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Title	The New Politics of Austerity: Fiscal Responses to the Economic Crisis in Ireland and Spain
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Publication date	2012-02
Publication information	Dellepiane, Sebastian, and Niamh Hardiman. "The New Politics of Austerity: Fiscal Responses to the Economic Crisis in Ireland and Spain." University College Dublin. Geary Institute, February 2012.
Series	UCD Geary Institute Discussion Paper Series, WP2012/07
Publisher	University College Dublin. Geary Institute
Item record/more information	http://hdl.handle.net/10197/4926

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The New Politics of Austerity: Fiscal Responses to the Economic Crisis in Ireland and Spain

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February 2012

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Abstract

This paper adopts a new analytical approach to explaining choices in fiscal politics in Ireland and Spain between 2008 and 2010, in response to international economic crisis. It adopts a comparative cross-national research design to explore why two countries with similar pre-crisis fiscal profiles adopted radically different strategies in the initial phase of the crisis: Ireland adopted an orthodox deficit-reduction strategy, while Spain implemented a 'heterodox' stimulus fiscal package. Yet by mid-2010, Spain's fiscal stance had converged with Ireland's, as the wider European crisis deepened and the scope for autonomous national policy choice narrowed. The paper tracks this shift in a second stage of the research design, examining within-country variation over time, to provide a nuanced and sophisticated analysis of strategic choices at critical moments. It argues that the shift toward a European politics of austerity is different in a number of important ways from the older politics of fiscal consolidation, and that this has far-reaching implications not only for the evolution of European integration, but also for the balance between democratic politics and transnational markets.

Introduction

The international economic crisis has brought the politics of fiscal management to the forefront of political debate. In the context of European Monetary Union, fiscal policy takes on a significant role in member states as a tool of domestic stabilization. Demand management is one of the only discretionary measures available to governments in a downturn. But the 'excessive deficits' incurred in breach of the Stability and Growth Pact must be reduced to below 3% within the next couple of years. This paper explores some aspects of commonality and variation in the new politics of how this is debated and implemented.

The politics of fiscal consolidation had a high salience during the 1980s and 1990s in those EU member states that wished to establish their eligibility for membership of the Euro by 1999, and there is an influential literature on the subject. Fiscal consolidation is normally defined with reference to a change of fixed size relative to government's cyclically adjusted primary balance, undertaken within a specific time period, normally between one and three years (Alesina and Perotti, 1995; Perotti, 1998; Alesina et al., 1998). A number of findings emerged from the comparative literature in the 1980s and 1990s concerning the political and institutional conditions facilitating fiscal consolidation, which took on the status of received wisdom, and which have defined the field of study ever since. Spending-based consolidation was deemed to be more successful and more durable in containing deficits; unitary and centralized governments were more successful (Wehner, 2010; Cheibub, 2006; Mulas-Granados, 2006); coalition governments were less successful; but depending on the strategies they used, coalition governments could also achieve successful fiscal consolidation (Hallerberg et al., 2009).

Our contention is that the politics of fiscal consolidation in the wake of the economic crisis that began in 2008 is quite different. The choice between fiscal stimulus and fiscal consolidation has itself been strongly contested. It is clear that the scale of the global crisis would have been greater had there not been some degree of international coordination to provide a fiscal stimulus: the European Economic Recovery Plan, launched by the European Commission in 2008, 'to treat the symptoms of the economic crisis and protect jobs and purchasing power' (European Commission, 2008). The lessons of the Great Depression were well taken this time, and an increase in deficits to stimulate demand was held to have been largely successful in the early stages of the crisis (Eichengreen and O'Rourke, 2010). But as the crisis evolved, the capacity of large and rising fiscal deficits to undermine the Euro gave rise to a mounting sovereign debt crisis, which was further intensified by

the scale of public funding committed to underpinning the financial sector. The credibility of the response was thrown into question in the Eurozone.

Consistent with the terms of the Stability and Growth Pact, the European Central Bank (ECB) requires that fiscal deficits should be reduced to beneath 3% within a fixed period in Eurozone member states. But the current economic crisis is unprecedented in scale and duration since the Great Depression. The requirement to engage in fiscal consolidation in the economies that suffered the most adverse effects of the economic crisis, when growth has not been securely established (if at all), risks introducing a pro-cyclical bias which may exacerbate rather than alleviate their problems. The fiscal deficits of Ireland, Spain, and Portugal are not primarily driven by excessive spending, but by the asymmetric effects of economic crisis, and even in Greece, the economic and social consequences of seeking to reduce long-standing deficits in the midst of recession have been severe.

Fiscal consolidation inside a monetary union, where there is no scope for competitiveness gains through devaluation, poses stark new challenges for domestic politics. Stabilization efforts where growth prospects are at best unsteady must tread a fine line between enabling stabilization and reinforcing recession. Moreover, deficits may also be compounded by the fragility of the financial system. Bank bail-outs, involving the socialization of private losses, have burdened the public finances of some countries quite significantly. Fiscal stabilization is more problematic where there is also a problem of financial sector indebtedness (Blanchard and Cottarelli, 2010; Giavazzi, 2010). Together, these conditions imply a severe contraction in living standards for the populations affected which must be implemented on a sustained basis, for year after year.

In addition to the considerable economic challenges involved in managing difficult choices, the political difficulties of undertaking the politics of austerity must not be under-estimated. The conventional literature from earlier periods of fiscal consolidation suggested that the electoral costs of retrenchment are few, if governments can secure a return to growth, and if voters believe the sacrifices are both inevitable and that they will bear fruit (Alesina et al., 2010; Mulas-Granados, 2004). But all these presumptions must be considered a good deal more tenuous this time round. Indeed, the IMF characterizes the continuing fragility of the European periphery as the most significant issue affecting the growth prospects of the EU economy as a whole (IMF, 2011b). This is surely ‘politics in hard times’ (Gourevitch, 1986), or even very hard times.

For these reasons, our analysis of the contemporary experiences of fiscal consolidation faces a new kind of analytical problem from the outset. The earlier literature typically identified episodes of

consolidation with reference to the outcomes, understood as a sustained change in the debt to GDP ratio. This was always somewhat problematic, as it bore little relationship to the intentionality of government strategy, and incidental changes in outcome in which the ratio improves as a result of GDP growth, or growth-induced revenue increases, may therefore be misclassified as explicit government policy (for example in the case of Ireland 2003-2005, (Kumar et al., 2007)). Countries that engage in strenuous efforts at fiscal retrenchment during the current crisis may experience no visible consolidation effect at all, since slow growth, larger welfare claims, and heavier debt interest repayments may well result in larger expenditures and continued weak revenue flows, and perhaps even a declining GDP base. There is no stable outcome to be seen, and the target is constantly shifting. Fiscal consolidation must therefore be analysed with reference to political strategy rather than outcome.

This leads us to hold that since episodes of change cannot be segmented and abstracted from contextual factors in the kind of fluid context we are considering, it is more appropriate to conceptualize fiscal consolidation as a series of decisions that form part of a dynamic process, in which each moment of political decision-making is conditioned both by current circumstances and by the effects of what went before, in a path-dependent trajectory (Dellepiane, 2010; Dellepiane and Hardiman, 2009). What matters most is the politics of fiscal effort, even if there is no perceptible consolidation as a result (Leigh, 2010). Variation in fiscal consolidation strategy needs to be subjected to a detailed, qualitative analysis, to expose the incentives and constraints that lie behind each moment of decision-making.

The extent of the budgetary adjustment achieved, that is, the outcome, is of course of interest. But what is of particular interest to us is the nature and composition of adjustment itself, and the reasons behind the decisions taken. In response to the enormous shock taking place during 2008, a number of countries initially had a choice. On the one hand, they could attempt to protect domestic levels of demand through fiscal stimulus, even at the cost of increasing the deficit. On the other, they could seek to reduce the exposure of the national economy to the risk of deficit and debt problems through ‘orthodox’ consolidation efforts. As the crisis deepened, as the ECB pressure to enforce austerity measures intensified, and in particular as the interdependencies within the Eurozone began to cause contagion effects that spread outward from Greece’s debt financing problems, we begin to see a greater convergence around ‘orthodox’ measures. And yet countries still face a choice over the composition of retrenchment measures, and the precise mix and incidence of spending cuts and tax increases may have a variety of distributive consequences.

All these choices are politically mediated, and even the tightening of the ECB's hold over domestic policy choice in the European periphery, particularly in the countries that have entered EU-IMF loan programmes (Greece, Ireland, and Portugal), does not preclude discretionary choice in the countries affected over how and where the burden of adjustment will fall. As Gourevitch noted, 'policy requires politics' (Gourevitch, 1986: , p.1).

Dimensions of crisis

The empirical starting point of this paper is the significant variation between countries in the sources, effects, and implications of the crisis. In the face of common challenges, we discern different experiences in the mix of distress they experienced. This provides the context for understanding variation in the choices countries faced and the policy mix with which they responded. As Figure 1 shows, countries were affected to very different degrees by recession and unemployment. Ireland and Spain were among the Eurozone countries that suffered the sharpest falls in growth and the steepest increases in unemployment in the first year after the crisis hit in 2008.

Figure 1. Change in growth and unemployment profile, 2007-2009

The crisis threw many countries' fiscal strategy into turmoil. Where recession hit hardest, the drop in economic activity depressed tax receipts, while the rise in unemployment increased pressures on government current spending in the form of automatic stabilizers. Figure 2 shows that there was a good deal of variation in the degree to which countries' fiscal stance was disrupted.

Figure 2. Change in debt and deficit profile, 2007-2010

Within the Eurozone, Portugal and Greece were already encountering fiscal deficits prior to the onset of crisis. But Ireland and Spain entered the crisis with very low accumulated debt burdens, and both ran primary surpluses during most years of the 2000s. The very sharp deterioration in Ireland's deficit profile in 2010 is due to the scale of transfers to the distressed banks, which pushed its deficit to 32% in that year. The underlying public deficit was about 12% at this point.

The fiscal deterioration profiled here has rather different sources. We must distinguish between countries in which the principal problem is centred on management of the public finances (that is, as a result of a problematic mismatch between spending commitments and the tax take, whether this is due to slow growth, or poor revenue compliance, or both), and countries in which, while there may also be a crisis-related public deficit issue, the size of the deficit is compounded by a banking crisis. Figure 3 provides a schematic representation of these categories of crisis.

Figure 3. Differentiating between types of debt problems

In this simplified categorization, the USA, the UK, and Japan may be seen as having a 'dual' problem of financial and fiscal exposure; but these are large economies with control over their own currency. A number of countries are categorized as having a low-problem status on both financial and sovereign debt because they did not experience a major banking crisis, and because either their deficit and debt burdens are modest, or their debt and deficits are large (as in the case of Italy and Belgium) but largely domestically owned (Gros, 2011; McKinsey Global Institute, 2012: , p.5).

The countries in the problematic 'GIPS' group (Greece, Ireland, Portugal, Spain) have suffered greater uncertainty in their capacity to borrow on the international bond markets, but for different reasons. Greece and to a lesser degree Portugal can be understood as having problems that are primarily to do with their capacity to fund their sovereign debt. In contrast, Ireland and Spain, while experiencing sharp public deficit problems as a consequence of recession – intensified in both cases by the sudden collapse of a construction boom and house price bubble – also have problems with distressed banks which aggravate their debt problems.

The dependent variable that we seek to explain in this paper is the nature and profile of the fiscal response to economic crisis adopted by Ireland and Spain. Figure 4 below summarizes the overall impact of fiscal response in OECD countries between 2008 and 2010.

Figure 4. Fiscal response to economic downturn, 2008-2010

This shows that the two countries with the most similar experience of crisis – Spain and Ireland – adopted very different initial fiscal responses (Tarrow, 2010). In Spain, the initial response to crisis involved a commitment to the politics of fiscal stimulus. A combination of tax cuts and spending increases was put in place to sustain demand, support growth, and attempt to alleviate emergent unemployment. In contrast, Ireland displays the most extreme version, among the OECD countries surveyed here, of an 'orthodox' strategy of fiscal austerity. A combination of tax increases and spending cuts produced a sharp contraction in fiscal effort. The commitment to austerity politics did not prevent Ireland from entering an EU-IMF loan agreement in November 2010, under the terms of the European Financial Stability Mechanism. How can we explain these contrasts?

In addition though, we must note that while Ireland continued on its contractionary fiscal path, and with measures that became ever more severe, Spain altered fiscal course during 2010 and turned toward austerity measures. The specific trigger in both cases was the intensification of the Greek crisis, which resulted in its requiring a special loan agreement, the European Financial Stability

Facility, in May 2010. Thus by 2010, Spain's fiscal response had converged with that of Ireland. How can we explain policy choices over time in the two countries in the context of shifts in the European economic environment? More specifically, we need to call upon the analytical resources of single case study research design, to explore within-case variation over time, to expose the dynamics of choice in Ireland (where the policy stance remained unchanged) and in Spain (where a dramatic policy reversal took place) (Mahoney et al., 2008; Bennett and Elman, 2006).

