Niamh Hardiman

School of Politics and International Relations, University College Dublin

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Rethinking the political economy of fiscal consolidation in two recessions in Ireland

Niamh Hardiman

UCD School of Politics and International Relations

UCD Geary Institute

Niamh.Hardiman@ucd.ie

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Abstract

Ireland has been taken to be an exemplary case of successful growth-promoting fiscal retrenchment, not once but twice – first, in the fiscal consolidation undertaken in the late 1980s, which was taken as one of the classic original instances of 'expansionary fiscal contraction', and again now, in the context of meeting the fiscal deficit targets set by the current EC-ECB-IMF loan conditions. This paper argues that many of the apparent lessons drawn from Ireland's experience turn out to be more complex and even misplaced upon closer inspection. Ireland was never an instance of 'expansionary fiscal contraction' in the sense in which it now understood, in the late 1980s; and the conditions that facilitated the restoration of growth at that time are no longer possible now.

Firstly, the paper shows that standard methodologies for identifying the object of interest in fiscal consolidation misses out on what is really central, which is the ongoing politics of 'fiscal effort'. Secondly, this approach challenges conventional ideas about the primacy of spending cuts over tax increases. Thirdly, Ireland's fiscal stabilization in the earlier period depended on devaluation, international growth, and strong social pacts. None of these conditions is present in the 'internal devaluation' under way since 2008. Ireland has committed to fulfilling the terms of the EU-ECB-IMF loan programme, but there are few grounds for anticipating that this will of itself result in the resumption of growth. Fiscal adjustment efforts are much more painful without the growth-promoting contextual conditions that were present in the earlier period.

Introduction

Ireland has been taken as an exemplary case of fiscal adjustment, not once, but twice, in its recent history: firstly in the late 1980s, more recently in the implementation of a sharply contractionary policy mix after the crisis of 2008, underpinned by the terms of the international loan agreement negotiated in November 2010. In both cases, Ireland has attracted international plaudits for the determined way in which it has implemented fiscal consolidation measures. In both cases, it has appeared to be a model case that would illustrate that economic recovery and renewed growth prospects follow from correction to the public finances. This paper examines the merits of the arguments in both cases. It considers the circumstances that governed the prospects for economic recovery both in the late 1980s and in the period after 208. It takes issue with the conceptualization of the issues in the standard literature, and suggests that the findings that have become an established part of the literature on fiscal consolidation in Ireland need to be qualified, since both the international and the domestic political and economics conditions were more complex than is often recognized, and the outcomes less clear-cut than is sometimes claimed.

Fiscal consolidation, then and now

Scholarly interest in analysing the comparative political economy of fiscal contraction has tended to fluctuate in response to the salience of the issue in policy debate. During the 1980s and 1990s, the issue attracted a great deal of interest as a consequence of the persistent debt overhang in many developed economies, following on from the economic crises of the 1970s. Well-established Keynesian strategies for managing inflation on the one hand, and unemployment on the other, proved much more difficult to manage in the wake of the exogenous oil-price shock. The political shift toward neo-liberal, market-driven solutions to stagflation prioritized domestic deregulation and the trans-national liberalization of capital markets. Activist fiscal policy had encountered problems in providing technical solutions to persistent public deficits, and as a result it fell out of favour politically. During the 2000s, the management of public deficits seemed to have stabilized, particularly in the countries aiming for eligibility for Economic and Monetary Union by 1999.

And yet a new phase of economic crisis since 2008 has put public deficits at the heart of political debate once again. Financial collapse resulted in a sudden stalling of economic activity, causing public revenues to plummet while new demands on spending were generated by rising unemployment. As a result, public deficits have yawned open once again. Within the Eurozone, notwithstanding a short period of concerted fiscal expansion, the prevailing policy response accorded the highest priority to adherence to the terms of the Stability and Growth Pact. Countries that were obliged to accept loan programmes (Greece, Ireland, and Portugal) are required to follow a planned programme to bring them back swiftly to public deficits of no more than 3% of GDP.

The logic of the case for fiscal retrenchment this time draws heavily on the inferences drawn from the literature of the 1990s. Scholars believed they had identified a causal connection between large public sector deficits and slow growth, based on the crowding-out of private investment, such that credibility gains could be secured by reducing public deficits (Alesina and Perotti, 1995b, Alesina and Perotti, 1995a, Reinhart and Rogoff, 2010). Thus reducing deficits could result in a resumption of economic growth, and a number of commentators believed they had adduced strong empirical evidence for what came to be termed expansionary fiscal contraction (Perotti, 1998, Alesina and Ardagna, 1998, Alesina et al., 1998, Giavazzi and Pagano, 1990).

But these scholars argued that reducing the deficit was not the only thing that mattered; the composition of adjustment mattered too. Cutting expenditure generated more sustained success in reducing deficits than raising taxes, mostly because taxes raised to cut deficits tended to be temporary and easily reversed, while spending cuts tended to depress the capacity of specific programmes to grow in future (Perotti, 1996, Alesina et al., 1998). These analysts, mostly economists by training, recognized that political conditions were an important mediating factor between the commitment to implement fiscal contractions and the achievement of successful outcomes, measured as a specific percentage reduction in total deficit over a particular period of time. They suggested that electoral systems, the degree of federalism, and the party composition of

government mattered (Milesi-Ferretti et al., 2002, Alesina and Perotti, 1995a, Alesina et al., 2003), arguments later made with greater nuance by political scientists, but with similar overall findings (von Hagen et al., 2002, von Hagen and Strauch, 2001, Hallerberg et al., 2009). Finally, they suggested that governments undertaking fiscal retrenchment, which would inevitably affect popular spending programmes, would not in fact suffer electoral disadvantage as a result, because voters would understand the necessity of the actions and would welcome the growth that would ensue (Alesina et al., 2010).

The lessons drawn from the analyses of the 1990s have shaped the terms of debate in official circles in response to the global financial crisis after 1998. Officials in the European Commission and the European Central Bank explicitly cite these findings, which have gained the status of received wisdom (Dellepiane, 2012, Blyth, 2013a, Blyth, 2013b). But the inferences drawn from the experiences of the 1980s and 1990s may be quite misleading for experiences since 2008.

Analytical approach

The analytical approach adopted in this paper takes issue with three elements of the conventional literature.

The first is the methodological approach adopted in much of the literature, particularly the definition of fiscal consolidation adopted, which is likely to exclude important issues from consideration. The second is the question of the composition of adjustment, and the balance adopted between spending cuts and tax increases. The third is the relevance of other, excluded variables, pertaining to the broader economic and international context of fiscal adjustment, which have a bearing upon the outcome of fiscal consolidation efforts. A revised approach to understanding the politics of fiscal consolidation brings new considerations to light. With these three issues clarified, the paper goes on to give a critical account of the politics of fiscal adjustment in Ireland in response to the challenges of deficit management in the 1980s and again since 2008.

Analysis of the politics of fiscal consolidation, or fiscal 'consolidation effort', is often focused on outcomes, that is, on the measured change in the fiscal deficit attained after a specified period of time. There are two problems with this approach. The first is that changes in the public budget deficit may come about for reasons that have very little to do with intentional political action. This is particularly significant during a recession, where a decline in GDP could result in a worsening of the measured deficit, even where large changes had been made either or increase revenue, or reduce expenditure, or both. A measured worsening of performance or outcome will therefore exclude what could be significance experiences of the object of interest, the 'fiscal consolidation effort' involved. Correspondingly, improved outcomes may result from GDP growth, improving the denominator even if there was no deliberate effort made to change the numerator. A striking feature of the standard ways of measuring and quantifying episodes of fiscal consolidation is that they can result in quite different classifications and quite different objects of investigation, which casts some doubt upon the reliability of the correlations obtained through quantitative analysis (Alesina et al., 1998, Mulas-Granados, 2006, Dellepiane and Hardiman, 2012a).

In contrast, a new research agenda has begun to emerge that focuses on the politics of choice in matters of fiscal policy (Kumar et al., 2007, Leigh, 2010, Dellepiane and Hardiman, 2012b, Dellepiane and Hardiman, 2012d). Rather than deciding ex post whether particular episodes merit inclusion in the data set, this approach seeks to identify ex ante when efforts were undertaken to target the fiscal deficit, the better to clarify what is at stake in analysing the content and also the outcome of these choices. We can then analyse the conditions under which governments prioritize and embark upon fiscal adjustments (as opposed to, for example, postponement of efforts to reduce fiscal deficits in favour of prioritization of growth-promoting expansion). We can also make sense of the size and timing of the adjustment attempted, and compare it with the actual outcome, the better to understand the role of political intentionality and context or accident in facilitating the outcome. And we can focus more intently on the composition of fiscal adjustment (that is, the mix of spending cuts and revenue-

increasing measures adopted), not least because the distributive effects of different mixes can be very different, quite apart from the potential significance for the success or durability of the fiscal adjustment achieved. Finally, by focusing on the contextual meaning of policy choice, we may be better able to understand variation in the political verdict cast upon episodes of fiscal consolidation. On this topic, there have been divergent findings. The mainstream analysts argue that there is no electoral cost to governments in undertaking fiscal retrenchment (Alesina et al., 2010), but this finding has been challenged with different empirical indicators (Mulas-Granados, 2004).

