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# **The Politics of Tough Budgets: The Eurozone Periphery 2008-2012**

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## ***Abstract***

The global financial crisis opened large budget deficit and public debt problems in the countries of the Eurozone periphery – Greece, Ireland, Portugal, Spain. All have been required to adopt budget retrenchment measures, particularly so for the first three once they entered EU-IMF loan programmes. This paper analyses the dynamics of fiscal responses to the crisis across the four cases, using the content of budget decisions and the profile of budgetary outcomes as the principal primary data. These countries provide interesting variation on several dimensions: in the origins of the crisis (with different mixes of public and private sector debt), in initial responses to the crisis (prioritizing an expansionary or a contractionary stance), in the composition of budget adjustment (revenue-raising or expenditure-cutting), and in the evolution of their budgetary stance over time. The paper uses the full resources of case study methods to examine the policy configurations that underpin commonality and variation, and to expose the elements involved in complex causal processes. This analytical strategy enables us to investigate the political economy conditions underpinning fiscal policy choices in hard times.

## ***Introduction***

The countries of the European periphery – Ireland, Portugal, Spain, and Greece – have experienced several years of tough fiscal measures in response to the global economic crisis that began in 2008. The sharp downturn in economic activity, resulting in reduced revenue flows and increased demands on government expenditures through welfare entitlements, produced a sudden widening in fiscal deficits. It also resulted in a crisis of confidence in these governments' borrowing capabilities. As financial institutions were the largest purchasers of government bonds, their retreat from the markets resulted in a growing problem in sovereign debt funding for the countries already suffering the greatest downturn. Increased provision of liquidity by the ECB in 2011 and 2012 eased this situation somewhat. But the European authorities' response to crisis continued to accord top priority to immediate fiscal stabilization of the countries most severely affected. Countries in loan programmes were expected to restore market confidence in their capacity to borrow within a relatively short span. Creating a framework for strong fiscal discipline in the medium to long term became the top priority in the EU policy response.

All four countries have therefore encountered strong pressures to reduce their budget deficits to the 3% mandated by the Stability and Growth Pact, and to implement a strategy to bring down their total government debt. They are required to do this while still in the grip of recession, with no possibility of securing competitiveness gains through devaluation, and in the absence of any international generator of demand to facilitate economic growth. This makes the current phase of fiscal adjustment different from the experiences of fiscal consolidation in the 1980s and 1990s.

Therefore the way we approach the study of fiscal adjustments needs to be reconceptualised. The standard analysis in the earlier period looked for a sustained improvement in the public balance sheet, over a specific period of time. But analysis focused on outcomes is likely to be misleading, particularly during an economic downturn. Fiscal retrenchment efforts, expressed as a proportion of GDP, may become invisible if GDP itself is declining (Leigh, 2010). We focus instead on the politics of fiscal effort, that is, the budgetary decisions governments make about expenditure cuts and tax increases. These require often considerable economic and political effort, even if they make relatively little sustained impact on outcomes.

All four countries of the European periphery experienced a common policy challenge when their economies contracted, unemployment rise, and budget deficits increased sharply. It quickly became apparent that in the absence of a coordinated European response to the crisis, individual countries

would be expected to take responsibility for their own stabilization. All four therefore quickly found that their capacity to fund government borrowing was now severely compromised, as market lenders disaggregated the risk associated with lending to different Eurozone members.

And yet, in the face of a common shock, we see a good deal of variation in the way these countries responded to crisis. There are differences in the timing of the shift from expansionary to austerity measures. There are differences in the composition of the adjustment measures adopted, that is, in the degree to which they rely on expenditure cuts or on revenue increases. There are differences in the ease with which governments were able to implement their chosen strategy.

Economists' explanations of government strategies in fiscal consolidation tend to emphasize countries' initial conditions as they enter the crisis period. For example, initial deficit and debt levels are looked to in order to explain the timing and size of consolidation; the size of the tax burden at the onset of crisis is taken to explain the adoption of spending-based or revenue-based consolidation. We acknowledge that initial conditions are important because they shape the options open to governments. However, we argue that fiscal decisions are not automatically given by market conditions, but are strongly shaped by politics. Policy decisions are under-determined by initial economic conditions. In this paper, we analyse the way politics mediates the relationship between initial conditions and policy choice.

## ***Research design***

Our approach analyses variation across four countries in the kind of fiscal measures adopted in response to crisis. We can characterize the options in two stylized models, which we might term orthodox and heterodox. These differ from each other on several key dimensions: in the kind of effect they have on economic activity; in the timing of their intervention, in the size of the impact on economic activity, and in the composition of the measures.

The orthodox approach is the one favoured by the Eurozone authorities: see for example the representative views articulated by German Finance Minister Wolfgang Schäuble in September 2011 (Schäuble, 2011). It prioritizes deficit reduction, and has a contractionary effect on economic activity. If undertaken in the course of an economic downturn, it will have pro-cyclical effects, but these are deemed necessary in order to generate confidence that a sustainable fiscal strategy is in place. This in turn is expected to facilitate a return to growth in due course. In the orthodox approach, preemptive action is therefore prioritized. It holds that it is better to front-load the necessary adjustments, on the

grounds that delay induces extra unwarranted costs in the eventual adjustment that would be necessary. And finally, the orthodox model prioritizes expenditure cuts over revenue increases as a means of achieving progress toward fiscal balance, since it is assumed that this approach is more durable and less likely to result in slippage in achieving deficit targets. This is taken to be a robust finding from the literature of the 1980s and 1990s, and although it has been challenged on both theoretical and empirical grounds, it is a recurring theme in contemporary policy advice.

In contrast, what we here term the heterodox approach is broadly Keynesian in nature. The emphasis is on expansionary measures or fiscal stimulus in an economic downturn, and while the need for eventual stabilization is recognized, it is deferred until after growth has resumed. The size and impact of expansionary measures can therefore be viewed as gradual. The preferred method of generating a fiscal stimulus involves a greater reliance on tax cuts than on spending increases. In 2011 the European Commission noted that:

As there is considerable evidence that expenditure-based consolidations are more likely to succeed than revenue based ones, it is a positive sign that the countries that are most in need to consolidate are turning to expenditure to reduce their deficits (European Commission, 2011i, p.41).

The main features of this typology of fiscal policy choice are set out below in Figure 1.

Figure 1. Typology of fiscal policy choice

Our four countries vary on all these dimensions in the approach they adopt to fiscal adjustment measures. Firstly, they vary in their initial response to crisis. In Spain and Portugal, governments increased their discretionary fiscal spending in avowedly heterodox responses to the sudden drop in GDP. In Greece, the government response was to continue with expansionary measures already in place. In Ireland, in contrast, the government adopted an orthodox stance much sooner – and indeed, was widely criticized by most professional economists for delaying too long in doing so.

Secondly, they vary in their response to crisis over time. In three of these countries, the European authorities became a key agent of policy change. The European Commission initiated Excessive Deficit Procedures against Ireland, Greece and Spain in October 2008. The proximate cause of the most profound policy change was the intensification of the crisis such that countries' sovereign borrowing capacity was threatened. The Greek debt crisis, which resulted in its entering a loan programme in May

2010, was the trigger. Ireland was obliged to avail of an EU-IMF loan in November 2010, and Portugal in April 2011. All three countries' fiscal adjustment measures have therefore been subject to close scrutiny and continuous monitoring since then. Spain's fiscal status also came under intensified pressure, and it too was obliged to adopt orthodox adjustment measures in mid-2010.

The European context shaped domestic policy responses, yet within the framework of EU policy priorities, we see a good deal of variation in the actual policy choices adopted by our four countries. EU Excessive Deficit Procedures against Ireland, Greece, and Spain, initiated in October 2008, required these countries to initiate contractionary measures to reduce their fiscal deficit to the 3%, the target required by the Stability and Growth Pact, by 2014. This did not require any particular combination of measures. The stepwise and cautious response of the European authorities to crisis in the periphery resulted in a loss of confidence on the part of the financial markets, causing them mounting difficulties with their domestic borrowing requirements. The fiscal problems of these states, which had originated in problems of banking sector liquidity and ultimately solvency, now became a sovereign debt crisis. In rapid succession, Greece, Ireland and Portugal entered EU-ECB-IMF loan programmes: Greece in May 2010, Ireland in November 2010, and Portugal in May 2011. Once under the direct surveillance of the European authorities, all three countries were required to undertake strongly front-loaded consolidation measures that were heavily tilted toward expenditure cuts rather than increased revenues. But it should nevertheless be noted that while this represented a major change of course for Portugal and Greece, it was entirely consistent with the domestic preferences already in evidence in Ireland.

Spain did not seek assistance from these programmes, and was considered 'too big to bail' (Jones, 2010). Spain therefore also came under increased pressure from the European authorities to alter its policy stance under its Stability and Convergence Programme, and to adopt more stringent and front-loaded austerity measures in order to restore the market confidence that would enable it to continue borrowing on the international markets at acceptable rates. The change of policy orientation in Spain came in May 2010, immediately after the Greek loan agreement. In the context of soaring borrowing costs, Socialist (PSOE) prime minister Zapatero announced a radical shift in government policy and the start of a new strategy of fiscal retrenchment. This cost the government very heavily: its popularity began to sink from that moment, and the PSOE lost heavily in the elections of November 2011. But Spain was not obliged to accept the full logic of heavily expenditure-based measures, and displayed a policy mix that slightly favoured revenue-increasing measures over spending cuts.

Figure 2 below summarizes these trends, giving us a research design that allows us to compare countries' experiences cross-nationally, and also to analyse within-country variation over time.

Figure 2. Countries' fiscal stance over time

We can identify a good deal of variation in the projected composition of fiscal adjustment, looking at the balance between spending cuts and tax increases. These data are summarized in Figure 3.

Figure 3. Planned changes in revenue and expenditure over 2010-2014

This figure shows that anticipated fiscal adjustment is heavily biased toward spending cuts in all EU member states. The European Commission noted that:

In 2010, the slight improvement in budgetary positions in the euro area was entirely the result of a lower expenditure-to-GDP ratio which was mainly due to lower public investment... revenue ratio remained stable overall between 2009 and 2010, while expenditure fell (European Commission, 2011i, p.27).