Explaining policy choice

Our method of progressing is first to identify key moments of fiscal policy choice in both Ireland and Spain. We then seek to identify the context of decision-making, the decision set open to political leaders, and the factors shaping their priorities. The objective is to identify the key variables required to generate good explanation. The next stage in the analysis will be to undertake a more rigorous process-tracing analysis, to explore to what extent and in what ways our hypothesized explanatory variables in fact shaped decision-making, and which may carry the greatest explanatory weight (Collier, 2011). The intention is to do full justice to the complexity of real-world decision-making, by identifying the importance of variation in the conditions obtaining at different moments in time – taking time serious, in other words (Grzymala-Busse, 2011; Bennett, 2010; Pierson, 2004).

Our explanatory variables are drawn from the rich literature on historical institutionalism. We share the power-distributive view that existing institutional structures are not neutral areas of decision-making, but reflect the preferences and priorities arising from earlier policy conflicts between different groups of actors (Mahoney and Thelen, 2010). Economic actors' interests are shaped by the broader political economy context of policy choice, particularly by the nature of the productive capacities of the economy, as well as by the organizational resources available to them. Politicians' decision-making processes are shaped by the kinds of coalitions they are required to build, to support particular policy preferences. This requires us to understand variation in partisan preferences, the constitutional framework within which these are articulated, as well as the broader coalitions of social support they need to mobilize, and the resources available to them to build networks of policy implementation in the wider society. These may well change over time, of course, , since the terms of political debate on both left and right have changed over time, a feature especially clear in the case of the accommodation on the part of many European Social Democratic parties to the logic of market competitiveness (Hall, 2011, forthcoming). The run-up to crisis and the impact of crisis has been highly differentiated across Europe between those countries in which domestic institutions have facilitated cost containment and internal deflation on an ongoing basis,

and countries in which this was not the case (Scharpf, 2011). Managing cost-based adjustments is all the more difficult when downward wage flexibility is at issue during a crisis. More generally though, countries that have a capacity for structured political engagement between organized economic interests may have greater scope for building legitimacy for fiscal consolidation than countries in which this is not present. We also accord independent weight to the role of 'ideas', that is, the taken-for-granted assumptions about how the world works and what policies are most appropriate at any given time. These may also be subject to change over time (Schmidt, 2010). But politicians are likely to deem some policy prescriptions to be more plausible than others to meet current needs. Policy choice is not only shaped by vested interests and conditioned by an existing institutional landscape, but it may also seek to achieve one set of objectives over another, in ways that intensify the institutionalization and therefore plausibility of a particular configuration of values (Hall, 1997; Blyth, 2002). Finally, we consider the external economic environment and the weight of exogenous influences – specifically, in this case, those emanating from EU and Eurozone decision-making institutions on the one hand, and the pressures stemming from market forces on the other. These too may exert varying influence, at different moments, over the decision-making of individual countries.

Fiscal responses to crisis

Governments face choices over the mix of fiscal policy responses they adopt: expansionary or contractionary; spending-based or revenue-based; rapid or gradual; large or small in scale; progressive or regressive in distributive effects. From these possibilities, we may construct two ideal-type modes of combining policy choices, each of them a 'pure' form of one kind of response. Of course, real policy choices may feature mixed strategies, and variations in governments' other policy preferences as well as the policy constraints the face will shape the combination of strategies adopted (Mulas-Granados, 2003; Mulas-Granados, 2006). Figure 5 sets out a schematic representation of varieties of fiscal policy response.

Figure 5. Typology of fiscal policy choice

The basic distinction is between an 'orthodox' and a 'heterodox' response to fiscal imbalances. The 'orthodox' approach accords primacy to deficit reduction and would imply a contractionary effect on the economy. It is an approach variously labelled as neo-classical, in the context of economic theory, or neo-liberal, in the context of an ideological or partisan prioritization of market conformity. The strategy is conceived of as signalling a credible government commitment to stabilizing the

macroeconomic framework, thereby indirectly contributing to restoring growth through improving conditions favourable to investment. In contrast, what is in the current context viewed as a 'heterodox' strategy follows from a Keynesian response to economic downturn, in which an expansionary fiscal stimulus is held to act counter-cyclically to restore the conditions for growth directly through increased demand.

The timing of the pure form of the 'orthodox' contractionary approach is early and preemptive. If fiscal consolidation is to be a key objective for government, the expectation would normally be that the sooner this is undertaken the better. 'Shock therapy', or front-loaded adjustment – the 'cold shower' effect – is likely to be the preferred way of doing this since, once again, the longer it takes to achieve an adjustment, given that the objective has already been adopted, the more painful and the more costly it will ultimately be. The principal means of achieving this kind of adjustment is through cuts to public spending. This is not to say that increases in taxation are precluded; rather, it suggests that the greater part of the adjustment is achieved through spending cuts.

In contrast, the 'heterodox' expansionary approach may well entail incurring a larger deficit, and indeed, very sizeable fiscal surpluses, on a scale that would enable stimulus measures to be taken in a downturn without recourse to borrowing, have not been common during the 2000s outside the Scandinavian countries. The lessons of their banking crisis in the early 1990s gave rise to strong financial sector regulation and a precautionary fiscal policy stance that left them well prepared for the current crisis. Deficit-incurring expansion implies that fiscal consolidation will eventually have to be addressed. But the fiscal stabilizing measures are likely to be delayed in order to permit the growth-promoting effects of stimulus to take effect. The size of the expansionary effect is likely to be gradual, since multiplier and other effects are not immediately palpable. And although the composition of stimulus policies need not be particularly biased toward either spending increases or tax cuts, in developed economies with large public sectors, the design of stimulus packages is on balance likely to lean toward tax reduction as a direct means of increasing demand, often complemented by packages of targeted or sectoral spending stimulus.

The profile of the Irish fiscal policy response to the economic crisis since 2008 has been quite consistently 'orthodox'. From an initial preemptive cutback in public spending early on (in July 2008), through a succession of budgets and expenditure adjustments, the Irish government has displayed a steady commitment to the politics of fiscal retrenchment. Moreover, the government has been quite explicit about the need to cut back public spending, and the position adopted has been that even in the context of increases in revenue, the balance between spending cuts and tax increases is to be in

the ratio of about two to one. Restoring fiscal discipline is constantly viewed as the precondition to the resumption of economic growth. This stance is maintained across a change of government, from the centre-right Fianna Fáil-Green coalition which held office from 2007, through the entry it negotiated to the EU-IMF programme in November 2010, until it lost power in February 2011, and onward to the Fine Gael-Labour centrist coalition that has been in government since then.

In contrast, the profile of Spanish fiscal policy shows a temporal change in strategic orientation. The initial policy response to crisis is one of classic Keynesian fiscal stimulus: the Spanish Socialist government of Zapatero adopted a strong expansionary stance, contending that the sudden shock to economic performance required direct fiscal supports to growth. They held this counter-cyclical position throughout most of 2009. Government speeches reiterate the primacy of the need stimulate the economy, to protect employment, to ensure that welfare beneficiaries are well protected. The same government then came under severe market pressure to modify its stance. During 2010, it adopted a commitment to introducing austerity measures. At first these were to have been gradual in impact. But the intensifying Greek crisis in May 2010 induced a sudden shift in orientation. The government then adopted classic 'shock therapy' or 'cold shower', featuring deep spending cuts, an orientation that intensified further during 2011.

The profile of the two countries' trajectories is summarized in Figure 6 below.

Figure 6. Summary profile of Irish and Spanish fiscal measures, 2008-2011

Irish fiscal strategy – the orthodox approach

The Irish fiscal adjustment spans six moments of fiscal adjustment between July 2008 and December 2011, outlined in Figure 7.

Figure 7. Summary of Irish fiscal policy decisions

The content of these budgets and expenditure adjustments make it clear why the older conventional approach to fiscal stabilization is inapplicable to policy choices in the current crisis. Notwithstanding a massive fiscal effort to date, and regular recalibrations of the deficit reduction timeline, the size of the effort required has had to be adjusted upward repeatedly. The deterioration in GDP, the rise in unemployment, the sliding revenue totals, forced year-on-year revisions of the size of the deficit and the scale of the adjustment required.

In addition, three reviews of the likely scale of bank losses and recapitalization requirements resulted in escalating upward adjustments to estimates of the public liability incurred in September

2008. What is particularly striking about the Irish strategy though is the early and consistent view that closing the deficit was an urgent priority, and that spending cuts were the most appropriate way of doing this. As the crisis advanced, ever greater cuts were imposed, and sharper increases in taxation, but the balance lay with spending cuts.

As Figure 7 indicates, we may consider Ireland's fiscal strategy in six phases.

1. July 2008: Expenditure adjustment

Public spending during the boom years had increased rapidly year on year. 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 (OECD, 2009). Government relied ever more heavily on buoyant revenues from construction-related activities. But the house-price boom had already stalled, and employment in construction had peaked in the second quarter of 2007 (Dellepiane and Hardiman, 2012). The underlying vulnerabilities of the fiscal situation did not come into political focus for some time, since the leading Fianna Fáil party was going through a protracted change in its leadership in the first half of 2008. Incoming Taoiseach Brian Cowen and his new Minister for Finance Brian Lenihan made some precautionary cuts to public spending, mostly in discretionary areas that had expanded over time such as outsourcing consultancy, advertising and public relations activities.

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. Access to low interest rates had resulted in a surge in borrowing capacity and inward capital flows. The domestic banks used this finance to engage in large high risk lending to the commercial and residential property sectors. Poor corporate governance practices, and in particular inadequate risk management, had led to increased opportunities for mismanagement. 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, including the UK and the US, where 'billions and billions of taxpayers' money are being poured into financial institutions' (Carswell, 2008).

When the scale of the implications became clearer, it would appear that the European Central Bank exerted pressure to insist that no measures should be introduced to require burden-sharing by the private sector (or at least not until the permanent European debt resolution facility came into effect in 2013). The consequence was that the total liabilities of the domestic banks were in effect to be borne by the taxpayers. The story of Irish fiscal adjustment, the size of the deficit, the scale of the debt, follows from this decision.

2. October 2008 –Budget 2009

However, even without the bank guarantee, there would still be a fiscal deficit problem in Ireland. Ireland's capacity to borrow on international markets was becoming more expensive, and Ireland seemed increasingly likely to be paired with Greece in the judgment of the bond markets. In October 2008, the European Commission launched excess deficit procedures for Ireland, Greece, Spain, France, Latvia and Malta, under the Euro Stability and Convergence Programmes (SCPs). From a small surplus in 2007, the Irish deficit was estimated at 6.3% GDP in 2008, and was expected to widen to 9.5% in 2009. The Irish Stability Programme was intended to work toward reducing the deficit to below 3% GDP by 2013, assuming a recovery in economy activity after 2010.

In response to this, the government brought forward the Budget for 2009 from December to October. The Budget undertook various spending cuts, among the most controversial of which was a plan to means-test medical card entitlements for over 70s. Remarkably, while student protests attracted relatively little attention, a massed street protest by older people led government to reverse this decision. Given the short time-frame for developing the budget, tax increases were imposed that fell outside the normal design of allowances and exemptions: direct income levies were introduced, tiered by income at 1, 2 and 3%, on all employees.

For a time, this seemed to calm the bond markets and to break the emergent linkage that had become apparent between the evaluation of Ireland's and Greece's fiscal prospects. Ireland's ratings stabilized at a high rate while Greece's continued to go up.

3. February 2009 – Expenditure adjustment

But the reprieve did not last long. As the economy dropped into recession and the revenue stream slowed, the projected deficit began to widen, and the bond markets grew more anxious. A new emergency measure was introduced in February 2009, which imposed a direct income levy on all public servants – termed a 'pension levy' – and this was the main plank of government's recovery plan for the year. But it was not in fact hypothecated to fund the pension reserve: it was rather a

means of getting toward the planned €1.4bn adjustment. It was set at a rate of 3% for those earning €15,000 per annum, rising to 9.6% for higher-paid employees. This generated discontent among public sector employees, particularly as media commentary began to feature ever more unfavourable comments about job security, relative income advantage and assured pension entitlements for public sector employees.

4. April 2009 – Supplementary budget

Despite two budget interventions, the fiscal situation continued to deteriorate during the spring of 2009, causing government to introduce yet another emergency budget. This increased the levies on all incomes, doubling the rates announced in October 2008 to 2%, 4%, and 6%. It also imposed charges for most potential users of hospital A&E (that is, anyone without a medical card which was means-tested with a low threshold), and on in-patient daily hospital charges.

