred” comparisons. „Y-centred designs try to explain the result of a dependent variable by incorporating all reasonable independent variable whereas “X-centred designs” focus on the influence of one specific dependent variable on the independent variable Ganghof (2005).

mechanisms of “social learning” and “lesson drawing”, the in-depth analysis of a small-N approach is necessary. As the programmes emphasize a “help for self help” they finally rely on endogenous municipal capacities for reform and fiscal consolidation. Researchers in the field of municipal fiscal policy explicitly emphasize qualitative case-study approaches if the focus lies on endogenous capacities or problems: *“Socio-economic data are included in official statistics but it is hard to integrate the influence of local government actors in regression analysis [...]”* (translated by the author: Holtkamp 2007, p. 18). Moreover, municipal fiscal policy is a non-transparent field, where informal rules and strategies are hidden behind apparently clear formalized fiscal rules (Holtkamp 2010, p. 11) which means that mechanisms can only be identified in limited number of cases. The disadvantage of the comparative case study approach is that the results are not generalizable for the whole population (*“statistical generalisation”*). Hence, I cannot generalize my results for all municipalities which participate in bailout programmes. However, it is possible to develop and generalize theory (*“analytical generalisation”*): *“case studies [...] are generalizable to theoretical propositions and not to population [...]”* (Yin 2003, p. 10). My research design is located in-between the ideal types of “theory-testing” or “theory-generating” comparative case studies. On the one hand side the idea is to adopt a theoretical approach from another policy field and to test its transferability to the case of the conditional bailout programmes. On the other hand side I will concretise the existing model of “conditionality” by this first empirical test. Therefore, the approach is not “theory-generating” but at least “modification of theory” (Rohlfing 2009, p. 134). To sum up, the advantages of the case study approach for my research interest are the appropriateness for complex variables and complex causal mechanisms and the ability to develop the theoretical approach further.

6.2. Case Selection

The case selection evolved in a filter process in two steps. Firstly, I chose the Länder or the specific conditional bailout programmes and secondly I selected the concrete cities under investigation. I picked the programmes of three “crisis states” of local government finance (North Rhine-Westphalia, Rhineland-Palatinate and Hesse, see Heinelt and Stolzenberg 2014, p. 3). Moreover, I selected one city in the low performing east-German *Land* Saxony-Anhalt (Holtkamp and Bathge 2014a) which was the first German Land that initiated a bailout program. Compared to other programmes the selected ones have a higher amount of funding and a longer duration. Therefore, these programmes have a clearly higher practical relevance as they are more ambitious but also have to solve more challenging fiscal problems than in the

other *Länder*. The selected programmes differ clearly compared to previous mechanisms of “special needs transfers”. Furthermore, the programmes had to be enacted not later than 2012 to provide at least some years of implementation for my investigation. The programmes vary remarkably in respect to their goals, conditions and benefits. Hence, the local governments under research have to deal with different costs and incentives in the conditionality program. Though, not only rational choice aspects vary between the programmes. As mentioned in paragraph 5.3.2 the process of agenda-setting and decision-making at the *Länder* level differed what possibly influenced the perceptions of local government actors towards the appropriateness of conditions.

The first restriction for the selection of concrete cities within the *Länder* was that only municipalities participating in conditional bailout programmes were possible cases. The selection of different programmes implied to have some other *Länder*-related differences, but I tried to isolate at least some non-institutional and institutional factors. Therefore, I chose only independent cities which have a similar amount of municipal tasks. As we know that processes of decision-making largely depend on municipal size I selected cities that have a similar number of inhabitants (150.000 to 350.000 inhabitants). Furthermore, the selection is reasoned by the fact that fiscal challenges are concentrated in the municipal type of independent cities and especially in independent cities of this size (Freier and Grass 2013, p. 14, Junkernheinrich and Wagschal 2014, p. 308). The selected cities also have a similar bargaining power towards their *Länder* governments. The appliance of these criteria produced a containment of possible cases in the different *Länder*. The selection within these cases followed some soft criteria like the access to the research field in each city.

