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The politics of fiscal effort in Ireland and Spain:

Market credibility versus political legitimacy

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Chapter 11 in Georgios Karyotis and Roman Gerodimos eds.,
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Abstract

Austerity measures in response to Eurozone crisis have tended to be planned and implemented as if only the technical parameters of budget management mattered. But policies that impose budgetary hardships on citizens go right to the heart of voter expectations about what it is both appropriate and acceptable for governments to do. Pro-cyclical measures that worsen an already difficult situation in a recession run counter to deep-seated norms and expectations in European countries, built up over decades of democratic governance, whereby governments are expected to provide offsetting protection for their citizens against the vicissitudes of the market. Moreover, if austerity measures are viewed as externally imposed by international authorities, new kinds of challenges to political legitimacy are likely to arise. While Greece is commonly seen as a critical test case, this chapter explores these issues through the contrasting experiences of Spain and Ireland.
Introduction

National governments within the Eurozone have had to face tough choices between the need to devise policy responses to stabilize market expectations, and the pressure to maintain responsiveness and accountability to their own voters. As Hindmoor and McConnell argue in Chapter 1 of this volume, the dynamics of political competition between the main political parties are central to accounting for what governments choose to do. We wish to show that crisis conditions heighten the difficulties governments experience in bridging the twin demands of economic stabilization and political legitimacy, and that this plays out rather differently depending on the nature of the political cleavages and the degree of policy convergence across the main political parties.

These issues are explored through the contrasting experiences of Spain and Ireland. The choice of these two countries is motivated by two considerations. Firstly, they display a marked contrast in their initial policy choices in response to the global financial crisis. During 2008, Spain adopted Keynesian measures to protect its population from the effects of crisis, attending primarily to legitimacy concerns, while Ireland began to implement spending cuts and tax increases early on, in a bid to strengthen its market credibility. Secondly though, their policy choices later converged in response to changes in the international economy. Greece’s slide into an emergency loan agreement in May 2010 was the trigger. The Spanish government came under extreme pressure to provide reassurance to the highly volatile international markets, and the only apparent resources with which to regain market confidence were those of fiscal austerity.
From May 2010 therefore, we see a sea-change in official policy in Spain, with a sharp turn toward austerity measures. From this point on, Ireland and Spain were on convergent policy paths, both locked into the politics of austerity. But Ireland’s attempts at stabilization faltered, and it was obliged to follow Greece into a ‘Troika’ loan programme in November 2010.

The following section provides an overview of the challenges involved in adopting the politics of austerity. The two subsequent sections examine the politics underpinning contrasting policy responses in Spain and in Ireland.

The challenges of austerity politics

The scale of fiscal effort in the Eurozone periphery has been considerable. Figure 1 shows that Greece made the most dramatic improvements among OECD countries in its primary fiscal balance between 2009 and 2012, and after Iceland, the adjustments in Ireland and Spain were the next most severe.

Figure 1. The scale of fiscal effort, 2009-2012

However, fiscal still deficits remained sizeable. The deficit is a function not only of governments’ efforts to cut spending and raise taxes, but also of the performance of the economy itself, since recessionary conditions dampen the revenue base while pushing up claims on automatic entitlements. Table 1 shows that governments have experienced different levels of success in meeting their mandated targets. Greece, mired in the deepest levels of recession, found it most difficult to reach the required goals; Spain suffered repeated slippage; Ireland mostly managed to perform to target, but even at that, there was often slippage
on particular items (European Commission, 2013, p.214).

Table 1. Expected and actual deficit out-turns in Greece, Spain, and Ireland

Under standard assumptions about democratic governance, governments must consider whether or not they can win enough popular support to implement tough policies. Opposition can come about immediately through popular protest, or at election time, when the incumbent government may risk losing power. We know relatively little about the conditions under which governments can undertake austerity measures on a sustained basis. Earlier phases of fiscal retrenchment seemed to suggest that it might be possible if the government could persuade enough of the electorate that the measures were unavoidable; if there is cross-party agreement on the objectives such that they cannot be derailed through adversarial party competition; and – crucially – that the austerity measures would be no more than a temporary correction (Mauro, 2011). But in a democracy, as attested to by other chapters in this volume, particularly the chapter by Dellepiane on the experience of Argentina, there are likely to be limits to how long voters will endure ongoing hardships without looking for protection from their consequences, and ultimately for an end to these policies (Polanyi, 1944/2002).

In the Eurozone, when ‘fiscal effort’ did not translate into sustained improvements in fiscal deficit outcomes, countries found that the political credibility they had expended on making the fiscal adjustments did not necessarily translate into gains in market credibility. As Figure 2 shows, as late as autumn 2009, the Eurozone states were able to secure long-term loans on the
bond markets at rates that were very similar to those of Germany. From then on, interest rates appeared to vary not only in relation to economic fundamentals and the realities of governments’ fiscal effort, but were also shaped by market expectations of European actions to alleviate issues of debt sustainability and financial sector recapitalization (De Grauwe, 2013).

