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Explaining Variations in Patterns of Fiscal Consolidation

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Abstract

The comparative study of debt and fiscal consolidation has acquired a new focus with the re-emergence of debt as a major problem consequent upon the global financial crisis. This leads us to re-evaluate the literature on fiscal consolidation that flourished during the 1980s and 1990s. We identify two broad schools of analysis, one which segments episodes of fiscal change into discrete observations, the other comparing budget profiles at two points in time. We argue that both strategies miss the dynamic features of government strategy, especially in the choices made between expenditure-based and revenue-based fiscal consolidation strategies. We propose a focus on pathways rather than episodes of adjustment, to recapture what Pierson terms ‘politics in time’. We draw on classical explanatory tools of comparative political economy, including structures of interest intermediation, the role of ideas in shaping the set of feasible policy choices, and the situation of national economies in the international political economy. We support our argument with qualitative data based on paired comparisons of Ireland and Britain, and Greece and Spain.

Introduction

Fiscal consolidation emerges as a problem for European societies in different forms over time. The imperative of domestic stabilization in the aftermath of the crises of the 1970s meant that deficit reduction policies dominated the political agenda during the 1980s. During the 1990s, the politics of fiscal discipline was given additional impetus by the adoption by many countries of the Maastricht convergence criteria, which placed debt exposure centre-stage. The combination of increasing capital mobility and the institutionalisation of macroeconomic discipline at both the national and EU levels was supposed to enforce good governance in the management of fiscal affairs. However, the disciplines required to qualify for EMU were not necessarily maintained once the Euro was adopted. Country-specific targets for a one-off qualification decision were replaced by common-pool obligations with more diffuse sanctions, and spread over iterated budget processes. Moreover, the current economic downturn is putting immense and unexpected pressure on governments' fiscal balances. As a result, fiscal deficits in many European countries are likely to reach unprecedented levels in the near future. Fiscal adjustment is bound to become, once again, an urgent political priority for many countries over the next decade.

One of the central issues in fiscal consolidation concerns the composition of the adjustment, that is, whether governments seek to reduce deficits and cut debts by raising taxes or cutting expenditure, or indeed relying on growth to lift the public finances out of difficulty. Despite commonality in pressures and incentives, we observe a great deal of variation not only in countries' performance at any one moment, but in the trajectory of change over time. Even when the combination of external and domestic factors enforced a low-deficit equilibrium, the process can be characterized as a non-convergent convergence. As McNamara argues, the rule-based constraint of EMU and the market-based constraint of the global economy have induced overall convergence in budget-deficit levels, but have produced 'neither a race to the bottom nor a convergence in the composition of fiscal policy' (McNamara 2003, p.333). European countries achieved balanced budgets in the late 1990s by following different pathways of fiscal consolidation.

However, this has not been fully accounted for in the existing literature. Two main comparative analytical strategies prevail. The dominant trend is work by economists such as Alesina and Perotti, and political scientists such as Hallerberg and von Hagen, among others. This breaks countries' experiences into multiple discrete episodes of fiscal consolidation, measured in terms of change in the fiscal situation between one time period and the next (Alesina and Perotti 1995a; Hallerberg et al. 2007; Perotti 1998). This research strategy has generated important insights into the main determinants of the stability and duration of fiscal consolidation strategies, and has yielded useful hypotheses to guide further research endeavour. The recent work of Mulas-Granados is perhaps the most thorough and sophisticated contribution to this literature, drawing on an extensive range of economic, political, and institutional explanatory variables (Mulas-Granados 2006). An alternative approach is that adopted by Frank Castles and his colleagues, where the strategy is to compare observations at two points in time (Castles 2007a). The principal emphasis here is on change in the main components of public spending, particularly shifts in social transfer spending on the one hand and non-transfer spending on the other; and shifts in the size of the deficit and volume of accumulated debt. This innovative work provides an alternative set of insights into the choices made across countries in deciding where the weight of adjustment is to fall, across the range of spending commitments of modern governments. Again, this analytical strategy relies upon quantitative indicators and formal analysis to evaluate explanations.

This paper takes issue with both of these standard ways of analysing the politics of fiscal consolidation. Firstly, we wish to renew the question of how best to capture the dynamics of countries' adjustment paths. Breaking down the dependent variable into discrete episodes of fiscal adjustment yields large numbers of observations. But some countries have many of these episodes, others have relatively few. Not only is fiscal discipline institutionalized in different ways across countries, but the underlying propensity to incur debt exposure appears to vary too. We need to understand trajectories across time as well as episodes within time or comparisons of two points in time. Situating 'politics in time' is a demanding but necessary research agenda (Pierson 2004). Secondly, we find it useful to remember that budgetary politics is not only a

function of the institutional design of the political system, or of the technical incentives and constraints facing decision-makers. It is also at the heart of politics itself (Levi 1988; Skocpol 1985; Steinmo 1993). How and to what degree taxes are raised is at the core of political life; how the fiscal bargain is struck between who pays and who benefits is the very stuff of democracy itself. Budgets are therefore inseparable from distributive politics, broadly conceived. How potentially conflicting interests are organized and represented, how and to what degree they are inserted into the decision-making process, may be vitally important for understanding the process as well as the outcome of fiscal adjustment strategies. We accept that institutional design is central to explaining variations in policy outcomes. But we wish to bring interests back into the frame too. Thirdly, we find ourselves dissatisfied with standardization of some explanatory variables, necessary though this may be for quantitative analysis. This is especially important when we seek to explain outcomes with reference to government composition. Aggregate indicators of government partisanship must presume that ‘left’ and ‘right’ have an invariant meaning over time. But the dominant ideas shaping party priorities, and the set of feasible policy options perceived by governments, have changed quite markedly over time. We think it is important to probe more deeply into the meaning of partisanship for policy choice, not only across countries but also within a single country over time.

The structure of this paper is as follows. Firstly, we review the literature on the economic and political determinants of fiscal consolidation with a view to identifying some key analytical gaps. Secondly, we outline alternative perspectives on political strategy over time, and propose a new explanatory strategy. Thirdly, we present a case-study analysis to illustrate some of our key arguments.

The political economy of fiscal consolidations

Three main lines of research can be identified in the literature on the economic, political and institutional sources of fiscal adjustment in European and OECD countries. The first generation of research opened up debt as an issue, and looked at the politico-institutional determinants of the government budgets, seeking to explain the sources of fiscal deficits (Alesina and Perotti 1995b; Grilli et al. 1991b; Roubini and Sachs 1989).

Building on new political economy, this literature studied the role of economic and political institutions in shaping the incentives policy-makers face. For example, Grilli, Masciandaro and Tabellini assessed the relationship between government attributes and the accumulation of public debt in 18 OECD countries. They found that the accumulation of large public debts is concentrated among countries characterized by representative democracies as opposed to majoritarian parliamentary and presidential democracies, and among countries with fractionalized party systems. A key mechanism inducing suboptimal public financial policies, by this account, is the existence of short-lived governments (Grilli et al. 1991a; Grilli et al. 1991b).

A second body of work, which we might term the ‘consolidation matters’ approach, focuses on the macroeconomic and political effects of adopting alternative consolidation strategies (Alesina et al. 1998a; McDermott and Wescott 1996; Perotti 1996). This literature distinguishes between revenue-based and expenditure-based adjustments. Some quite strong claims emanate from this literature. Alesina and colleagues, for example, claimed that ‘fiscal corrections relying mostly on spending cuts that are concentrated on government wages and transfers tend to be expansionary, whereas those relying mainly on tax increases are contractionary’. They also find that the political costs to governments arising from expenditure cuts are minimal: they argue that there ‘no evidence of a systematic electoral penalty or fall in popularity for governments that follow restrained fiscal policies’ (Alesina et al. 1998b, p.198; Alesina and Wacziarg 1998).

These rather counterintuitive findings have significant policy implications. Spending-based consolidations might not only produce positive economic outcomes (through non-Keynesian effects), but may also be rewarded by voters. Not surprisingly then, the case for expansionary fiscal adjustments (EFAs) has been quite popular in certain epistemic communities and policy circles (Alesina et al. 1998a; European Commission 2007; Giavazzi and Pagano 1990; Perotti 1996). The argument that revenue-increasing approaches to reducing budget deficits were more likely to fail, and that the only reliable budget consolidation strategy was one based on cutting expenditure, was consistent with a conservative political preference for small government. Indeed, the fiscal constraints expected to be institutionalized by the Stability and Growth Pact were

positively welcomed by some. Alesina et al., for example, wrote: ‘hopefully, the Stability Pact will force serious welfare reforms’ (Alesina and Ardagna 1998, p.517).

However, the case may not be as simple as at first argued. More recent research questions the conclusion that only a strategy based on expenditure will be durable and effective – a strategy based on revenue-raising can also have successful outcomes over time (Mulas-Granados 2003, pp.19-20, 34-5). Moreover, the argument that cutting spending is a politically cost-free exercise has also been empirically challenged: expenditure-cutting strategies appear to have more marked negative electoral consequences than had previously been shown (Mulas-Granados 2004).

