Fiscal Politics in Time:
Pathways to Budget Consolidation, 1980-2000

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Abstract
The comparative study of debt and fiscal consolidation has acquired a new focus in the context of the current fiscal crisis. This leads us to re-evaluate the literature on fiscal consolidation that flourished during the 1980s and 1990s. The conventional approach segments episodes of fiscal change into discrete observations. We argue that this misses the dynamic features of government strategy, especially in the choices made between expenditure-based and revenue-based fiscal consolidation strategies. We propose a focus on pathways rather than episodes of adjustment, to recapture what Pierson terms 'politics in time'. We draw on classical explanatory tools of comparative political economy, including structures of interest intermediation, the role of ideas in shaping the set of feasible policy choices, and the situation of national economies in the international political economy. We support our argument with qualitative data based on paired comparisons of Ireland and Britain, and Greece and Spain.

Keywords: comparative political economy, fiscal consolidation, European periphery, European Monetary Union, interest intermediation

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Introduction

The politics of fiscal deficits, thought to have been banished into irrelevance by the Maastricht convergence rules widely adopted in 1992, and by the advent of the Euro in 2000, once again tops the agenda of European societies. The institutionalization of macroeconomic discipline at both the national and EU levels was supposed to enforce good governance in the management of fiscal affairs. It is now clear that the disciplines required to qualify for EMU were not maintained once the Euro was adopted. Fiscal deficits in many European countries are already reaching levels that would have been inconceivable for most of the 2000s. Intensified pressure from the international bond markets risks destabilizing the Euro itself. If we are to understand the challenges the European economy currently faces, we would do well to reconsider what lessons may be learned from the earlier politics of fiscal deficits.

The low-deficit equilibrium broadly attained by 2000 can be characterized as a non-convergent convergence: countries achieved a similar end-point by different means (McNamara 2003, p.333). Fiscal consolidation may be brought about by raising taxes or by cutting expenditure. The conventional wisdom, said to be gleaned from the experiences of the 1990s, is now that spending cuts produce more sustainable and more growth-friendly outcomes.

This paper suggests that we need to consider many of the things we thought we knew about fiscal consolidation. There are deeper continuities in countries' pathways than the conventional literature suggests. The conventional wisdom that cutting spending is unequivocally a better route to deficit reduction than raising taxes needs to be reviewed. This advice reappears in response to the fiscal problems faced by Ireland, by Greece and the other Southern European countries ('PIIGS': Portugal, Ireland, Italy, Greece, Spain). Ireland became a model for the efficacy of 'expansionary fiscal contraction' during the late 1980s. The inference is that this policy prescription, having proved its value once, is the correct one to apply again. Greece is under extreme pressure to adopt these remedies in 2010. But the conditions under which they may be implemented successfully need to be specified more clearly.

The structure of this paper is as follows. Firstly, we analyse some key analytical gaps in the literature on the economic and political determinants of fiscal consolidation. Secondly, we outline an alternative approach to analysing political strategy over time. Thirdly, we present a case-study analysis to illustrate some of our key arguments. We conclude with some reflections on the lessons that can be inferred for the relative merits of expenditure versus revenue based strategies of fiscal consolidation.

Analysing fiscal consolidation: conventional approaches

The conventional approach to analysing countries' experiences of fiscal consolidation is to break countries' experiences into multiple discrete episodes of fiscal consolidation, measured in terms of change in the fiscal situation between one time period and the next (Alesina and Perotti 1995a; Hallerberg, Strauch and von Hagen 2007; Mulas-Granados 2006; Perotti 1998).

What best explains the origins and persistence of fiscal deficits? Adopting the segmented time-periods method, government fragmentation is seen to predispose countries to deficits. The accumulation of large public debts is said to be concentrated among countries characterized by representative as opposed to majoritarian democracies, and among countries with fractionalized party systems. And short-lived governments result in suboptimal public financial policies. These explanations accounted well for the poor performance of Belgium and Italy in the 1980s (Alesina and Perotti 1995b; Grilli, Masciandaro and Tabellini 1991; Roubini and Sachs 1989).