Figure 2. Ten-year interest rates on government bonds

The politics of austerity in the Eurozone periphery entailed a highly asymmetric adjustment, as it was not countered by any balancing measures in the ‘core’. This pushed the countries of the periphery into a cycle of low growth and high unemployment. But there are important variations not only in the way governments responded to crisis, but also in the extent to which they managed to bridge the conflicting imperatives of gaining market credibility and sustaining political legitimacy. The contrasting dynamics of party politics in Spain and Ireland help us to understand the origins and implications of these differences.

**Credibility and legitimacy issues in Spain**

The Spanish government’s initial response to the emergence of international economic crisis was to claim that its relevance to Spain was minimal. The Socialist Party (PSOE) had been re-elected in March 2008 at a time when concern was already mounting, as in Ireland, over the sustainability of the housing boom that had gathered pace under the low interest rate regime of European Monetary Union (Dellepiane-Avellaneda, Hardiman, & Las Heras, 2013). Prime Minister Zapatero initially characterized the situation as an economic slowdown, through
which the hoped-for ‘soft landing’ would resolve the asset price bubble painlessly. Spending commitments in the run-up to the election (including an annual income tax rebate and a grant for new-born children), following on a series of expansionary budgets, were predicated on continued economic buoyancy. As in Ireland, fiscal populism based on lower taxes and higher spending under conditions of growth had yielded electoral benefits, even though this weakened the bases of government’s fiscal capacity. Nevertheless the PSOE government implemented an early fiscal stimulus, mostly in the form of tax cuts and extra welfare entitlements, as a counter-measure to what was depicted as a temporary weakening in domestic demand. This was viewed as entirely consistent with the European Economic Recovery Plan. Discretionary fiscal stimulus in Spain accounted for 2.4% of GDP in 2009, as opposed to only 0.3% in Ireland (European Commission, 2009, 2010).

The budget for 2009 gave effect to a number of the spending commitments promised in the election campaign, based on projections of GDP growth of 1% and a deficit of 2%. These quickly proved to be unrealistic. It became clear that Spain had indeed entered a crisis when the actual outturn was a fall in GDP of 3.7% and a fiscal deficit of 11.7%.

Once the severity of the economic crisis became clear, Zapatero adopted what he termed a ‘Social Democratic approach to the crisis’. The Budget for 2010 was intended to phase out the extraordinary stimulus that had been in effect during 2009, not by cutting spending, but through a revenue-based consolidation strategy. This Budget was primarily based on revenue-increasing measures such
as withdrawing the earlier tax rebate and increasing VAT, which raised revenues by about 1.5% of GDP. The overt objective was to protect core social spending and to shield welfare beneficiaries from the effects of the downturn. For example, in one of his speeches Zapatero said ‘I am going to ask for a share of people’s income out of solidarity and to meet the demands of the most needy’.

The conservative opposition Partido Popular (PP), in contrast, argued for spending cuts in preference to tax increases.

The pivotal moment in Spain’s fiscal response to crisis came in May 2010, as a direct consequence of the crisis in Greece. Paradoxically, Spain’s fiscal fundamentals were not in bad shape at this time. Its projected debt for 2010 stood at some 65% of GDP. A combination of the confused European political response to the Greek crisis, and the market panic associated with this, put enormous pressure on Zapatero to change political course. According to insiders, the pressure was simply ‘unbearable’. Over the 8/9 May weekend, Merkel and Sarkozy demanded an immediate €30bn cut in the Spanish budget (Merkel especially stressed that the sacrifice must engage pensions). International pressure also involved telephone calls by many leaders, including President Obama.

Ironically, only weeks earlier, Dominique Strauss-Kahn, the then IMF General Director, had allegedly warned Zapatero about the sizeable risks associated with an early withdrawal of fiscal stimulus (taking into account Spain’s available fiscal space and notably high unemployment). This suggests that the major policy reversal of May 2010 should not perhaps be seen as the inevitable consequence
of market logic, but as a rapidly improvised response, in which many different actors were trying to gain influence over the Spanish Prime Minister including, it is reported, US President Obama. The decisions that resulted were taken under considerable duress and in a highly compressed time-frame. As Ortega and Pascual-Ramsay (2012) argue, the Spanish government was compelled to implement the adjustment quickly – in a matter of days – with little time to reflect. There was therefore very little time available to build consensus, let alone develop a convincing political narrative. The austerity package, widely construed by the media as ‘the biggest social adjustment under democracy’, was approved in parliament, but by a margin of only one vote.