A third stream of research focuses on the economic and political determinants of the choice of consolidation strategy. For example, Von Hagen and Strauch argue that economic conditions such as the cyclical position of the domestic economy, the stance of monetary policy, the sustainability of government’s financial position, and the state of the international political economy affect the choice of consolidation strategy (von Hagen et al. 2002). Political institutions shape government choices too. Mulas-Granados argues that strategies of adjustment are a function of the fragmentation of decision-making, the ideology of party in government, and the timing of elections (Mulas-Granados 2003; 2006). Constitutional forms of government and types of electoral system have attracted renewed attention from others too (Cheibub 2006; Fabrizio and Mody 2006; Gali and Perotti 2003; Milesi-Ferretti et al. 2002; Persson and Tabellini 2003, chapters 6 and 8; Poterba 1994; Poterba and von Hagen 1999). Finally, international political economy approaches have been also applied to explain patterns of fiscal stabilization in Europe (Freitag and Sciarini 2001; McNamara 2003).

Most analysts find that the institutional fragmentation of decision-making makes countries deficit-prone. The explanation is generally cast in terms of a common-pool problem (Weingast et al. 1981). In the context of large, fragmented and heterogeneous coalitions, interest groups that benefit from particular strands of public spending have more incentives to free ride on others’ contributions, which leads to high deficits and the accumulation of debt. Fragmented government depresses fiscal performance

(Fabrizio and Mody 2006; Perotti and Kontopoulos 2002; Poterba 1994; Roubini and Sachs 1989).

Another source of variation in fiscal policies on which there is wide-ranging agreement is government partisanship. Partisan explanations posit that political parties adopt distinctive economic strategies depending on their redistributive consequences, and this persists even in the context of increasing international capital mobility (Boix 1998; Garrett 1998). Thus Mulas-Granados argues that the ideology of parties in government has become the most powerful predictor of fiscal policies and strategies of adjustment. He shows that socialist or left-wing governments are inclined to use balanced budgets to finance supply-side policies of capital formation and to maintain public expenditure, and are reluctant to cut these expenditures even at the expense of public consumption and transfers. In contrast, conservative or right-wing governments focus on cutting primary spending (including both social transfers and public wages, and public investment), using these savings to fund reductions in direct taxation for business and individuals. Thus social-democratic governments usually implement, *ceteris paribus*, revenue-based strategies of deficit reduction, while conservative governments tend to prefer expenditure-based ones (Castles 2007b; c; Mulas-Granados 2006).

However, this literature is not without its limitations. The central problem of fiscal consolidation tends to be conceptualized in narrowly technical terms, and the explanatory variables are, of necessity, ones that can easily be quantified. As a consequence, the literature tends to miss what we normally recognize as core issues in political economy – issues about the distribution of pain in adjustment strategies, the extent of government engagement with major social actors, government's capacity to choose and implement one option over another, and the electoral considerations that underlie this. Furthermore, the slide from a positive to a normative stance is not uncommon in the literature. Policy prescriptions have been drawn that can have wide-ranging consequences for distributive outcomes. But these are not as well-founded as one might at first think.

A new approach to analysing fiscal adjustment

Political economy is about decision-making under constraints. But the nature of these constraints, where they come from, and how they evolve over time may be conceptualized quite differently by different schools of political economy (Caporaso and Levine 1992). Indeed some scholars explicitly view modern political economy as the application of economic methodology to political processes (Drazen 2000). We would argue for a more ambitious theoretical perspective that would seek a real integration of the substantive concerns of economics and politics (Alt and Chrystal 1983; Gourevitch 1986; Hall 1986). There is scope for a methodologically pluralistic approach that would draw on insights from different traditions in political economy and comparative politics, including approaches grounded in historical institutionalism, the varieties of capitalism literature, and comparative political economy (Hall and Soskice 2001; Kahler and Lake 2003; Pierson and Skocpol 2002). With these ideas in mind, this section identifies some of the analytical gaps of empirical studies on fiscal consolidation and proposes a new approach for explaining patterns of fiscal adjustments.

Locating strategic political choice in time

Taking time seriously requires us to think about three aspects of political choice. Firstly, governments must choose what to do about fiscal deficits under conditions of constraint. But the current range of options is strongly conditioned by what has gone before: politics is path-dependent. We need to find ways of capturing the real constraints shaping government options, and not bundle them into a black box of lagged effects, or country fixed effects. Secondly, the meaning of party politics may change quite considerably, and it may be misleading to treat partisanship as time-invariant. For example, the policy priorities of the British Labour Party in 1977 were not the same as those of 1997 or even 2007. And thirdly, the framework of received ideas, of assumptions about what works and what is politically necessary, is not a constant. The horizon of meaning that decision-makers bring to bear on the set of feasible options available to them has to be captured realistically.

The implication of taking time seriously in this way is that the conventional approach of identifying discrete episodes of consolidation, while gaining methodological leverage

through quantitative formalization, loses analytical leverage and misses important shadings of meaning. Episodes of fiscal consolidation are not experienced in real time as independent and unrelated events. Conventional methodologies cannot deal with the sequencing of decisions, policy learning, or the institutionalisation of policy solutions. In order to overcome this problem, we need to go beyond the analysis of episodes and begin to look at the politics shaping pathways of fiscal consolidation.

Bridging the gap between rational-choice and historical institutionalism

Institutions matter; but the way they affect policy outcomes needs to be explored further. A quantitative modelling approach can report correlations between variables, but offers little insight into how institutions shape actors' choices. Many authors agree that the fragmentation of fiscal decision-making weakens the prospects for fiscal stabilization. But there is a real danger of conceptual stretching here (Sartori 1970). A single concept may be asked to do too much work, conflating the effects of a range of underlying political processes. Indeed, Perotti recognised that 'fragmentation' captures not only formal institutional structures, but also the informal processes leading the negotiation in government, coalition and parliaments (political fragmentation) and the bargaining of fiscal policy between government and interest groups (social fragmentation) (Perotti 1998).

Rational-choice institutionalism has strong affinities with the economists' approach to modelling interactions. Institutions are created by those with bargaining power to establish the rules of the game (North 1990; 1994). But institutions are typically neither rationally designed nor optimally efficient. There is scope for complementing rational-choice institutionalism with a historical institutionalist approach, the better to be able to analyse how cross-national variations in institutional structure may have a systematic effect on shaping the patterns of interaction between political actors (Hall 1997; Hall and Taylor 1996; Pierson and Skocpol 2002; Swank 2002).

Taking interests seriously

Government decisions are shaped by many factors including electoral pressures and lobbying activities. Equally, governments' capacity to implement policy effectively may

be constrained by the nature and intensity of the linkages between state institutions and organized interests (Pierson 2001; Weiss 1998). The role of organized interests in general, and of the politics of wage negotiation in particular, is neglected in many political economy analyses. It can be difficult to assess the real influence of competing interests in the context of collective action problems, unequal access to power and endogenous preference formation. Quite often, the analytical power of interest group politics is sacrificed to a kind of institutionalist imperialism. The literature tends to focus on mechanisms of intermediation, but clearly overlooks the interest dimension. With Pontusson, we believe that there is a case for ‘putting institutions in their place and taking interests seriously’ (Pontusson 1995).

Interest-based explanations have been used to explain cross-national variations in economic policies. Gourevitch, for example, shows that the balance of power among societal actors shapes national policy responses to international economic crises (Gourevitch 1986). Similarly, Pierson argues that the interests of employers and trade unions must be taken into account in analysing the politics of welfare state restructuring (Pierson 2001). Sectoral interests are also an important source of variation in monetary and exchange rate policies (Frieden 1991; Posen 1995). The process of budget consolidation has far-reaching distributive consequences, affecting the material interests of powerful actors. These interests may be mobilized either to promote or to resist consolidation strategies. The mechanisms whereby governments are able to implement fiscal adjustment strategies may be powerfully conditioned by the profile of organized interests in a society, and by the degree to which they are institutionally embedded in consultative and decision-making processes. Whether or not organized interests can or choose to act as veto players over government choices, whether they are drawn into cost-restraining agreements or social pacts, and whether or not these entail high additional fiscal side-payments, may make a crucial difference to the possibility of implementing a spending-based or revenue-based adjustment strategy (Hardiman and Murphy 2008).

Partisanship and electoral politics

Political parties have the power to pursue quite distinctive economic policies, as they seek to accommodate and represent the demands of different distributional cleavages (Kitschelt et al. 1999; Rueda 2007). But there are problems with existing partisan explanations of strategies of fiscal consolidation. One issue is that of measurement, where a variable for partisanship is specified as the percentage of total cabinet posts held by social democratic and other left parties. But this does not capture ideological realignments within parties over time, differences of policy preferences between parties of the same ideological family across nations, or differential influence on cabinet decision-making. Another issue is that of turnover. If parties alternate in power regularly, more policy continuity may be expected, but if they have longer uninterrupted stretches in government, their capacity to shape distinctive policies may be increased; the sequencing of governments matters.