A qualitative, single-case-study approach provides a good alternative methodological approach to undertaking analysis of the themes outlined here (Goertz and Mahoney, 2012) . Firstly, it enables us to focus in on a case that are thought to be of particular substantive interest – indeed, that has been used as a test case by other studies (Rueschemeyer, 2003, Gerring, 2004). Ireland fulfils this criterion particularly well, as it has featured as one of the critical cases for the theory of expansionary fiscal contraction (Giavazzi and Pagano, 1990, Alesina and Ardagna, 1998). Secondly, it can enable us to explore the interaction between variables that are not readily disentangled, but that function as 'cluster concepts', such that sets of variables tend to be found together, and to work together rather than independently to shape policy choices and policy outcomes (Dellepiane and Hardiman, 2012c). Thirdly, we can use the advantages of within-case variation over time to isolate and clarify the conditions under which particular outcomes might ensue from specific policy choices (Gerring, 2004). And finally, a more nuanced and qualitative case-study approach can probe the conditions under which electorates may be persuaded that 'there is no alternative' to austerity measures, or alternatively may reject the legitimacy of governments' claims to be acting in voters' best interests (Mauro, 2011).

Composition of fiscal adjustment

The mainstream or orthodox approach in the current literature continues to assert that the findings of the 1990s remain robust in the fiscal consolidations undertaken in response to the current crisis. That is, the argument is that

spending cuts are more sustainable and more successful than tax increases in achieving and sustaining improvements in public deficits over time (Alesina and Giavazzi, 2012, Alesina and Ardagna, 2012). But the findings have not gone without challenge, and there is evidence that insofar as these results have proven robust in the past, they may have been shaped in part by the design features noted above, to do with the selection of episodes, and by contextual factors that have not been clearly identified or isolated (Illera and Mulas-Granados, 2008, Baldacci et al., 2010). Giavazzi has expressed a good deal more caution than his frequent co-author Alesina about the merits of adopting strong expenditure-based adjustments since 2008, in a context in which many countries are doing the same thing simultaneously, and the financial system is fragile (Giavazzi, 2010). And Mauro's colleagues have found evidence that different strategic mixes of tax increases and spending cuts may well prove durable and effective over time (Mauro, 2011).

Explaining success and failure of fiscal effort

International contextual factors that are likely to have made a significant difference in the earlier period no longer obtain in the international crisis since 2008, in the context of membership of European Monetary Union. The main contextual factors concern the role of monetary and exchange rate policy, and the state of the international economy. The capacity to devalue enables a country to alter its relative competitiveness features instantly, and to improve the access of its exports to international markets, as long as here is sufficient demand in other countries. By the late 1980s, Ireland's main trading partners were performing very much better than it was; this provided the buoyancy for Ireland to engage in an export-led recoverty.

The contextual conditions affecting recovery conditions after 2008 were very different. The economic crisis that began in 2008 was not primarily a fiscal crisis in Ireland. Indeed, as we shall see, Ireland ran very small fiscal deficits, and sometimes fiscal surpluses, during the 2000s. Ireland's problems were primarily driven by the rapidly growing scale of financial lending. Alongside this, an over-reliance on sources of revenue that depended on activities related to this,

including housing transactions and other property-related activities. In common with the other members of the Eurozone, Ireland could no longer adjust its exchange rate. Relative costs had varied greatly across the Eurozone between 2000 and 2008, as inflationary pressures, driven by surges in capital movements, began to adversely affect the peripheral countries of the EU, particularly Ireland and Spain. These resulted in large housing bubbles, the effects of which spilled over into other areas of economic activity also.

Ireland therefore experienced a serious financial crisis at the same time as it suffered a severe worsening in its fiscal position. The measures undertaken to stabilize the banking system transferred a large additional burden onto the public purse. Simultaneously, revenues collapsed even as spending on automatic stabilizers went up in the sudden unemployment shock caused by the collapse of the construction industry. The financial, fiscal, and competitiveness crises reinforced one another (Dellepiane and Hardiman, 2012b). The terms of the Stability and Growth Pact required Ireland, along with other EU member states, to adopt a course of fiscal corrections to return to a 3% deficit target. Once Ireland had entered an EU-ECB-IMF loan agreement, in November 2010, the fiscal adjustment targets were outside Irish government control. The unavailability of devaluation as a policy option made domestic adjustments considerably more difficult.

Once again, Ireland was acclaimed by international official sector commentators for having undertaken its fiscal adjustment strategy successfully. But with GDP growth either negative or below 1% in the years after 2010, the public deficit still in excess of -7% of GDP in 2013, unemployment at about 15%, and rising emigration, especially among young people, the public perception was of persistent gloom rather than prospective recovery.

Rethinking fiscal consolidation during the 1980s

We consider three themes in the politics of fiscal adjustment during the 1980s: the reasons for undertaking fiscal corrections; the composition of adjustment; and the economic and electoral outcomes. Drawing on the revised methodological approach adopted in this paper, and focusing on the politics of

fiscal effort, we can see that the conventional story about the timing, the composition, and the outcomes of so-called 'expansionary fiscal contraction' in Ireland needs to be revised.

Initiation of fiscal retrenchment

Much of the conventional analysis of the fiscal corrections undertaken in Ireland during the 1980s focuses narrowly on the period 1987-1989, because this is the period during which an appreciable change occurred in the recorded deficit. However, if what really matters is the politics of fiscal effort, and the sustained attempt to achieve an improvement through revenue-raising or expenditure-cutting, then we need to broaden the time-frame we analyse. Consistent government efforts to reduce the budget deficit and consolidate the public finances were undertaken, beginning in 1981. The whole period from 1981 to 1989 needs to be considered. The conventional narrative suggests that it was the sharp spending cuts of 1987-1989 that achieved significance and durable change in the deficit, and that this vindicates a preference for expenditure-based adjustments. However, a closer analysis reveals that 'most of the improvement in the fiscal balance was achieved through increases in tax revenues rather than expenditure cuts' (Honohan, 1992, p.312). Evaluation of the outcomes has tended to be viewed rather narrowly, where the resumption of GDP growth in the late 1980s is taken as vindication of the strategy of adjustment. But this inference is not warranted on the evidence.

Irish fiscal policy has displayed recurrent pro-cyclical tendencies since the 1970s (Lane, 1998, Lane, 2003, Benetrix and Lane, 2009, Bénétrix and Lane, 2012a). Prior to the mid-1970s, governments had adopted a conservative fiscal stance, and were reluctant to permit budget deficits in any circumstances. The departure from an orthodox stance was driven in large part by party-political competition, and specifically by the terms on which the populist, centre-right Fianna Fáil party, then in opposition, contested the general election of 1977. The coalition of a centre-right, fiscally orthodox Fine Gael party, with the centre-left but much smaller Labour Party, which held power from 1973 to 1977, during the worst of the oil-price crisis, had grown increasingly unpopular, as it sought to manage

stagflation without incurring large increases in debts or deficits. As in many other European countries at this time, the result was felt in rising unemployment. Fianna Fáil, the 'natural' party of government since the foundation of the state in 1922, anxious to return to power, committed itself to a series of expensive election pledges, promising to restore prosperity and to boost employment, while opposing some conspicuously unpopular revenue measures such as local domestic rates, car tax, and other quite visible tax instruments.

However, unused to managing stimulus policies, the government and its officials (in a new Department of Economic Planning and Development) undertook to spend their way to full employment. This meant creating new public sector jobs that generated little additional demand; and in a highly open economy, additional demand tended to increase the consumption of exports, thereby worsening the trade deficit (Bradley, 1990, Ó Gráda, 1997). This stimulus package took effect during a period of economic recovery, adding to public spending obligations during an upturn. And although official advisers in the Department of Finance were anxiously warning about the growth of budget deficits, leadership struggles within Fianna Fáil meant that this policy stance persisted into the early 1980s. During 1981 and 1982, efforts to address this fell foul of unstable electoral politics – three general elections were held in an 18-month period.

Late in 1982, a new government Fine Gael and Labour formed a new government which held power until 1987. Figures 1 and 2 show that the worst year of deficit performance was 1982, while the total public debt continued to accumulate until 1987, when it was about 112% of GDP.

Figure 1. General government gross debt, 1970-2010

Figure 2. Central government deficit, 1970-2010

But although they recognized that something had to be done, agreement between the two governing parties over how precisely to address the deficit proved very difficult to obtain. As the recession deepened, unemployment rose

rapidly, as Figure 3 shows; emigration also picked up pace severely in the mid-1980s, disguising the true effects of job losses and underemployment. Even after the resumption of GDP growth in the late 1980s, a period of 'jobless growth' followed, with no appreciable change in employment rates until after 2004. This put sustained pressure on welfare expenditure, and on other categories of entitlement such as housing benefits and food subsidies, an item of public spending often criticized for its inefficiency, yet a highly politically salient item of public spending.

Figure 3. Unemployment

Even though the debt-to-GDP or GNP ratio was not stabilized, significant fiscal retrenchment was undertaken during the lifetime of this government (Honohan, 1992, p.290). Between 1982 and 1986, on the key indicators of the time, the Exchequer Borrowing Requirement fell by three points and the Public Sector Borrowing Requirement by more than five points.

The composition of adjustment

During the first half of the 1980s, most of the change in the fiscal balance came about because of increases in the volume of tax raised. Figure 4 shows that revenues had been around 33% of GDP during the 1970s, and accounted for 37% of GDP in 1981, and that this rose rapidly to 41% in 1983, where it stabilized until 1988.