This ‘Copernican shift’ in the government’s stance resulted in a new emergency budget, which intensified the pace and impact of the deficit reduction programme announced in the 2010 Budget, and which changed the emphasis away from a revenue-increasing approach toward a strategy based on spending cuts. This dramatic shift aimed to secure €15bn in spending cuts for the second half of 2010 and into 2011, or 1.5% GDP. The plan was to achieve a debt-to-GDP ratio of 60.1% for 2010, instead of the previously forecast 65.9% - still relatively low debt levels by European standards. The measures included direct cuts to civil service salaries of an average of 5% in 2010, and an ongoing freeze in 2011; cuts of 15% to politicians’ pay; changes to pension entitlements; elimination of the headline-grabbing grants to infants; elimination of dependency benefits; and cuts to the public capital programme (Mulas-Granados, 2010).

The emergency budget represented a radical break from the government’s prior
fiscal stance. It was a very difficult moment for the ‘social Zapatero’ who had insisted upon the primacy of Social Democratic priorities over market pressures. But market pressures were probably only part of the story. It seems likely that Zapatero, having suffered from criticism for his failure to confront the crisis on time, felt compelled to go overboard to restore his damaged reputation. Indeed, it became an over-riding objective to avoid ‘at all costs’ the national humiliation of a European bailout (Sanchez-Cuenca 2012; Estefania 2013). The social approach to the crisis was abandoned in favour of an ‘epic’ rhetoric based on the ideas of necessity, responsibility and collective effort (Ortega and Pascual-Ramsay 2012). This over-commitment to the austerity cause was reflected in the reluctance to adopt compensatory measures; it also gave rise to PSOE’s unexpected support for the constitutionalization of budget limits in August 2011. All of these measures further alienated the core support base of the PSOE.

Notwithstanding these severe measures, it is far from clear that the change of fiscal direction and the recalibration of political strategy actually succeeded in securing market confidence. Successive moves to tighten fiscal policy were intended to signal to the markets that the government was serious about deficit reduction. But we can see from the ratings’ agencies assessments of Spain’s prospects, in Figure 3 below, that each moment of fiscal tightening was followed by a downgrading of its loan status – precisely because of expectations that Spain’s growth performance would be further dampened.

Figure 3. Ratings agencies’ ratings for Spain

The about-turn in fiscal strategy during 2010 was driven by the perceived need
to restore market credibility. But from this moment, we can see that a considerable political cost was exerted on the Socialist government. From May 2010 onward, Zapatero was obliged to prioritize market credibility over the party’s programmatic priorities, and this made it difficult to sustain the party’s core support in the teeth of painful fiscal retrenchment. The May 2010 Emergency Plan was a turning point in the PSOE’s popularity, illustrating the difficulties in both accommodating market pressures and building democratic legitimacy. The minority PSOE government lost the strategic support of all the small left-leaning groups (including BNG, ERC and IU) on which it had relied to secure voting majorities in parliament. These were alienated not only by the shift in focus toward spending cuts, but also by the lack of visible balancing measures such as a reversal of the apparently favourable treatment of wealth and of high-income earners.

From May 2010, as Figure 4 shows, we can see a steep decline in confidence in the government. A socialist deputy said in May 2010 that ‘today we have lost the next general election’. Indeed, the first of what was to be a series of general strikes was held in September 2010.

Figure 4. Opinion poll ratings of political parties in Spain

Zapatero’s government continued to pursue measures oriented toward bringing down Spain’s fiscal deficit, in an orthodox contractionary manner. The Budget for 2011, introduced at the end of 2010, came at a time of ongoing instability on the bond markets. Ireland entered an EU-IMF loan programme at this time, and speculation was running high as to whether Portugal or Spain would be next in
line. The prospect of Spain needing a rescue programme was the great worry for European decision-makers: it was thought 'too big to fail', yet too big to rescue too (Jones, 2010).

The objectives of the 2011 Budget were twofold. On the one hand, government stated its intention to embark on a steady path of fiscal consolidation; on the other, it stated its intention to undertake a programme of structural reforms aimed at ensuring long-term fiscal sustainability and accelerating ‘the change of the productive model’ ('el cambio en el modelo productivo'). The key objective was to meet the deficit target of 6% of GDP. The deficit had been 11.1% in 2009 and 9.3% in 2010. But in the context of a slow recovery, in which growth was expected to be 1.3%, this could prove challenging. Budget 2011 consolidated the emergency measures taken in May 2010 mostly through spending cuts. Non-financial spending was set to decrease by 7.9%. Austerity measures also entailed a drastic cut in public investment in infrastructure, which was reduced by 30%, and a moderate reduction in personnel.