Quantitative analysis of episodes of fiscal consolidation argues that the proximity of elections is important in explaining the choice of adjustment policies. The dynamics of party competition shapes politicians' calculations when choosing alternative consolidation strategies (Kitschelt 2001). But electoral politics is not only about parties, it is also about voters. Variations in public preferences have been shown to affect the formation of policy agendas and outcomes in the USA (Erikson et al. 2002; Kingdon 1997). But the relationship between public opinion and the choice of fiscal consolidation strategies has not been systematically explored. It seems that voters do acquiesce to tough fiscal remedies; but whether this is in a spirit of genuine acceptance of their necessity, or *faute de mieux*, is unclear. There are indications such as in the work of Mulas-Granados that voters can and do punish unpalatable policies under certain circumstances. But as yet, we have relatively little knowledge about what those conditions might be, and standard analyses of 'pocket-book voting' do not differentiate between the consequences of revenue-based or expenditure-based consolidation policies.

Varieties of capitalism

In mainstream analysis of fiscal consolidation, the focus is generally on domestic political institutions, whether constitutional or electoral. But developing the insights drawn from historical institutionalism, we suggest that it is also valuable to analyse the constraining effects that emanate from the structure of domestic production (Hall and Soskice 2001; Soskice 1999). The ‘varieties of capitalism’ literature is based on the centrality of the firm to production in market economies. Variations in coordination mechanisms and steering capacity provide the basis for differentiation between liberal and coordinated market economies, corresponding roughly with English-speaking versus Continental European economies, plus Japan; with scope also for a third, ‘state-led’ or ‘mixed’ market economy model, taking in France and the Mediterranean countries (Molina and Rhodes 2007; Schmidt 2002).

Pattern of policy making and implementation are therefore deeply grounded in economic structure, and the patterns of state-society relationships vary accordingly, with implications for the way public policy has adjusted to successive waves or cycles of economic activity (Hall 2007). Profiles of welfare state provision and welfare reform can also be viewed in this light. Esping-Andersen’s work, initially grounded on analysis of class coalitions, came to focus more on the interactions between labour markets, state employment, and family formation (Esping-Andersen 1990; 1999). But the deep linkages between the politics of production and distribution in the political economies of the advanced industrial societies have come to be recognized more clearly (Ebbinghaus and Manow 2001; Iversen and Wren 1998). Policy change normally takes place incrementally and selectively, and there is no guarantee that pressure for change in one policy area or another will not produce conflictual or suboptimal outcomes (Crouch 2005; Streeck and Thelen 2005). In the real world there are no pure models, and all political economies are made up of an admixture of elements. But the incentives and constraints facing governments as they undertake fiscal consolidation strategies are nevertheless likely to look rather different depending on whether the patterns of economic coordination fall more clearly into the liberal, coordinated, or mixed models. There are many ways in which governments may intervene in a country’s underlying growth model, that may help or hinder economic adjustment prospects. The conditions

shaping choice of fiscal consolidation strategy, and the consequences for employment, growth, and equity, are likely to be different across the varieties of capitalism.

Bringing ideas back into the politics of fiscal adjustment

The dominant ideas available to decision-makers may constrain the choice set of the actors confronting a fiscal crisis. Economic ideas ‘provide agents with both a *scientific* and a *normative* account of the existing economy and polity, and a vision that specifies how these elements *should* be constructed’ (Blyth 2001, p.11). Ideas may affect policies through different channels, including the institutionalisation of policy paradigms and the rise of epistemic communities advocating specific policy solutions (Hall 1993; 1997; McNamara 2002). Indeed, the causal weight of ideas is likely to be greater during crises, particularly if a war of policy paradigms is under way about the correct diagnosis and appropriate solutions to a given crisis (Blyth 2002; Gourevitch 1986).

Cognitive considerations may affect the dynamics of fiscal policy in general and processes of budget consolidation in particular. The evolution of ideas has shaped the politics of taxation in different societies; and the distribution of welfare-supporting values changes across societies at roughly the same time (Kato 2003; Kitschelt 2001; Steinmo 2003). It is difficult to assess empirically whose ideas matter, when and how. Nonetheless, we can hypothesise that ideas may influence the adoption of alternative fiscal consolidation strategies by defining the range of ‘perceived legitimate change’ (North 2005). The dominant set of policy beliefs, like the presence of social pacts, affects the politics of legitimisation of fiscal adjustments.

The international political economy context

Domestic sources of variation in fiscal adjustment strategies are only one part of the story. International political economy considerations are often overlooked, if not ignored altogether. Countries face external constraints which vary across space and time. Patterns of insertion into the international economic system are systematically different across countries. Nations are not equally exposed to global financial crises or to the pressures emanating from supranational fiscal rules of the game, and the intensity

of external exposure can vary over time too. This presents us with a challenge to integrate comparative and international economy analyses.

Growth in international trade and increasing capital mobility has affected the viability of welfare states, constraining governments' revenue-raising capacities (Scharpf and Schmidt 2000; Swank 2002). For example, Swank and Steinmo show that internationalization affects the development of tax policy in industrialised democracies, though in more complex ways than suggested by the globalization thesis (Swank and Steinmo 2002). It also influences patterns of government spending, as the ongoing debate over globalization and the politics of compensation suggests (Adserà and Boix 2002; Rodrik 1998; Schulze and Ursprung 1999).

External commitments may be a powerful source of domestic policy constraint. Rules governing eligibility for membership of the Euro provided incentives for fiscal discipline in European states during the 1990s. Indeed, partisan effects appear to have been attenuated during these years, when all governments were increasingly constrained to ensure compliance with the qualifying conditions for Euro membership (Illera and Mulas-Granados 2008, p.161). It is not clear whether external constraints played any significant role in explaining the composition of adjustments. But the incentives created by the Stability and Growth Pact appear to have been significantly weaker after 2000 in constraining fiscal policy choices (Hallerberg and Bridwell 2008; Hassel 2009; Johnston and Hancke 2009). All this suggests the importance of further exploring the systematic effects of international factors on the choice of fiscal consolidation strategies.

In summary, we take issue with the conventional ways of analysing the politics of fiscal adjustment. Neither the approach based on analysing segmented episodes nor that based on comparing two observation points can capture the dynamic aspects of country's adaptation strategies. Insofar as quantitative analyses attempt to acquire greater nuance, they risk engaging in conceptual stretching. We suggest that the role of organized interests in creating governance capacity, and the leading role of ideas, are more important than conventional analysis acknowledges in explaining variations in fiscal consolidation strategies. They cannot easily be modelled, yet they exercise a strong

shaping and constraining effect on governments' strategic decisions. We have outlined the key elements of a political economy analysis, including domestic institutions, the international political economy, partisan politics, organized interests, and the role of ideas. We think it is important to draw on all of these to analyse commonalities and variation in the trajectory and composition of fiscal adjustments, 'taking time seriously' in political analysis.

Profiling fiscal adjustments

By 1980, most of the advanced industrial societies were experiencing the fullest strains of adjustment to the oil price crises of the 1970s within the then-prevailing dominant economic management paradigm. Many countries had incurred sizeable debts trying to sustain spending within a context of rapidly increasing unemployment and high inflation. From the early 1980s on, divergences become apparent. Monetary-based inflation control policies were more readily implemented by governments of the right or centre-right, as in Britain and the Netherlands. But not even governments of the left, such as the incoming socialist administration in France, were exempt from dealing with the new fiscal constraints (Crouch and Streeck 1997; Gourevitch 1986).

Fiscal consolidation refers to the process by which governments attempt to put public finances on a sustainable path by taking a discretionary decision to reduce public deficits and debt levels. Change in the cyclically adjusted primary budget balance is a commonly used indicator. Following Perotti and Mulas-Granados, we focus on changes in the balance between revenue and expenditure (Mulas-Granados 2006; Perotti 1996).

Most European countries converged to a balanced-budget equilibrium in the run-up to EMU, following up to two decades of stop-go efforts to restore sound public finances. This process of general convergence was achieved in the context of a remarkable variation in the composition of adjustments, as countries adopted different types of consolidation strategies to meet the demands of fiscal austerity. Based on an analysis of 60 episodes of fiscal adjustment in Europe between 1970 and 2000, Mulas-Granados demonstrates that while some countries, notably Ireland, show a clear preference for expenditure-based adjustments, others such as Austria and Greece tend to rely on

revenue-based consolidations (Mulas-Granados 2006). A non-convergent convergence was also evident in the consolidation process that preceded the introduction of the single currency (European Commission 2000; von Hagen et al. 2002). Table 1 below summarizes Mulas-Granados's evidence of discrete episodes of consolidation, sorted by type.