By mid-2009, it was clear that the Irish banks were not able to lend to the business sector because of the scale of the distressed loans they were carrying, which further intensified the crisis. In late 2009 the government set up the National Asset Management Agency, a special-purpose vehicle that would support the recapitalization of the banks indirectly, by taking over control of the assets relating to non-performing property loans, and providing bonds at a discounted rate (controversially priced 'haircuts' that required complex individual calculations). Government appeared to treat the measure as a means of improving bank liquidity, but many observers noted that insufficient attention was being paid to the likelihood that the banks were actually insolvent.

5. December 2009: Budget 2010

The public sector unions held another one-day strike and street protest in November 2009, in anticipation of harsh measures in the forthcoming budget. And they were right to worry. Government decided to seek €4bn in spending cuts for the coming year, €1.4bn of which was to come directly from public sector pay. The Irish Congress of Trade Unions had proposed to find cost savings in line with the aims of Budget 2010 in the context of the social partnership process that had shaped pay negotiations since 1987. But the government chose to reject these plans, and the 'Financial Emergency Measures in the Public Interest (No. 2) Act 2009', drawn up within the Department of Finance, imposed direct headline cuts on public sector pay. These pay cuts were to be tapered by income tiers, and would result in overall reductions in annual salaries of 5-7% up to €125K, and 8-15% on those earning over that sum. The way these were implemented was controversial though, especially since most senior public service staff only suffered cuts of 3% instead of the anticipated 11.8% (Industrial Relations News, 2010).

Also controversial were the cuts on all categories of welfare recipients. The Minister for Finance, in his Budget speech, suggested that the impact would be softened by price deflation, particularly in food costs; and that many welfare payments had risen more rapidly in the Republic than in Northern Ireland and Britain during the boom. However, the cuts were not specifically targeted at improving labour market activation but were imposed on all categories of welfare dependents. Other measures included a public recruitment embargo, and a public sector rationalization plan which would result in 14 fewer agencies.

Again, the aim was to put distance between Ireland and Greece with decisive action. This preemptive approach to fiscal consolidation was widely lauded as exemplary and a model to other countries under pressure: 'In a week when Greece and Spain both saw their credit ratings under attack, the budget at least gave the government an opportunity to reassure international investors that Ireland, unlike some other EU countries, is serious about controlling its budget deficit and public-debt burden' (The Economist, 2009).

The Greek debt crisis continued to rumble along for several months, and eventually resulted in the creation of a new EU loan facility in May 2010. But the EU response was not designed as a measure to address either the possibility of other sovereign debt problems or the continued problems of fragility in the financial sector. And by now it had become clear that the crisis was not confined to the European periphery, but implicated various large-country banks whose lending portfolios were very exposed to them. Thus, 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, 2011a).

Addressing the weaknesses in the Irish banking sector was a long-drawn-out process. In July 2010, the two principal Irish banks, Bank of Ireland and Allied Irish Bank, passed the European stress tests. These tests were generally held to be too soft; but it appeared that the ECB did not wish to lean too hard on any banks at this time, and perhaps least of all the German banks.

6. December 2010: Budget 2011

In the course of 2010, GDP fell more than anticipated, and the scale of fiscal consolidation that would be required to meet the 2010 3% deficit target continued to escalate. The effort required to rescue the distressed banking sector also increased, and the new 'worst case scenario' estimate for bank bailout in the autumn of 2010 was €51bn (a figure that would go up again in spring 2011).

In September 2010, the government projected that the fiscal consolidation required in 2011 would now be €3bn. The estimated total effort required between 2011 and 2014 had stood at €7.5bn. Now a revised estimate indicated that €15bn of fiscal consolidation would be needed to meet the Stability Programme deficit targets.

At this time, government spending needs were fully funded into mid-2011 and there was no immediate need to return to the bond markets. There was no immediate prospect of any sovereign debt default. But by the end of November, Ireland had entered into a loan programme with the EU and the IMF. How did this come about, and so quickly?

It was the lack of any European framework for resolving the banking crisis that pushed the Irish government into this outcome. The Irish banks were locked out of international lending markets. But the European Central Bank exerted pressure to prevent the government from requiring any private sector involvement in sorting out their debts. The government had been constrained to renew the bank guarantee in September. Investors were slowly haemorrhaging abroad. The banks were becoming ever more heavily reliant on short-term liquidity from the ECB. It would appear that pressure came from the ECB to require the Irish government to seek a loan agreement until 2013 in November 2010 (Economist, 2010). By 2011, the Irish banks were being kept afloat on about €100bn in ECB loans at very low interest rates of 1%, plus a further €70bn in liquidity provided by the Irish central bank (and ultimately underwritten by the ECB) (Brown and Atkins, 2011).

That the ECB's role had indeed been pivotal was confirmed by Brian Lenihan in a wide-ranging interview he gave in April 2011, after he had left office. He recounts that neither the European Commission officials nor the IMF were concerned about the Irish situation, and that the ECB 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 terms of the €85bn EU-IMF loan package were controversial. They included an obligation to deploy the National Pension Reserve Fund in the front-line of bank recapitalization plans. The interest rate on the tranche of the loan extended by the ECB was subject to a higher interest rate than expected – a subject of contention since then.

In November 2010 therefore, the Government announced in its National Recovery Plan 2011-2014 that, consistent with the terms of the Memorandum of Understanding with the ECB and IMF announced at the same time, it would front-load its fiscal adjustment process. On the framing of

the 2011 budget that implemented the Plan, Lenihan later said: 'I was concerned that once we went beyond the figure of €4.5 billion adjustment, about the economic damage it would do to the country, and I was unhappy at having to put the figure much higher than that' (O'Brien, 2011). In the event, a total of €6bn was to be taken out of the economy in 2011 (Department of Finance, 2010).

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. At this point, national per capita income was already 20% lower in 2010 than it was in 2007.

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 to cover an extra 300,000 people, bringing the total from 45% to 60% of the workforce. The other key measure was the introduction of a Universal Social Charge, which replaced both the existing income levy and the health levy (also known as the health contribution) on 1 January 2011. The national hourly minimum wage was cut by €1 to €7.65, with a view to increasing low-end labour market flexibility.

However, 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, rigidities in some of the professions, and so on.

The Fianna Fáil-Green coalition's support in the polls had been sliding steadily over time. 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, historically the 'predominant party' in Irish politics, was very striking (Gallagher and Marsh, 2011).

In February 2011, the incoming Fine Gael-Labour coalition won a convincing majority of seats. But the change of government did not betoken a change of strategy. The new government accepted the framework of the national recovery plan because it was tied into the Memorandum of Understanding on which the EU-IMF funding depended. It secured some flexibility in the balance of

spending and revenues in order to channel funding into a relatively modest 'Jobs Programme', based on small reductions in taxation in tradable sectors such as tourism and food processing. Funding for this came in part through a controversial levy on private sector pension funds. But fiscal choice is tightly constrained by the Memorandum of Understanding which requires that any such measures be revenue neutral; no stimulus package is possible.

The new government had made a range of pre-election promises about renegotiating some of the details of the EU-IMF loan agreement, particularly on changing the interest rate on the portion loaned by the EU – 'it's Frankfurt's way or Labour's way', according to Labour Party leader Eamon Gilmore (McGee, 2011). But it proved impossible to obtain any concessions.

If a change in the interest rate were to be made conditional on Ireland raising its 12.5% corporation tax rate, as some European leaders urged, the government has insisted that this could not be conceded, since all governments have held the low corporation tax to be a vital attraction for FDI, particularly by US firms. Without the multinational exporting sector, Irish growth prospects would be dismal indeed.

The fiscal burden of rescuing the banks has proved to be extremely onerous. There were three moments of attempted final bail-out of the banks, following stress tests in March 2010, September 2010, and then again in March 2011. The running cost of rescuing the banks rose from an estimate of €5.5 billion in late 2008, to €11 billion in the first half of 2009, to €35 billion in March 2010, to €46 billion in September 2010, by which time the total bank recapitalization requirements totalled about €70bn, in what was announced as the last and final upward revision of the cost of bailing out the Irish banks (Irish Times, 31 March 2011). Fine Gael Finance Minister noted that 'The state will be committing approximately 45 per cent of gross domestic product in the banks in a two-year period' (Noonan, 2011). Losses at the Irish banks and the foreign lenders in Ireland topped €100 billion. In an ironic though unintended reversal of Lenihan's early claim about how lightly Ireland would get out of its bank bailout, the Governor of the Central Bank Professor Patrick Honohan called this 'one of the costliest banking crises in history' (Carswell, 2011b).

The Irish government made massive fiscal efforts, but with relatively little visible fiscal retrenchment. By end- 2010, despite already massive fiscal consolidation efforts, the size of the 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, 2011a). (It should be noted that this implies about 150% GNP). 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) amounts to €30bn, equivalent to about 20% of 2010-level GDP.

Spanish fiscal strategy – from heterodoxy to orthodoxy

Spain's approach to fiscal decision-making can be seen as falling into five phases, as summarized in Figure 8.

Figure 8. Summary of Spanish fiscal policy decisions

1. October-December 2008: Budget 2009

The Spanish government's first response to the emergence of international economic crisis was to claim that its relevance to Spain was minimal. Re-elected in March 2008 at a time when concern was already mounting, as in Ireland, over the sustainability of the housing boom, Socialist Party (PSOE) Prime Minister Zapatero initially preferred to characterize the situation as an economic slowdown, through which the hoped-for 'soft landing' would resolve the asset price bubble painlessly. Moreover, 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 proved electorally popular, even though it eventually weakened the bases of government's fiscal capacity in the context of mounting crisis. The government implemented its 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; European Commission, 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%.

2. October-December 2009: Budget 2010

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. The Budget for 2010 was primarily based on revenue-increasing measures such as withdrawing the earlier tax rebate and increasing VAT, which raised taxes 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, in contrast, argued for spending cuts to be introduced.

3. January 2010: Emergency measures

Like the Irish government, the Socialist government found itself increasingly pressed by the changing international environment to adopt more stringent fiscal measures. In early 2010, in the context of growing uncertainty about Greece's capacity to meet its borrowing requirements, the Spanish government announced two new rounds of measures: the Plan de Acción Inmediata 2010 and the Plan de Austeridad 2011-2013. Together, these aimed to accelerate the speed with which the deficit would be reduced, by introducing spending cuts of 0.5% of GDP, a freeze on public sector recruitment, and other cost control measures.

4. May 2010: Emergency measures and a shift in policy orientation

Zapatero's stance underwent a radical change after May 2010, in the wake of rising market uncertainty triggered by the financial rescue plan for Greece. In what was depicted as a 'Copernican shift' in the government's stance, a new emergency budget intensified the pace and impact of the deficit reduction programme announced in the 2010 Budget, and switched from a revenue-based to a spending-based strategy. The dramatic shift in fiscal strategy 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% - 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). These measures represented a radical break from the government's prior fiscal stance, and a very difficult moment for the 'social Zapatero' who had insisted upon the primacy of Social Democratic priorities over market pressures.

5. October-December 2010: Budget 2011

The Budget for 2011 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 this 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 government continued to protecting 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').

In summary, the Spanish government's fiscal response contrasts dramatically with that of Ireland. Starting with a commitment to counter-cyclical measures, the government was obliged during 2009 to acknowledge that the Spanish economy was encountering something more than a temporary downturn, and to take some more conventional deficit-control measures. The dynamic of international events, particularly the instability in the bond markets stemming from the Greek crisis, changed the situation dramatically in mid-2010. From then on, the Socialist government was constrained to adopt a more orthodox approach to addressing the fiscal deficit. And yet the PSOE tailored the package of measures in a manner that was clearly intended to protect its core electoral constituency, as well as finding its justification in the ideological preferences characteristic of a leftist party: protecting welfare and maintaining social spending were declared to be core principles. While 'orthodox' in its fiscal consolidation objectives and its embrace of spending cuts, it still relied on

revenue increases for about 60% of its adjustment effort (IDEAS, 2011). And although reducing public servants' pay was as challenging in Spain as in Ireland, the cuts were less severe in Spain.

Explaining fiscal policy responses

The contrast between the Irish and the Spanish experiences has been drawn quite strongly here. At first, Ireland was a classic exemplar of an orthodox response, while Spain displayed a distinctively 'heterodox' approach until well into 2009. As the crisis intensified, Ireland maintained its commitment to austerity politics, and intensified it. Spain, however, undertook a policy U-turn in May 2010, as it found itself increasingly constrained in its fiscal policy choices. Our cross-case comparison also permits us to consider both contrasting starting positions, and also within-case variation over time, the better to understand the choices and the limits to fiscal policy choice in hard times.