Does it matter whether fiscal consolidation is achieved through revenue-based as opposed to expenditure-based adjustments? Alesina and colleagues claimed that 'fiscal corrections relying mostly on spending cuts that are concentrated on government wages and transfers tend to be expansionary, whereas those relying mainly on tax increases are contractionary'. They also find that the political costs to governments arising from expenditure cuts are minimal: they argue that there 'no evidence of a systematic electoral penalty or fall in popularity for governments that follow restrained fiscal policies' (Alesina and Ardagna 1998; Alesina, Perotti and Tavares 1998, p.198; McDermott and Wescott 1996; Perotti 1996).

In this view, spending-based consolidations might not only produce positive economic outcomes (through non-Keynesian effects), but may also be rewarded by voters. Not surprisingly then, the case for expansionary fiscal adjustments has been popular in certain epistemic communities and policy circles, not least by those explicitly committed to small government (Alesina and Ardagna 1998; European Commission 2007; Giavazzi and Pagano 1990; Perotti 1996). Indeed, the fiscal constraints expected to be institutionalized by the Stability and Growth Pact were positively welcomed by, among others, Alesina and Ardagna: 'hopefully, the Stability Pact will force serious welfare reforms' (Alesina and Ardagna 1998, p.517).

If spending-based policies are clearly superior in their outcomes to revenue-based adjustment, why might governments choose the latter? Economic constraints may matter, such as the cyclical position of the domestic economy, the stance of monetary policy, the sustainability of government's financial position (Freitag and Sciarini 2001; McNamara 2003; von Hagen, Hallitt and Strauch 2002). The coherence of political institutions may shape government choices. Mulas-Granados argues that strategies of adjustment are a function of the fragmentation of decision-making, the ideology of party in government, and the timing of elections (Mulas-Granados 2003; 2006). Non-majoritarian governments are more likely to choose revenue-based adjustments (Cheibub 2006; Fabrizio and Mody 2006; Gali and Perotti 2003; Milesi-Ferretti, Perotti and Rostagno 2002; Persson and Tabellini 2003, chapters 6 and 8; Poterba 1994; Poterba and von Hagen 1999).

But why might the institutional fragmentation of decision-making makes countries deficit-prone? The explanation is generally cast in terms of a common-pool problem (Weingast, Shepsle and Johnsen 1981). In the context of large, fragmented and heterogeneous coalitions, interest groups that benefit from particular strands of public spending have more incentives to free ride on others' contributions, which leads to high deficits and the accumulation of debt. Fragmented governments find it harder to oppose selective interests (Fabrizio and Mody 2006; Perotti and Kontopoulos 2002; Poterba 1994; Roubini and Sachs 1989). Conservative or right-wing governments focus on cutting all primary spending, social transfers and public wages as well as public investment, and on using these savings to fund cuts in direct taxation for business and individuals. Therefore they tend to prefer expenditure-based adjustments. But left-wing governments are reluctant to cut public capital formation spending programmes, so they tend to favour revenue-based strategies of deficit reduction (Castles 2007a; b; Mulas-Granados 2006).

The conventional approach to analysing fiscal consolidation has clarified a number of important regularities. However, this literature is not without its limitations. Breaking down the dependent variable into discrete episodes of fiscal adjustment yields large numbers of observations. But some countries have many of these episodes, others have relatively few. Not only is fiscal discipline institutionalized in different ways across countries, but the underlying propensity to incur debt exposure appears to vary too. We need to understand trajectories across time as well as episodes within time (Pierson 2004). Parties' ideas about feasible strategies also change over time, and the meaning of left and right has changed more in some countries than in others.

Budgetary politics is not only a function of institutional design or of technical incentives and constraints. It is also at the heart of politics itself (Levi 1988; Skocpol 1985; Steinmo 1993). How the fiscal bargain is struck between those who pay and those who benefit is the very stuff of democracy itself. The organization and representation of potentially conflicting interests and the manner in which they are inserted into the decision-making process may shape the process as well as the outcome of fiscal adjustment strategies.