Table 1. Episodes of fiscal adjustment in the EU, 1970-2000

<i>Country</i>	<i>Episodes of fiscal consolidation</i>		<i>No of</i>	<i>Total</i>
	<i>Expenditure-based</i>	<i>Revenue-based</i>	<i>episodes</i>	<i>years</i>
Austria		1992-93; 1995-98	2	5
Belgium	1987-88	1977-78; 1982-85; 1993-98	4	13
Denmark	1983-87	1992-93; 1996-97; 1999-00	4	10
Finland	1971-72; 1998-99	1975-77; 1981-82; 1984-85; 1988-89; 1995-96	7	15
France	1980-81	1976-77; 1996-98	3	7
Germany	1982-82	1989-90	2	4
Greece	1994-2000	1974-75; 1982-83; 1986-88; 1991-92	4	16
Ireland	1983-85; 1991-95; 1996-99	1976-77	4	13
Italy	1976-78; 1997-00	1983-84; 1991-94	4	13
Luxemb.	1982-86	1977-78; 1996-97	3	9
Netherl.	1996-97	1972-73; 1977-78; 1985-86; 1988-89; 1991-94; 1999-00	7	16
Portugal	1982-84; 1986-87	1969-70; 1992-93; 1995-98	5	12
Spain	1996-00	1992-93	2	7
Sweden	1983-84; 1996-99	1976-77; 1986-90	4	12
UK	1969-70; 1996-00	1976-78; 1980-82; 1988-89	5	15

Source: Mulas-Granados (2006)

There is no clear consensus in the literature on the phasing and composition of adjustments episodes. While Mulas-Granados suggests that countries such as Greece and Ireland enforced significant expenditure-based consolidations during the 1990s, Von Hagen et al. identify revenue-led adjustments. Similarly, the European Commission suggests that Denmark implemented an expenditure-based retrenchment during the late 1980s, while Mulas-Granados claims that the adjustment was revenue-led (Mulas-Granados 2006; von Hagen et al. 2002). Ireland's well-known expenditure-based adjustment in the period 1987-89 is not captured by Mulas-Granados's methodology.

The diverse interpretations arise from trying to link discretionary policy choices to very short-term fluctuations on the structural components of the budget. A more long-term approach is needed to shed new light on this problem. Mulas-Granados defines 'strategy type' as the sum of the average variation of cyclically adjusted revenues and cyclically adjusted primary expenditures. The intuition is that the higher the value of the strategy type, the more expansionary is the effect of the government's strategy on the total size of the government budget. We can apply this thinking to assess countries' overall fiscal trajectories during the whole era of stabilisation. Figure 1 outlines the expansion or contraction of the public sector across European countries between 1980 and 2000. This confirms our intuition that Ireland is a typical case of public sector contractionary strategy, and Greece a typical case of public sector expansionary strategy. Ireland has relied on a expenditure-cutting fiscal stabilization strategy, while Greece has sought to bridge deficits by raising taxation.

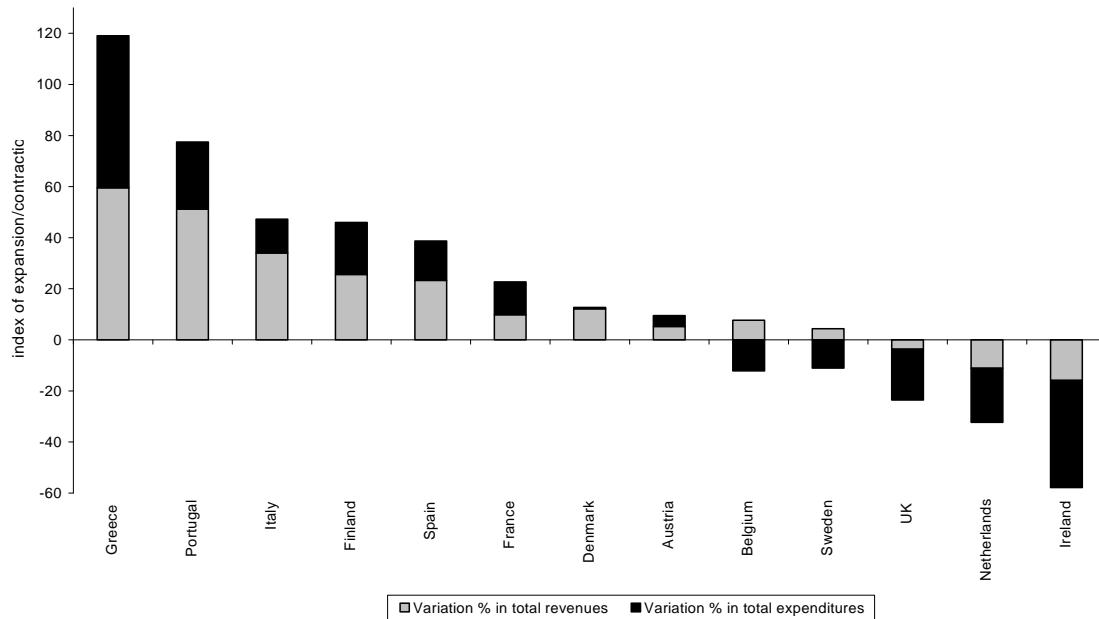


Figure 1. Expansion/contraction of public spending and revenues, 1980-2000

Source: Own elaboration based on *OECD Economic Outlook Database*. The index of expansion or contraction is the sum of the average variation of structural revenues and structural expenditures between 1980 and 2000 (both revenues and expenditures are measured as percent of GDP)

Comparative case studies

Case studies are not always good for testing hypotheses. However, they are good for revealing missing variables in existing explanations, generating arguments and ideas, and dealing with causal complexity (George and Bennett 2005; Gerring 2007). Case selection on the dependent variable is often held to be undesirable. But we believe that this methodological choice is appropriate in the process of discovery, serving crucial exploratory and heuristic purposes (Geddes 2003, p.129). We adopt a ‘diverse case’ selection strategy (Gerring 2007), choosing Ireland as an ideal type of expenditure-led consolidation and Greece as a paradigmatic case of revenue-led adjustment. This means that we are allowing for variation in the outcome of interest, as suggested by both King and his colleagues and by Geddes (Geddes 2003; King et al. 1994). We also consider the experiences of Britain and Spain to leverage our analysis of the Irish and Greek cases respectively. Taken together, these four countries entail an interesting mix of cross-case and within-case variation of fiscal consolidation experiences.

Ireland: expenditure-based adjustment

The fiscal trajectory of Ireland since 1980 is characterized principally by expenditure-based adjustments. Scholars disagree on the precise phasing of adjustment periods. During the 1980s and 1990s, Mulas-Granados identifies the periods 1983-5, 1991-5, 1996-9 (Mulas-Granados 2003, p.21; 2006, p.28), while Alesina and Ardagna argue that during the 1980s, 1983, 1984, 1987, 1988, and 1989 were all fiscal adjustment years (Alesina et al. 1998a, p.497). But the trend is clear: Mulas-Granados classes all three of the fiscal adjustment periods he identifies as based on expenditure-based episodes, and Alesina and Ardagna similarly note the reliance on expenditure-based adjustment (Alesina et al. 1998a, p.515; Mulas-Granados 2006, p.28). Figure 2 below shows the profile of revenues and expenditures in relation to GDP.¹

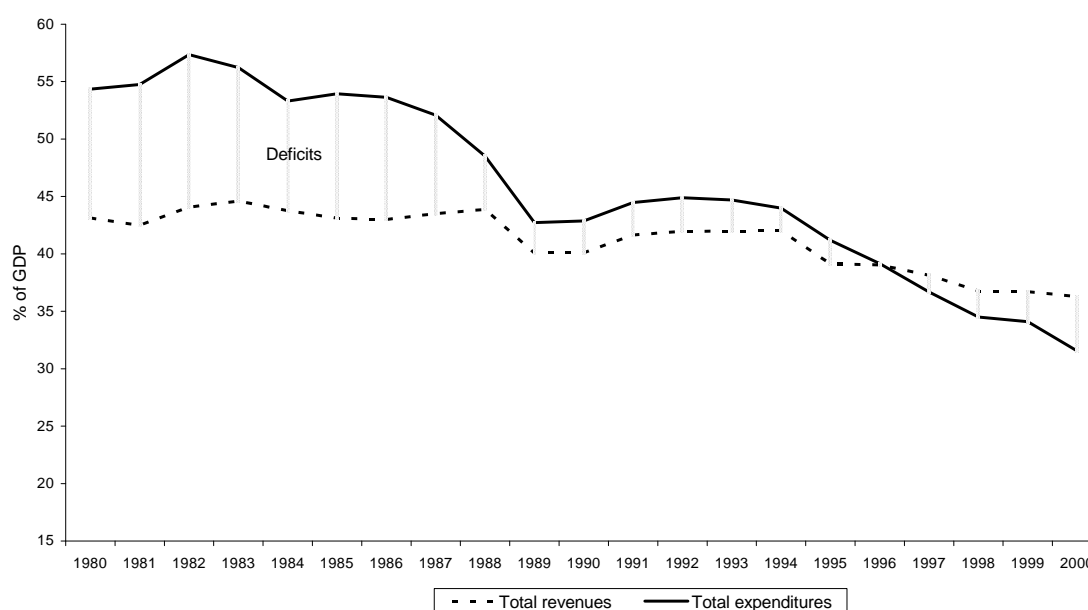


Figure 2. Revenue and expenditure trends in Ireland, 1980-2000 (per cent of GDP)

Source: Own elaboration based on OECD Economic Outlook Database

¹ Data based on GDP are often regarded as contentious in the Irish case, since there is a greater disparity between GDP and GNP in Ireland than in other OECD countries. But while tracing these trends in relation to GNP may alter the nuanced picture, the overall trajectory is relatively unchanged.