Figure 4. Real revenues, expenditure, and primary balance as % GDP

The intense reliance in raising taxation was a directly consequence of the policy stasis resulting from disagreement between the two governing parties over how to apportion spending cuts. It proved less contentious to permit revenues to increase through fiscal drag than to deliberately embark on spending cuts. However, it must be noted that the tax system had evolved in a rather ad hoc manner over time, so the distributive consequences of who bore the burden of the adjustment was not well planned. Many categories of income and expenditure used in other countries were exempt in Ireland (particularly property and wealth). Corporation tax had been held at a low rate since the

1950s, as part of a consistent economic development strategy based on attracting foreign direct investment (Barry, 2000). Groups such as farmers and the self-employed were able to avail of advantages such as self-reported income and lagged tax payment. Tax administration was patchy and inefficient. The result was that ever-heavier tax burdens were imposed on employees on ever-lower levels of income, since these were the easiest sources of revenue to target effectively. Pay-As-You-Earn (PAYE) and consolidated income and social insurance contributions were introduced in the early 1970s, and high inflation had resulted in a lot of fiscal drag, pushing larger numbers into the tax net (Hardiman, 2002a). In 1965, the marginal tax rate on a single person on average industrial earnings was 31.5%, and that of a single person on twice the average level of earnings was the same. In 1985, these rates were 56.3% and 62% respectively (Hardiman, 2004, Table 7.5). The distortions in the tax system had led to mass street protests in 1979 and 1980, organized by the trade union movement. But the situation only worsened as the fiscal crisis deepened.

Total expenditure in the early 1980s exceeded 50% of GDP. However, total spending net of debt servicing was appreciably lower. While the total budget deficit was over 12% in 1982, and 10% in 1986, total borrowing was under 5% by 1988. The Irish government's primary budget balance was already below -3% of GDP in 1983, and entered a surplus in 1987.

The Fine Gael-Labour government was very unpopular by this point though, and as a general election drew near, Fianna Fáil made political capital out of the high income tax rates and the under-funding of what were already quite low-level social and health services. Their election campaign was very critical of the government's fiscal stance, and they stood on a platform of reversing the cuts.

However, once elected, albeit with a minority government, Fianna Fáil changed its pre-election stance dramatically. It now accepted the case made by the outgoing government that the public finances had to be stabilized, since the total debt was still on an upward trajectory. The new government undertook a programme of fiscal consolidation more dramatic than anything of which the preceding government had been capable. The reason it was able to do this was

that Fine Gael in opposition, with Alan Dukes now as party leader, committed itself not to oppose government measures for electoral advantage (as Fianna Fáil in opposition had consistently sought to do), provided it adhered to the sort of deficit-reducing strategy that Fine Gael could assent to. This 'Tallaght Strategy' gave Fianna Fáil considerable freedom of manoeuvre; however, it proved electorally very costly to Fine Gael.

Fianna Fáil held power as a minority government until 1989, and from then until 1992, it ruled in coalition with a new small party with a mandate for market-liberal reform, the Progressive Democrats. Fianna Fáil's policy mix between 1987 and 1992 differed from that of the preceding government in its willingness to undertake spending cuts. At the same time, it committed to a broad-ranging programme of reform of tax composition and tax administration. A tax amnesty in 1988 signalled the start of a new era of enforcement of tax compliance. Employee tax rates were reduced, the tax base was broadened and the tax net widened, and new tax compliance measures were introduced.

But this was no straightforward neo-liberal programme. Fianna Fáil had gained a significant increase in its already strong working-class support base in the 1987 election. Already, while in opposition, it has been exploring initiatives with trade unions and employers with a view to forming a new social pact to try to tackle the joint problems of low growth, high inflation, and rising debt. The tripartite agreement negotiated in 1987, the Programme for National Recovery, involved pay increases lower than the anticipated inflation rate, which would be offset by improvements in disposable income as a result of changes in the incidence and level of taxation (Hardiman, 1988, Hardiman, 2002b). Total real tax revenues came down from 41% GDP in 1988 to 38% in 1989. But without the increase in revenues that had been achieved in the preceding years, the corresponding cuts in expenditure would have had to be very much more severe to achieve the fiscal stabilization the government was aiming for.

A corollary of the social partnership agreement was that the trade unions did indeed accept deep cuts in public spending, including not only an embargo on further public sector recruitment, but sharp cuts in spending on social services.

Fianna Fáil also consolidation effortd welfare spending in real terms, which the coalition government had not done – real welfare rates remained had constant between 1982 and 1987. Current spending was now curbed, but the biggest cuts were made in the capital budget, as Figure 5 shows.

Figure 5. Central government spending, current and capital, 1970-1995

In retrospect, many economic commentators noted that this was a mistake, and that squeezing investment in infrastructure had long-lasting damaging effects on growth as well as on the quality of services. But since the main target at the time was to reduce total borrowing, it was counted a successful strategy.

External factors

Behind the domestic strategic choices, international factors played an important role in facilitating deficit stabilization during the 1980s, in ways that have tended to be overlooked in the mainstream literature. The Irish Pound had severed its parity connection with sterling in 1979, and participated in the European Exchange Rate Mechanism during the 1980s and 1990s, before entering European Monetary Union in 1999. This meant that during the period of fiscal consolidation of the 1980s, the Irish government was able to avail of changes in exchange rate to adjust the distributive costs of fiscal management. In October 1986, it managed a smooth devaluation of 8% of the Irish Pound against sterling.[1] During the ERM currency crisis of 1992, the Irish Pound was further devalued by 9% against the Deutschmark (Honohan and Conroy, 1994).

Moreover, during the late 1980s, Ireland's attempts to reduce its public deficit and regain control over its debt dynamics were greatly assisted by an upturn in the international economy. Devaluation, supported by domestic attempts to restrain costs, was making Irish goods and services more competitive. But an improvement in international demand conditions made a significant difference to the capacity of Irish producers to benefits from domestic policy efforts. These international contextual factors have all too often been overlooked in the literature on fiscal consolidation in the 1980s, where fiscal policy efforts play

[1] http://debates.oireachtas.ie/dail/1986/10/30/00088.asp

most of the explanatory role. The Irish fiscal stance is credited with transforming Ireland's growth performance in the late 1980s. But once the international framework is fully brought into focus, Ireland's model status as an exemplary case of 'expansionary fiscal contraction' becomes much less convincing (Barry and Devereux, 1995, Hogan, 2004, Bradley and Whelan, 1997).

The fiscal out-turns for 1988 and 1989 therefore turned out to be very much better than those anticipated in the budgets of those years, in large measure on account of these changes in the exchange rate and the upturn in the external environment. The macroeconomic improvement between 1987 and 1989 owed a great deal to factors outside the control of government strategy. The recovery cannot be attributed to a rise in business confidence consequent upon fiscal cutbacks. Rather, causality ran in the opposite direction: the upturn in GDP growth and private sector recovery caused an improvement in the government's fiscal situation, as revenue flows improved and borrowing costs went down. The ratio of tax to GDP stayed constant during these years, but in real terms the flow of revenues to government rose quite markedly between 1987 and 1990.

The distributive effects of the strategies of fiscal stabilization undertaken by the two governments in power during the 1980s were rather different. Fine Gael and Labour, despite having used urgent rhetoric about fiscal crisis, maintained real welfare rates even at the height of the crisis and at the worst of the unemployment. Fianna Fáil, despite having campaigned on issues of social justice, imposed spending cuts that had more severe effects on the most economically and socially vulnerable. The electoral consequences of fiscal retrenchment do not provide endorsement for the expectation that governments suffer no adverse effects: both governments suffered large losses after their period in office, and Fine Gael all the more so as it was credited with responsibility for hardship whilst in opposition, during the minority government of 1987-89. The experience of fiscal crisis can be credited with giving rise to a new era in Irish electoral politics. The era of Fianna Fáil hegemony now seemed to have been broken. Coalition governments appeared to have come to stay. Electorates seemed readier to punish governments retrospectively for the performance of the economy.

Thus we can see that if the emphasis is on political commitment to fiscal retrenchment, we must consider not just the narrow period between 1987 and 1989, but the whole period from 1981 to 1990. In this broader perspective, the putative lessons drawn about the most effective composition of fiscal adjustment take on a very different hue. Spending cuts turn out to have had a much less important role in achieving fiscal stabilization. It becomes clearer too that the challenges facing governments about how to undertake fiscal stabilization can be complex, and subject to constraints arising from macroeconomic circumstances and from the realities of coalition-building, both within government and in the wider society.

History repeats itself, as tragedy: fiscal consolidation since 2008

The circumstances in which Irish governments found themselves required to engage in very tough fiscal consolidation effort once again, in the wake of the 2008 global economic crash, were very different from those of the 1980s. Ireland had been a member of the European Monetary Union since its inception in 1999. It could not secure competitiveness gains by devaluing its currency, and it was bound by the terms of the EU's Excessive Deficit Procedure. There was no external demand boost to stimulate domestic growth, and the fragility of the European banking sector as a whole constrained the availability of credit. Ireland was additionally encumbered by the terms of its own bank rescue decisions. The Fianna Fáil-led government provided a blanket guarantee to six major domestic financial institutions in September 2008 in order to stabilise a worsening run on the banks, but the liabilities turned out to be considerably worse than anticipated. Thus in November 2010, Ireland was obliged to enter a loan programme provided by the European Union, the European Central Bank, and the International Monetary Fund (which became known as the 'Troika'). The bailout of the Irish banking sector was amongst the largest in comparative terms (Laeven and Valencia, 2012, pp.20-21); but the home-grown fiscal mistakes made during the boom were mostly responsible for the severity of the problem.

This meant that from late 2010 onward, although there was some domestic discretion over the details of how spending cuts and tax increases were to be

implemented, the terms of the fiscal consolidation programme were set by the external lenders. Against this very different backdrop, compared with the 1980s, it is striking that this time round, there was extensive cross-party agreement on the principles and priorities of the extreme fiscal consolidation effort that were to be undertaken. The return to government by a Fine Gael-Labour coalition in February 2011 involved minimal changes in overall policy priorities. Once again, we might consider in turn how the terms of debate about fiscal consolidation effort came to be shaped, and how the composition of adjustment between tax increases and spending cuts were arrived at, before we turn to the political costs of undertaking fiscal consolidation effort this time round, and the electoral consequences for the parties involved.