We start first by seeking to explain why Ireland and Spain displayed such different policy responses between 2008 and 2010. As Figure 4 showed, Spain's response was stimulatory and heterodox, while Ireland's was contractionary and orthodox. We then consider why Spain's policy stance shifted during 2009 and 2010, so that by 2010, its policy stance had converged with Ireland's, and both were committed to implementing orthodox cost-cutting measures. Yet even then, as we have noted above, the composition of the adjustment in each case retained distinctive features. Ireland implement spending cuts and tax increases in a ratio of 2:1 while Spain displayed the reverse preference, with a ratio of some 2:3 between spending cuts and tax increases.

Divergent policy responses in Ireland and Spain, 2008-2010

Taking account of the explanatory variables outlined earlier in this paper, we draw upon a range of considerations to identify why the Irish and Spanish responses to crisis diverged initially. We first consider the initial fiscal conditions in which crisis was experienced, and then look at the composition of economic activity and the degree of exposure of each economy to international pressures. The unrolling crisis was experienced differently in economies that had dissimilar strengths and vulnerabilities. We then consider the significance of partisanship for government decisions, including electoral calculations affecting government preferences. In this context, we are also interested in the prevailing ideas that coloured political debate and informed the menu of strategic choices in each case. We are also interested in the profile of social dialogue and the role of social pacts in shaping the decisions governments adopt. These explanatory variables are summarized in Figure 9 below.

Figure 9 . Explaining divergent policy responses in Spain and Ireland, 2008-2010

1. Initial conditions in fiscal stance

The initial conditions in which fiscal consolidation strategies are undertaken can have a significant bearing on the choices governments make. Countries with fiscal surpluses or small deficits, and low accumulated debt, should have more scope for discretionary policy choice as between stimulus and consolidation. And when they do turn toward fiscal consolidation, the choice between taxation increases and spending cuts may be conditioned by their circumstances: 'The anticipated split between revenue and expenditure measures within the consolidations tends to reflect the initial revenue ratio; countries with relatively high revenue-to-GDP ratios are less likely to rely strongly on planned revenue increases' (European Commission, 2010).

As Figure 10 shows, both Ireland and Spain had good initial fiscal conditions, running surpluses and relatively low levels of accumulated debt throughout most of the 2000s. Both entered the crisis with better fiscal manoeuvring room than either Greece or Portugal. As late as 2009, in a symposium organized by the Banca de España, expert assessment of Spain's membership of the Euro was on the whole very positive (Jimeno, 2009). Yet these governments chose to adopt different strategies in response to crisis. This is underdetermined by technical features of their respective starting points. Policy choice is always mediated by politics.

Figure 10. Evolution of revenue and spending, Spain and Ireland

Within a year of the start of crisis, their relatively healthy-looking starting points looked less convincing. Ireland's fiscal conditions deteriorated rapidly as underlying weaknesses in the revenue base and the over-reliance on both construction and financial services quickly became apparent. The Spanish conditions proved more robust at first, which facilitated the initial counter-cyclical fiscal strategy. But in both cases, the proverbial 'hard landing' quickly came to pass, as the 'brick economy' foundations of their recent prosperity collapsed.

2. Economic structure and interest coalitions

Both Ireland and Spain had similarly been 'cohesion states' within the EU during the 1980s, with significantly lower living standards than the European average; both then enjoyed rapid catch-up growth during the 2000s, fuelled by the surge of capital available to them after they joined the Euro. But apart from their relative size (Ireland's population, at about 4.5m, is one-tenth of Spain's 46m), their economic structure was very different, and this shaped their respective orientation toward

fiscal strategy and indeed toward the composition of consolidation strategy. Figure 11 captures some of the key similarities and contrasts.

Figure 11. Key data for Ireland and Spain, 2003-2010

By the late 2000s, Ireland had an extremely open economy, and the total trade to GDP ratio was about 160% when the crisis began. Its industrial development strategy had long depended on attracting inward investment in manufacturing and increasingly in internationally traded services, and it valued its status as a low-tax, English-speaking platform for access to European markets. Ireland was therefore strongly integrated into the Anglo-American business environment; it fits quite well into Hall and Soskice's model of a liberal market economy (Hall and Soskice, 2001). Economic openness meant that fiscal stimulus would not be an effective means of generating growth, and the experiences of a similar fiscal experiment in the late 1970s, in which stimulus leaked away into exports and public spending ballooned while unemployment hardly moved, made policymakers poorly disposed toward Keynesian measures (Lane, 1998). And while the public sector and welfare recipients would be most adversely affected by cuts in public spending, they were unable to veto a strategy that was deemed to be essential to restoring both financial credibility and business confidence. The credibility of the dominant domestic economic coalition of the 2000s, which enabled property developers, builders, and bankers to gain a close political hearing while remaining relatively free of intrusive regulatory controls, had been spectacularly shattered. In a context in which bank lending was all but immobilized, government was deeply concerned to create conditions under which credit might begin to flow again. These are the concerns that underlay the original blanket bank guarantee; these are the considerations that persisted since late 2008.

In contrast, Spain is a markedly less open economy, with exports and imports summing to about 60% of GDP. It had experienced a highly successful transition to democracy and had implemented wide-ranging modernization of its economic, political and social institutions (Boix, 2005). It experienced rapid economic catch-up since joining the EU in 1986, and a cluster of Spanish multinationals had grown up, including powerful financial institutions such as Santander, which was the second-largest European bank after HSBC before the crisis hit. Both manufacturing and services sectors welcomed the initial approach to fiscal stimulus in response to crisis, particularly as a means of sustaining employment levels. The structure of the labour market is problematic, since many protective measures that had originated in the Franco era were retained during the 1980s and 1990s to facilitate the integration of the core working class into policies of market liberalization and democratic competition (Rueda, 2007). Employers sought flexibility through the creation of a dualist

structure of employment. As a result, when recession hit, unemployment levels shot up, and the principal victims were the younger and relatively more skilled workers who had been hired on short-term contracts (OECD, 2010b).

In both countries, as Figure 10 shows, the over-reliance on construction and the over-financialization of the economy during the 2000s were major weaknesses in their respective growth models, the collapse of which plunged both countries into recession. But the contextual conditions for selecting a strategy based on austerity or stimulus (initially at least) were very different.

3. Partisanship, electoral politics and public opinion

A clear difference in the partisan orientation of governments helps us understand the initial contrast between the fiscal adjustment strategies adopted in Ireland and Spain.

Partisan strategies of fiscal adjustment have been observed in Spain in the past (Mulas-Granados, 2006; von Hagen and 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 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). From spring 2010 onward, credibility issues began to trump partisanship considerations for Zapatero, and it proved more 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 balancing measures such as the apparently favourable treatment of wealth and of high-income earners. And the first general strike was held in September 2010.

The Irish party system does not feature a strong partisan left-right divide. Fianna Fáil has been a classic populist party, drawing on a broad spread of support from across all social classes. The Fine Gael-Labour coalition that took power in February 2011 similarly gains support from across a broad spread of social class support. Thus the government sought to portray the Fianna Fáil-Green

'orthodox' fiscal adjustment strategy as 'not beholden to any vested interests' (a phrase that recurs in Lenihan's budget speeches), and depicts the government as seeking to 'protect the disadvantaged' and 'the most vulnerable'. But in contrast to the Spanish case, where budget decisions had made clear distributive choices about whom to protect from the costs of adjustment, Irish governments were increasingly pressed to look for spending-based savings on every front, as well as increased tax revenues from across a broad spectrum. Some decisions raised eyebrows, such as the privileges accorded to higher civil servants noted earlier; lower-paid public servants felt themselves to be extremely adversely affected, as did many classes of welfare recipients. Overall inequality had not increased in Ireland during the boom. Economic analysts claimed that, compared with a baseline assumption of a 4% cut across the board for everyone, the distributive effects of the fiscal consolidation measures were broadly progressive in their impact (Callan et al., 2010). But households experiencing 'deprivation' increased from under 12% to over 17% between 2007 and 2009 (Central Statistics Office, 2009; Alderman, 2011).

Differences in the manner in which the costs of adjustment were distributed may be related to the structure of public opinion on redistribution. There is some evidence to suggest that 'the Irish public in general support individualist values in its interpretation of poverty and wealth, and that this stance co-exists with a structural view of poverty among people in lower socio-economic groups' (Hardiman et al., 2006: , p.). In contrast, strong support for the politics of redistribution has been discerned across a broad spread of Spanish public opinion (Svallfors, 2010).

In spite of attempts in both Spain and Ireland to protect their respective electoral bases as best they could, the crisis took a toll on the governing parties' electoral support bases. Figure 12 shows the steady slide in the polls over time in the aggregated support for Fianna Fáil and the Green Party, while the support of the main competitor parties, Fine Gael and Labour, taken together, shows a steady rise. Figure 13 shows that the decline in satisfaction with the government began soon after the 2007 general election, as scandals gathered around outgoing Taoiseach Bertie Ahern. Brian Cowen got a brief lift in the polls when he took over as Taoiseach in May 2008. But the gathering bad news about the economy – over which Fianna Fáil had presided since 1997 – resulted in a steady downward trend in their electoral standing.

Figure 12. Support for selected Irish parties, aggregated, 2007-2011

Figure 13. Confidence in government in Ireland, 2007-2011

Figure 14 shows that confidence in the PSOE government remained high in the early phase of the crisis, but worsening economic conditions eroded its support. The delayed recognition during 2008 and 2009 that a crisis on a larger scale was unfolding would eventually prove damaging to the PSOE's credibility (El Pais, 2010). But it was the about-turn in fiscal strategy during 2010, driven by the need to restore market credibility internationally, that started a steep decline in confidence in the government. A socialist deputy had said in May 2010 that 'today we lost the next general election'. It was indeed at about this point that opinion polls began to show the PP outstripping the PSOE in surveys of voting intentions, as Figure 15 shows. The regional elections of May 2011 brought heavy losses for the PSOE.

Figure 14. Confidence in the government of Zapatero, 2008-2011

Figure 15. Voting intentions in Spain, PSOE vs PP, 2008-2011

Nevertheless, what is remarkable throughout Zapatero's prime ministership is that even without a parliamentary majority (PSOE controlled 169 of 350 deputies, 7 short of a majority), the government managed to secure parliamentary support for its tough consolidation measures. Strong party discipline is part of the story, for although the unions withdrew their support, there were no party rebels in parliament. The PSOE faced a strategy of consistent parliamentary confrontation from the PP, even when they switched to an orthodox fiscal stance. But institutional features of the Spanish system enabled them to build coalitions of support in what is termed 'geometria variable'. After May 2010, Zapatero was able to build support among smaller nationalist parties, who obtained regional financial concessions in exchange for their support in the national parliament (relying in different groups depending on the issue in question). Delegation of policy control on a territorial basis secured support from the Basque nationalists (PNV) and the Coalición Canaria (CC). The orthodox measures the PSOE felt obliged to adopt were in any case likely to be appealing to the business and financial interests that provided the backbone of those parties' support.

4. The role of ideas

The explanatory power of prevailing 'ideas' is related to the profile of political partisanship, but it is not quite the same thing. What is meant here is the policy repertoire that proved most congenial and most appropriate to government, the reasons why one strategy can appear more plausible than another, and the wider yet diffuse spread of public opinion that also conditions government preferences at any particular moment.

In Ireland, successive Budget speeches prioritized the need to restore fiscal business to boost business confidence. For example, in his Budget 2009 speech in December 2008, Brian Lenihan said 'we must take the necessary steps to bring order to the public finances. This will instil confidence in those at home and abroad, who want to invest in our economy'. A year later, despite the mounting difficulties, and introducing an intensification of austerity measures, he stated that 'the Government's strategy over the last eighteen months is working and we can now see the first signs of a recovery here at home and in our main international markets'. And again: 'So if we cannot tax our way out of our difficulties and we all agree in this House that we cannot borrow our way to recovery then the only remaining option is to reduce our spending'. Introducing the first Budget under the EU-IMF loan, he commented that 'We got into this position by seeking, with the full support of those opposite, to spread the benefits of the boom across every section of the population'; and that 'In every measure I have introduced, on behalf of the Government, we have sought to stabilise our public finances'. The low tax regime had been justified in terms of seeking to 'reward work and investment'.

Prevailing opinion among professional economists at the outset of the crisis was that the most appropriate course of action was 'shock therapy': a quickly undertaken, massive fiscal consolidation, primarily based on spending cuts, front-loading the pain (McCarthy, 2010; Kinsella and Leddin, 2010).

The reasons for the prevalence of these views are not difficult to discern. The experience of fiscal consolidation during the 1980s seemed to have left this clear lesson as its legacy. That phase of fiscal adjustment – undertaken with the help of several currency devaluations – had been delayed somewhat by political instability and coalition disagreements. Once undertaken in earnest, which happened to take place under supportive international economic conditions, it was a plausible contributor to the restoration of growth conditions (Giavazzi and Pagano, 1990; MacSharry and White, 2000). But on another interpretation, it was not retrenchment in itself, but the competitiveness gains facilitated by devaluation, and the demand conditions emanating from the international environment, that enabled austerity measures to translate into growth in the late 1980s and into the 1990s (Barry and Devereux, 1995) (Perotti, 2011).