Ireland ran double-digit deficits from 1979 to 1985, accumulating a huge government debt (European Commission 2000). However, from 1987 on, the country embarked on a process of consolidation that ended up changing the structure of Irish public finances. The ratio of public spending to GDP decreased substantially from 1985 to 2000, from 53% to 32%, accompanied by a steady decline of structural revenues from 43% to 35% of GDP. As a result, Ireland's fiscal stance improved by around twelve points of GDP. How can we explain this dramatic turnaround?

Institutional fragmentation cannot readily explain either the scale of the problem incurred or the eventual turnaround. Ireland has a unitary state with centralized governmental institutions, and notwithstanding coalition governments, multiannual budgeting is quite recent and there is no coalition pre-commitment to performance targets. The Minister for Finance can exercise quite strong delegated powers.

Explanations grounded in partisanship encounter some difficulty in classifying governments in Ireland, as the Labour Party is very small, there is no clear left-right cleavage, and the two largest parties, Fianna Fáil and Fine Gael, cluster to the centre-right. Furthermore, the prevalence of coalition government since the late 1970s means that the two larger parties have each governed with Labour. The presence of a small liberal party, the Progressive Democratic Party, in coalition with Fianna Fáil between 1997 and 2007, is credited with exerting a rightward influence on budgetary policy. Hallerberg et al. note that these latter coalition governments display rather lower ideological distance than the Fine Gael-Labour coalitions of 1983-87 and 1994-97, or the Fianna-Fáil-Labour coalition of 1992-4 (Hallerberg et al. 2007, p.345). This might be expected to help explain budgetary discipline after 1997, but it should have increased coalition tensions prior to that date. Yet expenditure-based consolidations were in fact successfully undertaken, especially in the late 1980s, and it is in the period after 2000 (outside the scope of the current paper) that we note the most marked trends toward fiscal loosening. The broad cross-class base of electoral support which all parties seek to maintain gives partisan explanations less traction in the Irish case than elsewhere.

Party politics is certainly an important part of the story of fiscal consolidation in Ireland. Spending restraints proved difficult to impose during the lifetime of the coalition Fine

Gael and Labour Party government of 1983-87, as the budgetary situation worsened during the mid-1980s. Instead, fiscal drag drew increased revenues from the existing narrow but steeply graded tax base (Hardiman 2004). The sharp turnaround in fiscal management strategy from 1987 was undertaken by a Fianna Fáil government. This was a minority government: what made it possible was the commitment from the opposition benches by the next-largest party, Fine Gael, not to oppose fiscal retrenchment measures, as these incorporated many of the commitments Fine Gael had tried but failed to implement. Cross-party policy agreement, rather than partisanship, explains the adoption and implementation of spending cuts.

However, party politics is only part of the story. The legitimization of spending cuts was a constant problem for the coalition government of 1983-87. What made it possible for Fianna Fáil to undertake the same measures successfully after 1987 was the negotiation of a tripartite pay pact, initially a short-term crisis management measure, but increasingly proving its worth as a coordinating mechanism over time (Hardiman 2002). The Irish trade union movement, like the British, is fragmented and based on a combination of skills, professional unions, and large general unions. Its base is narrowed by the growing economic importance of US multinationals that are resistant to any union presence. Over the decades, governments had periodically attempted to induce agreement to pay pacts, with little success. The social partnership agreements negotiated after 1987 introduced a new governance mechanism into Irish political economy that was adopted by all successive governments, in which all the major political parties participated. The objectives of Maastricht were internalized into the social partnership process and created the framework for wage and inflation target-setting right through to 2000 and beyond (Roche 2009).

Conventional accounts of fiscal consolidation in Ireland cannot readily explain why and how spending controls, underpinned by an explicit commitment to a low-tax regime, were adopted from 1987 on. Corporate taxation had long been subject to favourable terms and was the basis on which surges in FDI-led growth were enabled in the 1970s and again in the 1990s (Barry et al. 1999). Reforms in tax administration, in line with OECD trends, led to a broadening of the tax base in the late 1980s. But the cuts in headline personal tax rates that were a key complement to this would not have been

undertaken, and would not have been possible without risking inflation, in the absence of wage moderation agreements (Barry 2009). The unions traded wage restraint for tax cuts, in a deal that resulted in steady increases in disposable income, even as the base from which provision of collective goods could be funded was eroded (Hardiman 2006). Notwithstanding the marked deficiencies in the Irish welfare state, and the incapacity of the health care system to respond adequately to demand, deep-seated suspicion of government capacity to deliver services efficiently, combined with tax breaks for private insurance, bolstered support for personal income-maximizing rather than service-enhancing pay pacts. A low-tax, service-poor equilibrium became deeply embedded in Irish political economy as the engine for growth and employment creation.

A comparison with Britain is instructive. Both countries are liberal market economies; in both, a fragmented trade union structure made wage management during the 1970s highly conflictual. Both countries attempted strong fiscal stabilization measures around 1980. But the profile of adjustment in Britain is rather different, as Figure 3 below shows.

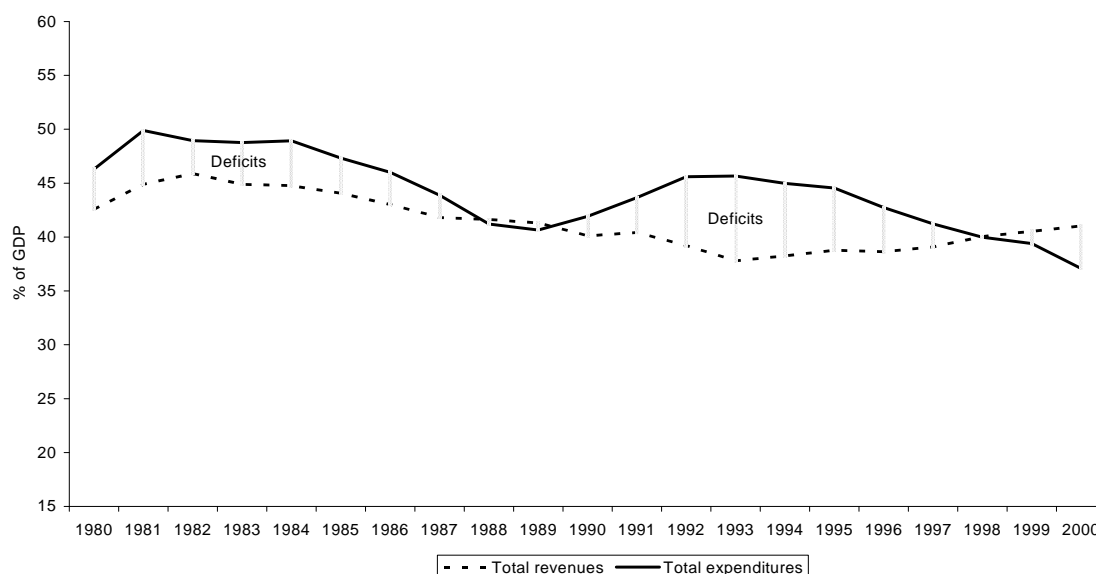


Figure 3. Revenue and expenditure trends in the UK, 1980-2000 (per cent of GDP)

Source: Own elaboration based on OECD Economic Outlook Database

Mulas-Granados classifies Britain as resorting more frequently to revenue-based adjustments (1980-82, 1988-9) than to expenditure-based adjustment (1996-2000)

(Mulas-Granados 2006, p.28). Alesina and Ardagna also view 1988 as a consolidation year (Alesina et al. 1998a, p.497). But what is perhaps even more striking is the very uneven trajectory in evidence over time. This is only in part explained by changes of government, because the Conservative Party held power until 1997, and the Labour Party which has been in government since then had pre-committed itself to the same spending targets as the Conservatives in order to increase its electoral credibility and to maintain the confidence of the financial markets. Britain has featured governments of long duration, the absence of coalitions, and a non-fragmented decision-making process. Yet a trend toward a stop-go policy style is apparent; so is a profile of mixed reliance on spending reductions and revenue increases. Britain shows an unusual pattern regarding partisanship, as Table 1 illustrates, since the Conservatives implemented two revenue-based adjustments during the 1980s and the Labour Party introduced a spending-based correction during the 1990s.

