



# Managing the crises – how did local governments react to the financial crisis in 2008 and what explains the differences? The case of Swiss municipalities<sup>1</sup>

**Andreas Ladner**

IDHEAP, Swiss Graduate Institute of Public Administration at the University of Lausanne, Switzerland

**Nils Soguel**

IDHEAP, Swiss Graduate Institute of Public Administration at the University of Lausanne, Switzerland

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## Abstract

Swiss municipalities are, to a large extent, responsible for their financial resources. Since these resources primarily depend on income and property taxes from individuals and enterprises, municipality budgets are likely to be directly affected by the current crisis in the financial sector and the economy. This article investigates how municipalities perceived this threat and how they reacted to it. In a nationwide survey conducted at the end of 2009 in all 2596 Swiss municipalities, we asked local secretaries which measures had been launched in order to cope with expected losses in tax income and a possible increase in welfare spending. Did the municipalities rely on Keynesian measures increasing public spending and accepting greater deficits, or did they try to avoid further deficits by using austerity measures and a withdrawal of planned investments? Our results show that only a few municipalities – mainly the bigger ones – expected to be greatly affected by the crisis. Their reactions, however, did not reveal any clear patterns that theory would lead one to expect. Preferences for austerity measures and deficit spending become visible but many municipalities took measures from both theories. The strongest explanatory factors for determining how/why municipalities react are: the municipality's level of affectedness followed by whether or not the municipality belongs to the French-speaking part of the country. Size also has an impact, whereas the strength of the Social Democrat party is negligible. Explaining what kind of measures municipalities are likely to take is more difficult. However, the more a municipality is affected, the more likely it is to stick to austerity measures.

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## Corresponding author:

Andreas Ladner, IDHEAP, Swiss Graduate Institute of Public Administration at the University of Lausanne, Quartier UNIL Mouline, Lausanne 1015, Switzerland.

Email: [andreas.ladner@unil.ch](mailto:andreas.ladner@unil.ch)

## Points for practitioners

How to react to a financial crisis is not only a challenging question to answer for the scientific community but also for practitioners being confronted with the crucial decisions to be taken. This contribution shows that the theoretical debates stipulating the exclusiveness of deficit spending or austerity measures is hardly reflecting reality, at least not at the local level. Policymakers are well advised to cut down expenditure and to invest where necessary. This is, at least, what can be learned from the practices of the Swiss municipalities after the 2008 crisis.

## Keywords

budgeting, public finance, public management, regional and local government

## Introduction

Shortly after the beginning of the financial and economic crisis – which began with the collapse of the housing bubble in the US in 2007 and the bankruptcy of the investment bank Lehman Brothers on 15 September 2008 – it became apparent that these events were going to have a considerable impact on local governments around the world as well. Cities and municipalities rightfully feared a decrease in revenues and an increase in expenditure. The World Council of United Cities and Local Governments (UCLG), for example, decided in late 2008 to survey its members around the world (United Cities and Local Governments, 2009) and, with a similar goal, the Council of European Municipalities and Regions surveyed its member associations (Council of Europe, 2010). In addition, the OECD began to publish a series of texts related to the topic (OECD, 2009a, 2009b, 2009c), bringing forward policy recommendations. These publications concentrate on larger municipalities and cities. Little is known about the impact of the crisis on smaller municipalities and their strategies to cope with it.

This article aims to fill this research gap by investigating how municipalities – especially the smaller ones – perceive the impact of the crisis and whether they react to it. And if they take action, do they try to balance their budget or do they opt for deficit spending? Knowing how local authorities actually reacted should inspire further research to discover which actions proved to be successful. Ideally, a close monitoring of the cities and municipalities will provide insight into how to successfully fight an economic crisis and what has to be done to immediately ease its negative impact, and, in a more long-term perspective, to protect local governments against such incidents. It goes without saying that this was also what citizens, the media, and the companies affected expected to know.

The empirical evidence stems from one of our regular nationwide surveys of all Swiss municipalities which took place towards the end of 2009. A set of questions on the impact of the crisis and the actions taken at the local level was included in the questionnaire. Indeed, by then it was apparent that the crisis was also going to

have an impact on the Swiss economy. Observers of Swiss politics, politicians and different lobby groups were engaged in a huge debate on what should be done. Some feared that the impact was going to be particularly strong. As a country that is significantly dependent on the financial sector with its large international banks and insurance companies, and given the dependence of the domestic industry on exports, it was expected that economic growth would turn negative, firms and companies would be confronted with losses, and that unemployment was going to increase. For the state sector this would mean fewer tax receipts on the one side, and a demand for state intervention on the other side, in order to back the banking sector under pressure and to fight economic recession and unemployment.