Fiscal consolidation effort as the only option

Ireland found itself in serious fiscal trouble early on in the course of the international crisis. Having been lauded for its super-normal growth experiences in the 1990s and 2000s, its crash proved to be one of the most severe among the developed economies. The immediate causes of Ireland's fiscal crisis, and the protracted experience of fiscal consolidation that was begun during 2008, were not due to excesses in the public finances prior to the crisis. Ireland's general public debt at the start of 2008 was 27.5% of GDP. By the end of 2011 it stood at 108.2% (Central Statistics Office, 2012a). Having run little or no deficit during the 2000s, the general government deficit rose to 7.3% in 2008 and 14% in 2009. The cost of bank recapitalisation resulted in a deficit of 31.2% being recorded in 2010 (as Figure 2 shows), which drove up the public debt in subsequent years. But the government's own deficit was still considerable, at over 12% in 2010, well outside the 3% EMU rules.

How did Ireland end up in such dire straits, from such apparently virtuous fiscal performance in the preceding years? Three features of the Irish public finances combined to produce hidden vulnerabilities. Firstly, the low interest rates available under EMU after 2000 resulted in a surge in borrowing, producing a large property bubble (Dellepiane et al., 2013). Government failed to control these unintended perverse consequences of monetary union, and indeed

intensified them through incentivizing construction and property speculation. Lax and even non-existent financial regulation permitted banks to become severely over-exposed, especially in the years between 2003 and 2007 (Clarke and Hardiman, 2012). Secondly, the tax reforms that had started in the late 1980s, involving lower rates and broader bases, were not systematically pursued (Christensen, 2012). Rather, tax cuts came to be valued for their own sake. Tax measures intended to be job-friendly even relieved large numbers of lower-paid employees of any tax liabilities, so that by 2008, some 50% of employees were outside the tax net altogether. This resulted in a continuous weakening of the state's revenue capacity, a vulnerability that only became fully apparent when the crisis hit. Thirdly, the surge of economic growth from 1994 to 2008 had given governments a new freedom to engage in public spending. They could do this without impairing EMU fiscal targets (which mandated a maximum deficit of 3% of GDP) because the revenue stream was so buoyant. But after 2000, permanent public spending commitments, especially current spending on public sector pay and welfare transfers, were increasingly reliant on transient revenues from the property bubble. Thus when the international crisis erupted in Ireland, the public finances were unusually vulnerable.

Ireland's fiscal consolidation effort from 2008 onward was harsh indeed. Between July 2008 and spring 2013, Ireland had nine episodes of fiscal adjustment. By 2014, the total adjustment will have amounted to almost €30bn, through a combination of spending cuts and increased taxation. The overall government deficit, which was -7.3% GDP in 2008 and-14% in 2009, was reduced somewhat to -13.1% in 2011 and 7.6% in 2012. Ireland was originally committed to getting the deficit to under 3% by 2015 (European Commission, 2012a p.27), a timetable relaxed somewhat in spring 2013. GDP was estimated to have fallen some 18% between 2007 and 2010 alone (Central Statistics Office, 2012b).

The context of the early adoption of fiscal retrenchment, and the unwavering commitment to this on the part of two successive governments, needs some explanation. After all, most developed economies adopted expansionary measures during 2008/9 in response to the global downturn; Ireland was an

outlier (Dellepiane and Hardiman, 2012c). The explanation lies partly in the new information that was then coming to light about the true fragility of the public finances. But part of the explanation can also be found in economic analysts' retrospective understanding of the fiscal consolidation effort of the 1980s. The persistent weaknesses in Irish macroeconomic policy-making and implementation were coming under more intense scrutiny. Academic economists were increasingly vocal in their criticism of governments' tendency to engage in pro-cyclical fiscal policy (Lane, 2010, Irish Fiscal Advisory Council, 2012, Bénétrix and Lane, 2012b). The stimulus of the late 1970s was followed by an unfortunately timed correction that worsened an already pronounced downturn. Again during the 'Celtic Tiger' period in the 1990s and 2000s, fiscal policy was also too expansionary, resulting in the argument that a fiscal consolidation effort could no longer be postponed in spite of the severe downturn. Prominent professional economists in Ireland argued that the difficulties experienced by the coalition government in pursuing fiscal consolidation effort between 1982 and 1987 led to an excessive delay in stabilising the public finances; that this had adverse consequences for lost output and had unnecessarily prolonged unemployment; and that these mistakes should not b repeated (McCarthy, 2010, McCarthy, 2009). And while Irish policy experts held no brief for 'expansionary fiscal contraction', there were few voices to counter the prevailing view that regaining national economic sovereignty was a top priority, that the scope for fiscal stimulus was vanishingly small, and that closing the deficit quickly was the most defensible way to restore the conditions that would facilitate recovery (Kinsella and Leddin, 2010).

Total government expenditure escalated rapidly from 42.8% GDP in 2008 to 48.8% in 2009. This was brought down to 44.1% in 2012. But percentages can be misleading when both numerator and denominator are fluctuating. Total government expenditure continue to rise, from €77.1bn in 2008 to €78.4bn in 2009. By 2011 it had been brought down to €76.4bn, and to about €70bn in 2012. But meanwhile, revenues had plummeted from €63.9bn in 2008 to €55.9bn in 2009. New tax increases pushed this figure up somewhat to €57bn in 2012, and projections would have it at €63.1bn by 2015. The overall fiscal

adjustment, in an economy with a GDP of €163,938bn in 2012, was estimated at almost €21bn between 2008 and 2011, a considerable fiscal effort[2].

The composition of fiscal adjustment

The composition of Irish fiscal adjustment after 2008 followed the 'orthodox' approach whereby priority is given to cutting expenditure over increasing revenues(Dellepiane and Hardiman, 2012c). The profile of fiscal adjustment is summarised in Figure 6, which shows that the Irish strategy was based on securing about two-thirds of the fiscal effort through cutting spending, and one-third through raising taxes.

Figure 6. Composition of Irish fiscal adjustment strategy, 2008-2012

The first aim of fiscal consolidation effort was to prevent public spending from continuing the upward trajectory on which it was headed during the 2000s. It has been estimated that if no action had been undertaken, the deficit in 2011 would have grown to 20% of GDP, and Ireland would have been heading for a debt to GDP ratio of 180% GDP by 2014 or 2015 (Coffey, 2011). Coffey estimated in 2011 that between 2008 and 2011, 'almost €9bn of current expenditure cuts have been announced, but gross voted current expenditure is only €0.5bn lower than it was four years ago'. On the other hand, government was running to stand still on the revenue side, in the context of declining and depressed economic activity. Coffey notes that almost €8bn of revenue-raising measures were introduced over the period, but that revenue was actually €7.4bn less than it had been four years previously. Large spending cuts were announced, the net effect of which was quite small; significant tax increases were announced and implemented, but total revenues still fell far short of spending commitments.

[2] GNP was €132,649bn in 2012 (Central Statistics Office, National Income, consulted online on 1 October 2013). The gap between GNP and GDP in Ireland rose steadily from the 1980s on, due to the significance of the foreign-owned sector in the Irish economy; see DEPARTMENT OF FINANCE 2012. Budgetary and Economic Statistics. Dublin, ECONOMIC AND SOCIAL RESEARCH INSTITUTE. 2013. *Irish Economy* [Online]. Dublin: ESRI. Available: http://www.esri.ie/irish_economy/.

But that is not to say that the effects of spending cuts were not felt in a very real way. The first round of fiscal consolidation effort, in a small supplementary budget in July 2008, involved cuts that were intended to gain efficiencies. But a series of scheduled and emergency budgets followed in 2008, 2009, and 2010, to try to arrest the slide toward a potential sovereign debt crisis. Headline public sector pay was cut on a tapered basis, not once but twice, in 2009 and again in 2013, and headline rates of social welfare were cut for most categories of recipients. In 2011, almost one-third of current expenditure in the public service was accounted for by pay alone. Pay rates had already improved considerably during the 2000s. Allowing for difficulties in comparing education levels and skill deployment across sectors, it was estimated that between 2003 and 2006 alone, the relative overall gap (or pay premium) between public and private sector workers had risen from 14 to 26 per cent (Kelly et al., 2009). The EU-IMF progress report of March 2012 reported that as a result of the spending cuts, gross rates of public service pay were reduced by about 14% cumulatively over 2009 and 2010.

In 2009, the Fianna Fáil-led government commissioned a report from economist Colm McCarthy on cutting public spending. This recommended reductions in the order of 17,300 personnel or approximately 5% of the public service (Report of the Special Group on Public Service Numbers and Expenditure Programmes, 2009b, Report of the Special Group on Public Service Numbers and Expenditure Programmes, 2009a). An overall reduction of some 25,000 personnel (albeit on pre-crisis 2008 figures) by 2014 was agreed with the EU-ECB-IMF in November 2010 as part of Ireland's bailout deal; these targets were met in 2013 (Hardiman and MacCarthaigh, 2013). The profile of changes in the composition of spending can be seen in Figure 7.

Figure 7. Impact of spending cuts by category of public spending 2008-2012, €bn

The scale of the fiscal consolidation effort implemented in Ireland has been considerable, resulting in a fiscal consolidation that ranked third only after Iceland and Greece (OECD, 2012, Annex Table 30). Bootstrapping out of a fiscal crisis in recessionary conditions is particularly painful, and despite the many tax

increases imposed since the onset of the crisis, Ireland's total tax take relative to GDP was 28.9% in 2011, down from 32.1% in 2006, which made it 'the sixth lowest in the Union and the second lowest in the euro area' (Eurostat, 2013). The profile of tax revenues is summarised in Figure 8.