Three features of Britain's political economy may be contrasted with the Irish experience outlined above. Firstly, while Britain is also a liberal market economy, the historical inheritance of higher levels of social protection and welfare state institutions meant that gravitation toward a low-revenue equilibrium was not possible. Mrs. Thatcher's governments attempted to curtail spending on education, the NHS, and transfer payments; but despite her electoral successes, public opinion proved resistant to these core provisions being dismantled (Rhodes 2000). Secondly, Britain's brief experiment with managing the value of sterling within the European currency system left it vulnerable to the exchange-rate crisis of 1992 and resistant to the prospect of the Euro. It was not therefore subject to Maastricht criteria and did not need to attend to the spending constraints this entailed. Its growing exposure to international financial markets, with growing capital market deregulation and the diversification of increasingly complex investment products, left it with incentives to curb deficits. The newly independent Bank of England took over inflation targeting from 1997. But the British government was still relatively free to mix strategies of revenue and expenditure based consolidation. Thirdly, trade unions in Britain could exert only weak political influence, which also left central government with a relatively free hand. The marginalization of labour under Thatcher's early administrations was followed by the

organizational fragmentation of public sector unions, leaving virtually all sectors of the workforce more systematically exposed than ever before to decentralized wage-setting, responsive to local market conditions, and with much more attenuated national reference points than previously (Bieler 2008). From a situation in the 1970s during which Ireland and Britain had well-organized but poorly coordinated trade union movements, Ireland moved in the late 1980s toward government-led coordination efforts, while Britain moved in the opposite direction toward a deliberate strategy of labour disorganization (Crouch 2000; Traxler et al. 2001). This meant that British governments did not need to rely on effective social interlocutors, and further increased the autonomy of government in its strategic options.

The evolution of economic ideas also plays a role in explaining change in both the Irish and the British cases. In Ireland, the case for curbing public spending commitments came to be increasingly widely held, grounded partly in awareness of the role of the low-tax model in supporting its FDI-based growth potential, and partly in an acceptance of the argument that a large public sector is inherently a drag on growth. In Britain, the dispiriting experience of repeated electoral losses between 1979 and 1997 drove the Labour Party to undertake not only organizational modernization, but also radical modification of many policy commitments in a bid to reposition itself more favourably with the electorate. From its origins as a left of centre party, New Labour came to adopt many elements of neo-classical economic orthodoxies, which made it possible for it to accommodate an expenditure-driven adjustment by the late 1990s (Hay 1999; Wickham-Jones 1996).

Greece: revenue-based adjustment

In contrast to Ireland, Greece can be regarded as a paradigmatic case of revenue-based consolidation. Indeed, three out of four of the episodes of fiscal adjustment that Greece underwent in the post-authoritarian era were based on increasing structural revenues (Mulas-Granados 2006, p.28). Figure 4 shows the expansionary trajectory of Greek public finances in the period from 1980 to 2000. The size of the public sector expanded by almost 60% during this period, funded by a revolution in the revenue-raising capacities of the state. Total revenues increased by more than fifteen points of GDP.

Successive Greek governments faced the challenge of having to adopt measures to enforce fiscal discipline. Indeed, as Table 1 shows, Greece is the European country which is most likely to be involved in a fiscal adjustment process. Most of these are based on raising revenues rather than cutting primary spending.

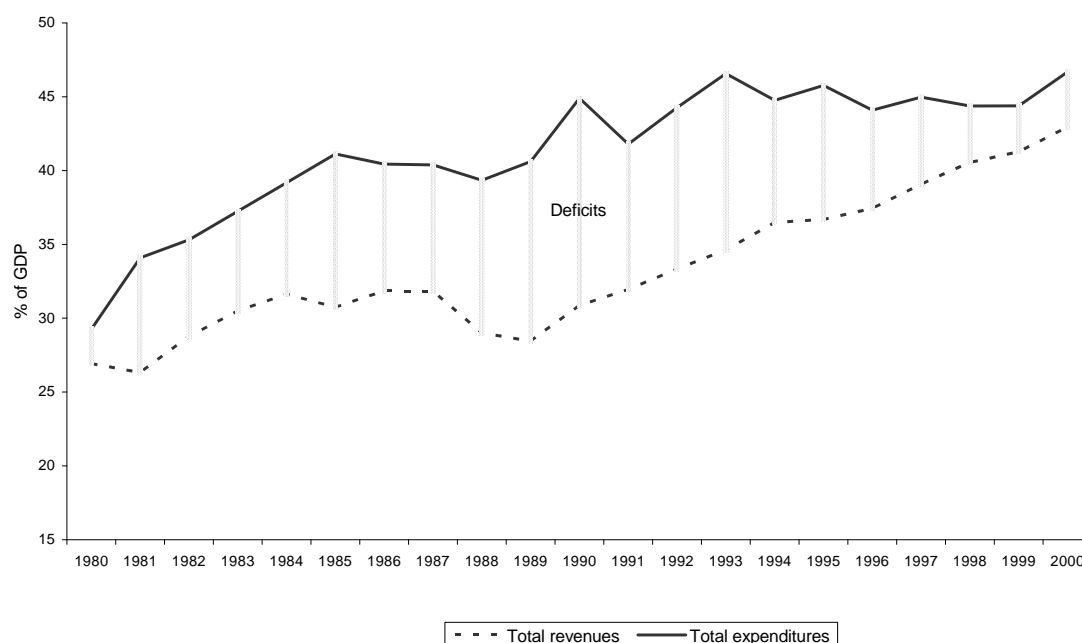


Figure 4. Revenue and expenditures trends in Greece, 1980-2000 (per cent of GDP)

Source: Own elaboration based on OECD Economic Outlook Database

Partisanship should explain much of the dynamics of fiscal consolidation in Greece. The Pan-Hellenic Socialist Movement, PASOK, has been the dominant political force in recent decades, and parties of the left tend to prefer revenue-based adjustments in order to protect government wages, public investment, and social transfers. But the partisan argument is not clear-cut. The revenue-based retrenchment of 1974-75 took place during the conservative-led democratic transition, and the socialists implemented expenditure-based adjustments in the period between 1994 and 2000. Nor can the fragmentation of decision-making be called upon to explain these anomalies: Greece is a unitary and highly centralized state, and governments and coalitions are not particularly large or short-lived.

Greece's fiscal trajectory is embedded in the political economic of growth, starting from a relatively low base in the 1970s. A relatively weak administrative capacity, and a fragmented and politicized set of organized economic interests, curtailed the governance options of parties in power. The country started out with a small tax take, poorly developed tax instruments, a weak tax administrative system, and low levels of compliance. The first socialist governments of Andreas Papandreu in the late 1970s presided over political as well as economic stabilization, with strong public sector support. During the 1980s, there was strong popular demand for more public sector employment and welfare expansion, giving rise to the creation of new services such the national health system in 1984. These new expenditures were met through increased taxation and improved tax administration. But in the 1990s, the same socialist party, this time led by Kostas Simitis, faced a radically different set of political economy constraints, both domestic and international. There was a recognition, however reluctantly arrived at, that the freer spending environment of the 1980s had led to populist excesses that needed to be curbed. This paved the way for a more modernizing and technocratic approach to policy-making, which was in turn externally enforced by the incentives embedded in the Maastricht convergence criteria.

But expenditure-based adjustments have been the exception rather than the rule in Greece. There is some confusion about the classification of episodes here too, and some studies suggest that the fiscal consolidation process of the 1990s was indeed a revenue-based retrenchment (European Commission 2000; von Hagen et al. 2002). The significant consolidation effort of the late 1990s only occurred in the context of a singular mix of incentives, not least the sense of urgency brought about by EMU conditionality. Yet Greece experienced a recurrent need to resort to fresh consolidation measures which appeared difficult to institutionalize stably. Greece is a country that tends to generate high public deficits and accumulate unsustainable debts. The average public deficit between 1970 and 2000 was second only to Italy's among the EU15 (Mulas-Granados 2006, p.28).

Persistent fiscal indiscipline reflects a weak governance system arising from features of state structures on the one hand and the profile of organized interests on the other. As Featherstone argues, policy-making in Greece features a particularly intense set of

structural constraints which create *une société bloquée*, with ‘systemic weaknesses deriving from the institutional capacity of the state, the regime of disjointed corporatism, and cultural practices of clientelism and rent-seeking’ (Featherstone 2005, p.223). The issue is not that the formal institutions are poorly structured. The problem is one of the government’s capacity to generate coherent policies that command sufficient consent among civil society, and the administrative system’s capacity to implement them: it is a governance problem. The Greek government is all too often entrapped in a stalemate bargaining game, unable to offer sufficient incentives to break deadlocks and overcome powerful vested interests.