Apart from simply being affected like almost all other countries, Switzerland offers an excellent opportunity to analyse the reactions of local governments facing this particular crisis. As a federalist country which grants its municipalities a very large amount of organizational and financial autonomy (see Ladner, 2010), it is very likely that different municipalities will opt for different strategies to cope with the upcoming challenges. Local governments rely on their own resources mainly generated through income tax at a rate they set themselves, the percentage of transfers from a higher political level is low, municipalities are entitled to borrow money and take out loans and they decide on important projects independently. Thus, they have at their disposal – theoretically – a full slate of possibilities to balance their budget or to stimulate economic growth. In addition, there is enough variety concerning both the likelihood of being strongly affected as well as culturally and politically motivated differences in terms of the measures to be taken. Depending on the structural and economic situation, as well as on cultural and political preferences, it is likely that municipalities react differently: the more a municipality depends on tax payers who work in the industrial and service sector, and the worse its financial situation is, the more likely it is to become active. Municipalities dominated by centre and left parties can be expected to invest and allow for a growing deficit, whereas municipalities dominated by the right can be expected to abstain from further investments and/or reduce their services.

The article starts with the presentation of our conceptual framework followed by a section containing our research question, the hypotheses and the methodology applied. For a better understanding of the results, the fourth section provides some basic information about the Swiss municipalities. The fifth section shows which municipalities were affected by the crisis, and details their main fears. The next two sections analyse the municipalities' reactions and the measures undertaken. In the following section, we test our hypotheses and try to explain the different strategies and reactions chosen by the municipalities. The article ends with some concluding remarks.

## **Conceptual framework and overview of the existing literature**

Quite a large body of literature exists regarding the definition of the concept of crisis (e.g. Barton, 1970; Dynes, 1974). Insightful for our purposes is the focused

definition by Rosenthal et al. (1989: 10). They describe a crisis which calls for critical choices as being ‘a serious threat to the basic structures or the fundamental values and norms of a social system, which – under time pressure and highly uncertain circumstances – necessitates making critical decisions’. This definition corresponds well to the 2008 financial crisis as described by Reinhart and Rogoff (2008).

However, Claessens et al. (2010) rightly highlight the differences in this financial crisis compared to previous ones: a more widespread use of complex and opaque financial instruments; an increased national and international interconnectedness among financial markets, a higher degree of leverage of financial institutions; and the central role played by the indebted household sector.

These unusual aspects of the 2008 crisis explain why central banks and governments decisively embarked on crisis management. As enumerated by Rosenthal and Kouzmin (1997), a government typically goes through consecutive heuristic steps before eventually deciding whether to intervene or not: (1) Is the social-political system seriously threatened? (2) Is it necessary to respond to the threat? (3) Is it necessary for the government to take any decision? (4) Is it necessary to decide promptly? The fact that these steps are heuristic in essence emphasizes that they rely strongly on perception and consensus in order to quickly find a response. There is barely time to search for optimality and synoptic rationalism otherwise the risk increases that the situation will run out of control (Ramos, 1981). Kingdon (1973: 160) speaks about a strategy of concurrency where government bodies have to solve problems without being able to rely on the established procedure and channels of information. The strategy especially applies in cases of high uncertainty and complexity.

Municipalities can be affected by a financial crisis in various ways. There are immediate direct impacts which can be expected both on the side of a municipality’s revenues and on the side of its expenditure. As for the former, the most important reductions might concern revenues from their own taxes, from fees and charges, less income stemming from shared taxes, a decrease in transfers coming from higher levels or the central government or losses of assets in the form of resources deposited in banks that failed during the crisis (see United Cities and Local Governments, 2009: 10f.). The extent to which a municipality is affected varies, for example, according to the composition of its revenues, the amount of direct tax it depends upon, the tax payer structure and the stability of the transfers it can expect. As for expenditures, a municipality is likely to have to increase its payments for social services.

From a conceptual standpoint, a government, either centralized or decentralized, may react passively or actively to a change in economic conditions. It will react passively if, say, it accepts a reduction in its tax receipts after a downturn. It will also react passively if it accepts an increase in expenditure triggered by a recession. This kind of passive reaction means that it will accept deficits and rely on automatic stabilizers in the budget. These reactions were identified long ago by Wernette (1945): ‘To a certain extent the budget deficit would rise or fall, or even

change into a surplus, more or less automatically, without any special fiscal actions'. The phenomenon of deficit creation is automatic since it follows from the existing legislation. It also stabilizes the business cycle fluctuation since it stimulates aggregate demand.

But the perspective of an economic crisis and of the automatic appearance of a deficit may also prompt a government to respond actively. The decision can be of two types according to political priorities. If the priority is to help spark economic growth, the government's fiscal policy will follow a countercyclical Keynesian stance: taxes may be reduced and spending increased, which goes together with growing deficits. If the priority is to rein in the deficit, the government will act conservatively and procyclically by reducing spending and possibly increasing taxes.

From a macro-economic stabilization perspective, a government's reaction to a crisis that threatens economic growth can thus be countercyclical by either not thwarting the automatic stabilizers or by taking discretionary measures that further increase deficits. Or the reaction can be procyclical if the government takes discretionary measures to curb the deficit.

Government reactions have been extensively investigated in the literature, essentially at the state level. For example, Poterba (1994) found strong evidence that US states contract spending and raise taxes when faced with a negative fiscal shock, especially due to stringent balanced budget rules. Later, Taylor (2000: 35) indicated that the US central government 'discretionary actions have shown little consistent response over time'. The same conclusions are drawn for other countries, for example the euro-area countries, the UE accession candidates (e.g. Buiter and Grafe, 2004) or Switzerland (see Soguel, 2006, for the Swiss cantons). There is less empirical evidence concerning municipalities although the vertical and horizontal coordination of fiscal policies is crucial, especially in federalist structures, to ensure a sound countercyclical macroeconomic policy.