Critical voices came from the trade union movement, which pointed to the changed circumstances of this crisis and the risks of choking off growth prospects (Begg, 2009; Irish Congress of Trade Unions, 2009a; Irish Congress of Trade Unions, 2009b). But this view gained little political traction.

And public opinion in Ireland shows 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.

In contrast, the choice of economic strategy wa subject to regular and vigorous partisan debate in Spain. 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. Public opinion in Spain shows 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 and Rhodes, 2007).

5. Social pacts and legitimation

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.

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 it to secure support for a critical pension reform (from 65 to 67; the Irish government had similarly changed public sector pension entitlements from 65 to 66 for new entrants as a matter of budget decision) (Rhodes, 2011).

In the short term, the capacity to engage in social dialogue and to negotiate social pacts is likely to result in a more coherent economic adjustment path, and by making it more legitimate, ensure its viability (Molina and Rhodes, 2007; Pérez, 2000; Pérez-Díaz, 1993; Roche, 2009; Baccaro and Simoni, 2008; Culpepper, 2008). Social pacts were negotiated in both Spain and Ireland by governments of varying partisan composition. But social partnership may also have serious unintended

consequences. For example, 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 (McGuinness et al., 2010). In Spain, 'pactista' traditions have contributed to delaying reform of labour market rigidities that confer employment security to 'insiders' at the expense of other categories of workers.

Explaining convergence in policy choices in Spain and Ireland, 2010

The explanatory variables which we believe account for policy divergence in response to crisis are both structural and relatively invariant, and political and therefore variable over time. But what is particularly striking is that during 2010, Spain displayed a marked shift in policy orientation toward acceptance of the primacy of austerity measures. This shift had been presaged to some degree during 2009. But it was in May 2010 that the Zapatero government adopted a dramatic shift in priorities, and introduced the first budget aimed at reducing the deficit.

What had changed was not the partisanship of government, or the credibility of the ideas underlying the government's policy stance. What altered was the international economic context to which the government was required to respond. The key explanatory variables are summarized in Figure 16 below.

Figure 16. Explaining convergent policy responses in Spain and Ireland, 2010

1. The international economy and the role of the bond markets

We have noted in the narrative summary of the course of events in Ireland and Spain that as international conditions worsened, the decision-set open to each country changed.

In the Irish case, governments found that austerity measures did not bring the hoped-for credibility gains that would generate increased investment. The parlous condition of the lending institutions, the huge scale of whose indebtedness was revealed piecemeal, hindered business confidence. Declining consumer purchasing power in a barely-growing economy depressed demand. The goalposts continued to move, and the fiscal consolidation effort required seemed to become more difficult rather than more attainable. A consistently-followed path of austerity did not succeed in closing the fiscal deficit, while the volume of borrowing required remained sizeable. What was particularly difficult was that the bond markets, rather than rewarding the orthodox strategy with lower risk assessments, responded adversely to these challenges of fiscal consolidation. The downgrading of the Irish sovereign debt, as well as the problematic status of the Irish banking sector, resulted in a steady outflow of investment capital. Reliance on the ECB to provide liquidity to

the banking sector grew ever more pronounced. And the difficulties the government faced in trying to borrow on international markets became ever greater.

As Figure 17 shows, the Irish government was constantly playing catch-up to the markets. Irish sovereign debt was repeatedly downgraded during 2009-10, and by the time it entered the EU-IMF loan programme in November 2010, it was barely above junk bond status. European-wide developments are the main drivers of Ireland's fate now.

Figure 17. Credit ratings agencies – Ireland

The decision set facing Spain was initially more benign. The scale of impaired loans in the banking sector was not as great, and the over-exposure to housing did not dominate the economy to the same degree. The government had policy space to implement a fiscal boost at first. And even when it began to implement the projected fiscal consolidation, this could be introduced gradually, with a period of reflection available to assess the effects before the next stage was to be introduced. What caused the policy U-turn and threw Spain onto an 'orthodox' pathway was the spillover effects emanating from the Greek debt crisis. In the Spanish case, like the Irish, it was the adverse judgment of risk on the part of the ratings agencies, and the consequences for the behaviour of the bond markets, that pushed the government into a strategy that was intended to garner the approval of the international markets.

The Spanish case was less severely assessed on the international markets, but the credit ratings of Spain's sovereign debt have similarly suffered downgrades precisely when the government had hoped they would improve – that is, right after the dramatic shift in policy orientation and the adoption of an orthodox spending-based fiscal strategy (Mallet et al., 2011; Eurointelligence, 2010). Nevertheless, by March 2011 its ratings had only slipped from triple-A to the second notch, nothing like the precipitous fall suffered by Ireland.

The fear that Spain might need to be bailed out appeared to have been allayed after the Portuguese entry to the EU-IMF loan programme in April 2011. With over €500bn of public and private Spanish debt held by European banks and investors, any bailout would overwhelm the European capacity to extend a loan facility, the total amount of which, at €750bn, had already been so difficult to negotiate.

But markets are volatile and respond quickly to political signals. Both Ireland and Spain remained highly exposed to political decision-making at European level. Ireland was expected to exit the loan

programme sometime late in 2012. But as Figure 18 shows, the bond markets did not anticipate that this will be possible. The risk premium attached to Irish government debt remained stubbornly high. Spanish debt appeared at first to be assessed more favourably, not least because Spain actually did hit its deficit target in 2010 (9.2% against a projected 9.3%), and its total debt at 60% GDP was about 25 points below the European average. However, some of the emergent problems of expenditure control were displaced to regional level, where spending powers on health and education are mainly now situated. Spain's consolidation efforts, like Ireland's, continued after a change of government in 2011. But in both countries, meaningful consolidation looked increasingly difficult during 2011 and 2012, against a backdrop of continuing recession across the Eurozone.

Figure 18. Ten-year government bond yields in the European periphery

Conclusion

This paper has set out new approach to thinking about the politics of fiscal policy choice. We have used both a comparative case-study and within-case research design to increase explanatory leverage in analysing commonality and variation in fiscal responses to the current economic crisis. Selecting the cases of Ireland and Spain, both of which have experienced similar kinds of crisis, we have identified two dimensions of contrast between their policy responses. Initially, Ireland adopted a strategy of preemptive consolidation, while Spain undertook a strategy of fiscal stimulus to be followed by gradual consolidation. Over time, Ireland's stance remained totally consistent, varying only in intensity. It was committed to a total adjustment of €30bn between 2008 and 2014, two-thirds in spending cuts and one-third in revenue increases. Spain shifted strategy during 2010, and adopted a fiscal consolidation approach. But this was almost a mirror image of the Irish experience, since it amounted to an adjustment based on 40% spending cuts and 60% revenue increases.

We have identified several explanatory variables that shaped the decision-set facing governments at each critical policy moment. We argue that the profile of economic policy choice is always mediated by political considerations: the structure of economic interests shapes the terms of debate and conditions the terms in which choices are framed, and partisanship makes a difference. Bit we have also identified an ongoing tension between political imperatives and economic pressures: as contemporary capitalism has come to depend on increasingly integrated capital markets, national decision-making becomes more vulnerable to market evaluations of risk. Transnational decision-making at EU level can change the markets' risk evaluation of member states' sovereign debt. But the institutional structures to facilitate the requisite collective action are as yet weak. We have

shown that the spectrum of choice therefore narrowed drastically for both Ireland and Spain as the European dimension of the crisis loomed larger.

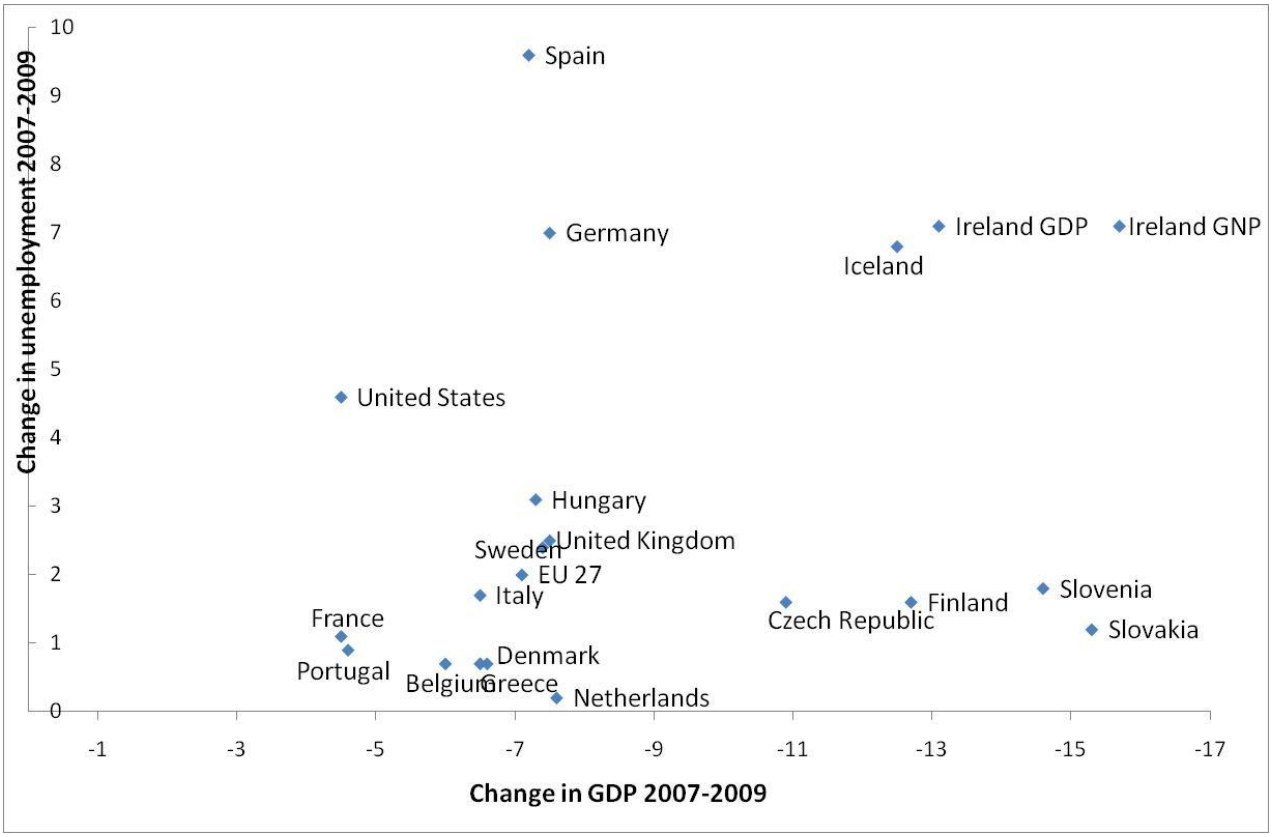
A further implication of our findings is that much of the established literature on fiscal consolidation is no longer applicable to the current situation. Our qualitative approach seeks to provide a nuanced account of the policy choices made by governments over time, and a sophisticated account of the causal complexity underpinning these choices. The methodological advantages of this approach are that we can uncover the interplay between variables that has produced a new politics of austerity that may escape the reach of quantitative modelling.

Our findings throw into question some of the generalizations established by the earlier literature on fiscal consolidation. Firstly, the underlying assumption in the earlier period was that fiscal contraction would generate new growth opportunities in the medium term, by signalling the credibility of government's self-binding commitments to investors (Alesina and Ardagna, 1998; Giavazzi and Pagano, 1990). But fiscal contraction in recessionary conditions and within a monetary union risks undermining the very conditions that make recovery possible. The hoped-for credibility gains have often not only failed to appear, but the reverse has happened, as the international ratings agencies downgrade the status of sovereign debt because of the increased uncertainties over growth prospects. Secondly, the earlier expectation that a strategy of fiscal consolidation would not prove electorally costly to the parties that undertake it is not borne out in the current situation. In Ireland, Fianna Fáil was severely punished in the election of February 2011 not only because it was held to have been responsible for the failures of the past, but as a direct consequence of the austerity measures it had implemented. It remains to be seen how enduring the new government's support remains as voters contemplate the harsh spending cuts still in store. Similarly in Spain, Zapatero's administration began its sharp decline in popularity at the moment when it changed political direction toward the politics of austerity. It fell vicitim to a resounding defeat in national elections in November 2011, which brought the Partido Popular to power, under the leadership of Mariano Rajoy. Thirdly, the implication is that there is a fundamental tension between responding convincingly to market pressures on the one hand, and building political legitimacy on the other. Some commentators, drawing attention to the experience of a non-accommodating monetary policy under conditions of recession in inter-war decades Europe, have warned of the dangers that disaffection with mainstream politics could result in a growing economic nationalism that could undermine support for the European project altogether, and perhaps even the growth of anti-system political movements (O'Rourke, 2011).