Figure 8. Actual outturn in revenue, 2002-2011, €bn

The fiscal consolidation effort this time was undertaken this time in conditions that differed from the 1980s in important ways. The country was now richer, living standards had risen rapidly during the 2000s, and large cutbacks might now be expected to be more easily absorbed without causing major hardships. However, the constraints of EMU meant that any competitiveness gains could only be achieved through painful and unevenly experienced 'internal deflation', that is, by reducing real living standards. EMU member countries were all undergoing simultaneous deleveraging in the public sector intensified the cumulative impact of parallel internal deflation. Notwithstanding their extensive public recapitalisation, banks sought to consolidate their balance sheets and still faced large unresolved issues of non-performing private sector loans and mortgages. This meant a dearth of lending activity, further squeezing the activities of firms in the private sector. Fiscal consolidation effort in these conditions has contractionary and not expansionary effects (De Grauwe and Ji, 2013, De Grauwe, 2013).

The effects of fiscal consolidation effort within a monetary union might therefore be expected to be experienced unevenly across different sectors of the population. Heavier tax burdens on income and on transactions may raise more revenue, but new revenue streams on items such as residential property, waste disposal and water were more visible. Public spending cuts were felt in shrinking pay packets and welfare payments, and in worsening health, education and other social services. But the cost in the private sector were most clearly felt in the form of unemployment, first in the devastation of the construction sector, then across a whole range of mostly domestically-owned enterprises.

The impact of fiscal consolidation effort on the disposable income available to households can be difficult to estimate accurately, in light of the multiple effects

of changes in income tax and indirect taxes, public sector pay and welfare entitlements. Some research findings suggest that while the impact of income tax, pay and welfare changes on household disposable income was more severe in Ireland than elsewhere, both the overall policy stance and the distributive outcomes between 2008 and 2012 had a progressive profile (Callan et al., 2012, p. 53, European Commission, 2012b, p.17). That said, the increasing reliance on indirect taxation is regressive in effect, and different kinds of households were disproportionately affected. People dependent on welfare suffered most, cuts to Child Benefit were particularly marked, whereas older people fared less badly overall. The proportion of the population deemed to be suffering 'deprivation' almost doubled from 11.8% in 2007 to 22.5% in 2010, and was 24.5% in 2011 (NERI, 2012 p.75, NERI, 2013 p.75, Nolan et al., 2013, forthcoming).

Resistance, protest, and fragmentation of the party system

What, then, of the political costs of imposing fiscal consolidation effort this time round? Street protests against 'austerity' in Ireland were much less in evidence compared to the mass mobilisation that occurred in Spain, Portugal, Greece, and Italy. Some public sector unions organised small-scale industrial action, and in one early and quite successful rally, older people protested over medical entitlements. But negotiated agreements about the scale of pay cuts, concluded between both governments and the public sector unions, kept mass organised protest off the streets (Stafford, 2010, Sheehan, 2013). Regular small-scale protests organised by various left parties made relatively little public impact.

The political effect of fiscal consolidation effort is seen most clearly in the electoral arena. Irish political life was transformed by the 'earthquake election' held in February 2011 (Little, 2011, Gallagher and Marsh, 2011). Fianna Fáil, Ireland's historically dominant party, suffered devastating losses at the polls. It secured only 17% of the popular vote, falling from 71 to 20 Dáil seats. Figure 9 illustrates a trend that had been apparent for quite some time, that is, that Fianna Fáil was deeply unpopular.

Figure 9. Opinion polls on support for parties, 2007-2013

Fianna Fáil was being punished not only for its implementation of fiscal consolidation effort after 2008, but also for its longer-term mismanagement of the economy. It was now also paying the price for its panicked bank guarantee of September 2008, and for the years of inadequate financial regulation that had led the domestic banks to the brink of melt-down, and the Irish economy to catastrophic collapse.

The Fine Gael-Labour coalitions government that was formed in February 2011 recognised that it was bound by the conditions of the EC-ECB-IMF loan agreement. While voter dissatisfaction with Fianna Fáil ran deep, these two parties similarly held that to the only feasible or realistic course of action is to continue with fiscal consolidation effort, modified a little where possible, at least until the terms of the loan programme was finished and the fiscal deficit was sufficiently reduced. It is therefore striking that these two parties gained 42 seats in the election.

But the extent and durability of electoral acquiescence should not be taken for granted. New institutions that had been set up to monitor the public finances resulted in some shifts in priorities, for example in capital spending and in labour market policy (Department of Public Expenditure and Reform, 2011). But in Ireland as elsewhere in the Eurozone, it was unclear how long fiscal consolidation effort could be sustained without a clear expectation that better economic performance would eventually come about. Much of Europe suffered from a 'mutually reinforcing interaction between limited productivity gains, protracted deleveraging, weak banking sectors and distorted relative prices' (Darvas et al., 2013, p.7). The commingling of financial crisis with sovereign debt crisis in Ireland, in the context of an all but stagnant European economy, appeared to point toward real problems of debt sustainability (Whelan, 2011). It is surely a matter of some concern that Irish citizens' trust in their own government, always more continent than the EU average, fell precipitously after the crisis began. It recovered in the context of anticipation of fresh elections and a change of government, but fell sharply again thereafter, as Figure 10 shows.

Figure 10. Net trust in national government

Weakening support for all the established political parties is also reflected in Figure 9. This shows that, while support for Fine Gael and Labour had been strong for over two years prior to the election, it peaked shortly thereafter. For as long as this government was implementing the more systematic fiscal consolidation effort required by the Troika, its popularity was shrinking. The biggest beneficiaries of this were a wide variety of small leftist parties and independent politicians. In September 2013, Fianna Fáil was reported to be making some comeback in the polls. But Sinn Féin was reported to be the third most popular party with 21% support, while the diverse array of 'others' (independents and small socialist parties) came in next with an aggregated support level of 18%. Fine Gael dropped to 27% of voters' support, while Labour fell back from the 19% they had won in the election to about 10% (Elections Ireland, 2013, Kavanagh, 2013). Meanwhile, new protest groups, organizing around local issues to do with increased levies and service charges, prepared to contest local elections in 2014. Electoral volatility seemed to be considerable, and it remained unclear whether or not Ireland was entering into a new phase of potential electoral realignment.

Conclusion

This paper has shown that while Ireland has been taken to be an exemplary case of successful growth-promoting fiscal retrenchment, many of the apparent lessons drawn from its experience turn out to be more complex and even misplaced upon closer inspection.

We have suggested that it is important to draw on detailed case study research to capture what was really at stake, since the standard methodologies for identifying the object of interest in fiscal consolidation can all too easily obscure the strategic decisions and the political effort involved in undertaking fiscal correction measures.

The paper has focused on the framing of the decision to undertake fiscal consolidation, the composition of adjustment, and the factors influencing the

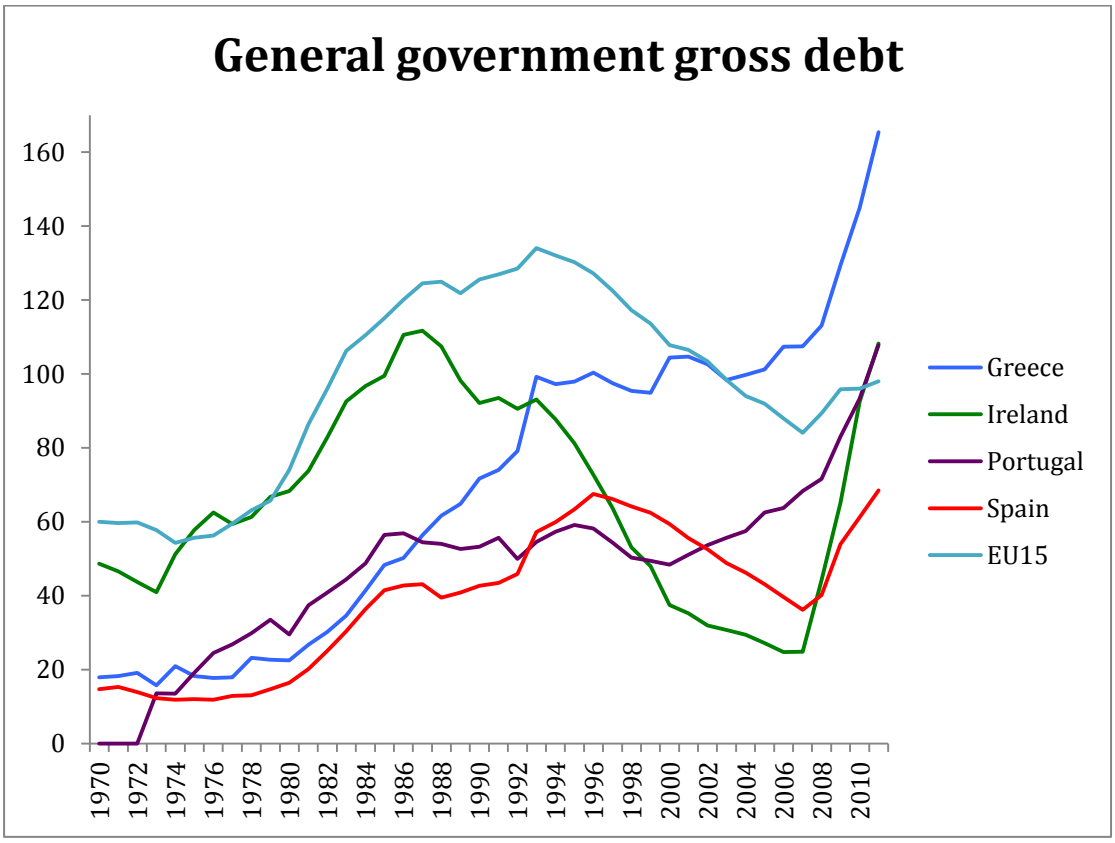
outcomes, as well as what we might judge to be successes or failures in the outcomes.