Figure 4 shows the anticipated trajectory of budget adjustment for our four countries. 2008-10 are actual data, and 2011 and 2012 date are estimates (already overtaken by events in Greece, as we shall see below).

Figure 4. Revenue and expenditure in four countries, 2008-2012, % GDP

These graphs reveal the increase in spending and the tax cuts put in place in Spain and Portugal in 2008-9, during the period of fiscal stimulus, and the subsequent turn toward austerity measures from 2010. In each of the four countries, somewhat greater weight is given to reduction of public spending as a proportion of GDP, rather than to increases in public revenues. A very large expenditure-based adjustment is projected in Greece. Ireland also is projected to rely more heavily on expenditure reduction, with revenue trends rising very little; Portugal's expected adjustment profile resembles Ireland's. In Spain, the anticipated trend is still for greater weight to fall on spending cuts than on tax increases, but with a greater reliance on increased revenues than in any of the other three countries.

The profile of budget adjustments undertaken in each of the four countries is summarized in Appendix A, Tables, A1-A5.



## ***Explaining policy choice***

Economists' analyses of the determinants of fiscal policy choice are generally concerned with establishing regularities in relationships between variables. But this methodological approach misses some of the crucial features of what is really at issue. Firstly, as with all variable-centred analysis, the focus on central tendencies abstracts away from the different ways in which variables are embedded in their context. A qualitative case-study approach overcomes this limitation, and lets us focus on the complexities of decision-making under conditions of uncertainty in real time. Decision-making is always embedded in an institutional context that is itself relatively invariant – there are strong path dependencies at work in shaping the options available to policy-makers. We need to be able to understand 'politics in time' (Pierson, 2004, Dellepiane and Hardiman, 2011). Secondly, economists' approaches abstract away from the conflictual issues that inevitably arise in making tough decisions about how to distribute the pain. Technical advice may be indispensable, but it is often contested and under-determined in relation to the available evidence. The choices about which options to adopt are ultimately political – 'policy requires politics' (Gourevitch, 1986, p.1).

### 1. Initial conditions

A country's fiscal trajectory in the years preceding the crisis has an important bearing on the nature of its response to crisis. This is not because of economic determinism; nothing should be read a priori into a country's choices simply in virtue of its fiscal starting position. But the policy options look rather different for governments facing a solid surplus, compared with governments already carrying a fiscal deficit. A country without a deficit or with a surplus entering crisis has more scope to engage in heterodox stimulus measures, should it choose to do so, and has scope to accommodate a fall in GDP without incurring the negative repercussions from the markets of incurring a large deficit (Ostry et al., 2010). A fragile revenue base or strongly expansionary spending commitments in the run-up to crisis, even under conditions of balanced budgets, can leave a country vulnerable to a more severe experience of crisis. Moreover, the policy options available to government are not infinite: the policy mix in place prior to the crisis constrains some options and incentivizes others. Policy options are embedded in an institutional network and relations with organized interests and other key actors, so there is a path dependent aspect to policy options. A change of policy direction may then require investment of political and reputational effort in order to shift orientation.

## 2. Domestic factors

But information about countries' initial fiscal position only sets the scene for policy choice – it cannot account fully, by itself, for the variation we have noted above in the choices countries have actually made. Since we adopt the classic political economy view that policy choices are embedded in institutional structures and networks of policy actors, this points us toward some key factors that are relevant to explaining cross-national variation in policy response. Three are salient here: the role of policy ideas; the policy capacity of the state; and the ideological polarization in the party system, since partisanship also has implications for the relationship between parties and of organized interests in the coalitions of interests built up to make and implement difficult policy choices.

By 'ideas' we mean the dominant discourse or policy paradigm that shapes the framework of policy debate in a country (Blyth, 1997, Béland and Cox, 2011, Schmidt, 2010). Policy ideas may of course be contested. They may well be aligned with the partisan divisions in the political party system – our variables are not clearly distinguishable from each other – for what we are most interested in is the cluster of political conditions that obtain in shaping the moments of decision-making. We think that 'ideas' play a role both in the initial response to crisis and the timing of adoption of orthodox measures, and in the composition of policy adjustment when an orthodox adjustment strategy is implemented. We anticipate that a preference for orthodox measures will be favoured at the onset of crisis where market performance is prioritized, and that heterodox or stimulus measures will prevail where statist policy ideas that legitimate counter-cyclical policy are already well accepted. Once fiscal retrenchment measures are adopted, we anticipate that spending cuts will weigh more heavily where dominant ideas within the policy-making community favour market-conforming outcomes. We anticipate that tax increases will weigh more heavily where dominant ideas within the policy-making community understand the state to be a key actor both in production and distribution.

The policy capacity of the state is also a key intervening variable in shaping variation in policy response. By this we mean both what it is relatively easy or difficult for policy-makers to undertake. Making and implementing policy requires some convergence among key policy actors on relevant ideas, as identified above. But formulating and implementing policy effectively involves many difficulties in negotiating sufficient consent, dealing with the legacy of past policies, and ensuring that policy decisions are put into effect. Capturing the features of 'good governance' and administrative capacity is challenging. As Weiss notes, effective policy making and implementation requires sufficient capacity to consult to ensure that appropriate information and advice is available, and that the solutions will be relevant to

the problem addressed: this implies networks of advice and flows of information between civil society and the state. But effectiveness also requires that decision-making should be sufficiently distanced from civil society interests to permit critical evaluation of past policy and to make it possible to change policy direction or impose difficult decisions (Weiss, 1998). In essence, this is what Rothstein and Teorell mean by ‘impartiality’ as a key measure of the quality of government, that is, what we might think of as the ‘Weberianness’ of the public administration (Rothstein and Teorell, 2008).

Our third consideration has to do with the spread of ideological opinion in public life and the role of veto players in domestic politics. These themes are important in two domains: in parliamentary politics, and in the political role of organized interests and especially economic interests; these two dimensions can also overlap extensively. The fragmentation of the parliamentary party system can make it more or less difficult to general sufficient agreement about the appropriate policy response to crisis. The electoral base of party support, and parties’ freedom of action in relation to their core supporters, can vary in important ways. Whether or not government can build coalitions of support among organized interests may make an important difference to the choices made. We anticipate that strongly ideologically divided party systems will result in sharper partisan conflicts and more conflictual alignments of societal interests (including trade unions). On the other hand, cross-party agreement on the definition of the problem does not preclude partisan differences regarding the nature, timing and composition of the policy response. A summary of variation in the key explanatory variables is set out in Figure 5 below.

Figure 5. Key explanatory variables

### ***Initial conditions***

The initial fiscal conditions in the four countries of interest display interesting variation. Neither Spain nor Ireland had a fiscal deficit in the years prior to the crisis: both ran budget surpluses during most years of the 2000s. In contrast, both Portugal and Greece were already running ongoing fiscal deficits before 2008. However, they were not exceptional in this. The average deficit profile of the Euro17 was also negative for most of the 2000s. In 2007, while only Greece (at -6.5% GDP) and Portugal (at -3.1% GDP) were in breach of the 3% SGP rule, and were the worst performers in this regard, the UK, France, Italy, and Austria were also running negative numbers. Figure 6 shows the profile of government deficits over time.

Figure 6. Net lending and borrowing under the EDP (Excessive Deficit Procedure), % GDP

But the fiscal profile only captures one dimension of the problem burden of these four countries. Only in Greece was the crisis primarily one of poorly controlled public finances. Portugal's deficit and debt problems stemmed mainly from the fact that growth performance, having been good during the 1990s, had slowed during the 2000s, as rising domestic costs lost it export markets. In contrast, Ireland and Spain had experienced very rapid growth during the 2000s. In both countries, access to cheap credit had caused a property boom, with massive investment in property, and heavy bank lending for construction purposes. When the crisis hit, the bubble burst, resulting not only in a sharp rise in unemployment in construction sector, but heavy bank liabilities as the value of their loans plummeted. Ireland and Spain share the common feature that their banking crises were not mainly due to speculation in complex derivative products or exposure to the US markets, but stemmed largely from home-grown policy mistakes (Conefrey and FitzGerald, 2010).

Figure 7 shows the composition of total debt across a range of countries. From this, it is clear that Greece's public sector debt burden is considerably heavier than that of any other country. While Ireland was running a sizeable public deficit, it is clear that financial sector debt is the principal source of its current fiscal problems. Spain and Portugal are similar to one another in that both lean toward having greater private than public sector debt problems.

Figure 7. Composition of debt in large OECD countries and in the four Eurozone peripheral countries, 2<sup>nd</sup> quarter 2011

What is most important, of course, is how the private sector indebtedness is being wound down, and how the recapitalization of the failed banking sector is being managed across Europe. Ireland acted early on this, in the face of an imminent collapse of the banking system in September 2008, and most unfortunately, as it transpired. It provided a blanket guarantee not only to the depositors of its banks, but to all bondholders, even those without legal entitlement to recompense. When the time came to revisit this guarantee, Ireland was already in the EU-IMF loan programme, and it was obliged to renew the guarantee and to eschew the possibility of private sector involvement in managing the costs of the failed banks (O'Brien, 2011). This means, as Figure 8 shows, that a very large share of the rescue of the banks has been socialized in Ireland, and on a scale that outstrips even that of Iceland.

Figure 8. Direct fiscal costs of the banking crisis, 2007-2009

The scale of the fiscal effort required in each of our four countries varies a good deal as a result, as Figure 9 shows.

Figure 9. Budget efforts required 2010-2020 to reach 60% debt/GDP ratio by 2030

Ireland and Greece faced the most challenging fiscal consolidation effort. The fiscal effort required of Spain and Portugal is quite comparable and is at a lower level than that of Ireland or Greece. However, these projections are subject to constant revision, and the evolving crisis in Greece makes these long-run projections particularly problematic. As Figure 10 shows, Greece has been required to undertake a much more extensive fiscal consolidation effort than any other EU member state to date – and without the benefit of the major devaluation and debt repudiation that has greatly eased the recovery prospects of Iceland.