Cities and their governments are the strategic nodes of the national economy and they are highly vulnerable to the effects of crises, namely unemployment and social problems (Guidoum et al., 2010). It is not surprising then that the recent and severe economic downturn prompted a fresh stream of reports. The OECD (2009a) emphasizes the role of local governments in mitigating the effect of a recession in different areas such as the labour market. According to the OECD (2009b), the distinctiveness of the latest crisis, with the tertiary sector no longer creating jobs, largely prevented local governments from acting in the way they had during previous recessions. Several studies surveyed the impact on cities (Clayton and Morris, 2010; Lewis, 2010; OECD, 2009c). In most cases, the findings are that most municipalities took discretionary action to mitigate the local effect of the recession. Short-term actions targeted the economy, the population at risk and the labour market. Long-term strategies included leadership, governance and quality of place especially in terms of speeding up infrastructure projects (e.g. road building, bridge maintenance). Simultaneously, many municipalities also adjusted their budgets, revised their priorities and cut spending in order to limit deficits (Guidoum et al., 2010). Different variables explain the policy choices such as the degree of

affectedness, the room for manoeuvre and the capacity to act, or cultural and political dispositions which so far have only been addressed at a higher level (Golinelli and Momigliano, 2006; Imbeau and Tellier, 2004; Krishnakumar et al., 2010).

## Research questions, hypotheses and methodology

When it comes to exploring the reactions to fiscal imbalance or financial crisis, the existing literature focuses on the central, state or city levels. There is a gap in knowledge regarding the reaction of municipalities of a smaller size. To fill this gap we have to integrate the size of a municipality together with other variables in our research design. We also have to look more closely at the actions that were taken.

Therefore, our first research question was: to what extent does the size of a municipality influence the expectations regarding the impact of a crisis like the 2008 financial crisis on fiscal performance? And more generally, are there other factors that influence this perception? The hypothesis that goes with this first question is that the smaller municipalities are less likely to perceive a financial crisis as a threat to their fiscal condition, since they depend to a lesser extent on the economic sectors directly hit by the crisis.

Our second research question asked whether municipalities react passively or actively to the perceived situation; and, in the latter case, if they embark on countercyclical or procyclical measures. The hypothesis that goes with this second question was that the smaller the municipality the less likely it is to behave countercyclically: Programmes to stimulate the economy might make sense in larger cities but should be considered less useful in small municipalities because of spill-over effects.

The third and last research question was whether any actions taken (either pro- or countercyclical) really relate to the perceived affectedness of the municipality or whether they just flow from business-as-usual conduct. More broadly, the question looked at what factors can explain the actions that are taken. Here the following causal hypotheses were tested: affectedness, municipal size, political leaning and culture.

As mentioned in the above literature review, crisis management relies heavily on individual perception because of time constraints, uncertainty and complexity which is backed up by more general observations claiming that strategic management in the public sector often relies on educated guesses and heuristics (see Bryson et al., 2010). This is, of course, particularly so when it comes to the impact of a financial crisis on the economic and fiscal performance of a municipality: the time-lag between the start of the crisis and the eventual economic and fiscal impact at the local level may be quite long especially if the crisis originates in a foreign country. To put it differently, any actions intended to mitigate the effect of such a crisis would come too late if decision-makers were waiting to know the real effects. By using a survey of municipal officials we deliberately concentrated (a) on the local

government's perceptions of the affectedness at the time of the crisis and (b) on the government's awareness of the action it took. This seems to us more relevant to our research interest than *ex-post*-measured real effects or actions.

The necessary questions were included in the regular nationwide survey of all Swiss municipalities that was about to take place for the fifth time since 1988. Being able to use this vehicle was a great opportunity since it would not otherwise have been possible to design and administer a specific questionnaire in such a short time. Furthermore, our regular survey also provided us with the necessary control variable we needed to analyse the answers. The survey was conducted in 2009/10 by the Swiss Graduate School of Public Administration (IDHEAP) in Lausanne and the Center of Competence for Public Management (CCPM) at the University of Bern. The questionnaire was administered nationwide to the secretaries of all Swiss municipalities (also referred to as municipal clerks). The response rate was about 50 percent of the 2596 municipalities.

### **Some characteristics of Swiss municipalities**

Swiss municipalities offer an excellent opportunity to address the questions outlined in the previous section. They enjoy far-reaching political, financial and fiscal autonomy and they are sufficiently different in terms of size, cultural and political preferences in order to test our hypotheses.