And yet, throughout all these spending cuts, the PSOE government continued to protect the core components of the welfare state and social policy. According to the government, social cohesion was still a central objective, even in the context of austerity. In the words of the Socialist Minister for Economy and Finance Elena Salgado, ‘Son unos Presupuestos austeros, que generan cohesión social e impulsan la actividad económica’ ('This is an austere budget that generates social cohesion and fosters economic activity'). The government had some discretion over how to manage the deficit-reduction strategy whose targets it
had accepted, under the aegis of the European Excessive Deficit Procedures.

In the election of November 2011, PSOE suffered the expected electoral defeat. It was not a business-as-usual incumbent defeat – the socialists suffered the worst electoral defeat since 1977. A change of government did not mean a change in the policy objectives the government pursued, but it did mean a change in the priorities and methods adopted. The new PP government, headed by Mariano Rajoy, accepted the framework of deficit reduction. Cristobal Montoro, the Ministry for Finance, made clear the objectives of the incoming government:

‘The first objective is the deficit; the second, the deficit; and the third, the deficit’ (El Pais, 4/4/12). If anything, the budgets for 2012 and 2013 deepened the commitment towards spending-based consolidation and structural reforms. In the interests of boosting business confidence, and consistent with the market-liberalizing advice coming from the EU policy leaders, the emphasis shifted more decisively toward cutting expenditure rather than broadening the tax base and increasing revenues.

The results were highly disappointing. The promised ‘expansionary fiscal contraction’ never materialised. The economic slump continued, and unemployment kept rising to historically unprecedented levels. In the context of increasing uncertainty and, we might add, lower credibility, the Spanish financial system was finally bailed out through direct European recapitalization measures. By now, the conservatives were struggling just as much as the socialists had been to retain their political legitimacy, not least because they were forced to break, one by one, practically all their electoral pledges – on taxes, on pensions, on the
bailout, on the bank rescue. In November 2011, PP had a voting intention of 44.6%; in May 2013, this figure was down to 22.5%, and the ratings of the government and its key figures, including Rajoy, were at record low levels. Strikingly, the opposition PSOE was performing even worse: about 20% of voters declared that they would be likely to support the socialists if an election were to be held at that time, some nine points below the already low levels of November 2011. Crisis management has clearly compromised and indeed heavily undermined the political bases of the PP-PSOE duopoly.

**Credibility and legitimacy issues in Ireland**

In marked contrast with the Spanish experience, the Irish government that held power between 2007 and February 2011, composed of the centre-right Fianna Fáil party and the small Green Party, took the view from mid-2008 that closing the deficit was the most urgent priority. It also held the 'orthodox' position that an emphasis on spending cuts over tax increases was the most appropriate way of doing so, and this view was consistently maintained throughout the very tough times to follow. Furthermore, although the opposition parties that formed the subsequent coalition government, comprising the centre-right Fine Gael party and the Labour Party, differed on matters of emphasis, they accepted the constraints imposed by the loan agreement of November 2010. There was no fundamental disagreement over the policy objectives Ireland was required to adopt or over the means of achieving them.

The consistency of approach after 2008 was frequently lauded by EU and IMF policy leaders: by 2012 and 2013, Ireland was widely seen as a so-called poster-
child for austerity, meeting its targets for deficit reduction, and giving rise to some signs that investor confidence was improving. The worst moment (as Figure 2 illustrates) was in mid-2011, when market confidence in Irish capacity to return to borrowing on the international markets was at its shakiest, as the scale of banking-related losses was subject to further upward estimation. Matters improved subsequently, such that Ireland was expected to be able to exit the loan programme on schedule at end-2013.

However, mismanagement of the economy during the boom years, especially between 2000 and 2008, had contributed to making the crisis much more severe than it needed to be. A persistent bias toward pro-cyclical fiscal policy during the boom meant that public spending had increased rapidly year on year. Meanwhile, the income tax base had been narrowed through cuts in headline rates and exemptions for the lowest-paid, resulting in a situation where the average incidence of income tax and social insurance liabilities on most households was among the lowest in the OECD, and about 40% of employees paid no income tax at all (Dellepiane & Hardiman, 2012; OECD, 2009). Reckless bank lending, combined with inappropriate fiscal incentives, resulted in a housing boom on an even larger scale than that of Spain’s. Government had come to rely ever more heavily on buoyant revenues from construction-related activities, and the implosion of the building industry had a disproportionate impact on the public finances (Hardiman, 2014).

A series of deficit-tightening measures during 2008 and 2009 failed to improve Ireland’s market credibility. They also stoked up some one-day episodes of strike
action and street protest by public sector union employees (Dellepiane-Avellaneda & Hardiman, 2012). The sharpest budget cuts came in December 2009, and involving overall cuts to public sector salaries of between 7% and 15%, and cuts to all categories of welfare recipients. The aim, as ever, was to put some distance between Ireland and Greece. This preemptive approach to fiscal consolidation was widely lauded as exemplary and a model to other countries under pressure (The Economist, 2009).