Figure 10. The scale of fiscal effort: change in government primary balance as % GDP, 2009-2012 (projected)

We see variation therefore in the initial conditions shaping responses to crisis; in the nature of the crisis, considering the relative weight of financial and fiscal problems; and in the scale of the fiscal response undertaken. But we need to look deeper into the underlying politics behind the fiscal choices made in each case to understand the trajectory of what actually happened.

### ***Domestic political contellations underpinning fiscal consolidation efforts***

In each case, we consider the phasing of heterodox and orthodox policy responses, and the size and composition of the austerity measures once they are undertaken, in the light of our explanatory variables.

#### **Ireland**

In Ireland, the government adopted an orthodox stance almost from the start of the crisis. The dominant policy discourse gave strong legitimation to a cold-shower approach privileging a front-loaded adjustment and prioritizing spending-based measures. The public administration system was able to implement proposed changes with relatively little slippage. A change of government resulted in continuation of the same policy measures. While centralized framework pay bargaining was abolished, a tradition of tripartite consultative policy processes meant that social conflict was minimized. Entering a loan programme in November 2010 did not cause any additional compliance burdens beyond those already envisaged and in train.

Although Ireland entered the crisis in 2008 with a slight budget surplus, the underlying fiscal conditions were not very solid. As in Spain, the collapse of the property bubble had a severe effect on employment; but in addition, the tax system had become distorted during the 2000s, with a growing reliance on construction-related sources of revenue, and extensive exemptions which meant that about 40% of employees paid no income tax at all (Dellepiane and Hardiman, 2012b). A change of leadership in the Fianna Fáil-led government delayed policy response to the crisis. But there was relatively little public debate about potential competing fiscal strategies: the prevailing wisdom was that the top government priority must be to address the fiscal deficit then opening up. This is attributable at least in part to the lessons the professional economists drew from an earlier phase of delayed fiscal consolidation in the 1980s, that early, front-loaded, and drastic action would ultimately be less costly and would facilitate a faster return to growth. Even though the crisis conditions in Europe were different this time, and compounded by banking crises, this is the assessment that prevailed. Notwithstanding some dissenting voices among the small Labour Party, it was not subject to any serious challenge thereafter. The orthodox model prevailed in Ireland throughout the following years (Dellepiane and Hardiman, 2012a).

In October 2008, the European Commission opened an Excessive Deficit Procedure against Ireland, Greece, and Spain (as well as France, Latvia and Malta), under the European Stability and Convergence Programme, putting these countries under pressure to address their fiscal deficits. The Irish government brought forward to October the budget for 2009, from its usual December date. Given the shortness of time available, this budget introduced blunt new tax measures in the form of direct income levies, as well as a range of expenditure cuts including tighter means-testing of some benefits. Meanwhile, on 30 September 2008, it introduced what would eventually prove to be an extremely controversial and costly blanket guarantee to six Irish banks, including at least two which had been widely rumoured to be not merely suffering liquidity problems (as they claimed to the government) but insolvent and with enormous bad debts (Carswell, 2011, Ross, 2009).

The fiscal and banking measures implemented in the autumn of 2008 were expected to calm markets' developing worries about Irish government bonds. But the reprieve proved to be temporary. During 2009, the government introduced two more three emergency budgets, in February and in April, as well as the standard December budget for 2010, each of them introducing progressively more severe budgetary measures. In each case, the main focus was on cutting expenditure. The February 2009 measures imposed a public sector 'pension levy', which was in fact a targeted income tax and a means of reducing the aggregate public sector pay bill. In April, the rates at which the income levies were

charged were doubled, and new charges were introduced for a range of public services, especially health care. The budget for 2010, introduced in December 2009, introduced the most extensive fiscal adjustment measures yet. For the first time, nominal public sector pay was cut by between 5.7% and 8.2%, and the rates at which most welfare entitlements were payable were also cut. The cumulative effect of cuts in public sector pay over 2009 and 2010 was in the region of 14% (European Commission, 2011d, p.15).

In a deteriorating economic environment, with GDP falling year on year, the government's efforts to plug the fiscal deficit fell further short of their targets. The deficit in 2010 was reported at some 32% of GDP – for technical reasons, because the costs of bank recapitalization were counted as having been disbursed in this year – but the underlying public deficit was still close to 13% of GDP. Rising unemployment generated heavier demands on spending, and falling numbers at work as well as the collapse of consumer confidence meant that revenue projections repeatedly fell short of expectations. The 2010 budget had calmed market fears temporarily, creating a gap between the bond yields of Ireland and Greece. However, the rapid escalation of the Greek fiscal crisis and its recourse to a European loan programme in May 2010 put increasing pressure on the Irish government. Notwithstanding the Irish government's repeated assurances that Ireland was 'fully funded' until mid-2011, and despite the fact that an ambitious new programme of fiscal retrenchment was in preparation, termed the National Recovery Programme 2011-2014, the Irish government was required to seek assistance from an EU-IMF loan programme in November 2010.

The Memorandum of Understanding with the EU and IMF simply adopted the terms of the National Recovery Programme; the Commission also dropped the Excessive Deficit Procedure measures and permitted Ireland an extra year, that is, until 2015, to return to a deficit of 3% GDP. The main features of the fiscal adjustment plan were that it was front-loaded with a strong 'cold shower' effect in 2011, and strongly based on spending cuts, including a phased reduction in public sector numbers through an embargo on public sector recruitment and an accelerated early retirement plan. The Plan states that:

To demonstrate the seriousness of its intent, the Government has decided that 40% or €6 billion of the €15 billion adjustment will be made in 2011. This commitment to the early delivery of the Plan will engender confidence at home and abroad that we can restore order to our public finances. The adjustment will be made up of €10 billion in spending reductions and €5 billion in tax and revenue raising measures. These are demanding but realistic targets. With a concerted

national effort, they can be achieved (Department of Finance, 2010, p.6). (Department of Finance, 2010, p. 6)

GDP declined in each successive year between 2008 and 2012, with a very slight growth trend apparent in early 2012. Export performance held up well, due to the buoyant high-tech multinational sector, which meant that Ireland's balance of payments was better than any of the three other troubled countries. But the domestic economy remained stagnant, and unemployment was 14.5% in 2011. Nevertheless, the government succeeded in meeting its deficit reduction targets for each quarterly review of the loan programme. The deficit in 2011 was expected to be 9.9%, below the programme target of 10.6%. The budget for 2012 intensified its fiscal ambitions, aiming for a larger consolidation effort than required by the programme, to reach a deficit of 8.6% in 2013. But without growth in the European economy, the prospects of attaining this target remain uncertain.

The dominant political coalition of the boom period, in which the main party in power, Fianna Fáil, had created strong alliances with property developers, construction interests, and the financial sector, was delegitimated by the onset of crisis. But Irish governments were also able to change policy course in response to crisis quite quickly. Even the embedded institutions of social partnership, through which unions and employers had engaged in wide-ranging negotiations for over twenty years and which had gone well beyond issues of pay determination, were disbanded virtually overnight, when government saw fit to do so. Subsequent negotiations with public sector unions were undertaken in a very different political context, in which unions' veto power was radically diminished (Teague and Donaghey, 2009, D'Art and Turner, 2011, Stafford, 2010).

In the general election of February 2011, the parties that had presided over the run-up to crisis as well as the early stages of its management (including the bank guarantee) suffered drastic punishment at the polls. Support for Fianna Fáil, the centre-right party which had held a dominant place in the Irish political system since the 1930s, traditionally securing about 40% of the popular vote, shrank to 17%. The main beneficiaries were another smaller centre-right party, Fine Gael, who formed a coalition with the Labour Party in February 2012. The new government adopted virtually all of the policy priorities of the outgoing government, though with the addition of a small (fiscally neutral) jobs policy: a wide-ranging convergence on fiscal strategy had developed since 2010. The Fine Gael-Labour government stated that it would do 'whatever it takes' to ensure that the fiscal targets were met (European Commission, 2012a, p.14). (European Commission, 2012a, p.14)(European Commission, 2012a, p.14).



Ideas

State capacity

Partisanship and social coalitions

## Spain

In Spain, with some flexibility for fiscal discretion, the government initially adopted an expansionary and heterodox policy to counteract the sharp deterioration in output and employment. This was legitimated by a Social Democratic policy framework which accorded a strong investment and stimulus role to government. Under pressure of external circumstances, the government was obliged to change policy direction and to introduce orthodox fiscal consolidation measures. However, since Spain was not in a loan programme, it had more domestic discretion about the mix of instruments it used, and expenditure-cutting measures feature much less strongly than in the other three countries. A change of government resulted in adoption of the same priorities. A tradition of consultation with trade unions as well as employers made it possible to initiate structural labour market and welfare reform measures. State policy capacity was good: public administration reforms had been undertaken in the course of adaptation to European integration programmes

Spain, like Ireland, had a positive fiscal balance when the international economic crisis began in 2008. The Socialist Party government, led by Prime Minister Zapatero, had been re-elected in March 2008, and saw no cause for concern in Spain's public finances. As in Ireland, the end of the property bubble resulted in a surge of job losses in the construction sector, and economic contraction further worsened unemployment rates and revenue collection. But in marked contrast with Ireland, Spain participated willingly in the European Economic Recovery Programme. The budget for 2009, prepared between October and December 2008, introduced a discretionary stimulus amounting to about 2.4% of GDP as a counter-cyclical measure to prevent any worsening in levels of economic activity.

These measures contributed to the worsening of Spain's fiscal deficit, and the European Commission notified it of its excessive deficit status in October 2008. The government saw little reason to reverse its policy stance at that point. But after the fall of Lehman Brothers in the US in September 2008, financial markets began to differentiate between the risk status of certain Eurozone member states, none of which had previously been treated as any riskier than Germany. Greek bond yield rose rapidly, followed by Ireland's. As Spain's borrowing capacity came under pressure, the government framed the budget for 2010 (between October and December 2010) as 'a Social Democratic response to the crisis' (El Pais,

2010). This entailed a commitment not to impose hardship on welfare recipients; the budget was committed to phasing out the effects of the stimulus through a modest increase in taxes.