The politics of interest intermediation in Greece may be usefully contrasted with the Irish experience. The scope for social dialogue in Greece is limited. Party politics is highly confrontational both between and within parties, and clientelist electoral politics is well established. But civil society is weakly organized, and the trade unions are highly politicized. There is little scope for creating stable structures integrating organized interests into administrative routines of consultation and coordination. Structural reform initiatives are likely to encounter resistance from within the system of ‘disjointed corporatism’. Economic policy-making is constrained by ‘the reproduction of a pattern of power relations relying on a weak and asymmetrically penetrated state apparatus’ (Lavdas 2005, p.309). Governments are obliged to undertake fiscal consolidation measures without the legitimating support of union and employer consent. This leaves open the further risk of populist lobbying from potentially disadvantaged sectors, and reinforces politically destabilizing clientelism as governments seek to shore up their electoral support base.

Post-authoritarian stabilization policies need not take this form, as a brief comparison between Greece and Spain reveals. These countries share common economic development patterns, welfare state profiles, processes of modernization through Europeanization, and a Southern European political culture. Yet despite these similarities, these two countries have undertaken contrasting policy paths in many areas, including the management of their respective public finances. The economic policies of their respective left-wing governments, Greece’s PASOK and Spain’s PSOE, diverged markedly through the 1980s (Pagoulatos 2004). The Spanish socialist party made

decisive efforts to converge to the new economic orthodoxy of austerity and market liberalization, while the Greek socialists continued to practice outdated economic expansionism and populist distributionism well into the late 1980s. As a result, public deficits and inflation in Greece peaked during the early 1990s. Both Greece and Spain had relatively similar public sectors, with low ratios of expenditure to GDP, in the 1970s. Yet as Figure 1 showed, Greece followed a more expansionary fiscal path during the 1980s and 1990s. Even though we have shown that Greece relied on increasing public revenues to fund its spending ambitions, Figure 5 below shows that Greece faced more severe problems than Spain in successfully financing the growth and modernization of its welfare state, and that deficit levels constantly outstripped Spain's, often by a large margin.

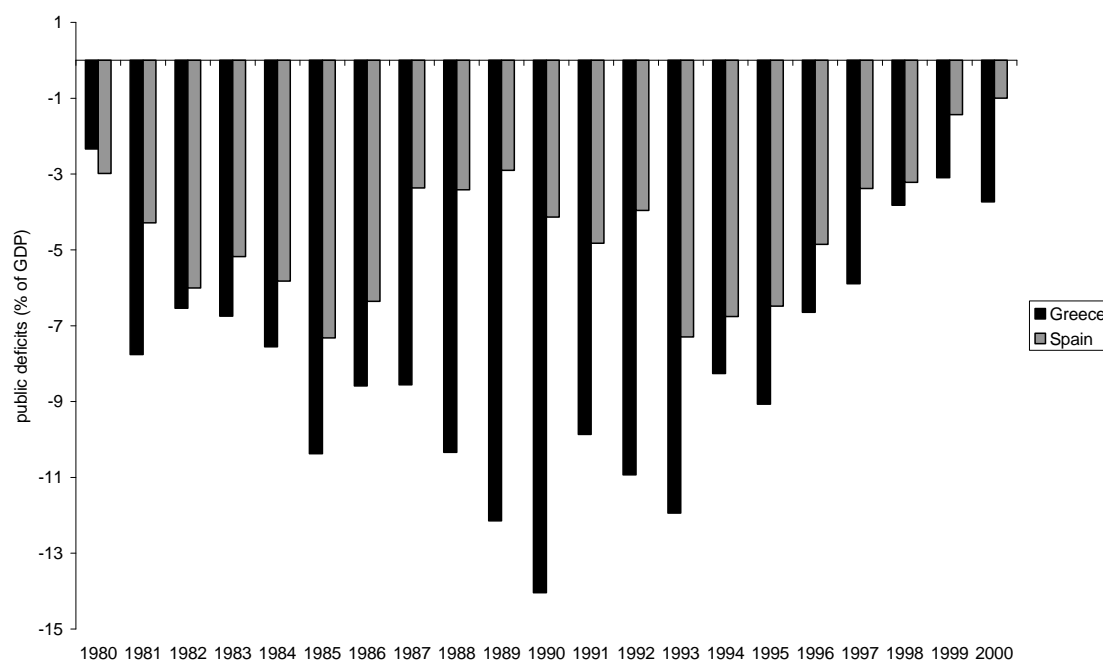


Figure 5. Borrowing requirements in Greece and Spain, 1980-2000 (per cent of GDP)

Source: Own elaboration based on OECD Economic Outlook

The partisanship thesis is helpful in explaining the fiscal trajectories of these two countries, as both PSOE and PASOK have preferred to implement revenue-led consolidations, while the Spanish right-wing Partido Popular (PP) enforced a substantive expenditure-based adjustment between 1996 and 2000. However, the

partisan argument cannot explain why the Spanish socialists (and indeed the Spanish conservatives) have been consistently more successful than their Greek counterparts in enforcing fiscal discipline on a permanent basis. Nor can it account for the shifts in PASOK's own policy stance over time. This can only be understood by looking at the competition for influence within the party between ideological factions – difficult to capture with a single indicator of partisanship, but with far-reaching policy significance.

A comparison between Greece and Spain shows that the constitutional and administrative politics of budget formation only captures part of the variation in institutional configurations. We also need to take account of the terms on which governments engage with powerful social actors in the process of bargaining and implementing fiscal adjustments. Spain enjoyed certain advantages in the form of highly-disciplined political parties and a *pactista* tradition that had successfully facilitated the democratic transition (Pérez-Díaz 1993). Spain was able to manage the transition to 'modern' class and interest-based civil society organization, even though still characterized by separate partisan affiliations, facilitating a basis for consensus-oriented bargaining. But economic interest organization in Greece continued to be fragmented and highly conflictual, providing a weak base for social pacts (Avdagic et al. 2005).

The role of ideas in shaping the range of feasible options was also different in Greece and in Spain. Greece's adherence to high-spending economic policies during the 1980s was underpinned by a perception widely shared in government circles of a relatively weak set of domestic and external constraints on their policy choices. A dominant culture of national exceptionalism in Greece led to economic policies based on political voluntarism and ideological maximalism. In contrast, the prevailing belief structures in Spain created the conditions for a strong endorsement of the European project. This further strengthened the commitment to administrative modernization and the prevalence of technocratic criteria in budget formation (Pagoulatos 2004).

Contrasting deficit profiles

Looking at our four cases, Ireland in relation to Britain, and Greece in relation to Spain, we might also note some commonalities as well as variations in the profile of budget

deficits. Firstly, Figure 6 below shows Britain to be more deficit-averse, on the whole, than any of the other countries. This may at first seem paradoxical, given the prominent place of deficit targeting in the EMU project, since Britain is the only one of our four cases to stand outside the European exchange rate system and the Euro. A permanent commitment to lower deficits is attributable, rather, to its situation as a hub of international finance. Formal independence for the Bank of England after 1997 intensified but did not fundamentally alter these features. Growing political demands for welfare-oriented spending as Labour bedded down in office proved hard to match with revenue increases. Despite recourse to so-called stealth taxes, Britain's revenue-enhancing capabilities have not kept pace with spending expectations, and the current financial crisis finds Britain exposed to a high deficit, with plummeting revenues failing to match spending commitments that are consistently higher than any of our other three countries. But monetary and exchange rate autonomy also permits greater autonomy in its fiscal response to international crisis than is available to the Eurozone countries. Gordon Brown's Labour government undertook a classic Keynesian fiscal stimulus programme, with tax cuts and spending increases, to bolster demand and support employment. Britain had gained a competitive advantage from the gradual depreciation of sterling relative to the Euro during the 2000s. A large primary deficit causes it fewer worries than would be the case for Ireland, for example, where downgrading by international credit rating agencies limits the scope of feasible policy choice and constrains the set of ideas deemed appropriate to respond to the crisis.

As we have already noted, among our four cases Greece displays the weakest capacity to manage deficits due to its institutional and administrative deficiencies. Ireland exhibits the most marked fluctuation between failures and successes, Spain the least.

Our comments about the role of social pacts in facilitating adjustments in Spain and Ireland are reflected in the trends toward sharply reduced deficits in the periods in which pacts are in effect. In Ireland, a particularly strong contrast is apparent between the pre-pact and post-pact situation (assisted of course by especially strong growth between 1994 and 2000). Spain's especially sharp improvement after 1993 is similarly attributable in large measure to improved governance capabilities arising from coordination of labour market interests.