The collapse of Lehman Brothers in the US brought underlying worries about the stability of the Irish economy to a head. In particular, the banks now revealed that, despite assurances under the ‘light-touch’ financial regulatory regime that all was well, they were in fact in deep trouble (Clarke & Hardiman, 2012). On the assumption that this was a liquidity and not an insolvency problem, Minister for Finance Brian Lenihan took the single most far-reaching decision in the Irish crisis on 30 September 2008, which was to guarantee not only all bank deposits, but the liabilities of most categories of bondholders. At the time, due to the wholly inadequate information available to government about the devastation the banks had brought upon themselves, Lenihan announced that the Irish bank bailout would be ‘the cheapest in the world’, compared with bank rescues in other countries (Carswell, 2008).

Greece’s need to avail of a new EU loan facility in May 2010 was a key moment in Ireland as in Spain, but for different reasons. As the scale of losses in the Irish banks – particularly Anglo Irish Bank – became clearer, and as fear of the contagion effects of Greek vulnerability spread, Irish bond spreads reach a new
high, and the rate continued to go up throughout May and June (Carswell, 2011). In the course of 2010, GDP fell more than anticipated, and the scale of the fiscal consolidation that would be required to meet the 2010 3% deficit target continued to escalate. At this time, the government issued public assurances that its spending needs were fully funded into mid-2011 and there was no immediate need to return to the bond markets. Right up to a very short time before the loan agreement actually happened, the government continued to deny publicly that it was in negotiations with the EU and the IMF.

However, interest rates on Irish bonds were rising; besides, the Irish banks were now, in effect, locked out of international lending markets, and something needed to be done about their drastically impaired balance sheets. Ireland’s 2008 bank guarantee was due to expire at this time. Investors were slowly haemorrhaging abroad. The banks were becoming ever more heavily reliant on short-term liquidity from the ECB. It would appear that extreme pressure came from the ECB to require the Irish government to seek a loan agreement until 2013 in November 2010 (Economist, 2010). Not only this, but the government came under intense pressure to extend its earlier blanket guarantee to the banks. This meant that instead of imposing some of the burden of adjustment on private sector bondholders, and getting assistance for the public rescue of the banking system from the Eurozone at large, all the liabilities of the ruined banks now had to be met by Irish taxpayers.

In a wide-ranging interview he gave in April 2011, after he had left office and shortly before he died, Brian Lenihan, who had been the Fianna Fáil Finance
Minister at the critical time, discussed what had happened in November 2010. He confirmed that the ECB had played a central role in insisting that the full cost of the ruined banks had to be borne by the Irish state. He recounted that neither the European Commission officials nor the IMF had been concerned about the situation, and that it was the ECB that forced the issue. Their top echelon pressed their view ‘with great vigour’ that ‘putting the fiscal house in order’ more rapidly would resolve the banking problem, a view that Lenihan did not agree with. But the ECB insisted that ‘the future of the currency union was at stake’ (O’Brien, 2011). The consequence was that the total liabilities of the domestic banks were to be borne by the taxpayers, which brought the cost of bank rescue to some 40% of GDP, and raised the total volume of public debt by about one-third by 2013 (Donovan & Murphy, 2013; O’Brien, 2011).

In November 2010, the Government announced its National Recovery Plan 2011-2014: this was in fact entirely consistent with the terms of the Memorandum of Understanding with the ECB and IMF which was announced at the same time. The policy stance involved an ‘orthodox’ strategy of front-loading the adjustments, that is, imposing the largest adjustments at the start of the process. The National Recovery Plan projected adjustments of €15bn between 2011 and 2014, €10bn in spending cuts and €5bn in taxation. It anticipated that the deficit would be reduced to 9.1% GDP in 2011, with steady reductions thereafter to below 3% by 2014. The debt to GDP ratio was expected to peak at 102% GDP in 2013, and to fall to 100% by 2014. These projections set the framework for the specific measures set out in Budget 2011 in December 2010. But as Table 1 shows, these estimates had to be revised further over time, because fiscal
contraction in a stagnant economy caused further worsening of the outcomes, meaning that government was chasing a moving target.

In addition to large spending cuts, there were big increases in most forms of taxation in the December 2010 Budget. Rates of income tax remained constant, but the tax net widened from 45% to 60% of the workforce. The other key measure was the introduction of a Universal Social Charge, which consolidated other direct levies – thereby making them more visible. And controversially, the national hourly minimum wage was cut by €1 to €7.65, with a view to increasing low-end labour market flexibility (although this was reversed by the new government in early 2011).