- More than half of the 2596 (1 January 2010) municipalities have less than 1000 inhabitants; about 140 municipalities have more than 10,000 inhabitants.
- Municipalities provide important public services. Their share of total government expenditure is over 25 percent (Ladner, 2009: 340).
- They have to generate their income themselves. Transfers from higher fiscal tiers only amount to 17 percent (4 percent stem from other municipalities).
- They have the power to tax income and property. About half of their revenue stems from these taxes (see Ladner, 2009: 347). The second most important source is fees and charges, at about 30 percent.
- Formally, all municipalities are regarded as equal. In reality, however, their resources, the range of their services, and the problems they face vary considerably.
- In the realm of their activities, municipalities have the opportunity to support the economy by investing in local projects or to balance their budget by cutting expenses on activities and salaries independently.
- There are considerable differences between municipalities in terms of the strength of political parties.

If businesses and companies make less profit or go bankrupt and their citizens earn less or are made redundant and start to depend on public welfare in a long term perspective, the municipalities thus have a full slate of possibilities to react to the expected impact of an oncoming crisis which makes the study of their reactions

and the determinants of them especially salient. However, there are also some severe constraints to be kept in mind. The fear of losing important tax payers prevents them from increasing the tax rate too readily and there are sometimes legal provisions which force them to present balanced budgets.

Before we turn our attention to the measures the Swiss municipalities opted for to cope with the crisis, we will look at which municipalities were particularly affected.

### **Municipalities affected by the crisis**

According to our survey, Swiss municipalities taken all together were – at least in the perception of the local secretaries who answered our survey – not too strongly hit by the crisis. Only something like 7 percent of the municipalities ( $N=1404$ ) stated that they were ‘strongly’ affected. About 80 percent were ‘a little affected’, and 10 percent were not affected at all (4 percent don’t know). Looking at the size of the municipalities and the language area, municipalities with more than 10,000 inhabitants considered themselves much more strongly affected (more than 20 percent strongly affected) as did municipalities in the Italian-speaking canton of Ticino, almost 20 percent, compared to 6 percent in the German and French parts of the country.

A closer look at the type of municipalities affected reveals that these are the more urban municipalities, those with a higher percentage of people working in the industrial sector (not necessarily in the third sector) and which already have a considerable number of unemployed inhabitants and which occasionally encounter difficulties in providing the wide range of local services requested. Interesting to note also is that these municipalities have both a higher percentage of citizens voting for the Liberal Party and a higher percentage of citizens voting for the Social Democratic Party.

Nearly 10 percent of the municipalities ( $N=1398$ ) expected strong losses in tax income. For about 70 percent the expected losses were going to be moderate, while about 20 percent did not expect any losses in tax income. Here again, strongly expected losses were higher in the bigger municipalities. Among the municipalities with more than 10,000 inhabitants, about one-third expected heavy losses in tax income. Other characteristics revealed a very similar pattern in terms of the degree of affectedness mentioned above.

Not surprisingly, there is a strong correlation between the feeling of being affected by the crisis and expected losses in tax income (Pearson corr. = .472, sig. = .000,  $N=1297$ ). Almost 80 percent of the municipalities which consider themselves strongly affected by the crisis also fear an important loss in tax income. The only significant difference concerns the French-speaking municipalities. They seem to have been less likely to fear a loss in tax income than the municipalities in the other parts of Switzerland.

In a nutshell, only a small group of Swiss municipalities reported that they were strongly affected by the crisis and confronted with a severe loss of tax income.

This concerns mainly the biggest municipalities with more than 10,000 inhabitants and those in the Italian-speaking part of the country. A large majority of the municipalities, however, consider themselves to be slightly affected. And considering oneself as having being affected goes closely hand in hand with a loss in tax income.

## Do the municipalities react?

To be affected by the crisis and to expect a loss in tax income is one thing; another question is whether the municipalities react and take action to cope with the crisis. We shall first have a look at the number of municipalities which reacted and took measures as well as at the characteristics of these municipalities, and then we shall ask to what extent their reaction depended on their degree of affectedness.

According to our results, Swiss municipalities did not become very active in coping with the crisis. Taken together, only about 15 percent of the municipalities ( $N = 1403$ ) did take any specific action or planned to do so in the near future.

If we compare the language areas, it is now the French-speaking municipalities which became most active, followed by the Italian- and the German-speaking municipalities. This is an interesting result as the French-speaking municipalities did not seem to be more affected by the crisis than the German-speaking municipalities. As far as the size of the municipalities is concerned, there is a strong increase in action with the increasing size of a municipality. Half of all municipalities with over 10,000 inhabitants took action or were about to take action to counter the crisis (Figure 1).

Taking action against the crisis goes hand in hand with affectedness. More than 50 percent of the municipalities which claimed they were strongly affected by the crisis and which expected a severe loss in tax income also stated that they had taken action to cope with the crisis (see Table 1). This result is not surprising at first sight. However, this also means that half of these municipalities did not take any action

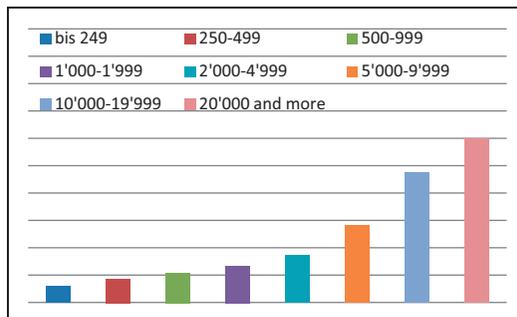


Figure 1. Action taken and the size of the municipality

**Table 1.** Degree of affectedness and taking measures against the crisis, all municipalities and different language areas (percentages)