Table 4: number of possible cases in each federal state

	Municipalities	Independent cities	Participating municipalities	Participating independent cities	Participating independent cities (150.000 to 300.000 inhabitants)
Rhineland-Palatinate	2,330	12	838	12	2
North Rhine-Westphalia	426	22	34/27*	6	4
Hesse	447	5	100	3	1
Saxony-Anhalt	369	3	251	3	2

To sum up, the selection followed merely pragmatic criteria. Moreover, I made sure that the specific actor constellation (coalitions or party affiliations) differed between the remaining cases. Therefore, the independent variables (conditions, actors and actor-constellations)

diverged between the cases. However, for a comparative case study that aims at theory modification methods literature demands also for a variation of the dependent variable (Rohlfing 2009, p. 138). For my research this is challenging due the complexity of the effectiveness variable and the currentness of the investigation that makes a preceding empirical assessment impossible. However, at least for the dimension of fiscal outcomes a certain variation is obvious at the first glance (two cases with budget deficits and two cases with budget surpluses).

6.3. Empirical Methods

The empirical research will be carried out with the help of a structured analysis of documents and guideline based interviews. Budget data as well as the most important socio-economic frame-data of all four cities have already been analysed. Besides, there are already first evaluation reports available, which can be analysed according to the implementation of programmes (Investitionsbank Sachsen-Anhalt 2011, Ministerium für Inneres und Kommunales Nordrhein-Westfalen 2014). As my objective was to reach a high degree of triangulation of data and methods I decided to combine guided interviews and document analyses.

In sum, I have already conducted guideline based interviews with 51 actors from the local and the federal state level. At the local level I interviewed the political and administrative leadership (treasurer, chief of financial department) and leading politicians (chairmen of council fractions or members of the financial committee) from the majority and the opposition. Moreover, civil society actors were interviewed if the document analysis proved their relevance in debates on fiscal policies (e.g. actors from trade unions or tax payers' alliances). At the federal state level, I interviewed actors of ministries, supervisions and other relevant organisations with responsibilities of development and implementation of bailout programmes. Moreover, I interviewed representatives of local government associations in federal states. During the interview phase, the interview guideline had to be adapted due to considerable differences of the actors' current knowledge of specific policy questions as well as specific knowledge of the selected municipalities. Qualitative interviews are recommended in opaque research fields which are characterized by complex mechanisms. This perfectly fits to fiscal policy and the mechanisms of conditionality. Moreover, actors may depart from their official bulletins in face-to-face interactions (Blatter *et al.* 2007, p. 22). With the help of the interviews I tried to reconstruct the processes of municipal and multi-level decision-making, the actor-related problem perceptions and different preferences on fiscal policy and on

concrete means. The idea was to investigate how actors justify the choice of specific measures out of the range of feasible options.

Moreover, council minutes, municipal press releases and documents from council fractions were examined. The selection of the documents should guarantee data triangulation. However, it was obvious that many documents reproduce the arguments of the municipal leadership. This refers especially to local newspapers which were merely announcement tools of the municipalities. For the councils only decision minutes were available. Therefore, the number of convenient documents from council or committee meetings was limited and it was not possible to reconstruct the debates of single meetings. However, although the decisions minutes do not allow analysing debates they at least provide the opportunity to reconstruct the overall decision-making process.

All documents and all transcribed interviews will be analysed with MAXQDA, which is a software for qualitative data analyses. The software helps to systematize texts by relating and clustering statements and to identify causal relations and patterns of argumentation. Therefore, it helps to ensure basic criteria of qualitative research like procedural documentation and the use of analysis rules. The analysis is a combined deductive and inductive approaches starting with some provisional codes. These deductive codes had the purpose to organize data according to the predefined concepts (Miles and Huberman 1994). However, in the ongoing analysis inductive codes should be developed that interpret the case specific mechanisms of decision-making and help to develop the initial theoretical approaches further.

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