The contagion effect of the crisis in Greek public finances was not easily contained, so the government was obliged to introduce emergency measures in January 2010 to stem additional public spending obligations. This cut public spending by about 0.5% of GDP and introduced restrictions on new public sector recruitment. In May 2010, Greece was no longer able to fund its borrowing requirements from market sources, and was obliged to seek assistance from the European Commission, the ECB, and the IMF, in a structured loan programme. This had an immediate effect on confidence in Spanish bonds. The Spanish government was required to take immediate action, and an emergency budget introduced a radical shift in its fiscal strategy (Dellepiane and Hardiman, 2012b). This involved a reversal of revenue-based adjustment to primarily spending-based adjustment, with cuts in infrastructure spending, and cuts to current spending such as politicians' pay and some categories of welfare entitlement. Some high-profile benefits such as grants for infants were eliminated. Public sector recruitment came to a standstill. The pace of fiscal adjustment was to be intensified considerably. The budget imposed a total fiscal adjustment amounting to €15bn, or 1.5% of GDP. The budget for 2011, developed between October and December 2010, consolidated the changes introduced the previous years, intensifying spending cuts and imposing new taxes. The balance of adjustment tilted toward spending cuts, though to a less marked degree than in Ireland (Mulas-Granados, 2010).

But the net effect of these two consolidation budgets was to target the bulk of the spending cuts onto areas of expenditure that did not directly affect the core constituency of those dependent on welfare payments and on social services. 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'). 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.

Ireland's entry into an EU-IMF loan programme in November 2010, then Portugal's in May 2011, increased concerns over the viability of Spain's adjustment strategy. The size of the non-financial private sector debt in Spain, as in Portugal, as noted in Figure 4, was an ongoing source of concern. The private sector – household and net business debt – showed strong signs of deleveraging during 2011. Since

Spain was under intense pressure to keep up its contraction of public sector spending in order to reduce its deficit, the risk was that the economy would tilt into an unsustainable spiral, and become a second Greece (Dumas, 2011). Notwithstanding the PSOE's attempts to distribute the costs of adjustment in a socially equitable manner, they lost heavily in the elections held in November 2011, and the centre-right People's Party (PP), under Prime Minister Rajoy, formed a new government.

In both Spain and Portugal, once austerity measures were undertaken, governments were able to generate strong cross-partisan parliamentary consent, and were also able to engage in selective deal-making with organized interests and especially public sector unions to undertake structural change on issues such as retirement age and pension entitlements, and to initiate measures to liberalize the labour market (Rhodes, 2011, Etchemendy, 2011).

As was the case in both Ireland and Portugal, the new government adopted the priorities of its predecessor in full. But it quickly became apparent, as the budget for 2012 was in preparation, that the deficit targets for 2012 which Spain was obliged to meet under the European Commission's Stability and Convergence Programme, would not now be met. The target ceiling was a deficit of 6% GDP, and the government had committed to reaching a deficit of 4.4%. The outturn was now likely to be 8% or over €20bn above the agreed maximum. Immediately, a package of spending cuts of €8.9bn and tax increases of €6bn was announced in December 2011, and this in the context of declining GDP and an unemployment rate of 23% (Mallet and Wigglesworth, 2012). The biggest challenge for the government was to rein in the spending programmes of Spain's autonomous regions. This is where the bulk of the overshoot in the 2011 deficit target came from. I

In March 2012, the government announced that it would set a deficit target of 5.8% GDP, which would be more realistic than the 4.4% it had projected, while considerably below the projected 8%. This led it into conflict with the European Union finance ministers. Against the backdrop of the negotiation of a second loan programme for Greece, Spain was induced to agree to a more intensive fiscal retrenchment programme to reach a lower deficit target of 5.3% for 2012 and to achieve the EU goal of 3% deficit in 2013. Spanish economy minister Luis de Guindos stated that 'Spain's commitment to the fiscal rules is absolute' (Kanter, 2012). And yet the economic outlook appeared grim, with a slide toward recession increasingly likely during 2012: 'According to the Commission's latest assessment, the risks with regards to long term sustainability of public finances appear to be high' (European Commission, 2011i, p.55).(European Commission, 2011i, p.55).

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## Portugal

In Portugal, initial conditions were not strong. Like Spain, the left-wing government implemented stimulus measures as its first response to crisis. But worsening market conditions and an EU intervention forced it to change course. Entry into a loan programme in 2011 resulted in adoption of a classic orthodox strategy, with a cold-shower front-loaded adjustment that was heavily spending-based. Compliance was quite well managed by a public administration system which, although facing tough structural adjustment measures like Spain, appeared able to adjust capably. Cross-party agreement on crisis management priorities was reached and a change of government did not cause discontinuity in the strategy. Consultative processes with the trade unions made it possible to keep tough spending cuts on track.

At the beginning of the crisis, Portugal's fiscal position was not strong. After a decade of steady growth during the 1990s, average annual GDP growth rates was about 1% between 2001 and 2008, the second lowest in the OECD. The Socialist Party, which took power in 2005 and was re-elected to office in 2009, under the leadership of Prime Minister Socrates, was running a small deficit prior to the crisis. In 2008, like Spain, Portugal undertook some discretionary fiscal expansion, motivated in part by the European Economic Recovery Plan. This was consistent with the left-dominated political economy of Portugal since the re-establishment of democracy in the mid-1970s.

The European Commission's Excessive Deficit notice in October 2008 presented a challenge to the government, and it felt obliged to undertake some corrective action during 2009. By now, the fiscal deficit had deteriorated to over 10% of GDP. A fall in GDP and rising unemployment put greater pressure on public spending, in addition to the stimulus measures that had been adopted. The budget for 2010 therefore introduced some adjustment measures, falling mostly on the revenue-increasing side, and including an increase in VAT rates. Some improvement in the public finances was also anticipated as a result of transferring the banks' pension funds into the public accounts, as part of a bank rescue programme. The deficit for 2010 was estimated in May of that year to come down to 7.3% GDP.

However, the outturn for 2010 was significantly worse than this: Eurostat revised it upward to 9.1% in June 2011. The final outturn was revised again to 9.8% in December 2011. A good deal of this worsening was due to technical reasons, including losses in state-owned enterprises which were incorporated into the public finances in this year, as well as bank rescue costs. But the worsened headline deficit dented the markets' confidence in Portuguese government bonds. This prompted the government to initiate a much more severe budgetary adjustment programme, to meet the requirements of the Stability and Convergence Programme targets of restoring a deficit of 3% or under by 2013, set out in a note addressed to the European Commission and the ECB in March 2011. But the proposed measures failed to secure a majority in the Portuguese parliament, prompting a political crisis and the fall of the government; new elections were scheduled for June 2011.

This left Portugal in a political limbo, with a caretaker PS government in charge, and market responses were predictably extremely negative. In April 2011, interest rates for ten-year bonds reached nearly 9%, a level considered by most observers to be unsustainably high and signalling that the government would be unable to continue to borrow on international markets. At this point, the caretaker government requested assistance from the European Financial Stability Mechanism (EFSM)/ European Financial Stability Fund (EFSF) and from the IMF, on a similar basis to Ireland's loan programme in November 2010. It remained unclear whether this interim government had the authority or legitimacy to conclude the agreement; nevertheless a Memorandum of Understanding was signed in May 2011 (European Commission, 2011f). When the elections were held in June 2011, the PS suffered heavy electoral losses and a new government comprising a coalition of Social Democrats and the small People's Party, under the leadership of Prime Minister Coelho, took power. The crisis since April had changed these parties' thinking on economic policy, and in truth, their options were by now very limited. The new government adopted fully the terms of the Memorandum of Understanding and the fiscal adjustment targets for the coming years.

The adjustments in question were 'ambitious', that is, front-loaded in a cold-shower effect, and consistently with the European authorities' preference for spending-based adjustment, they now rested more heavily on cutting expenditure than on raising taxes. During 2011, in the context of a further decline in GDP, it became clear that the government was not going to make its deficit reduction targets. To avoid 'substantial slippage', new emergency tax measures were introduced, including an increase of two points on VAT. Meanwhile, measures to cut public sector spending were implemented, including a direct 5% cut in government pay rates, cuts to transfer payment rates, a freeze on public sector

recruitment – similar measures to those put in place in Ireland. In addition, plans to privatize some public utilities were developed, along with plans to liberalize the labour market, to dismantle some professional cost-increasing privileges, and other structural measures (European Commission, 2011h, European Commission, 2011g). Finance minister Vitor Gaspar stated that a broad political and social consensus underpinning Portugal’s adjustment programme was ‘a key asset’; a new agreement between government, employers, and one of the two largest union federations demonstrated Portugal’s ability ‘to take bold reform steps’. He stated that:

Our capacity to return to the international bond market depends on building confidence and credibility. That means fully complying with the terms of the adjustment programme and meeting our fiscal targets in one quarterly review after another (Wise, 2012).

Against a backdrop of a further drop in GDP (though lower than anticipated), and sluggish export performance, the budget for 2012 was expected to bring the deficit down to 4.5% GDP, well below the programme ceiling of 5.9% (European Commission, 2012c). The accelerated, front-loaded, expenditure-based consolidation plan was held to be well on target. But the economy was expected to contract by a further 3.3% GDP during 2012, and unemployment stood at over 14%.

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## **Greece**

In Greece, initial conditions were very poor, and fiscal management had long been a problem in a state that had undergone relatively little reform or modernization since joining the EU. As a result, entry into a loan programme in May 2010 left it facing not only extremely difficult fiscal retrenchment in the midst of recession, but also very tough structural adjustment measures. Both the public administration and the political parties were prey to influence by sectional interests on whose ongoing support they depended. This resulted in the failure of representative politics altogether at the end of 2011, and the creation of an interim technocratic government, pending elections in April 2012. Consultative networks with organized interests were poorly developed, and strong if minority section of radical opinion in the trade union movement kept contestatory politics at a high pitch. Coherent policy formation and implementation therefore faced major challenges. In spite of these continuing problems, Greece

managed to bring about significant fiscal adjustment in 2010 and 2011, to begin to address shortcomings in tax administration, and to start some structural reforms. But against the backdrop of already very high debt and deficit levels, market pressures forced the Greek fiscal crisis to the point where the viability of the sovereign debt, even under a loan programme, was in doubt.