	All municipalities		German-speaking municipalities		French-speaking municipalities		Italian-speaking municipalities	
	%	N	%	N	%	N	%	N
Strongly affected	52.8	89	54.0	50	50.0	20	53.3	15
Weakly affected	14.1	1105	12.5	696	19.0	295	10.7	56
Not affected	5.0	139	4.9	82	5.3	29	0.0	4

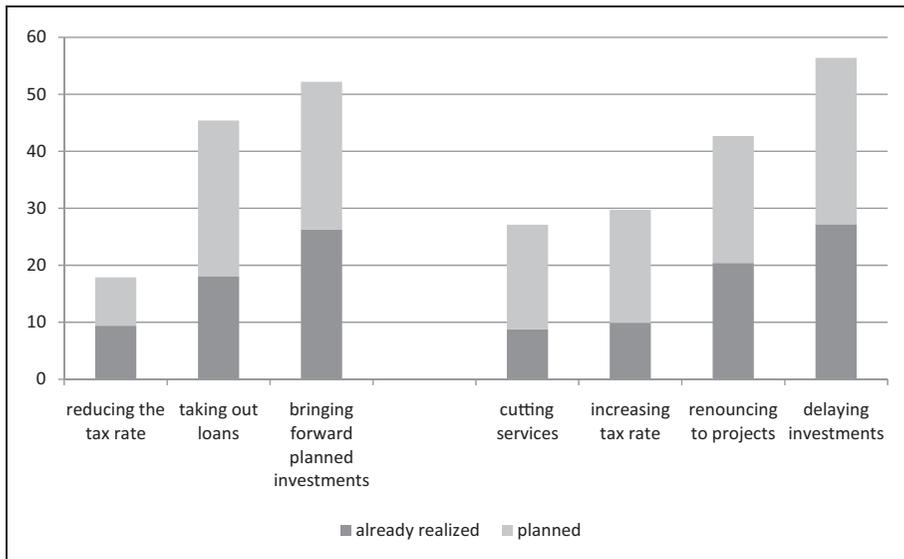
despite the fact that they were suffering from the crisis. Among those which were only slightly affected, less than 15 percent reacted with additional measures. Here again, size matters. In the size categories of above 10,000 inhabitants, more than 80 percent of the municipalities strongly affected also reacted, whereas in the smaller municipalities this was considerably less often the case.

If we compare the degree of affectedness with the question of whether the municipalities took measures to cope with the crisis for the different language areas, a somewhat distinct pattern appears. In all parts of the country, it is clearly the strongly affected municipalities which reacted more often. Comparing the French-speaking municipalities to the other two language areas, it is of note that a larger portion of the weakly affected municipalities also took some measures against the crisis.

## Measures taken

There is a wide range of measures a municipality can take to fight the crisis.<sup>2</sup> The crucial decision for a municipality is whether it should try to keep its budget as balanced as possible through cuts or the delay of planned investments and expenditures, or whether it keeps local business and trade going through investments and taking up loans even if there is going to be a deficit in the short run. Given the municipalities' considerable leverage on their tax income, they can also balance their budgets through an increase in the tax rate or they can lower the tax rate to relieve the burden for businesses and enterprises and to foster consumption.

Figure 2 shows the measures taken by the municipalities placing procyclical measures to balance the budget (austerity policies) on the right and countercyclical measures (deficit spending) on the left-hand side. Interesting to note, the most popular reactions – the advancement of planned investments and a delay in investments – are to be found on both sides of the figure. Austerity policies and deficit spending seem to be equally popular. Nearly 60 percent of the municipalities taking measures against the crisis delay investments and rather more than 50 percent advance already planned investments. On the austerity side, the second most



**Figure 2.** Measures taken by the municipalities (only includes municipalities taking action)  
N = 230–255

popular measure is a renunciation of new projects followed by a tax increase and cuts as far as special services are concerned. On the countercyclical side, the second most popular measure is increasing the debt rate by taking out loans, followed by the least popular measure which is the reduction of the tax rate.

Based on these two different strategies used to cope with a crisis, one might expect that there are basically two groups of municipalities: those favouring an austerity policy and those which prefer deficit spending. The reality, however, seems to be more complex. Table 2 shows that, at times, there are also contradictory measures being taken. For example, among those 73 municipalities which increased their tax rate, some also took out loans (36 percent) or advanced investments (37 percent). Other measures, like the 89 percent of the municipalities which also delayed investments, are more in line with the general strategy.

One of the reasons why the overall pattern in Table 2 is less clear than theory might lead one to expect is probably the varying role of some of the measures discussed together with a restricted room for manoeuvre. A municipality with a comparatively high tax rate will find it more difficult to increase it further, even if it considers this to be necessary. Or, it is possible to take out a loan to start a specific project which creates jobs within the municipality and at the same time some projects are delayed because they are less likely to foster economic growth within the municipality.