A slide from a positive to a normative stance is not uncommon in the literature. Economic ideas 'provide agents with both a *scientific* and a *normative* account of the existing economy and polity, and a vision that specifies how these elements *should* be constructed' (Blyth 2001, p.11, emphasis added). But these may not be as well-founded as one might at first think. Making a success of cost-cutting adjustment in the past depended on national and international economic factors that may no longer obtain.

Expenditure-cutting strategies appear to have more severe electoral consequences than had previously been shown (Mulas-Granados 2004). Under certain conditions, a strategy based on revenue-raising can have successful outcomes over time (Mulas-Granados 2003, pp.19-20, 34-5). But the conditions for making both cost-cutting and revenue-boosting adjustments successful are more complex than conventional account suggest.

A new approach to the political economy of fiscal adjustment

An alternative to the conventional episodic approach draws on historical institutionalism, the varieties of capitalism literature, and classic comparative political economy (Hall and Soskice 2001; Kahler and Lake 2003; Pierson and Skocpol 2002). Instead of segmenting units of time, we see political choice unfolding in a sequence of decision-making. We re-evaluate the role of organized interests. We note that ideas and the terms of political debate may change over time. And we suggest that the broader constraints of countries' domestic economic structure and location in the international market need to be brought back into focus.

Locating strategic political choice in time

If politics is path-dependent, and choices are shaped by interactions across institutional fields (Mahoney and Thelen 2010; Pierson 2004), breaking countries' experiences into episodes of consolidation will miss important shadings of meaning. Episodes in country-specific pathways are linked; capacity for policy learning, the sequencing of decisions, and the institutionalization of policy solutions all make a difference to outcomes.

Institutions shape actors' choices, and many authors agree that the fragmentation of fiscal decision-making weakens the prospects for fiscal stabilization. But there is a real danger of conceptual stretching here (Sartori 1970). A single concept may be asked to do too much work, conflating the effects of a range of underlying political processes. Indeed, Perotti recognized that 'fragmentation' captures not only formal constitutional structures, but also the informal processes leading the negotiation in government, coalition and parliaments (political fragmentation) and the bargaining of fiscal policy between government and interest groups (social fragmentation) (Perotti 1998).

Institutions are created by those with bargaining power to establish the rules of the game (North 1990; 1994). But institutions are typically neither rationally designed nor optimally efficient (Hall 1997; Hall and Taylor 1996; Pierson and Skocpol 2002; Swank 2002). The bridging concepts we need concern the strategic and coordinating capacity of government, and the quality of policy advice provided by the public administration.

Taking interests seriously

Governments' capacity to implement policy effectively may be constrained by the nature and intensity of the linkages between state institutions and organized interests (Mahoney and Thelen 2010; Pierson 2001; Weiss 1998). The balance of power among societal actors shapes national policy responses to international economic crises (Gourevitch 1986). Organized interests may act as veto players over government choices, or they may be drawn into cost-restraining agreements or social pacts. These may entail high additional fiscal side-payments, or they may make a crucial difference to the possibility of implementing a spending-based or revenue-based adjustment strategy. Where economic interests are well organized, even if not highly centralized, we would anticipate that governments would seek to engage them in legitimating pacts to manage a fiscal crisis. Where political contestation polarizes organized interests, the price of agreement may be prohibitive. Where organized interests are weakly organized, governments may choose to exclude their preferences from consideration altogether.

Partisanship, electoral politics, and the role of ideas

Political parties may pursue distinctive economic policies as they seek to accommodate and represent the demands of different distributional cleavages (Kitschelt, Lange, Marks and Stephens 1999; Rueda 2007). But partisanship, specified as the percentage of total cabinet posts held by social democratic and other left parties, does not capture ideological realignments within parties over time, differences of policy preferences between parties of the same ideological family across nations, or differential influence on cabinet decision-making. Left parties have been constrained to shift their ideological preferences on economic management; the British Labour Party may have shifted more than most.

Electoral politics is not only about parties, it is also about voters. Variations in public preferences have been shown to affect the formation of policy agendas and outcomes in the USA (Erikson, Mackuen and Stimson 2002; Kingdon 1997). But the relationship between public opinion and the choice of fiscal consolidation strategies has not been systematically explored. Voters may acquiesce in tough fiscal remedies; but whether this is in a spirit of genuine acceptance of their necessity, or *faute de mieux*, is unclear.