Greece's initial fiscal conditions at the beginning of the international economic crisis were very weak. The model of political economy that had been developed since the 1970s had had relatively little reform incentive. Even during the boom years between 2000 and 2008, Greece had poor fiscal performance: the deficit always exceeded 3% of GDP, and public debt was already above 100% of GDP. Both the size of the public sector and the scale of the tax burden were unsustainable, and yet the tax administration system was highly inefficient, combining high marginal rates and extensive tax evasion.

Political response to the onset of crisis was slow. Although Greece was the recipient of an Excessive Deficit Procedure notice in October 2008, the incumbent right-wing New Democracy party was reluctant to address fiscal cutbacks in the run-up to the election which was held in October 2009. This election returned the left-wing Socialist (PASOK) party to power under the Prime Ministership of George Papandreou. This administration undertook a review of the official statistics series which revealed an even worse fiscal situation than had previously been known about. The financial markets quickly made it all but impossible for Greece to continue to fund its borrowing requirements. Having been elected on a mandate to maintain public sector spending, PASOK was forced to make a sharp U-turn and to adopt a stance of fiscal austerity. In January 2009, the government submitted a stability programme to the European Commission for the period 2010-2013 which included a plan to reduce the deficit by 4 percentage points to 8.7% of GDP in 2010, 5.6% in 2011, 2.8% in 2012 and 2% in 2013. This included a plan to tackle some tax loopholes and raise indirect taxes, to trim public sector spending, and to stem the growth in public sector employment. But this plan was insufficient to calm the markets, and in May 2010, Greece entered an EU-ECB-IMF loan programme:

The short-term programme objectives are to restore confidence and maintain financial stability. The medium-term programme objective is to improve competitiveness and alter the economy's structure towards a more investment- and export-led growth model. An overarching objective is to durably restore Greece's credibility for private investors (European Commission, 2010a, p.10).

The strategy for fiscal consolidation was strongly front-loaded, that is, a 'cold-shower' effect, and it was decisively biased toward expenditure reduction. The size of the fiscal adjustment Greece was required

to implement was much larger than any of the other three countries considered here – indeed, it was one of the largest austerity packages ever implemented . Not only was Greece required to reduce the deficit to below the Stability and Growth Pact rule of 3%, it was expected to generate and maintain a fiscal surplus to allow for heavy interest rate obligations arising from ongoing debt servicing obligations (European Commission, 2010a, p.13). (European Commission, 2010a, p.13)(European Commission, 2010a, p.13)The programme recognized that Greece would have to ‘swim against the tide’ during the adjustment, since it assumed negative growth of 4.5% in 2010 and 2.5% in 2011. It would have to cut its deficit from 14% GDP in 2009 to under 3% in 2014. But:

Relative to an unchanged-policy baseline, this will require fiscal measures amounting to 13 percent of GDP over the period 2010-2014, over and above those already implemented in 2010 (estimated by Commission services at 51/2 percent of GDP)... The size of the required fiscal consolidation measures over the period 2010-2013 exceeds by far the required reduction in the government deficit (European Commission, 2010a, pp. 13, 14). (European Commission, 2010a, pp. 13, 14)

The total fiscal consolidation measures required of Greece by 2014 thus totalled 18% of GDP, not 11%. However, in the context of recession, with economic decline of 4.5% in 2010, and a particularly large drop in output, the adjustment programme was off-track almost from the outset. This is notwithstanding the very large fiscal efforts that were undertaken, amounting to a cut in the deficit of 5 points during 2010, a performance termed ‘the largest annual fiscal consolidation ever by a Eurozone economy’ (Hellenic Republic Ministry of Finance, 2011a, p.16 ).

The terms of the loan programme, in line with the orthodoxy embraced by European officials, was strongly spending-based. Expenditure cuts of 7% GDP and tax measures amounting to 4% GDP were mandated. Among the spending cuts were direct cuts to public sector pay rates through the abolition of the Easter, summer and Christmas bonuses and their replacement by a flat bonus (€1000) for those earning less than €3000 per month (gross). The fall in nominal remunerations amounted almost 15% from 2009 to 2010, well above the 5% cut implemented in Spain or even the tiered cuts implemented in Ireland – and on pay rates that were already considerably lower. Welfare recipients, including pensioners, also had their benefit rates cut. The fiscal adjustment plan is summarized in Figure 14.

The economic adjustment programme proved to be extremely difficult to implement. In addition to the very harsh fiscal measures, the government was required to undertake a range of structural reforms to



improve competitiveness, and to begin a programme of privatization that would yield additional exchequer revenues. In each successive official review of the implementation of the programme, the EU monitors report a variety of measures on which no progress had been made, or on which implementation had been partial or delayed (European Commission, 2010b, European Commission, 2010c, European Commission, 2011c, European Commission, 2011a, European Commission, 2011b). Yet another political stalemate in November 2011 resulted in a decisive intervention by the European authorities to require that Prime Minister Papandreou step down, and that a new all-party government be formed. This was headed by former Governor of the Bank of Greece and Vice-President of the European Central Bank Lucas Papademos. But continuing high levels of social protest made cuts to public sector pay and employment levels politically very difficult, even when talks to restructure part of the public debt were nearing conclusion in early 2012 – proposals to cut the minimum wage by 22%, to introduce a new property tax, and to impose a new round of public sector layoffs sparked more protest (Kitsantonis and Donadio, 2012).(Kitsantonis and Donadio, 2012)(Kitsantonis and Donadio, 2012) In February 2012, a second bailout agreement was concluded with Greece (Hellenic Republic Ministry of Finance, 2011b). But fresh doubts began to be expressed almost immediately about the sustainability of Greece’s public debt (Spiegel, 2012).

The support base of political parties in Greece had long depended on the construction of sectional alliances with a whole variety of civil society interests. This created a network of expectations and obligations that shaped the way policy was made and had profound implications for the conduct of the public administration itself. Most evidently perhaps, the design of the public revenue system had been shaped by these tacit deals over time, resulting in very complex and differentiated obligations, and high levels of tacitly overlooked non-compliance. The ‘public service bargain’ had depended on a range of selective benefits (such as preferential retirement and pensions schemes, and additional monthly bonus salaries) which, once abrogated under pressure of austerity measures, resulted not only in wage-earner disaffection, but in a rising sense of political alienation and the growth of protest politics (Featherstone, 2011, Mitsopoulos and Pelagidis, 2010, Hood and Lodge, 2006).

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## ***Conclusion***

In the face of a common economic shock, the four countries of the Eurozone periphery have displayed a range of different responses, in the choice of initial strategy between expansionary and contractionary, in the timing of their adoption of orthodox measures, in the scale of adjustment and degree of front-loading of adjustment measures, and in the composition of adjustment between expenditure-based and revenue-based measures. We have argued that standard economists' accounts that would seek to privilege structural variables may fail to capture important variation, not only across countries, but also in changes within countries over time. Instead, we have argued that politics matters, that is, political decisions that are shaped by a specific set of institutional and ideational factors mediate between initial conditions and policy outcomes. We identified three main types of influence: the role of ideas, state capacity, and the pattern of political partisanship and the social coalitions of support associated with these.

In all four countries, we can identify a dominant interpretation of the way the economy works at the onset of crisis. We identify two broad schools of thought that have shaped responses to crisis: on the one hand we see ideas that would prioritize market-conforming or orthodox policy responses: this is very characteristic of Ireland's very open, liberal market economy (McCarthy, 2010, McCarthy, 2009). On the other hand, we identify a statist policy paradigm, which would prioritize public investment in infrastructure and support for the supply side of the economy. These priorities are well established in the southern European mixed market economies (Molina and Rhodes, 2007) . They were very apparent in Spain's growth trajectory since the 1980s (Boix, 1998).

We suggest that the quality of government in this sense varies a good deal across the four countries in question, and all of them are compromised in different ways and to different degrees. Engagement with processes of European integration since the 1980s (or the 1970s in Ireland) wrought change in the policy routines of these countries. Ireland's 'policy capacity' was the most effective of the four; Spain and Portugal continued to have difficulties; and Greece's was the most inefficient and ineffective (Blavoukos and Pagoulatos, 2008, Parrado, 2008, Hardiman et al., 2012, Ongaro, 2010).

Partisanship and social coalitions of interests...

Paradoxically, the ratings agencies' evaluations of all four countries' government bonds did not recover as a result of austerity measures. All four suffered continuous decline in their ratings, making it more

difficult to envisage a return to the markets on the part of the three countries currently in loan programmes, and increasing the funding costs to the Spanish government in a way that continues to pose challenges to the stability of the Euro. But it is the Greek crisis that has proved the most intractable within the current EU policy framework. Greece's deficit was the largest and its debt, already high before the crisis, has soared. Greece has been required to impose the harshest and most far-reaching austerity measures of all four countries. In the context of continuously declining GDP, this has imposed growing hardships on the Greek population.