Already in December, the underlying budget deficit was estimated at 11.6% GDP, and the Budget statement claimed that the measures adopted would stabilize it at that level. The Budget also stated that GDP was expected to grow at an annual rate of 2.7% until 2014. Commentators considered these commitments to be optimistic, and indeed ECOFIN extended Ireland’s excessive deficit target deadline from 2014 to 2015 at this point. Meanwhile, government was also committed to undertaking a range of structural reforms including stronger fiscal oversight arrangements, review of labour market flexibility, and rigidities in some of the professions.

As in the Spanish case, Ireland’s long-drawn-out efforts to improve its market credibility proved self-defeating. As Figure 5 shows, in Ireland as in Spain, the ratings agencies downgraded Ireland’s sovereign risk rating, even as Irish governments made ever-greater efforts to deal with the deficit. Large fiscal
efforts resulted in relatively little visible fiscal retrenchment. By end-2010, the size of the public deficit had risen to 12% or about €18bn (with a GDP of €153.9bn), the debt-to-GDP ratio was about 100%, and the IMF projected that it would peak at 120% in 2013 before stabilizing (IMF, 2011). Minister for Finance Brian Lenihan noted in Budget 2011 that Ireland had undertaken an implicit consolidation effort of about 10% of GDP in two years. The total fiscal adjustment between 2008 and 2014, according to the National Recovery Plan 2011-2014, would amount to €30bn, equivalent to about 20% of 2010-level GDP.

Figure 5. Ratings agencies’ ratings for Ireland

By the time of the loan programme in November 2010, the incumbent government was extremely unpopular. The fact that Irish taxpayers had been required to renew the bank guarantee and to assume total liability for their private-sector debts was the focus of intense anger and frustration in the run-up to the election of February 2011.

The Fianna Fáil-Green coalition’s support in the polls had been sliding steadily over time. Fianna Fáil was historically the dominant party in the Irish party system, and had typically secured up to 40% of the total vote, drawn from across all social classes. Figure 6 shows that the first marked drop in support for the governing parties came after the bank guarantee in September 2008, and that it plummeted after the EC-ECB-IMF loan programme in November 2010.

Figure 6. Opinion poll ratings of political parties in Ireland

The general election of February 2011 brought the expected change of
government – a coalition of Fine Gael and Labour – but the scale of the losses suffered by Fianna Fáil was very striking (Gallagher & Marsh, 2011). Its vote-share sank to 17%. Its historically strong cross-class support base fragmented. Fianna Fáil was held responsible for causing the crisis, but it gained no credit for tackling the crisis consistently: this was one of the most dramatic experiences of the political toll taken by austerity on any European political party. The implications remained unclear: the lost vote-share benefited a surge in the number of non-party individuals as well as some smaller left parties. But poised in the wings was Sinn Féin, newly committed to parliamentary politics in the aftermath of the Northern Ireland Good Friday Agreement, and eager to displace Fianna Fáil through vigorous use of anti-austerity rhetoric.

However, the political gains made by Fine Gael and Labour in 2011 were not guaranteed to be durable. The government’s standing in the opinion polls fell sharply almost immediately, in the wake of the further tough measures they took in subsequent budgets. And notwithstanding some success in renegotiating some of the terms of the refinancing of Anglo Irish Bank, now a zombie bank with massive liabilities but no future as a functioning financial institution (Whelan, 2012), the government did not manage to gain any traction with the main issue on which it had campaigned originally, that is, retrospective European support for direct refinancing of the Irish banking sector. Labour, the junior party in government, took the brunt of popular dissatisfaction. It had secured 19% of first-preference votes in 2011. But its showing in the European elections of May 2014 was a mere 6%, and its party leader, Eamon Gilmore, was obliged to resign.
Dynamics of party competition and the challenges of political legitimation

In Spain and in Ireland, governments experienced less difficulty than in Greece in adopting and implementing tough budgets. But the Spanish and Irish terms of debate about what to do and when to do it proved to be very different from each other. This can best be understood by considering the partisan profile of the party system in each case, and the way this translated into party competition in the context of crisis.

The choice of economic strategy and the composition of budget adjustment were subject to regular and vigorous partisan debate in Spain, where strong left-right partisanship was well-established. Zapatero’s rhetoric was consistently Keynesian and Social Democratic. The shift in strategy in May 2010, he insisted, arose not from conviction but from necessity, under pressure from the international markets. And public opinion in Spain consistently showed much stronger support for tax increases over spending cuts. Ever since the stabilization of democracy had been assured through the belated expansion of the welfare state, a constituency of support had been built up that had a strong vested interest in welfare transfers and services (Molina & Rhodes, 2007).