Nevertheless, for the following analyses, we suggest reducing the complexity empirically. The following factor analyses on the seven measures discussed produce two factors which reveal the two strategies discussed in theory (see Table 3). The

**Table 2.** The different combinations of measures taken or planned (percentages)

	Increasing the tax rate	Reducing the tax rate	Taking out loans	Cutting services	Advancing investments	Delaying investments	Abandoning projects
Increasing the tax rate (N = 75)	0.0		36.0	46.8	37.0	89.1	64.6
Reducing the tax rate (N = 42)	0.0		33.3	17.1	59.0	28.6	25.0
Taking out loans (N = 108)	35.1	12.4		37.1	51.1	63.0	50.5
Cutting services (N = 65)	50.9	11.8	64.3		51.9	81.0	66.1
Advancing investments (N = 133)	19.2	21.3	48.0	26.2		39.4	37.3
Delaying investments (N = 144)	46.0	9.0	52.5	41.8	36.6		65.4
Abandoning projects (N = 111)	46.2	10.8	58.8	46.1	47.7	88.1	

**Table 3.** Factor analysis on the measures taken by the municipalities (factor loadings)

	'Austerity policy'	'Deficit spending'
Increased tax rate completed/planned	<b>.671</b>	-.042
Reduced tax rate completed/planned	-.399	-.114
Take out a loan completed/planned	.261	<b>.632</b>
Cut services completed/planned	.490	.474
Bring forward investments completed/planned	-.354	<b>.740</b>
Delay of investments completed/planned	<b>.825</b>	-.089
Abandoning projects completed/planned	<b>.719</b>	.113

N = 201, Rotated Factor Matrix (Varimax).

variables with an impact on the first factor are 'delaying investments', 'abandoning projects' and 'increasing the tax rate'. Therefore, we consider this factor to be an 'austerity policy'. The variables with an impact on the second factor are 'advancing investments' and 'taking out a loan'. This second factor will be called 'deficit spending'. A reduction of the tax rate and cutting services cannot be clearly attributed to either of the factors. These two factors explain about 50 percent of the variance contained in the seven variables. In the next section we use the factor scores to test our hypotheses.

## What explains the different reactions? Hypotheses and results

There are – as we have seen in the descriptive part of this article – differences in the way municipalities reacted to the crisis in terms of their size and, to a lesser extent, in terms of the prevailing culture. Since the different variables are not completely independent of each other, we have to rely on multivariate methods to reveal a causal relationship. In addition to size and culture, two other variables possibly influence the way in which a municipality might respond to the crisis, namely the level of a municipality's affectedness and its political orientation.

We will first present our hypotheses and the arguments behind them. Then we will look at all our municipality data and try to explain what makes some of these municipalities react in the way they do, or not react at all. And finally, we will look specifically at the municipalities which reacted and try to find out what made them opt for deficit spending or for an austerity policy. Since there are correlations between some of the independent variables, a stepwise procedure is needed. The following effects can be expected.

### Size matters!

The bigger a municipality is, the more likely it is to react to the crisis. In the descriptive part of this article we have seen that this is case, but we do not yet

know whether this is really due to the size of the municipality or to other characteristics of a large municipality such as its affectedness or to the different political preferences of the members of the executive. The argument in favour of our hypothesis is: the more important a city is, economically and in terms of jobs, the bigger are the expectations that there will be a reaction. And when it comes to a reaction, it is more likely this will be a countercyclical reaction (deficit spending) since the bigger cities have more possibilities at their disposal (to promote projects to create jobs) and the less likely their efforts are in vain and end up sending profit to other municipalities (spill-overs).

### *Affectedness matters!*

As far as affectedness is concerned, the first hypothesis is straightforward. If a municipality is affected, all other variables held equal, it will be more likely to react. Of course, it might be that some municipalities take preventive measures in order to avoid the possibility of being affected at a later stage, but still we claim that those which are affected are more likely to react. As for the type of reaction, we do not expect specific preferences from the two different policies. Here, we would need to know more about the way the municipalities are affected. If they only expect a loss of tax income, they will most probably cut expenses to balance their budget; if they also expect unemployment, they might advance investments to maintain or create jobs. Since we do not have these data for all municipalities, we will rely on the subjectively felt general affectedness taken from the survey and refrain from bringing forward a one-sided hypothesis.

### *Culture matters!*

In the French-speaking part of Switzerland, citizens are more interventionist and generally feel that the state should play a stronger role. We can therefore expect that the fact that a municipality is located in the French-speaking part also increases the likelihood that it would take measures to fight the crisis. As for the type of reaction, this might be decided by other factors or it is a countercyclical reaction focused on increasing spending to keep the economy going and to avoid redundancies.

### *Politics matter!*

Left-wing parties such as the Social Democrats are generally more interventionist and favour a Keynesian model to manage a crisis. Oriented towards the demand side of the market they are opposed to an austerity policy of cutting expenses. They want the state sector to create jobs and to invest. The stronger the Social Democrats or left-wing parties are in general, the more likely the municipalities are to take measures, and, more especially, to invest and to take out loans.