Finally, we have flagged the broader European context of governments' political choice. The EU, and particularly the ECB, identified fiscal consolidation as the top priority, and the problems emanating from managing the Greek sovereign debt crisis during 2010-2012 appeared to endorse this emphasis. Debt restructuring or default within the Eurozone was not meant to be a possibility, and the European institutions have had great difficulty finding a coherent and coordinated response. But there is potentially an even greater challenge to the stability of the Euro that comes from the ongoing and as yet unresolved problems within the European banking system. There is still a contentious issue to do with who 'pays for' the banks. There is a less visible but no less serious problem over the very large continuing reliance of the European banking system on low-interest liquidity.

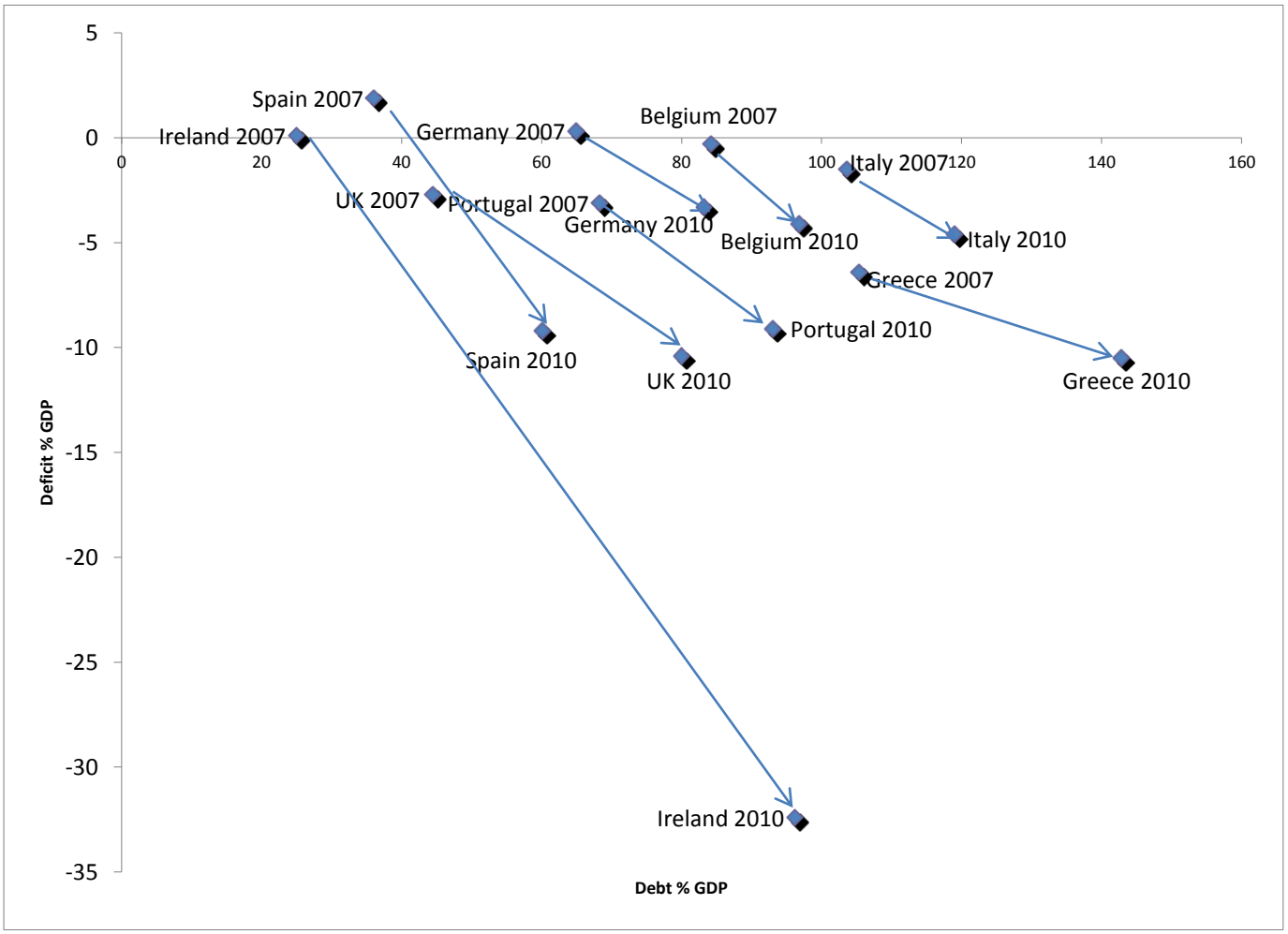
European decision-making has multiple equilibria, each with a different cost and benefit calculus for the various actors. The sorts of deficits we now see in the European periphery have never been seen before. Their connectedness not only to fiscal politics but to financial politics makes this situation different from earlier experiences. The new politics of fiscal austerity has itself resulted in very hard times, and they may yet grow harder still.

Figure 1. Change in growth and unemployment, 2007-2009



Source: EU Ameco

Figure 2. Change in debt and deficit profiles, 2007-2010



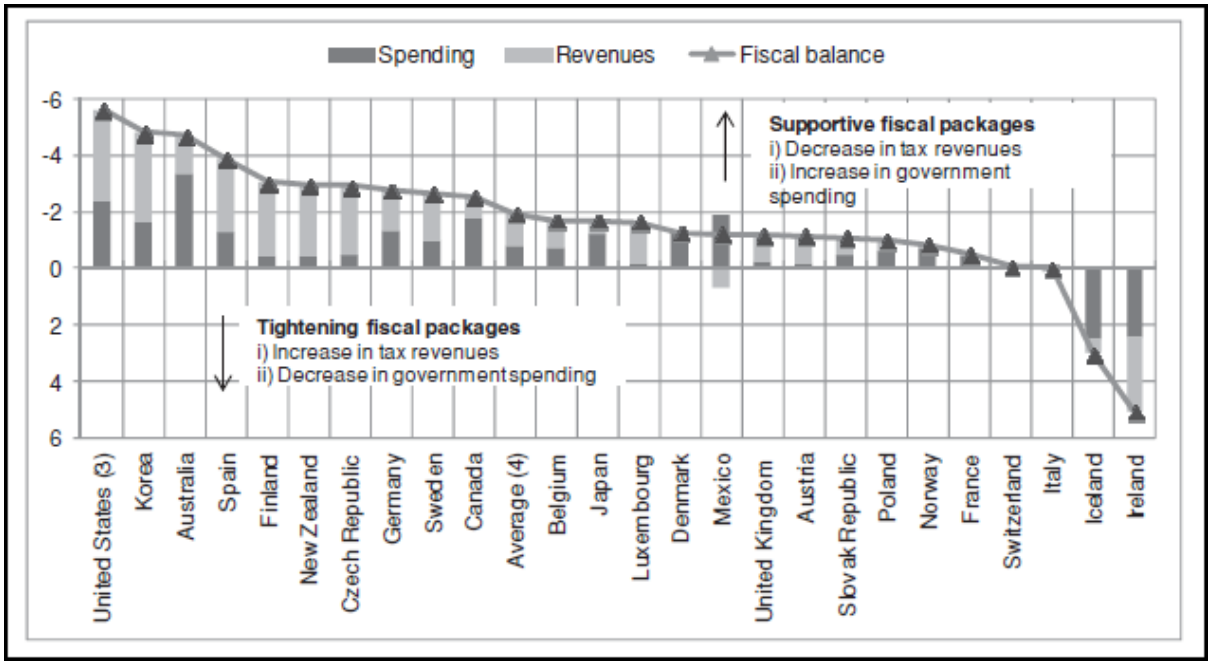
Source: Eurostat, April 2011

Figure 3. Differentiating between types of debt problems

		Problem status of private (financial sector) debt	
		High	Low
Problem status of public (sovereign) debt	High	US, USA, Japan	Greece, Portugal
	Low	Ireland, Spain	Australia, New Zealand, Canada; Denmark, Norway, Sweden, Finland; Germany, Netherlands; Switzerland

Figure 4. Fiscal response to economic downturn, 2008-2010

The impact of fiscal packages between 2008 and 2010 on fiscal balances as a proportion of 2008 GDP



(OECD, 2010a: , p.290)

Figure 5. Typology of fiscal policy choice

		Consolidation strategy			
		Focus	Timing	Size	Composition
Fiscal response	Orthodox	Contractionary (deficit reduction)	Preemptive action	Cold shower (shock therapy)	Spending-based
	Heterodox	Expansionary (fiscal stimulus)	Delayed stabilization	Gradual	Revenue-based

Figure 6. Summary profile of Irish and Spanish fiscal measures, 2008-2011

	Budget 2009 **(end-2008)**	**Budget 2010** **(end-2009)**	**Budget 2011** **(end-2010)**
Ireland	Orthodox approach: spending cuts with some tax increases to create stability as a precursor to growth	Orthodox approach: spending cuts with some tax increases to create stability as a precursor to growth	Orthodox approach: spending cuts with some tax increases to create stability as a precursor to growth
Spain	Keynesian counter-cyclical policy and delayed stabilization to stimulate growth	Gradual, revenue-based consolidation	Shock therapy, spending-based consolidation, and structural reforms

Figure 7. Summary of Irish fiscal policy decisions

Intervention	**Key budgetary measures**	**Size of fiscal effort**	**Consolidation strategy**
July 2008: Expenditure adjustments	Efficiency cuts	€1bn	Orthodox, gradual
October 2008: Budget 2009	Income levy; spending cuts, including welfare	€2bn	Orthodox, shock therapy, spending-based
February 2009: Expenditure Adjustments	Cuts to public sector pay as 'pension levy'; public sector pay increase stopped	€2.1bn €1bn in 2010	Orthodox, shock therapy, spending-based
April 2009: Supplementary Budget	Tax increases esp. levy; €1.2bn current , €600m capital	€3.6bn €1.8bn	Orthodox, shock therapy, spending-based
December 2009: Budget 2010	Spending cuts on all welfare, public sector pay and numbers; capital cuts; tax increases	€4.1bn	Orthodox, shock therapy, spending-based
December 2010: Budget 2011	Current cuts €2.1bn, capital cuts €1.9bn, other €0.7bn; tax increases €1.4bn	National Recovery Plan 2011-2014 projects €10bn cuts, €5bn tax	Orthodox, shock therapy, spending-based
Overall adjustment 2008-2014		€29.6bn*	65% Expenditure 35% Revenue

*Equivalent to 19% GDP and 22% GNP in 2010

Source: (Department of Finance, 2011; European Commission, 2010), Budget documents 2009, 2010, 2010

Figure 8. Summary of Spanish fiscal policy decisions

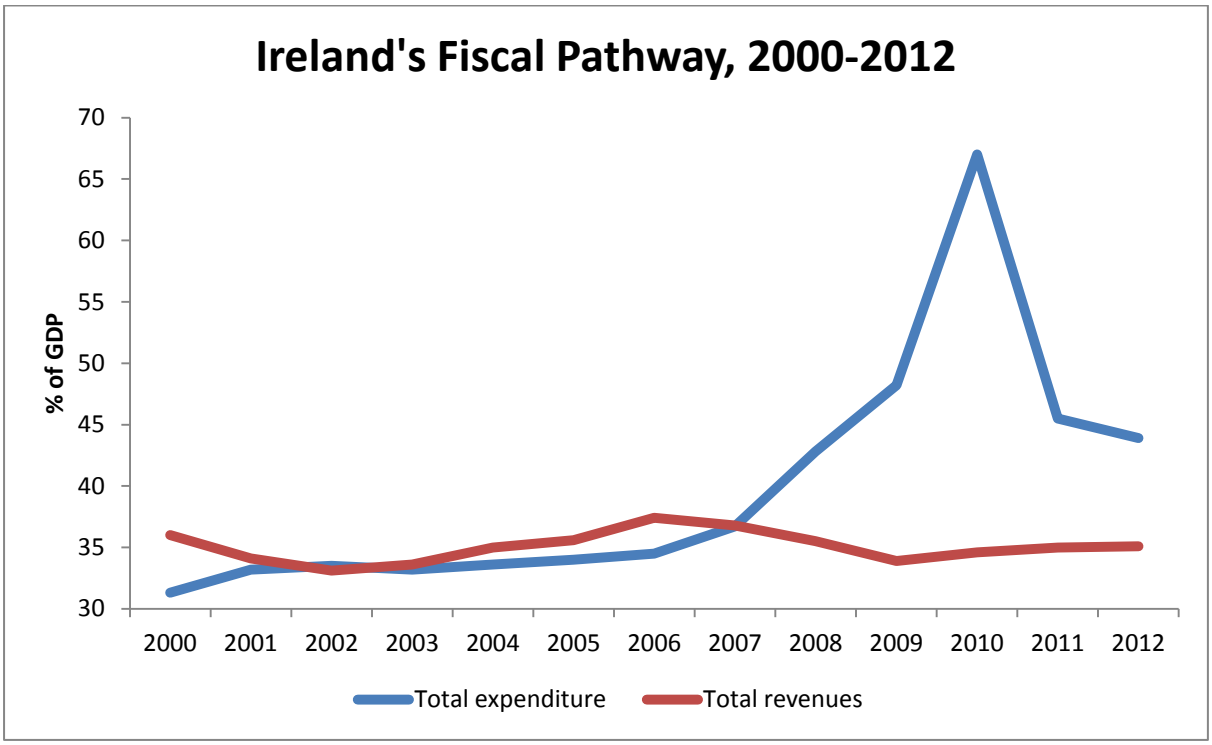
Intervention	Key budgetary measures	Size of fiscal effort	Consolidation strategy
Oct-Dec 2008: Budget 2009	Income tax rebate, wealth tax cut; regional public investment, strategic sectoral stimulus	+0.4% GDP	Counter-cyclical fiscal expansion; delayed stabilization
Oct-Dec 2009: Budget 2010	€400m tax rebate cut; VAT increase; restraint but not reduction in public spending	-1.4% GDP	Partial withdrawal of stimulus; gradual, revenue-based
January 2010: Plan de Accion Inmediata	Acceleration of deficit-reduction programme; spending cuts of €5bn	-0.5% GDP	Switch to spending-based approach; gradual
May 2010: Real Decreto-ley 8/2010	Public service pay cut by 5%, ministers' by 15%; abolition of new-born and dependency benefits; freeze in many public pensions; capital spending cuts of €6bn	-1.5% GDP €15bn savings in 2010 and 2011	Orthodox turn: cold shower, spending-based
Oct-Dec 2010: Budget 2011	Consolidation of earlier cuts; 'historic' cuts of 8%; sharp cuts in capital spending	-3.3% GDP in 2011 and 7% through to 2014	Orthodox: spending-based, structural reforms