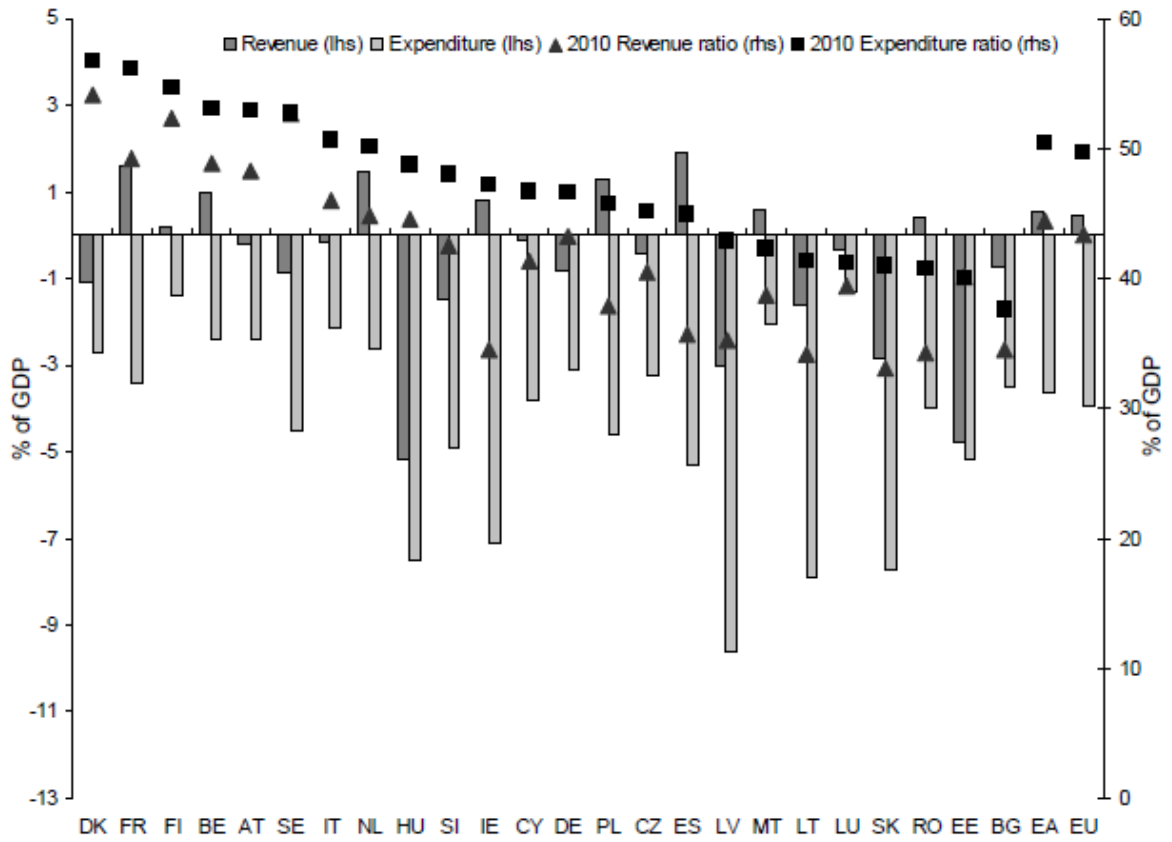
Figure 1. Typology of fiscal policy choice

		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 2. Countries' fiscal stance over time

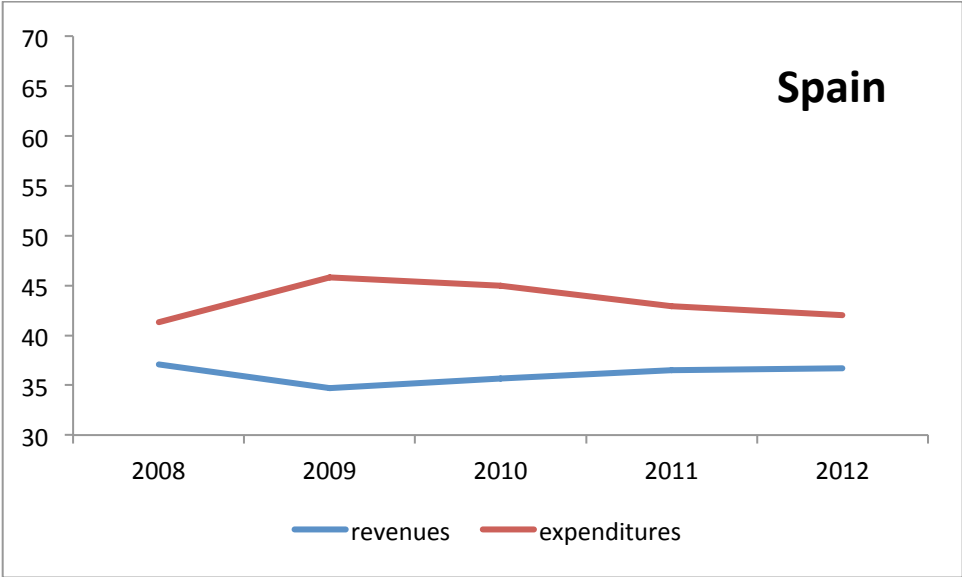
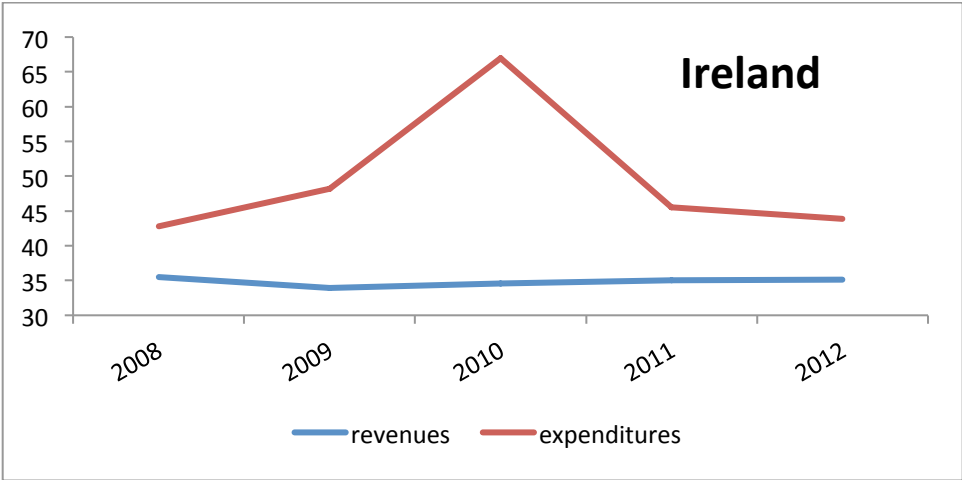
	2008	2009	2010	2011	2012
<b>Ireland</b>	Mildly orthodox	Orthodox	Orthodox	Orthodox	Orthodox
<b>Portugal</b>	Heterodox	Heterodox	Orthodox	Orthodox	Orthodox
<b>Spain</b>	Heterodox	Mixed	Orthodox	Orthodox	Orthodox
<b>Greece</b>	Heterodox	Mixed	Orthodox	Orthodox	Orthodox

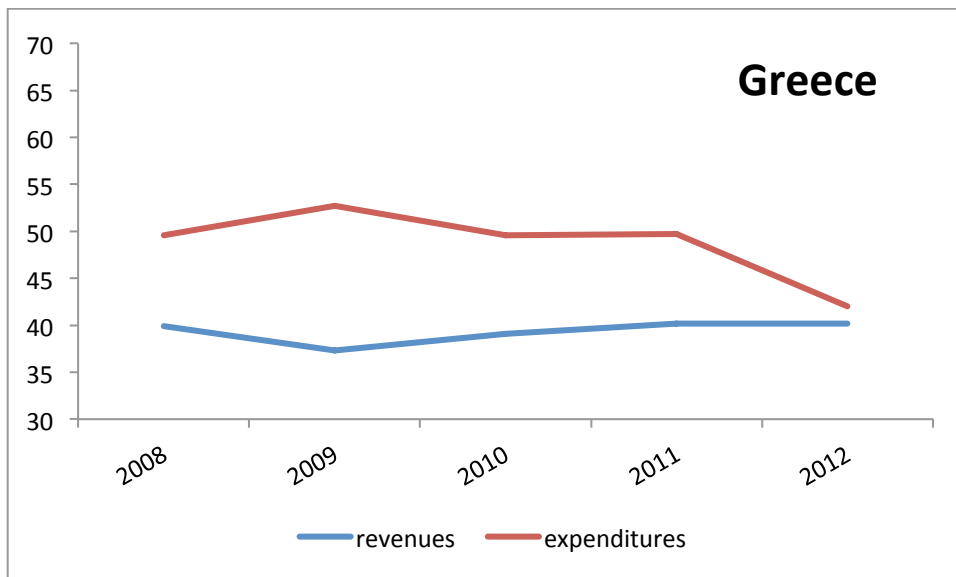
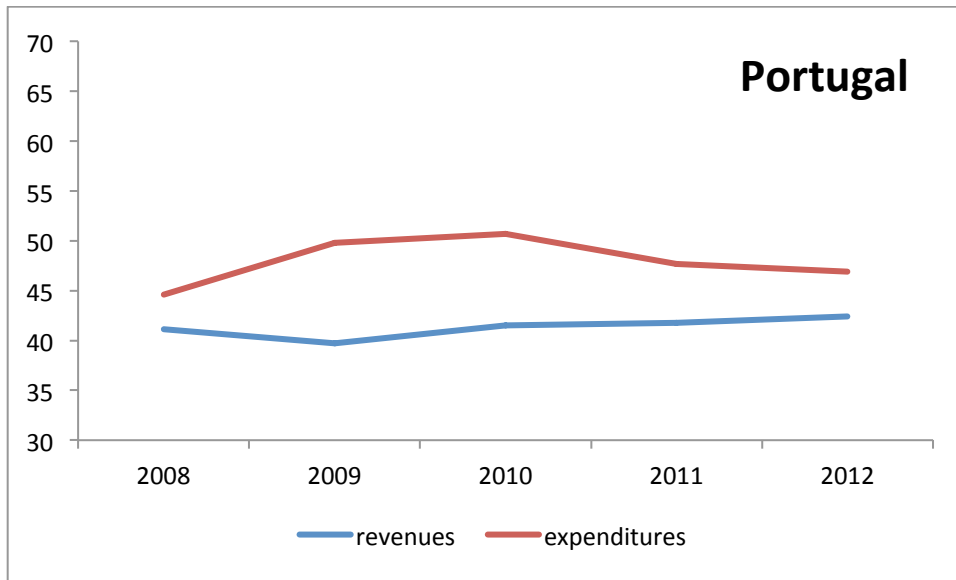
Figure 3. Planned changes in revenue and expenditure over 2010-2014



Source: (European Commission, 2011i, p. 41)

Figure 4. Revenue and expenditure in four countries, 2008-2012, % GDP





Source: (European Commission, 2011i)

2011 and 2012 figures are 2011 forecasts.