For the first set of our hypotheses – those trying to explain whether a municipality reacts or not – the results of the binary logistic regression (see Table 4) meet the expectations apart from the positive influence of the strength of the Social Democrats. The chances that a municipality which considers itself affected by the crisis would enact a measure is 4.7 times higher than a municipality which does not consider itself affected. If a municipality is in the French-speaking part of Switzerland, the chances that it would react to the crisis are 1.9 times higher. Size also has an influence, whereas there is no influence as far as the strength of the Social Democrats is concerned. The small significant influence of the strength of the Social Democrats (not reported in the table) disappears when the language area is entered into the model.

In a next step we repeat the same analyses for the measures taken by the municipalities. It is here that we should find differences in terms of the strength of the Social Democrats. The two dependent variables now are the factor scores from the previous factor analysis, i.e. ‘austerity policy’ and ‘deficit spending’.

The regression models in the case of deficit spending at least partially show the expected influence of the strength of the left-wing Social Democrats (see Table 5). If

**Table 4.** Binary logistic regression: Dependent variable: Measures taken

Variable	(1)	(2)	(3)	(4)
Constant	–5.850 (.000)*** .003	–6.422 (.000)*** .002	–6.562 (.000)*** .001	–9.210 (.000)*** .000
Size (log.)	.559 (.000)*** 1.748	.607 (.000)*** 1.834	.591 (.000)*** 1.806	.510 (.000)*** 1.665
Language area (1 = French, 0 = others)		.737 (.000)*** 2.091	.626 (.000)*** 1.870	.652 (.001)*** 1.920
Social Democrats (per- centage of the votes at last national elections)			.016 (.091) 1.017	.015 (.145) 1.015
Affectedness (1 = not affected; 2 = weakly affected; 3 = strongly affected)				1.592 (.000)*** 4.913
Nagelkerkes R-squared	.105	.124	.127	.191
N	1403	1349	1340	1272

Notes: The dependent variable is binary (0 = no measures taken; 1 = measures taken).

The first value shows the regression coefficient, the second value in brackets the significance; \* = significant on the 10% level, \*\* = significant on the 5% level, \*\*\* = significant on the 1% level (two tailed), and the third value gives the coefficient of the effect [Exp(B)].

**Table 5.** Linear regression: Dependent variable: 'Deficit spending' (factor scores)

Variable	(1)	(2a)	(2b)	(3)	(4)
Constant	-.661 (.087)	-1.058 (.009)***	-1.114 (.004)***	-1.235 (.002)***	-1.325 (.006)***
Size (log.)	.086 (.082) .123	.083 (.088) .119	.116 (.017)** .164	.109 (.024)** .155	.111 (.030)* .158
Language area (1 = French, 0 = others)			.732 (.000)*** .342	.653 (.000)*** .305	.725 (.000)*** .335
Social Democrats (per- centage of the votes at last national elections)		.023 (.003)*** .207		.010 (.207) .093	.007 (.420) .063
Affectedness (1 = not affected; 2 = weakly affected; 3 = strongly affected)					.067 (.713) .027
F =	3.057	6.131***	14.191***	8.877***	7.660***
Adj. R-square	.010	.049	.120	.123	.126
N	200	198	194	193	184

Notes: The first value shows the regression coefficient B, the second value in brackets the significance; \* = significant on the 10% level, \*\* = significant on the 5% level, \*\*\* = significant on the 1% level (two tailed), and the third value shows the standardized coefficient Beta.

we follow the regression models, we note first of all that size alone cannot explain whether or not a municipality relies on investment. The electoral strength of the Social Democrats, as shown in Model 2a, has, in fact, a slightly positive influence on deficit spending. This influence, however, disappears when we add the language variable to our model (Model 3). This is not astonishing since the Social Democrats are stronger in the French-speaking part of the country. Whether a municipality opts for deficit spending, finally, does not depend on the affectedness (Model 4). The final model contains the two variables of size and language area. The explanatory power of the model, however, remains relatively weak.

If we repeat the analyses for the other factor – austerity policy – we initially find no influence of the strength of the Social Democrats (see Table 6). Here we actually expected a negative influence. Again, being in the French-speaking part has a positive influence. And the degree of affectedness this time leads to measures to keep the budget balanced. Relying on austerity measures, however, seems to be a more general pattern which does not depend on the size of a municipality.

Taken together, our empirical results quite nicely meet at least some of our expectations. The size of a municipality has an (independent) influence on whether a municipality reacted or not to the crisis and whether it decided to support the economy through investment in projects. Austerity policies, however, do not

**Table 6.** Linear regression: Dependent variable: 'Austerity policy' (factor scores)

Variable	(1)	(2a)	(2b)	(3)	(4)
Constant	-.311 (.393)	-.478 (.241)	-.598 (.134)	-.592 (.150)	-1.367 (.006)***
Size (log.)	.043 (.385)	.039 (.433)	.056 (.265)	.059 (.242)	.012 (.813)
	.062	.056	.080	.084	.018
Language area (1 = French; 0 = others)			.540 (.001)***	.506 (.003)***	.506 (.003)***
Social Democrats (per- centage of the votes at last national elections)		.009 (.224)		-.001 (.904)	-.006 (.509)
		.087		-.009	-.053
Affectedness (1 = not affected; 2 = weakly affected; 3 = strongly affected)					.579 (.002)***
					.235
F	0.757	1.092	3.773*	4.147***	4.843***
Adj. R-square	-.001	.001	.041	.048	.077
N	200	198	193	189	184