The findings provide further bases for arguing that Ireland's experiences in the 1980s did not constitute a case of 'expansionary fiscal contraction', and indeed that the dominant strategy was based on revenue increases rather than on spending cuts, as the conventional argument suggests. Moreover, insofar as it can indeed be said that rapid improvements were made to the fiscal deficit during the period 1987 to 1989, the main reasons for this have to do with devaluation in 1986, domestic cost containment due to social partnership, and an international economic upturn generating demand for Ireland's newly competitive exportable goods and services.

The argument of this paper is also that none of these externally helpful factors are present in the context of the major fiscal efforts undertaken since 2008, which have been heavily biased toward cutting expenditure. No significant or sustainable growth benefits have resulted (O'Rourke, 2013), and this is mostly because while the 'periphery' countries have been engaging in painful internal devaluation and deficit cutting, the large economies of the Eurozone 'core' have not been reflating correspondingly. This has perpetuated the downturn and generated an ongoing drag on all countries' economic performance.

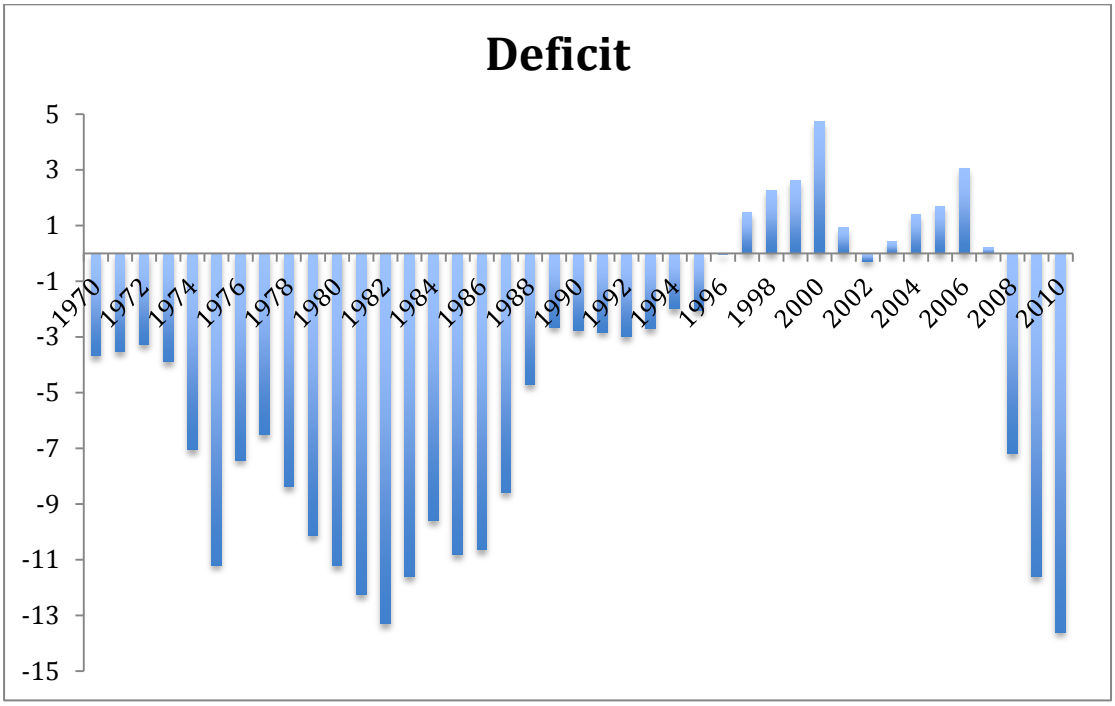
Underneath the fiscal story, there is the major unresolved problem of the stabilization and recapitalization of the European banking sector. Increasingly, support for the banking sector is implicating both governments (through injections of public funds), thereby destabilizing their borrowing capacity, and the official lending sector (through ongoing liquidity provision to the financial sector, and changing ECB rules about the acceptability of less robust forms of security on the part of governments). Ireland's problems include a problem of fiscal sustainability. But without the resolution of these other issues, which can only be undertaken at a European level, Ireland's prospects for any reasonable level of recovery and growth appear all but impossible.