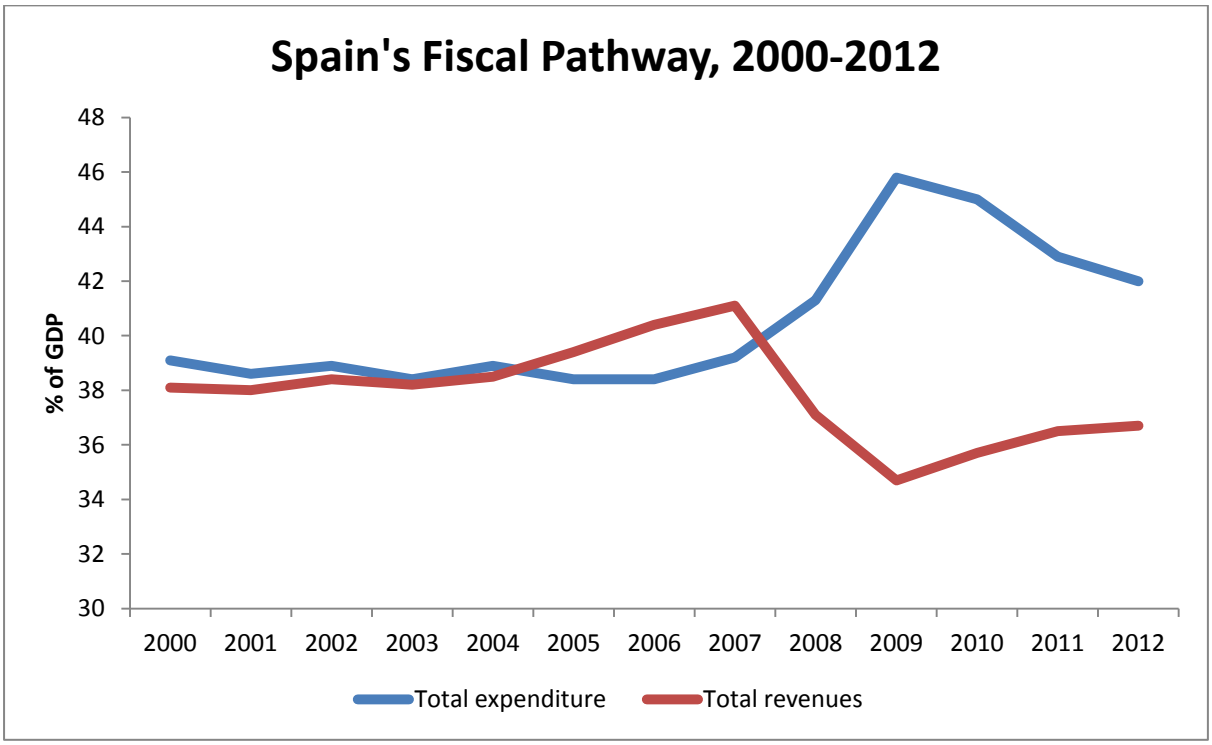
Source: PGE (General Budget Law) 2009, 2010, 2011; (European Commission, 2010); (Ministerio de Economia y Hacienda, 2011; Ministerio de Economia y Hacienda, 2010)

Figure 9. Explaining divergent policy responses in Spain and Ireland, 2008-2010

	SPAIN	IRELAND
Policy response	Initial stimulus	Early spending cuts and tax increases
Initial fiscal conditions	Positive	Positive
Economic structure and interest coalitions	Relatively closed Lower-skill manufacturing	Very open, trade and FDI High-tech Traded goods and services
Partisanship	Social Democracy	Right/ populist
Dominant ideas	State-led supply side investment	Market-conforming competitiveness
Social pacts	New concession bargaining	New public-sector concession bargaining

Figure 10. Evolution of revenue and spending, Spain and Ireland





Source: (European Commission, 2011)

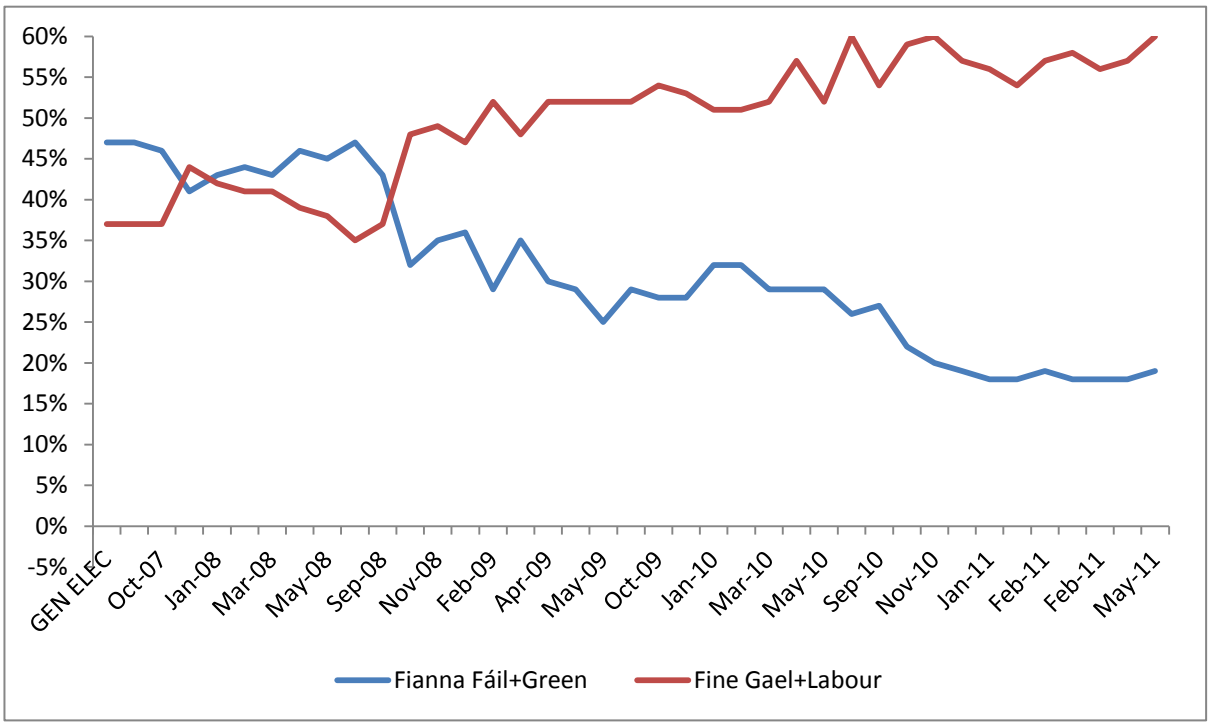
Figure 11. Key data for Ireland and Spain, 2003-2010

IRELAND	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Budget balance (% of GDP)	0.4	1.4	1.6	2.9	0.1	-7.3	-14.3	-32.4
Government debt (% of GDP)	30.9	29.6	27.4	24.8	25.0	44.4	65.6	96.2
GDP growth (%)	4.4	4.6	6.0	5.3	5.6	-3.5	-7.6	-1.0
Inflation (GDP deflator)	2.8	2.0	2.5	3.7	1.1	-1.5	-4.0	-2.6
Unemployment rate (%)	4.6	4.5	4.4	4.5	4.6	6.3	11.9	13.7
Openness (total trade to GDP)	151.3	152.7	151.5	149.0	152.0	157.8	166.1	186.9
Current account balance (% of GDP)	0.8	-0.1	-3.0	-3.7	-5.5	-5.6	-3.1	-0.7
Construction (% of GDP)	8.1	9.0	10.0	10.6	9.7	7.7	5.6	5.6
Employment in construction (% of total)	10.7	11.2	12.6	13.1	13.4	12.1		
Total assets of financial institutions/GDP	4.1	4.9	5.8	6.7	7.0	7.6		

SPAIN	2003	2004	2005	2006	2007	2008	2009	2010
Budget balance (% of GDP)	-0.2	-0.3	1.0	2.0	1.9	-4.2	-11.1	-9.2
Government debt (% of GDP)	48.7	46.2	43.0	39.6	36.1	39.8	53.3	60.1
GDP growth (%)	3.1	3.3	3.6	4.0	3.6	0.9	-3.7	-0.1
Inflation (GDP deflator)	4.1	4.0	4.3	4.1	3.3	2.4	0.6	1.0
Unemployment rate (%)	11.1	10.6	9.2	8.5	8.3	11.3	18.0	20.1
Openness (total trade to GDP)	55.0	55.8	56.7	59.0	60.5	58.7	48.9	54.7
Current account balance (% of GDP)	-4.0	-5.9	-7.5	-9.0	-10.0	-9.6	-5.5	-4.5
Construction (% of GDP)	9.9	10.6	11.5	12.1	11.9	11.4	10.8	10.1
Total assets of financial institutions/GDP	1.9	2.0	2.4	2.6	2.8	3.1		

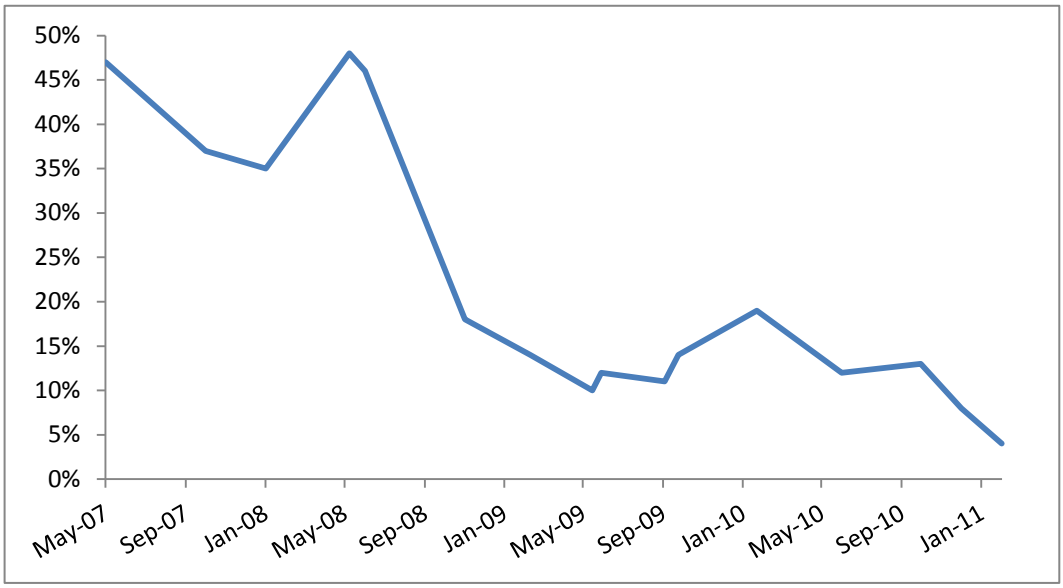
Source: (European Commission, 2011)