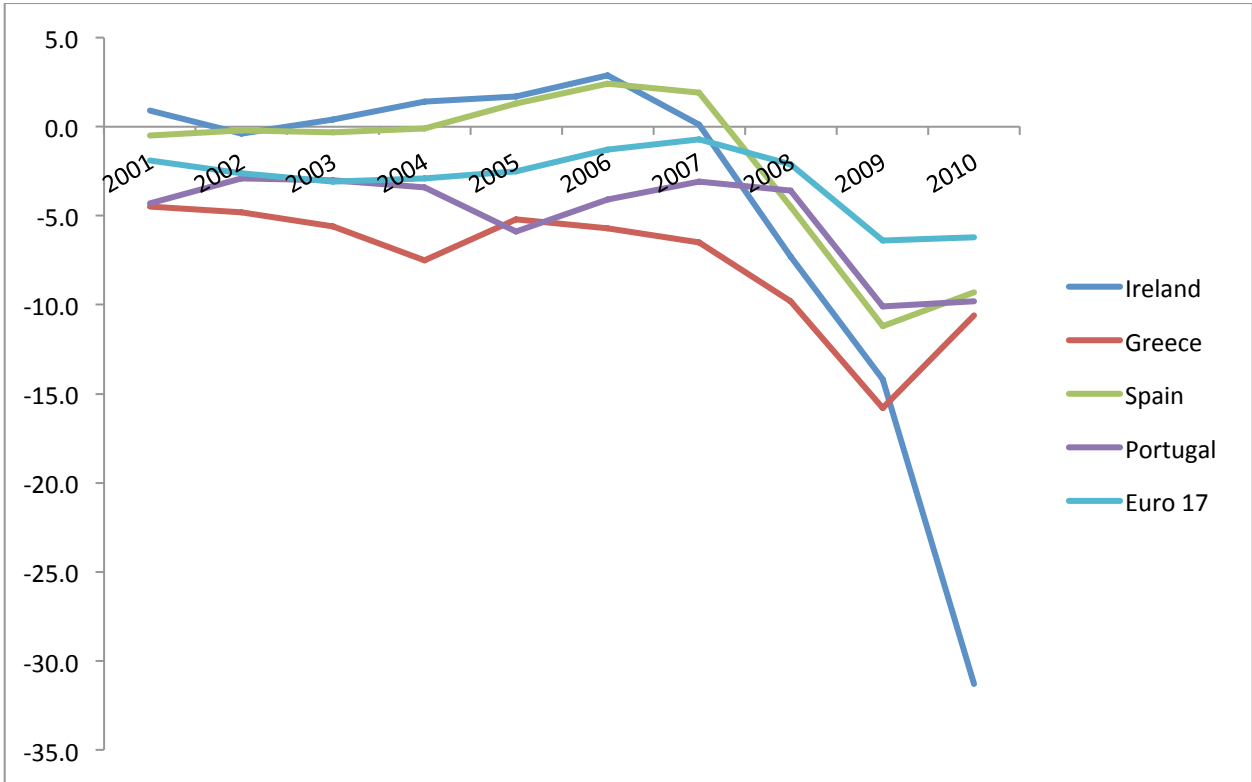
The surge in expenditure in Ireland in 2010 reflects the public assumption of liability for bank recapitalization.

Figure 5. Key explanatory variables

	<b>Ireland</b>	<b>Spain</b>	<b>Portugal</b>	<b>Greece</b>
<b>Initial conditions</b>	Medium	Good	Poor	Very poor
<b>Domestic factors</b>				
<b>Ideas</b>	Market-conforming	Statist	Statist	Statist
<b>State capacity</b>	High	High	Medium	Low
<b>Veto player capacity in party politics</b>	Cross-party agreement	Cross-party agreement	Cross-party agreement	Conflictual
<b>Role of organized interests</b>	Social pact abolished, but consultation	Consultation, new partial social pact	Lower levels of consultation	Conflictual
<b>External factors</b>	Loan programme did not change domestic policy stance in favour of spending-based adjustment	Market pressure forced change of strategy. Scope for domestic preference for tax not spending-based adjustment	Market pressure forced change of strategy. Loan programme required prioritizing spending-based adjustment.	Market pressure forced change of strategy. Loan programme required prioritizing spending-based adjustment.

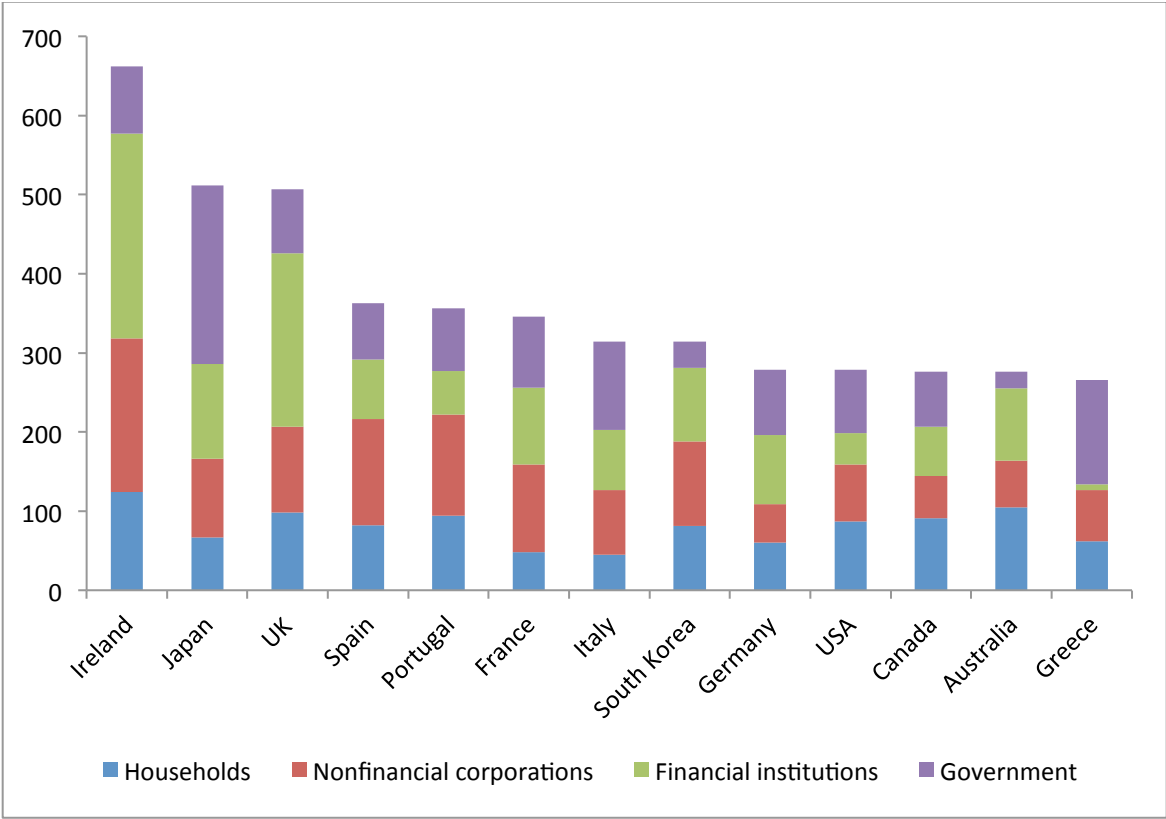


Figure 6. Net lending and borrowing under the EDP (Excessive Deficit Procedure), % GDP



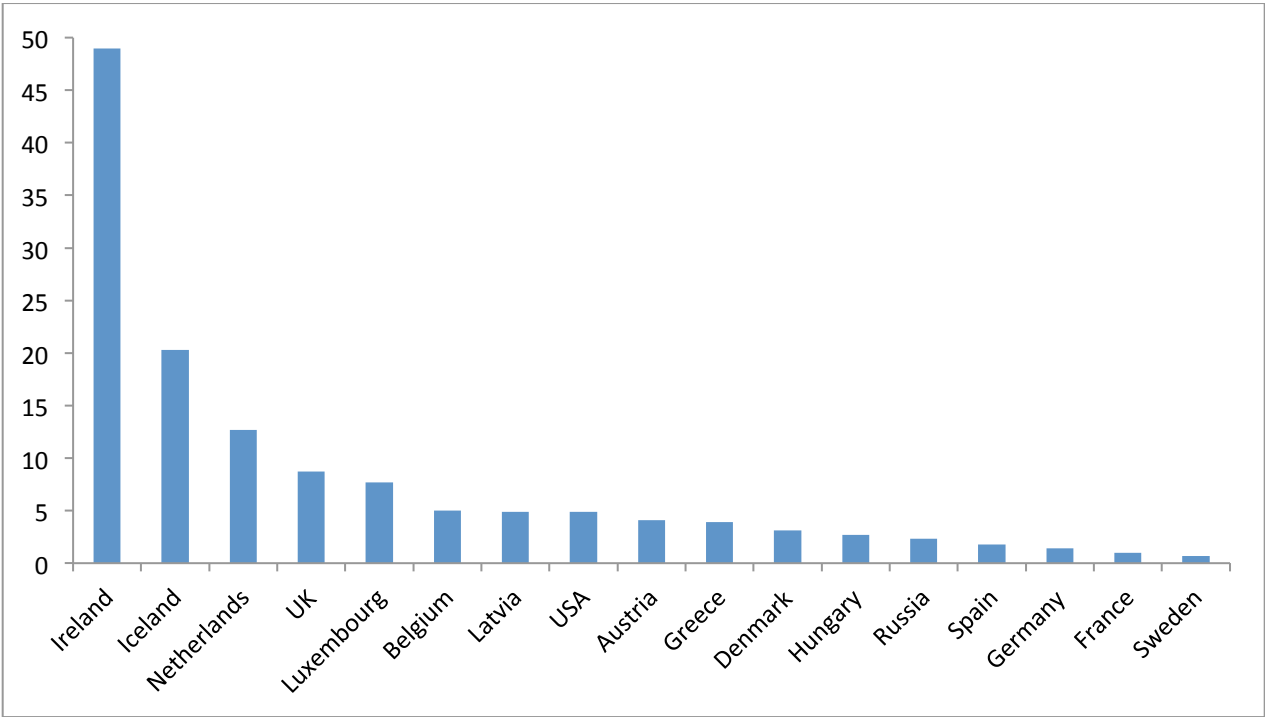
Source: Eurostat, <http://epp.eurostat.ec.europa.eu/>. Accessed 21 February 2012

Figure 7. Composition of debt in large OECD countries and in the four Eurozone peripheral countries, 2<sup>nd</sup> quarter 2011