The dominant ideas available to decision-makers may constrain the choice set of the actors confronting a fiscal crisis. Channels of transmission include the institutionalization of policy paradigms, and the rise of epistemic communities advocating specific policy solutions (Hall 1993; 1997; McNamara 2002). The causal weight of ideas is likely to be greater during crises, particularly if a war of policy paradigms is under way about the correct diagnosis and appropriate solutions to a given crisis (Blyth 2002; Gourevitch 1986; Kato 2003; Kitschelt 2001; Steinmo 2003). Ideas influence the adoption of alternative fiscal consolidation strategies by defining the range of 'perceived legitimate change' (North 2005). The dominant set of policy beliefs, like the presence of social pacts, affects the politics of legitimation of fiscal adjustments.

Economic structure

The constraining effects embedded in the structure of domestic production may have a bearing on the choice of fiscal consolidation strategy, for the politics of production and the politics of redistribution are related in complex ways. (Ebbinghaus and Manow 2001; Hall 2007; Hall and Soskice 2001; Iversen and Wren 1998; Molina and Rhodes 2007; Schmidt 2002; Soskice 1999). Policy change normally takes place incrementally and selectively, and there is no guarantee that pressure for change will not produce conflictual or suboptimal outcomes (Crouch 2005; Mahoney and Thelen 2010; Streeck and Thelen 2005). Nonetheless we might expect, other things being equal, that liberal market economies would display a preference for small-state fiscal solutions and would converge on adjustment strategies based on cutting spending. We would expect that southern European countries with a stronger reliance on state activism would prefer revenue-supporting measures. But these possibilities must be mediated by party politics and interest group politics.

Countries are not equally exposed to global financial crises or to the pressures emanating from supranational fiscal rules of the game, and the intensity of external exposure can vary over time too. Other things being equal, international trade and capital mobility constrains governments' revenue-raising capacities (Scharpf and Schmidt 2000; Swank 2002; Swank and Steinmo 2002); the effects on government spending are contested (Adserà and Boix 2002; Rodrik 1998; Schulze and Ursprung 1999). Much depends on the domestic alignment of interests and the partisan orientation of government.

External commitments may be a powerful source of domestic policy constraint. The Maastricht convergence rules provided incentives for fiscal discipline in European states during the 1990s. Indeed, partisan effects appear to have been attenuated during these years, when all governments were increasingly constrained to ensure compliance with the qualifying conditions for Euro membership (Illera and Mulas-Granados 2008, p.161). In contrast, the incentives created by the Stability and Growth Pact appear to have been significantly weaker after 2000 in constraining fiscal policy choices (Blavoukos and Pagoulatos 2008; Hallerberg and Bridwell 2008; Hassel 2009; Johnston and Hancke 2009).

In summary, we take issue with the conventional ways of analysing the politics of fiscal adjustment. Segmenting episodes of fiscal consolidation fails to capture the dynamic aspects of country's adaptation strategies. Insofar as quantitative analyses attempt to acquire greater nuance, they risk conceptual stretching. Conventional analysis underestimates the role of organized interests in creating governance capacity and the leading role of ideas. They cannot easily be modelled, yet they exercise a strong shaping and constraining effect on governments' strategic decisions.

Profiling fiscal adjustments: a case study approach

Following Perotti and Mulas-Granados, we use changes in the cyclically adjusted primary budget deficit as our indicator of fiscal consolidation (Mulas-Granados 2006; Perotti 1996). Most European countries converged on a balanced-budget equilibrium by 2000. But Mulas-Granados demonstrates that while some countries, notably Ireland, show a clear preference for expenditure-based adjustments, others such as Austria and Greece tended to rely on revenue-based consolidations (Mulas-Granados 2006).

European countries display a non-convergent convergence, as Table 1 below shows (European Commission 2000; von Hagen et al. 2002).