Partisan strategies of fiscal adjustment have been observed in Spain in the past (Mulas-Granados, 2006; von Hagen & Strauch, 2001). In the early 1990s, the PSOE undertook revenue-based adjustments that protected social policy, public wages and investment. Between 1996 and 2000, the conservative PP had preferred expenditure-based strategies of adjustment that focused on spending cuts and structural reforms. Zapatero continually stressed the Social Democratic
motivation of his initial strategy in 2008 and 2009. This is grounded in the broader Spanish Socialist conception of how structural adjustment may be undertaken without conceding the ground to conservative opinion, by enhancing competitiveness through building up the skill base, and improving productivity through public investment (Boix, 2003).

In contrast, in Ireland, the political left was historically very weak. Most political contestation was tilted toward the centre-right, with little basis for clearly differentiated, ideologically grounded debate over either policy objectives or the mix of policy methods. The ‘orthodox’ perspective that prioritized the need to restore fiscal stability in order to boost business confidence was much more widely established than in Spain. Market-conforming policy was deemed an essential complement to a growth strategy based on incentivizing foreign direct investment. Prevailing opinion among professional economists at the outset of the crisis was that the most appropriate course of action was ‘shock therapy’. Citing the experience of a ‘lost decade’ of delayed deficit reduction in the 1980s, they now recommended a quickly undertaken, massive fiscal consolidation, primarily based on spending cuts (Kinsella & Leddin, 2010; McCarthy, 2010).

Critical voices came from the trade union movement, which pointed to the real risks of choking off growth prospects (Begg, 2009; Irish Congress of Trade Unions, 2009a, 2009b). But the unions’ view gained little political traction. And public opinion in Ireland showed a consistent preference for spending cuts over tax increases, even after two decades of tax cuts had made Ireland one of the most lightly taxed of all the OECD countries (Regan, 2012).
Both Ireland and Spain may be contrasted with Greece in the nature and scale of popular protest against the politics of austerity. Even in the face of very high unemployment, trade union leaders led largely peaceful short-term general strikes and occasional street protests, without the violent confrontations that were a recurrent feature of Greek politics. This can be understood as a consequence of differences in long-established patterns of industrial relations, but crisis management strategies also played a part. Wage-setting institutions came under intolerable pressure in both countries as the crisis deepened. In Ireland, government chose not to follow the social partnership route of gradual efficiency-based cost recovery in December 2009, but imposed direct spending-based adjustment. In Spain, the government lost the support of the unions and left-wing political sectors after the May 2010 emergency programme. Yet in both countries, some form of social dialogue was re-established. In Ireland, the public sector unions engaged in a new form of concession bargaining in June 2010, securing efficiency gains in exchange for a suspension of direct pay cuts. In Spain, a new social pact, deemed the most important since the celebrated Moncloa Pacts of 1978, was agreed in January 2011. This enabled the government to secure support for a critical pension reform (Rhodes, 2011).

In the short term, the capacity to engage in even limited social dialogue and to negotiate social pacts seemed likely to result in a more coherent economic adjustment path, and by making it more legitimate, ensure its viability (Baccaro & Simoni, 2008; Culpepper, 2008; Molina & Rhodes, 2007; Pérez, 2000; Pérez-Díaz, 1993; Roche, 2009). Social pacts were negotiated in both Spain and Ireland by governments of varying partisan composition. But social partnership may also
have other serious unintended consequences for distributive outcomes. For example, Spain, older ‘pactista' traditions contributed to delaying reform of labour market rigidities that confer employment security to ‘insiders’ at the expense of other categories of workers (Cuñat, 2012). New forms of mass mobilization and street protests by labour market outsiders, especially young politically disaffected people, presented a new kind of challenge to the political insiders from both major parties during 2011 and 2013.

In Ireland, the insider power of the public sector and the low levels of unionization of the private sector, especially in the exporting sector, may have distorted wage structures prior to the crisis (McGuinness, Kelly, & O'Connell, 2010). Public sector deals on pay cuts in 2010 and again in 2013 were undertaken under the clear threat of unilateral government action. But at the same time, the terms of these deals excluded those with the weakest power in the labour market in both public and private sectors, especially the growing numbers of temporary and part-time workers, the rising numbers of unemployed, and those who had voted with their feet in growing numbers and who had simply emigrated.

In neither Spain nor Ireland, despite the extreme problems in securing market credibility and the profound challenges posed to the major political parties, did any fundamental challenge emerge to the political system itself. Unlike in Greece, both countries managed to sustain some broad level of agreement across the largest political parties about what the principal objectives needed to be. Spanish parties were more adversary-inclined about policy objectives, at least until May
2010, and Irish parties more consensus-inclined in their party positioning (chapter 1, Table 1.1). Spanish political narratives also featured more contestation about the composition of policy adjustment. But in neither country do we see the emergence of the strongly polarizing conflicts that characterized Greek politics, or the prevalence of street protests; nor has either country experienced the sustained rise of an anti-system protest party of the extreme right. Despite the stresses on social services, especially in Spain, neither country experienced the effective collapse of the social contract that, as Polanyi warned, could presage a fundamental threat to the sustainability of democracy itself.