Notes: The first value shows the regression coefficient B, the second value in brackets the significance; \* = significant on the 10% level, \*\* = significant on the 5% level, \*\*\* = significant on the 1% level (two tailed), and the third value shows the standardized coefficient Beta.

depend on the size of the municipality. The municipalities in the more interventionist French-speaking part of the county were more likely to react. But there is, and this is surprising, no clear pattern concerning the way they react. Austerity measures are as popular as deficit spending. If we look at the political preferences, we do not find – at least when we control for the language area – stronger support for deficit spending. And finally, the degree of affectedness clearly has a strong influence on whether municipalities react with austerity measures to balance the budget. There is, however, no positive impact on additional expenditure to keep the economy going.

## Conclusion

How did Swiss municipalities manage this crisis? First of all, it can be noted that only a small minority of the municipalities considered themselves to be severely hit by the financial and economic crisis of the late 2000s. It is primarily the bigger municipalities which considered themselves hit and which feared losses in tax income.

Whether a municipality reacts or not depends on its level of affectedness. We also demonstrated that municipalities in the French-speaking part of Switzerland

were more likely to react, as well as the bigger ones. This latter result can be seen as a particular argument for the larger municipalities which happen to have room for manoeuvre and do not take the risk that their efforts will be mainly beneficial for other municipalities.

As for the measures taken, there are basically two strategies that we refer to as deficit spending and austerity policies, respectively. The first strategy is mainly associated with taking out loans and with bringing forward investments and projects to stimulate economic growth; in the second case investments and projects are delayed. Cutting services seems to be less widespread, which might be due to the fact that the consequences of the crisis have been so far rather moderate in Switzerland. The same applies to the reduction of the tax rate. Although municipalities have at their disposal far-reaching financial and tax autonomy and generate the greatest part of their income themselves, they prefer to abstain from lowering the tax rate to relieve financial pressure for enterprises and consumers. The same is true for an increase in the tax rate, since this might endanger a municipality's attractiveness and stall consumption and economic growth. If changes in the provision of services and changes in the tax rate are considered to be measures with a mid-term perspective, an increase in expenses for specific projects or the delay of such projects can be seen as more immediate actions to curb a downturn or to reduce the accumulation of debt.

It is interesting to note from a theoretical point of view that there is a lack of a clear pattern in the measures taken by the different municipalities. Contrary to our theoretical expectations, there is no clear distinction between municipalities relying on deficit spending or on an austerity policy. Quite a few municipalities go both ways: they try to cut expenses and they invest in some promising projects at the same time. This more pragmatic approach – and this is, in our eyes, the first important contribution of this article – seems to dominate the more theoretical or ideological positions about the right way to cope with a financial crisis.

In any case, an ideological position – measured here through support for the Social Democratic Party at the polls – hardly explains the measures a municipality would take to handle the crisis. If there is a difference, it depends first of all on cultural characteristics. In the more state-oriented French-speaking part of the country, municipalities are more likely to go in either direction. If municipalities are strongly affected, they react but not necessarily in a countercyclical manner. The stronger the affect, the more likely the municipalities will balance their budget. This observation is our second important contribution to the overall theoretical discussion.

In this article we tried to show whether and how the Swiss municipalities reacted to the 2008 financial crisis on the basis of a nationwide survey of all Swiss municipalities. We limited our analyses to a few variables; we decided to look at the perception of the affectedness at the measures planned. It remains to be investigated whether the affectedness reported by the respondents really required actions or whether it was simply taken as an opportunity to increase the political

acceptability of policy changes. Further research will also have to look more in depth, increase the number of variables to consider, look at what has been done and whether a positive effect on the municipalities' finances and economy can be identified. It is by combining financial data with survey data that we will be able to provide insight into what can and should be done at the local level when the next crisis occurs.

## Notes

1. An earlier version of this article was presented at the XIV IRSPM Conference at the University of Berne, 7–9 April 2010 in the workshop 'The Crisis: Challenges for Public Management'. We would like to thank the anonymous reviewers and the editor for their insightful comments.
2. For a comprehensive overview of big city abilities to cope with the crisis, see Perlo Cohen (2011).

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**Andreas Ladner** is a full professor for Political Institutions and Public Administration at the IDHEAP at the University of Lausanne. His areas of research include the quality of democracy, local government, institutional change, political parties and voting advice applications. He has published articles in various leading journals, conducted several major research projects funded by the Swiss National Science Foundation and also regularly comments on Swiss

politics in the media. He is one of the authors of the book *Size and Local Democracy* (Edward Elgar, 2014).

**Nils Soguel** is full professor of public finance at the Swiss Graduate School of Public Administration, IDHEAP (University of Lausanne, Switzerland). He is also chairman of the Swiss Public Sector Financial Reporting Advisory Committee. His research interests include public sector financial management, fiscal policy, fiscal federalism and valuation of nonmarket goods. He has written, co-authored or edited several books along with numerous articles in professional journals. He holds a PhD in economics from the University of Neuchâtel.