Table 1 here

Categorization of episodes is disputed. While Mulas-Granados suggests that countries such as Greece and Ireland enforced expenditure-based consolidations during the 1990s, von Hagen and his colleagues identify revenue-led adjustments. The European Commission suggests that Denmark implemented an expenditure-based retrenchment during the late 1980s, while Mulas-Granados claims that the adjustment was revenue-led (Mulas-Granados 2006; von Hagen et al. 2002). Ireland's well-known expenditure-based adjustment in the period 1987-89 is not captured by Mulas-Granados's methodology. These diverse interpretations arise from trying to link discretionary policy choices to short-term fluctuations in the structural components of the budget. A longer-term approach is required.

Mulas-Granados defines 'strategy type' as the sum of the average variation of cyclically adjusted revenues and cyclically adjusted primary expenditures. The intuition is that the higher the value of the strategy type, the more expansionary is the effect of the government's strategy on the total size of the government budget. We can apply this thinking to assess countries' overall fiscal trajectories during the whole era of the trajectory of stabilization. Figure 1 outlines the expansion or contraction of the public sector across European countries between 1980 and 2000. This confirms our intuition that Ireland is a typical case of public sector contractionary strategy, and Greece a typical case of public sector expansionary strategy. Ireland has relied on an expenditure-cutting fiscal stabilization strategy, while Greece has sought to bridge deficits by raising taxation.

Figure 1 here

The rank ordering of countries as given by this index reveals some patterning according to varieties of capitalism. Greece, Portugal, Italy, Spain and France all share features of the state-led 'mixed market' system, though Finland sits a little awkwardly in this cluster (Molina and Rhodes 2007). Denmark, Austria, Belgium and Sweden are classified as coordinated market economies; we can see here that they exhibit far less fluctuation in the management of their public finances. Germany is not represented here; its strong domestic monetary policy meant that fiscal fluctuations were minimal. Ireland and Britain exhibit the most contractionary stance, with a strong emphasis on spending cuts. They are separated only by the Netherlands, normally classed as 'coordinated'. But the Netherlands, having incurred heavy debt during the 1970s, adopted market-conforming spending-control measures during the 1980s.

Case studies are not always good for testing hypotheses, but they are good for revealing missing variables in existing explanations, generating arguments and ideas, and dealing with causal complexity (George and Bennett 2005; Gerring 2007). Our interest in exploring strategic choices, in analysing political economy constraints, and in tracing the continuities implicit in taking time seriously, prompts us to adopt a case study approach.

Case selection on the dependent variable is often held to be undesirable. But we believe that this methodological choice is appropriate in the process of discovery, serving crucial exploratory and heuristic purposes (Geddes 2003, p.129). We adopt a diverse case selection strategy (Gerring 2007), choosing Ireland as an ideal type of expenditure-led consolidation and Greece as a paradigmatic case of revenue-led adjustment. This means we are allowing for variation in the outcome of interest, as suggested by both King and his colleagues and by Geddes (Geddes 2003; King, Keohane and Verba 1994).

We also consider the experiences of Spain, another 'mixed-market' economy, but whose profile is a good deal less extreme than Greece's, to deepen our analysis of the dynamics of adjustment in mixed-market economies. We compare Ireland with Britain with a view to understanding similarities and variations across liberal market economies. Taken together, these four countries entail an interesting mix of cross-case and within-case variation of fiscal consolidation experiences.

Government strategies to manage fiscal consolidation depend on a synthesis of the explanatory variables summarized in the preceding section. We depict these as a rough dichotomy between 'conflictual' and 'consensus-oriented' strategies, drawing on two dimensions: inter-party ideological distance, the possibility of securing negotiated agreement with the principal social actors in support of fiscal stabilization. These are combined in the classifications adopted here: we propose a conflictual profile, in which we situate both Greece and Britain, and a consensus-seeking profile, in which we situate both Ireland and Spain. It will be noted that the governments' strategic orientations, as sketched here, do not neatly bundle into varieties of capitalism. Figure 2 below summarizes the analytical schema.