Figure 1. General government gross debt, 1970-2010



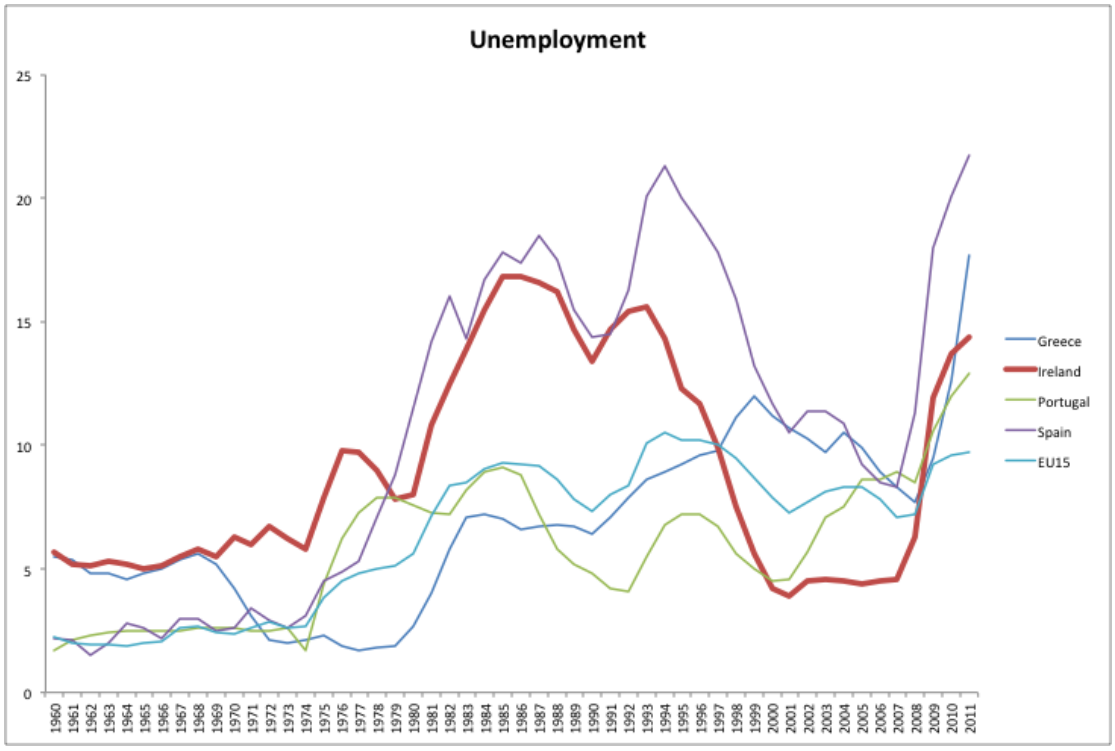
Source: EU Ameco

Figure 2. Central government deficit, 1970-2010



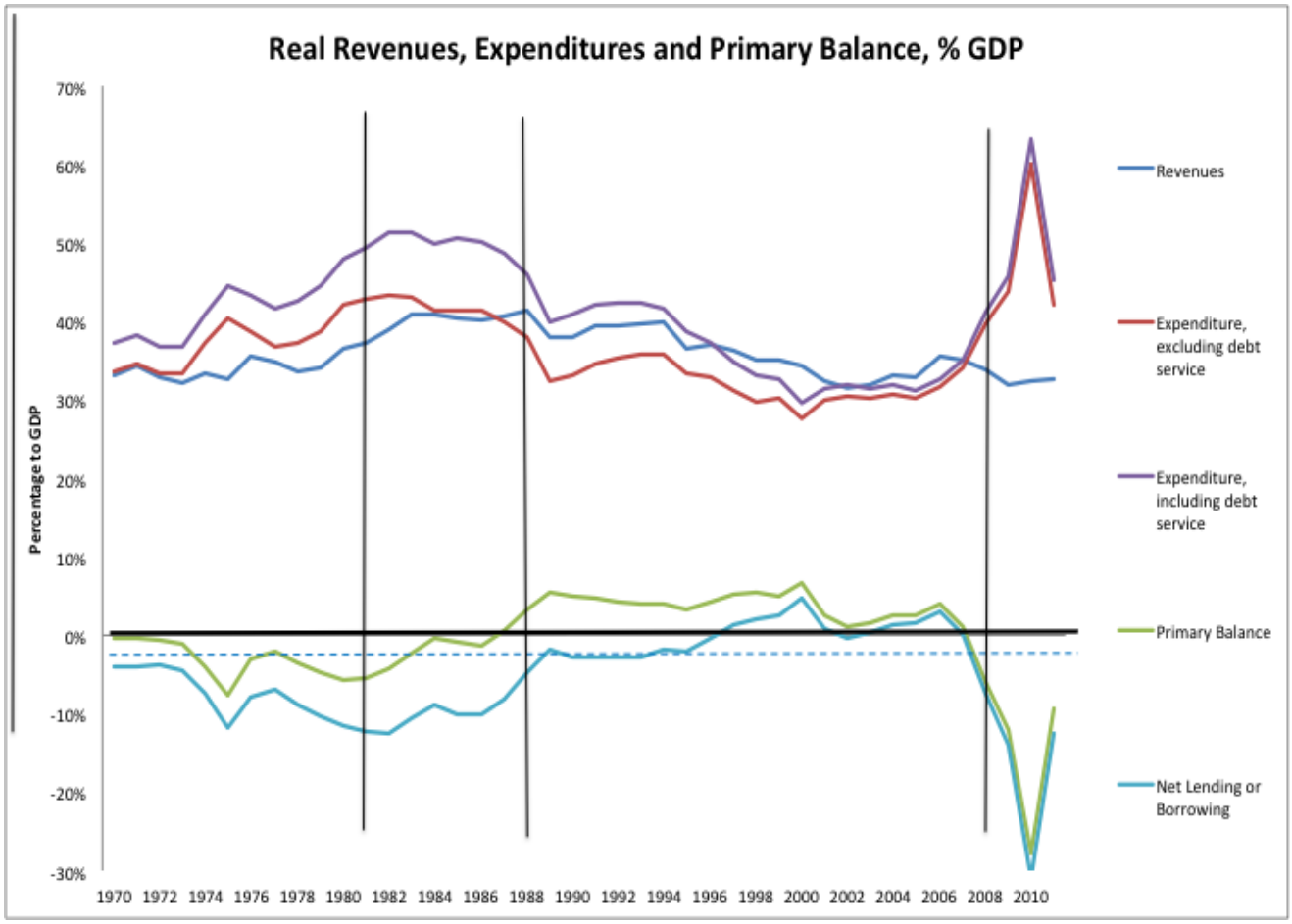
OECD Economic Outlook

Figure 3. Unemployment



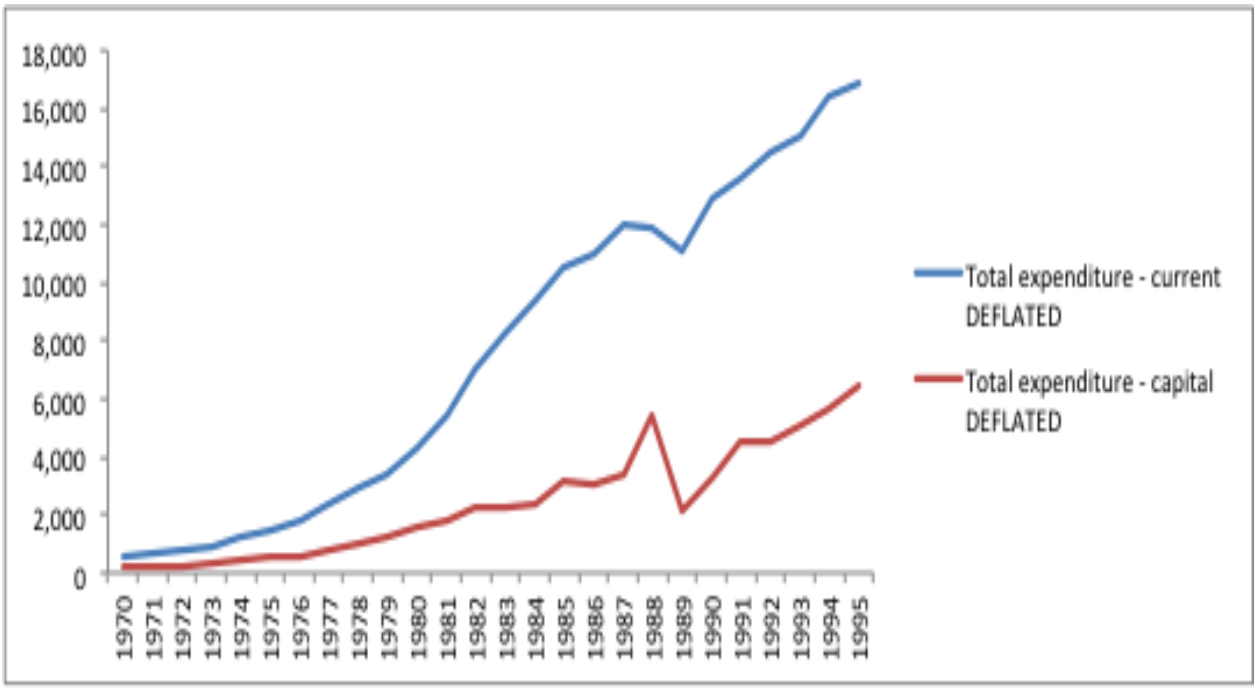
Source: Ameco

Figure 4. Real revenues, expenditure, and primary balance as % GDP



Source: Central Statistics Office, National Income and Expenditure, calculated from Table 21, Receipts and Expenditure of Central and Local Government. GDP deflator from Ameco.

Figure 5. Central government spending, current and capital, 1970-1995



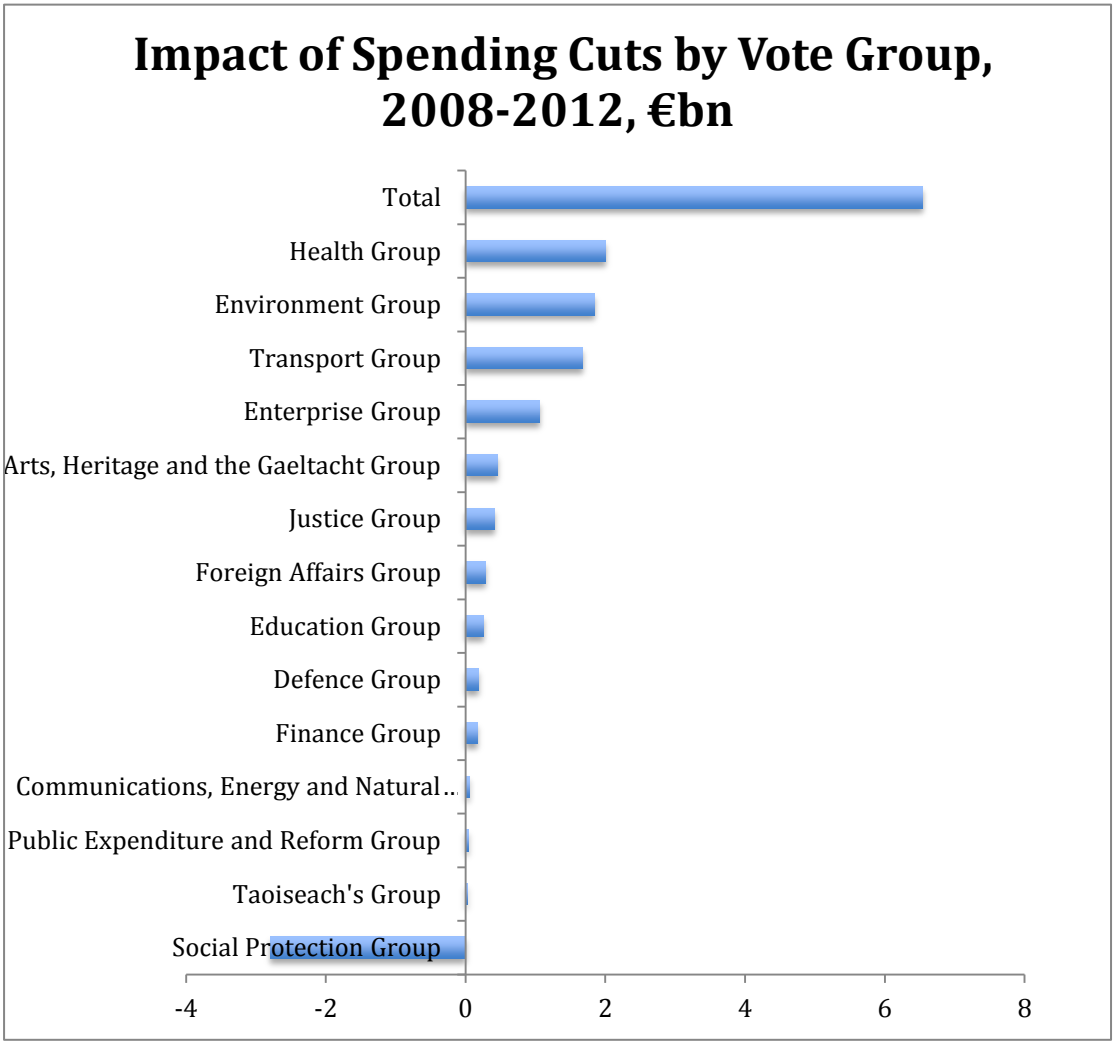
CSO, Historical National Income and Expenditure Accounts

Figure 6. Composition of Irish fiscal adjustment strategy, 2008-2012

Intervention	Key budgetary measures	Size of fiscal effort
July 2008: Expenditure adjustments	Efficiency cuts	€1bn
October 2008: Budget 2009	Income levy; spending cuts, including welfare	€2bn
February 2009: Expenditure Adjustments	Cuts to public sector pay as 'pension levy'; public sector pay increase stopped	€2.1bn (€1bn in 2010)
April 2009: Supplementary Budget	Tax increases esp. levy; €1.2bn current , €600m capital	€3.6bn Total €5.4bn €1.8bn
December 2009: Budget 2010	Spending cuts on all welfare, public sector pay and numbers; capital cuts; tax increases	€4.4bn
December 2010: Budget 2011	Current cuts €2.1bn, capital cuts €1.9bn, other €0.7bn; tax increases €1.4bn	National Recovery Plan 2011-2014 projects €10bn cuts, €5bn tax
December 2011: Budget 2012	Current cuts €1.4bn, capital cuts €0.8bn, Tax increases €1bn	€3.2bn
Adjustment 2008-2011		€20.8bn
Projected overall adjustment 2008-2014	65% Expenditure 35% Revenue	€29.6bn