But neither should this be taken as grounds for complacency. Eurobarometer data on trust in national governments, shown in Figure 7, indicated a growing trend in popular dissatisfaction with their own national political systems among citizens in the Eurozone periphery countries. In mid-2012, no government had experienced net positive ratings since before the crisis. The average for the 17 countries of the Eurozone as a whole was about -25%, and in Germany the figure was better again, at under -20%. But dissatisfaction was most marked in Greece, where the difference between those who trust and those who do not trust their own government was recorded at a massive -80%. The other periphery countries were not far behind, with Spain, Portugal and Ireland recording rates of between -50% and -70%. Notwithstanding brief rallies with changes of government, the downward trend was very marked in all these countries. It started as the first symptoms of impending crisis began to appear, with the stalling of the housing boom, the tightening of the availability of credit, and the worsening market performance of bank shares. The outcomes of the local and
European elections in May 2014 suggested that anti-austerity feelings were become stronger, and that further fragmentation of the party systems of these countries could not be ruled out in subsequent national elections.

Figure 7. Net trust in national government

**Conclusion**

Neither Spain nor Ireland experienced fundamental difficulty in adopting and implementing harsh policies once they were deemed to be necessary. In both countries, external pressures coming from European policy-makers caused critical policy shifts on the part of national governments. But there are marked differences in the way these decisions were arrived at, which can only be understood in the context of the partisan dynamics of party competition and the underlying political cleavages in the two societies.

Partisan differentiation of policy preferences was more deeply rooted in Spain than in Ireland, which meant that the breach in the preferred government policy stance in May 2010 was particularly damaging for the incumbent PSOE. In Ireland, weak ideological differentiation and a more market-oriented political discourse made an orthodox policy response more acceptable to two successive governments.

In both countries, though, we find that there are deeper consequences for the political legitimacy of the parties imposing austerity. The experience of duress, that is, the recognition that external pressures limited national options, generated additional citizen resentment in both Spain and Ireland. In Spain, the
tipping point came in May 2010, when the PSOE was obliged to reverse its preferred policy response to crisis. In Ireland, the realization in September 2008 that the banking system was out of control was the moment at which trust in government started to fall, but it was the terms of the loan programme in November 2010, which put the entire burden of the bank bail-out onto the Irish taxpayers, that was particularly resented. In both countries, voters found that they could change their government, but they could not change the policies. This resulted in growing dissatisfaction with and alienation from the political system.

In both Spain and Ireland, the consequences of austerity include a worsening of social services and of the conditions underpinning social cohesion. In both countries, too, the crisis hit younger people harder than older people, in terms of job losses and exclusion from the labour market, household debt, and the burden of negative equity. In Spain, the distributive impact of adjustment measures tilted over time, and became broadly regressive in their effects from 2011. In Ireland, there is some indication that the cumulative impact of the tax and spending measures to 2012 may have been broadly progressive (Callan, Keane, Savage, & Walsh, 2012). However, the most salient forms of new taxes – the Universal Social Charge, a tax on residential property, and moves to introduce water charges – were those that had a regressive impact; and the reduction in access to public services, and especially the worsening of deep-seated inequalities in access to health services, further increased dissatisfaction with government (Nolan et al., 2014).

In both Spain and Ireland, the struggle to secure market credibility on terms
acceptable to the domestic electorate proved extremely difficult. In the short term, incumbent governments were severely punished at the polls; and yet the standing of their successors in government also suffered, as the international market pressures bore down heavily on government options and on national growth prospects. The most severe consequences of these trends were seen in Greece, where the party system imploded, and more radical alternatives gained support. But the European elections of May 2014 showed that in both Spain and Ireland, the challenge to established parties was gathering pace, fuelled by voters’ anger at the consequences of the way they were obliged to adjust to international market conditions. The prevailing European stance toward market-led adjustment provided minimal scope for state intervention to stimulate growth or alleviate hardship. The consequences in terms of loss of political legitimacy may yet prove costly.
Figure 1. The scale of fiscal effort, 2009-2012

Table 13.1 Expected and actual deficit out-turns in Greece, Spain, and Ireland

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Source: Governments’ Stability Programmes, and EC Adjustment Programmes
Figure 2. Ten-year interest rates on government bonds

Figure 3. Ratings agencies’ ratings for Spain
Figure 4. Opinion poll ratings of political parties in Spain

Figure 5. Ratings agencies’ ratings for Ireland

Source: ratings agencies’ websites
Figure 6. Opinion poll ratings of political parties in Ireland

Figure 7. Net trust in national government

Source: Eurobarometer
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