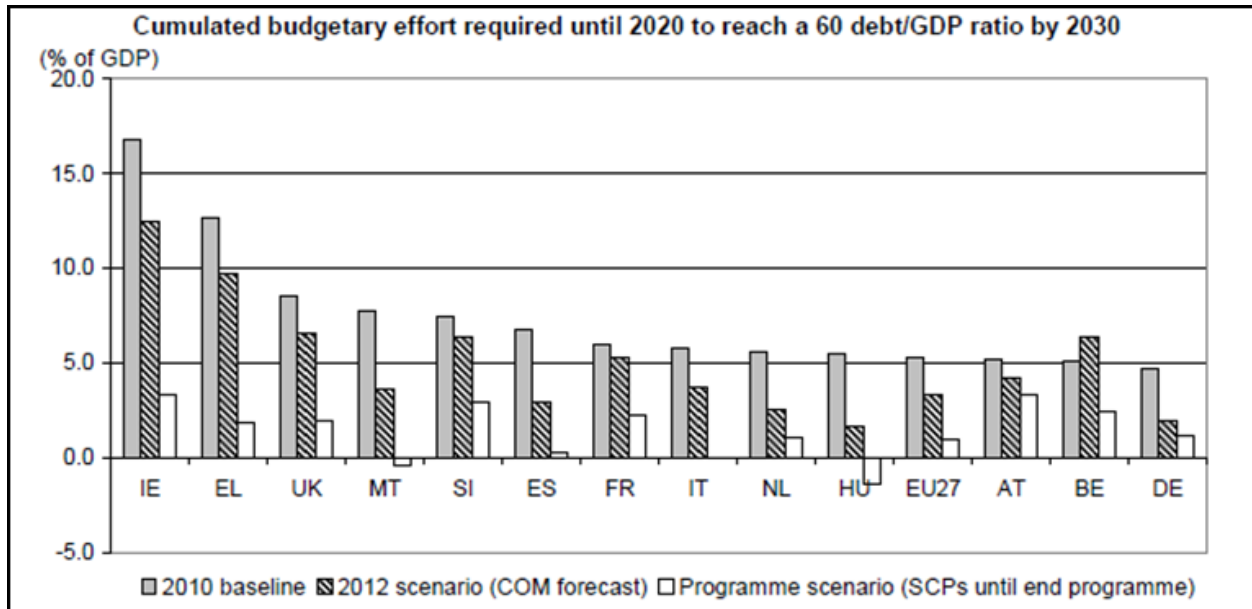
Source: (McKinsey Global Institute, 2012)

Figure 8. Direct fiscal costs of the banking crisis, 2007-2009



Source: (OECD, 2011, p.52)

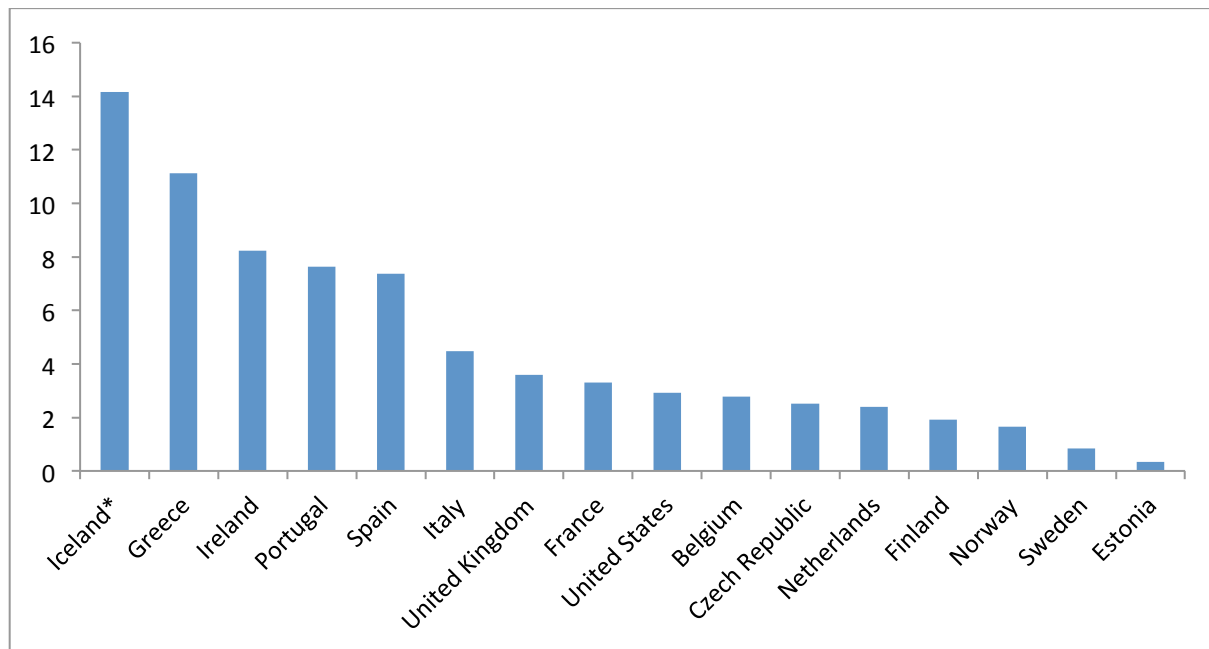
Figure 9. Budget efforts required 2010-2020 to reach 60% debt/GDP ratio by 2030



Source: (European Commission, 2011i, p.48)

Portugal has only one data point, a 2012 scenario at about 4.5% GDP.

Figure 10. The scale of fiscal effort: change in government primary balance as % GDP, 2009-2012 (projected)



Source: OECD Economic Outlook online, [www.sourceoecd.org](http://www.sourceoecd.org). Accessed 20 February 2012

Note: In all these countries 2009 was the trough year, except for Iceland where the trough year is 2008.

APPENDIX TABLE A.

A1. Fiscal adjustment plan in Ireland, 2011-2015

	2008	2009	2010	2011	2012	2013	2014	2015
<b>Deficit targets</b>	-7.2	-14.2	-31.3	-9.9	-8.6	-7.6	-4.8	-3.0
<b>Debt targets</b>								
<b>Consolidation measures as % GDP</b>	0.3	4.3	5.1	3.7	2.7	2.1	1.8	1.1
<b>Revenue as % total</b>				25	45	36	35	35
<b>Expenditure as % total</b>				75	55	64	65	65
<b>Cumulative impact</b>	2008-2010: €14.6bn			2011-2015: €15bn; 67% spending, 33% revenue				
<b>GDP at market prices, €bn</b>	184.3	167.4	159.9	161.3	162.9	166.7		

Source: (European Commission, 2011d, European Commission, 2012a, European Commission, 2011e, p.24, Department of Finance, 2010, p.16); Eurostat (GDP)

## A2. Fiscal adjustment plan in Spain

	2008	2009	2010	2011	2012	2013	2014	2015
<b>Deficit targets</b>	-4.2	-11.1	-9.2	-6.3	-5.3	-3.0	-2.1	
<b>Debt targets</b>	39.8	53.3	60.1	68.1	71.0	69.3		
<b>Consolidation measures as % GDP</b>	-	+0.4	-3.9	-3.3				
<b>Revenue as % total</b>								
<b>Expenditure as % total</b>								
<b>Cumulative impact</b>	-			€15 bn in 2010 and 2011; -3.3% in 2011 and 7% through to 2014				
<b>GDP market prices, €bn</b>	at 1962.5	1047.1	1047.1	1058.8	1048.2	1062.6		

Source: (Ministerio de Economía y Hacienda, 2011, European Commission, 2011i, pp. 24, 26, 55, Dellepiane and Hardiman, 2012b); Eurostat (GDP)

### A3. Fiscal adjustment plan in Portugal

	2008	2009	2010	2011	2012	2013	2014	2015
<b>Deficit targets</b>	-3.5	-10.1	-9.1*	-5.9	-4.5	-3.0	-2.3	-1.9
<b>Debt targets</b>	68.3	71.6	93.0	101.7	107.4	108.6	107.6	105.7
<b>Consolidation measures as % GDP</b>	-	-	-	5.7	3.0	1.9	0.0	0.0
<b>Revenue as % total</b>	-	-	-		33	33	-	-
<b>Expenditure as % total</b>	-	-	-		67	67	-	-
<b>Cumulative impact</b>	-				6% GDP in 2012 alone			
<b>GDP at market prices, €bn</b>	169.3	167.0	171.0	169.9	164.3	166.1		

\*revised from 7.8% in May 2010 to 9.1% in June 2011, and then revised again to 9.8% in December 2011

Source: (European Commission, 2011f, European Commission, 2011h, European Commission, 2011g, European Commission, 2011i, pp. 24, 26); Eurostat (GDP)



A4. Fiscal adjustment plan in Greece, May 2010

	2008	2009	2010	2011	2012	2013	2014	2015
<b>Deficit baseline</b>		n.a.	-10.5	-14.2	-15.6	-15.9	-15.6	
<b>Deficit targets</b>		-	-8.0	-7.6	-6.5	-4.9	-2.6	
<b>Debt targets</b>		115.1	133.2	145.2	148.8	149.6	148.4	
<b>Consolidation measures as % GDP</b>			2.4	6.6	9.0	11.1	13.1	
<b>Revenue as % total</b>			20	40	40	40	40	
<b>Expenditure as % total</b>			80	60	60	60	60	
<b>Cumulative impact</b>				18% between 2010 and 2014				
<b>GDP at market prices, €bn</b>	222.4	225.4	223.5	211.6	202.3	203.7		

Source: (European Commission, 2010a); Eurostat (GDP)

A5. Fiscal adjustment plan in Greece, March 2012

	2008	2009	2010	2011	2012	2013	2014	2015
<b>Deficit targets % GDP</b>		-15.8	-10.6	-9.3	-7.3	-4.6	-2.1	
<b>Debt targets % GDP</b>		129.3	144.9	165.3	160.5	164.2	161.1	
<b>Consolidation measures as % GDP</b>			8.4	7.7	6.5	2.4		
<b>Revenue as % total</b>								
<b>Expenditure as % total</b>								
<b>Cumulative impact</b>				Additional fiscal effort of €6.4bn in 2011				
<b>GDP at market prices, €bn</b>	222.4	225.4	223.5	211.6	202.3	203.7		

Source: (European Commission, 2012b, Hellenic Republic Ministry of Finance, 2011b, p.39); Eurostat (GDP)

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