Figure 12. Support for selected Irish parties, aggregated



Source: Red C polls

Figure 13. Satisfaction with the Irish government, 2007-2011



Source: IPSOS

Figure 14. Confidence in the government of Zapatero, 2008-2011

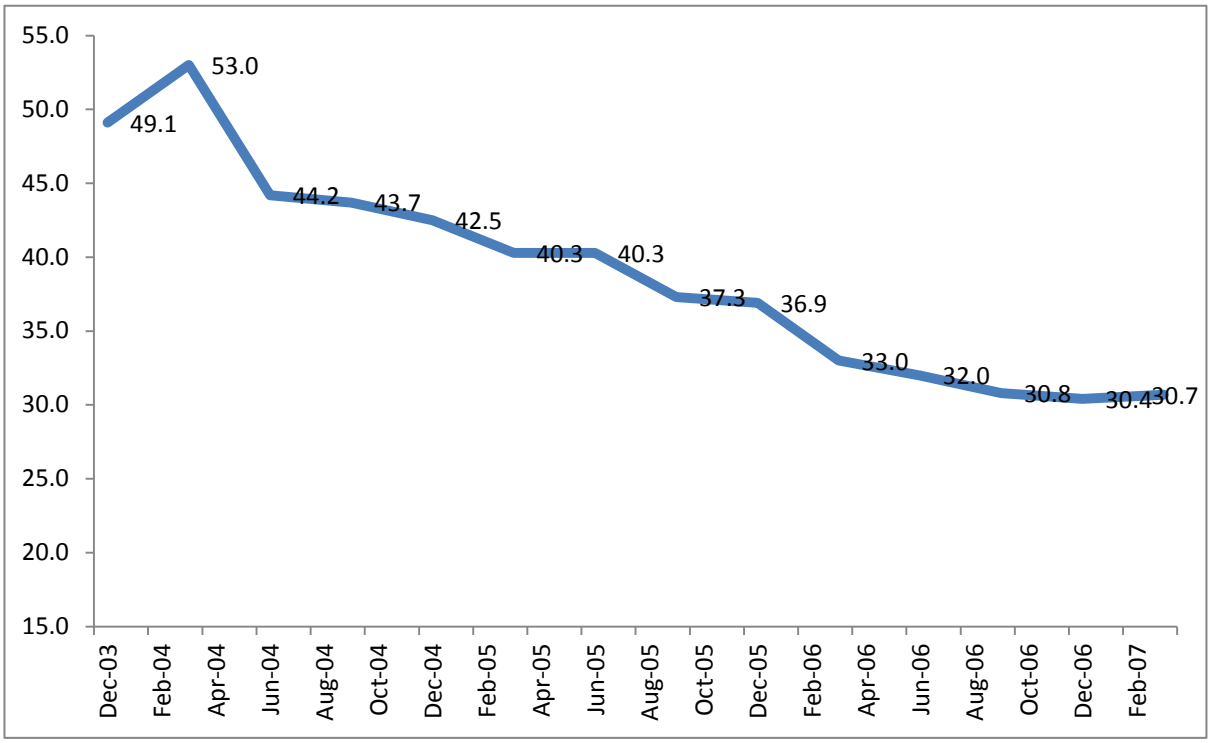


Figure 15. Voting intentions in Spain, PSOE vs PP, 2008-2011

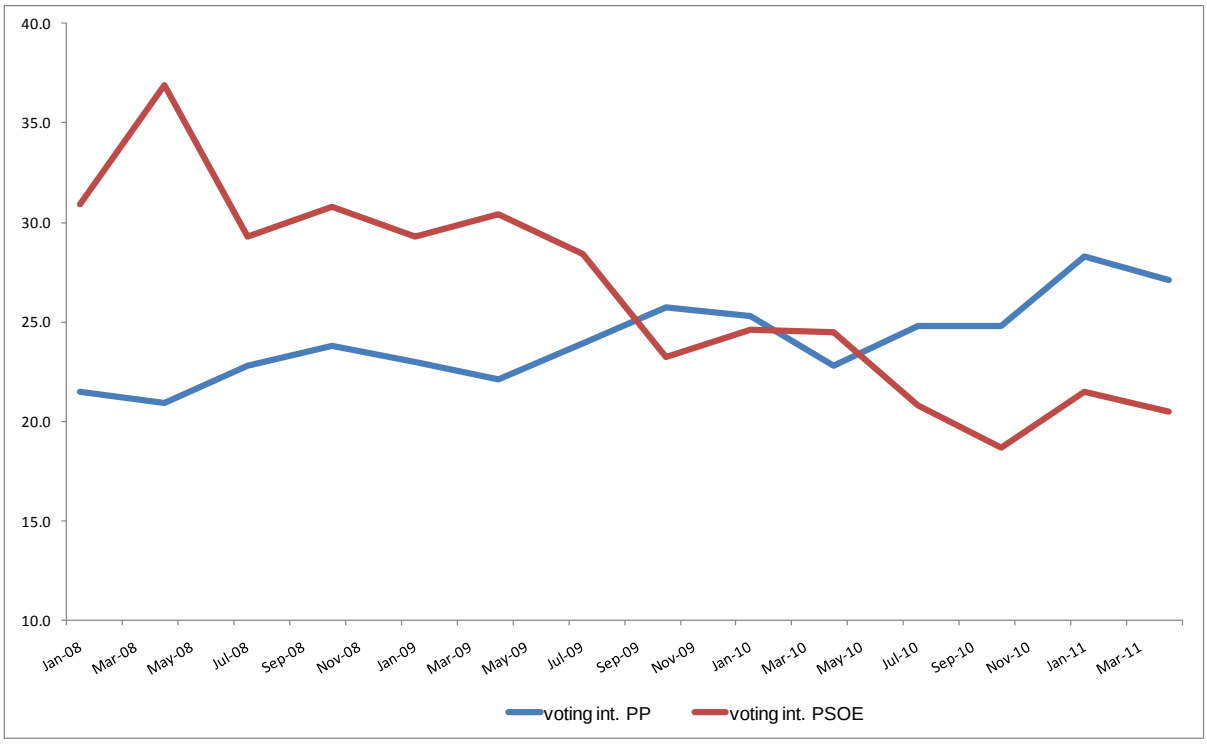
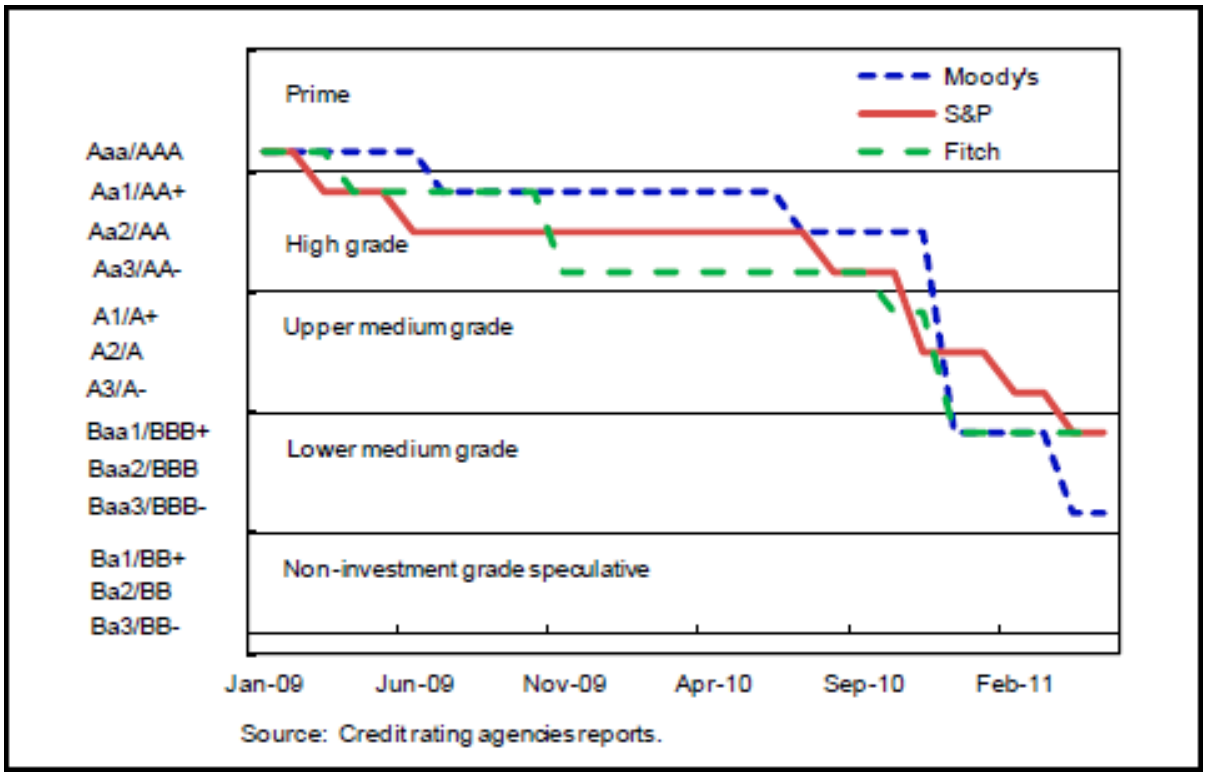


Table 16. Explaining convergent policy responses in Spain and Ireland, 2010

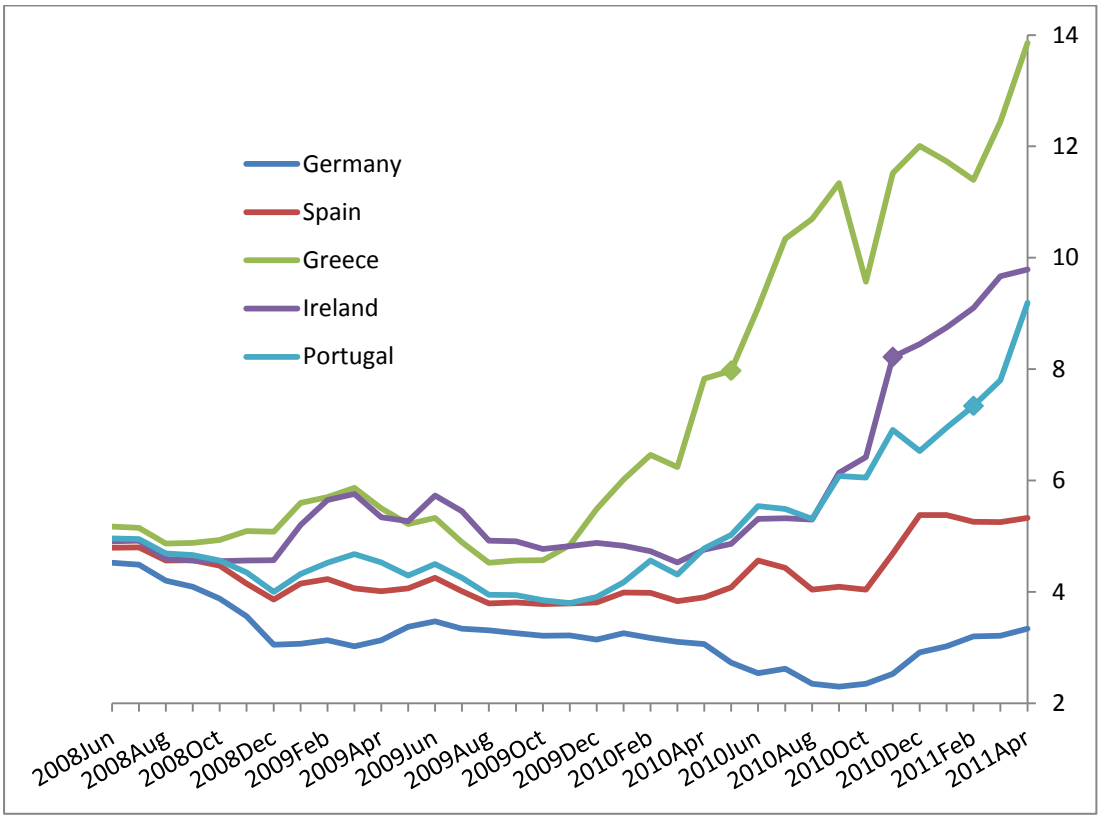
	SPAIN	IRELAND
Policy response	Radical policy shift, May 2010	Continuous orthodoxy
International markets	Negative market response to cuts	Negative market response to cuts
	Intensifying pressure	Intensifying pressure
	ECB preferences prevail	ECB preferences prevail
	Extreme pressure to avert need for bail-out, following Greek loan programme in May 2010	EU-IMF programme, Nov 2010
Dominant ideas	Reluctant shift	Market-conforming competitiveness

Figure 17. Credit ratings agencies – Ireland



Source: (IMF, 2011a: , p.9)

Figure 18. Ten-year interest rate on government debt



Source: ECB, June 2011

Markers indicate date of bailout request

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