Figure 6. Evolution of budget deficits, 1970-2007 (per cent of GDP)

Source: Own elaboration based on OECD Economic Outlook Database

Policy implications: are expenditure-based adjustments better?

Fiscal consolidation is a subject of enduring political interest, and policy implications have been drawn from past experience, not least by the European Commission itself, that are intended to guide future government choices. The normative agenda has been dominated by the debate surrounding expansionary fiscal adjustments (EFAs). The received wisdom is that ‘corrections that are mainly based on current primary expenditure, in particular the government wage bill, are more likely to be successful than corrections relying on higher revenues or cuts in investment expenditure’ (European Commission 2007, p.196). This claim, drawn from the work of Perotti, Alesina and Ardagna, and others, is that expenditure-based adjustments, that is, spending cuts to secure deficit reduction, have an expansionary effect on economic growth, without incurring adverse electoral consequences. Thus the case for

expansionary fiscal adjustments has acquired the status of a 'policy paradigm' (Hall 1993). How persuasive are these arguments about how best to secure successful consolidations? Are expenditure-based measures really both economically and electorally optimal?

We believe that inferring lessons from prior consolidation experiences is problematic at best and misleading at worst. We have argued that some of the factors that best explain outcomes are deeply embedded in a country's political economy and that national models are not readily amenable to export. National development paths and national patterns of interest intermediation are path dependent and time-bound. Firstly, spending cuts needs to be supported by wage moderation and the defusion of distributive conflict to legitimate the strategy, and this in turn is likely to mean that the government needs viable interlocutors among organized employer and union interests. Secondly, some of the factors that have clearly shaped past stabilization experiences go beyond the control of national governments and are no longer available in the current international political economy. Chief among these is the role played by devaluation in securing stable expenditure-based fiscal consolidation (Alesina et al. 1998a, p.516). Ireland's experiences in the late 1980s have been cited as a classic instance of non-Keynesian EFA (Giavazzi and Pagano 1990). But the fiscal disciplines alone did not secure renewed growth. The combination of wage moderation with devaluation, against a backdrop of international economic recovery, increased competitiveness, improved the terms of trade, and boosted export opportunities (Barry 1991). This is rather different from the readily exportable policy remedy it is sometimes represented to be. Thirdly, expenditure-based cuts may have made sense as a credibility-boosting strategy against the backdrop of widespread credit market imperfections during the 1980s and 1990s. But the current crisis has been preceded by a long period of low interest rates and credit expansion. The value of the strategy as a credibility-securing mechanism to prepare the way for future growth is now, at best, questionable.

The mechanisms through which a strategy of EFA is said to work tend to radically underestimate the importance of political factors to make it work, especially the need for government to secure the legitimacy of its strategy. Procedural rules and the phasing of elections are not the only or even the most important political variables that matter

(European Commission 2007). Spending cuts are said to secure credibility by signalling a commitment to economic orthodoxy. Tight control over spending would be expected to result in better resource allocation and lower interest rates, which would trigger consumption and investment booms through non-Keynesian channels. But the relationship between economic discipline and credibility is problematic (Dellepiane-Avellaneda 2005). Not all expenditure-based efforts are credible, especially if they provoke electoral resistance and societal conflict. They may even risk incurring credibility losses, not gains, through undermining coalition support and increasing political contestation, leading in some cases to the breakdown of the governing coalition – precisely the experience of Argentina in 2001. The political sources of credibility, including the trade-off between macroeconomic consistency, coalition cohesiveness, and public opinion support for stabilisation policies, need to be kept clearly in view.

The political dimension of some economic variables is also overlooked in the literature. For example, devaluation of the exchange rate often preceded successful stabilizations, easing the realignment of relative prices and especially of wages. But devaluations also played a key political role by allowing governments to accommodate distributive struggles: devaluation and the inflation associated with it have a smoothing effect during the transition. Most European countries can no longer do this. Any alternative EU-centred strategy would require the development of a redistributive capability to complement its monetary policy, which would be bound to be severely contested at both national and European levels. The political sustainability of EMU itself may be called into question, particularly if parties and voters were to blame Brussels for unpopular adjustment policies (McKay 1999).

Advocates of EFAs argue that adjustments which target primary expenditures are not necessarily punished at elections, and that adjustment strategies based on cutting spending rather than raising taxes may work best for political sustainability. The key issue here is how best to assess the political consequences of expenditure-cutting adjustment. If governments do not in fact pay a heavy electoral price, it may be that voters reward the credit and consumption booms that often follow a successful stabilization plan rather than the fiscal strategy itself, so the timing of elections becomes crucial. It may be that a perception of crisis induces a passive if grudging acquiescence

to unpleasant policy choices, where no alternative seems available. In either case, the success of a stabilization plan is a function of credibility, which needs to be generated through the mobilization of costly institutional and political resources. It is a high-risk electoral strategy that can come unstuck at many points. The fact that many governments (even right-wing coalitions) continue to avoid expenditure-driven adjustments suggests that fiscal conservatism is less attractive than suggested by the literature on consolidation. And more recent empirical evidence suggests that electoral costs associated with expenditure-based adjustments may be more severe and more common than had previously been recognized (Mulas-Granados 2004).

Conclusion

This paper has argued that conventional analyses of fiscal consolidation, based either on segmenting episodes and analysing them as discrete observations, or comparing budget profiles at two points in time, are less than satisfactory. They fail to capture the dynamic and path-dependent evolution of fiscal consolidation strategies. Much detail is lost as ‘country fixed effects’. We have made the case for a new approach to thinking about fiscal consolidation that locates politics in time: we think much can be gained by looking at pathways to consolidation rather than episodes of change. We wish to look beyond the conventional forms of institutional and partisan explanations, and to renew interest in the core issues of political economy. Among these are the role of interests and ideas, the domestic politics underpinning the legitimation of fiscal adjustment policies, and the changing context of the international political economy.

Our case studies featured a comparison between Ireland as the most pronounced case of expenditure-based consolidation, and Greece as the clearest instance of revenue-based adjustment. We also considered the cases of Britain and Spain to provide variation within each case-study type. These exploratory but theoretically well-grounded investigations convince us of three key points. Firstly, the politics of interest intermediation is vitally important in securing stable consolidation. Where it is possible to negotiate social pacts to secure wage moderation and to legitimate the adjustment strategy, it is likely to be more durable, as in Ireland and Spain. Britain’s governance mechanisms are more unbalanced as they rely more heavily on links with employer and

financial interests than with the representation of union interests. This reduces the need for wage-managing negotiations, but increases the need to attend to electoral legitimation, which is arguably one of the major challenges faced by the Labour Party in power during the 2000s. Where interest intermediation is weakly institutionalized, politicized and conflictual, as in Greece, the destabilizing potential is significant.

Secondly, changes in the ideas and policy paradigms in official circles condition governments' perceptions of feasible policy options. These change over time in each country, but they are not uniform at any one time and may be the subject of contestation and factional competition within governing parties themselves. We have noted that Spanish policy debates feature a reasonably coherent account of the Europeanizing and modernizing process, consistent with a revenue-increasing but fiscally prudent strategy. Irish political circles, having experienced partisan conflict within the governing coalition over the need for expenditure cuts during the 1980s, thereafter adopted a quite widely legitimated view of the need for expenditure-restraining priorities. In Britain, the Labour Party underwent a long-drawn-out adjustment of its ideological orientation, such that its initial commitment upon its election in 1997 was to implement the Conservative Party's budget projections. In Greece, priorities and objectives originating in wider European debates did not secure a legitimate foothold. This resulted in a higher level of ideological contestation over policy options than elsewhere.

Thirdly, we argue that the importance of the international dimension has been systematically underestimated in conventional analyses. Individual countries' strategic choices are shaped by the stage of the international business cycle. The option of devaluation to ease a consolidation strategy proved crucial for both economic and political reasons in the era prior to European Monetary Union. This is no longer available to Eurozone members, and is much costlier to other countries too, in the context of the internationalization of financial services and increased reliance on transnational financial products. And finally, the manner in which national economies are embedded in the international economic system shapes their evolving development models and growth strategies, in ways that are rarely conceptualized let alone modelled in conventional analyses.

The current global economic crisis is provoking a dramatic deterioration in governments' fiscal positions. Substantial budget consolidation will be unavoidable in most industrial democracies (OECD 2009). We have shown that the 'lessons from successful consolidations' are less straightforward than often suggested. Two main arguments have been highlighted. The first is that international conditions that facilitated fiscal consolidation in the past are no longer present, and without the option of sharp devaluation, the pain of adjustment may be both politically and economically unmanageable. The second is that the fiscal consolidation literature has overlooked core issues in domestic political economy, including the role of interest representation, political legitimacy, and policy contestation. Without bringing politics back into the frame, the analysis of what would work and what would not work in fiscal consolidation policies is unlikely to deliver plausible policy advice.

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