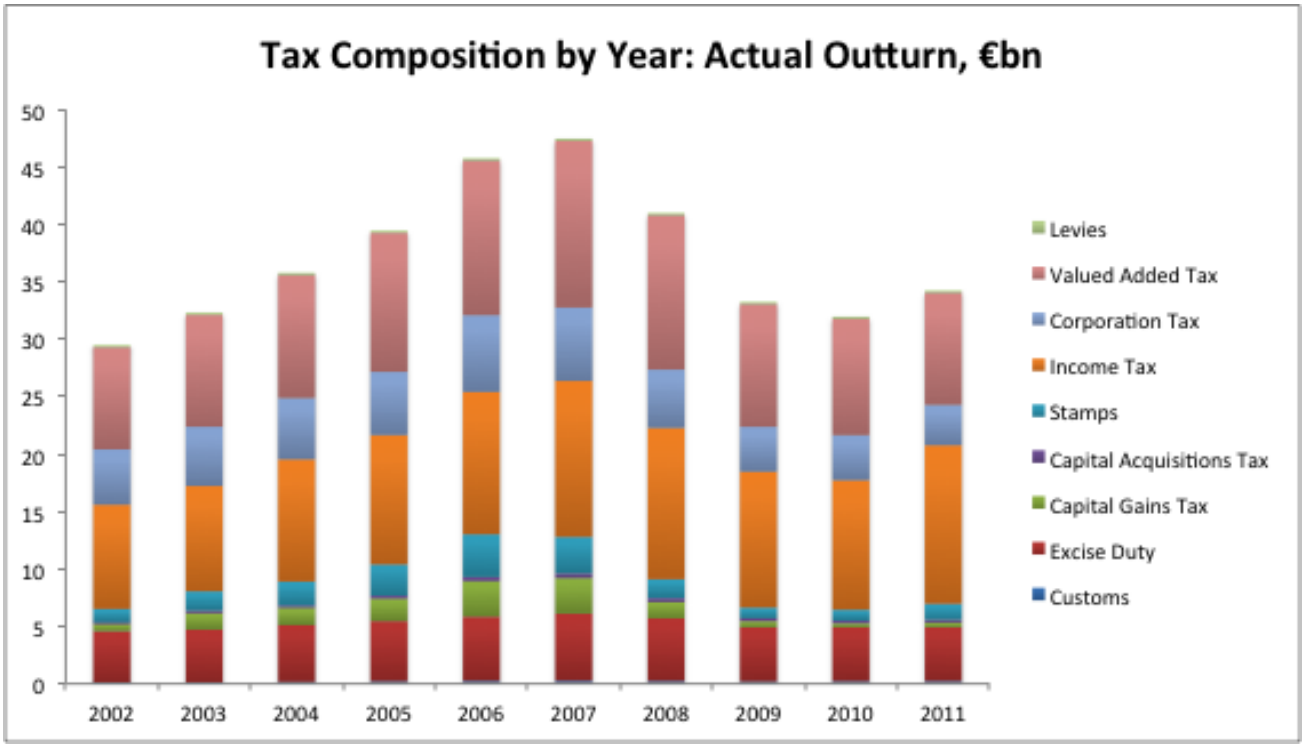
Source: (Department of Finance, 2011, European Commission, 2010), Budget documents 2009, 2010, 2010, 2011.

Figure 7. Impact of spending cuts by policy area, €m, 2008-2012



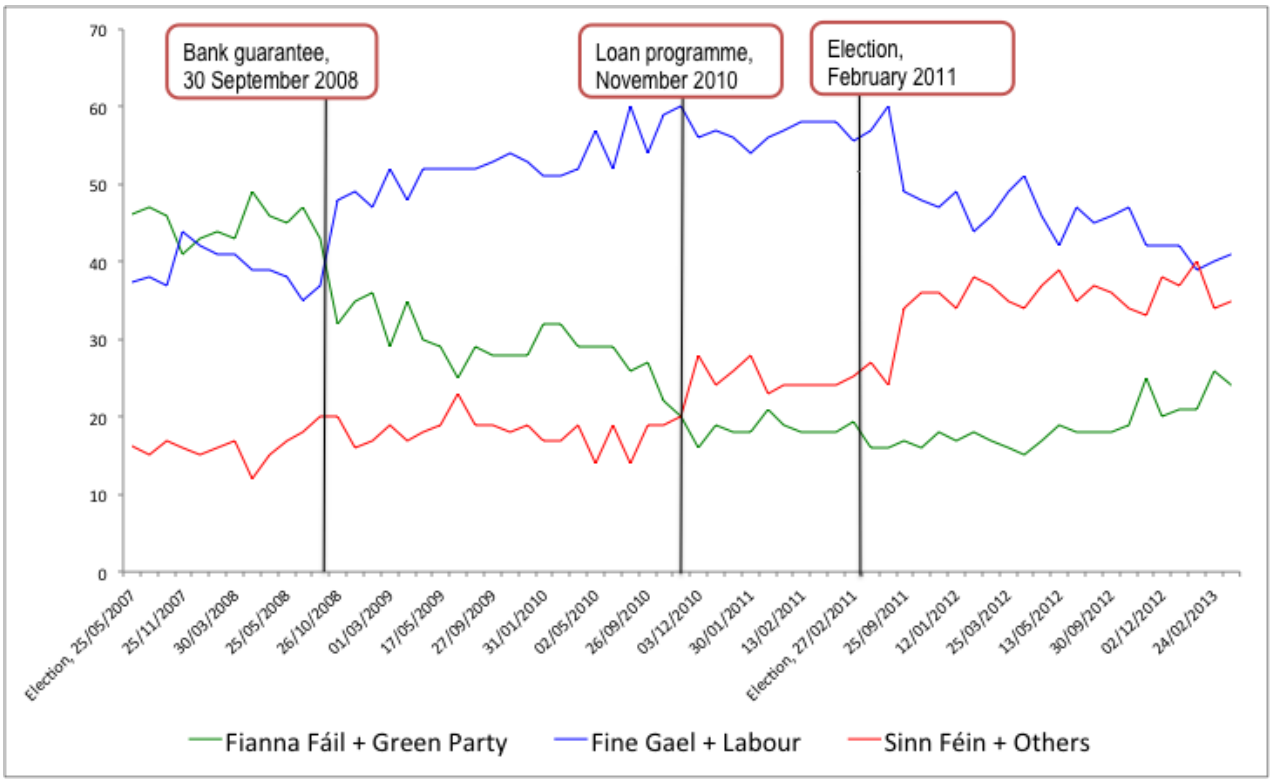
http://per.gov.ie/databank/

Figure 8. Composition of tax revenues, 2002-2011



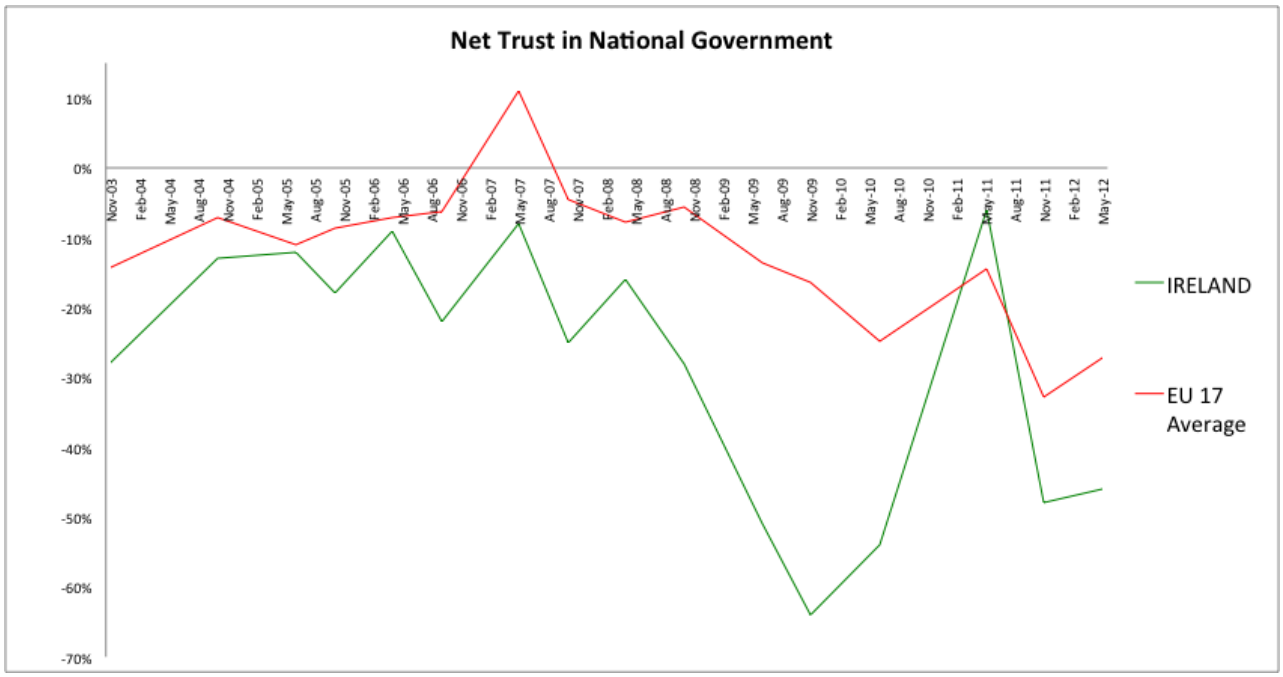
Source: Department of Finance Databank. http://databank.finance.gov.ie

Figure 9. Support for political parties



Source: www.electionsireland.org

Figure 10. Net trust in national government



Source: Eurobarometer

'Net trust' is a measure of the difference in score calculated from the proportion of respondents answering positively and those answering negatively in response to this question in Eurobarometer surveys: 'I would like to ask you a question about how much trust you have in certain institutions. For each of the following institutions, please tell me if you tend to trust it or tend not to trust it'.

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