Figure 2 here

Ireland and Britain: expenditure-based adjustment

The fiscal trajectory of Ireland between 1980 and 2000 is characterized principally by expenditure-based adjustments. Scholars disagree on the precise phasing of adjustment periods. But the trend is clear: Mulas-Granados classes all three of the fiscal adjustment periods he identifies as based on expenditure-based episodes, and Alesina and Ardagna similarly note the reliance on expenditure-based adjustment (Alesina and Ardagna 1998, pp.497, 515; Mulas-Granados 2006, pp. 21, 28). Figure 3 below shows the profile of revenues and expenditures in relation to GDP.

Figure 3 here

The ratio of public spending to GDP in Ireland decreased substantially between 1985 and 2000, from 53% to 32%, accompanied by a steady decline of structural revenues from 43% to 35% of GDP. As a result, Ireland's fiscal stance improved by around twelve points of GDP (European Commission 2000). Some of this apparent fall is due to the rapid growth in GDP . But real fiscal consolidation also took place. How can it be explained?

Explanations grounded in partisanship encounter some difficulty in classifying governments in Ireland, as the Labour Party is very small and there is no strong left-right cleavage. But there is a bias toward seeking cross-class electoral support, and a trend toward governments of the centre-right. The presence of a small liberal party, the Progressive Democratic Party, in coalition with Fianna Fáil between 1997 and 2007, is credited with exerting a rightward influence on budgetary policy. Hallerberg et al. note that these latter coalition governments display rather lower ideological distance than the Fine Gael-Labour coalitions of 1983-87 and 1994-97, or the Fianna-Fáil-Labour coalition of 1992-4 (Hallerberg et al. 2007, p.345). This might be expected to help explain budgetary discipline after 1997, but it should have increased coalition tensions prior to that date. Yet expenditure-based consolidations were successfully undertaken, especially in the late 1980s. Cross-party policy agreement explains the adoption and implementation of spending cuts.

The legitimation of spending cuts was a constant problem for the coalition government of 1983-87. What made it possible for Fianna Fáil to undertake the same measures successfully after 1987 was the negotiation of a tripartite pay pact. Initially this was a short-term crisis management measure, but increasingly proving its value as a coordinating mechanism over time (Hardiman 2002). The objectives of Maastricht were internalized into the social partnership process and created the framework for wage and inflation target-setting right through to 2000 (Roche 2009).

Cuts in headline personal tax rates would not have been undertaken, and would not have been possible without risking inflation, in the absence of wage moderation agreements (Barry 2009). The unions traded wage restraint for tax cuts, in deals that resulted in steady increases in disposable income, even as the base from which provision of collective goods could be funded was eroded (Hardiman 2006). Yet there was broad popular support for personal income-maximizing rather than service-enhancing pay pacts. A low-tax, service-poor equilibrium became embedded in Irish political economy as the engine for growth and employment creation (Barry 2007).

A comparison with Britain is instructive. Both countries are liberal market economies. In both, a fragmented trade union structure made wage management during the 1970s highly conflictual. Both countries attempted strong fiscal stabilization measures after about 1980. But the profile of adjustment in Britain is different, as Figure 4 below shows.

Figure 4 here

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

Several features of Britain's political economy may be contrasted with the Irish. While Britain is also a liberal market economy, the historical inheritance of higher levels of social protection and welfare state institutions meant that gravitation toward a low-revenue equilibrium was not possible. Mrs. Thatcher's governments attempted to curtail spending on education, the NHS, and transfer payments; but despite her electoral successes, public opinion proved resistant to these core provisions being dismantled (Rhodes 2000).

The structure of interest representation had developed along contrasting paths. In the 1970s both Ireland and Britain had well-organized but poorly coordinated trade union movements. Ireland moved in the late 1980s toward government-led coordination efforts, while Britain moved in the opposite direction toward a strategy of labour disorganization (Crouch 2000; Traxler, Blaschke and Kittel 2001). Trade unions in Britain could exert only weak political influence, which left central government with a relatively free hand (Bieler 2008). British governments did not need to rely on effective social interlocutors, which increased the autonomy of government in its strategic options.

Labour was internally divided over entry to the Euro, and Chancellor Gordon Brown prevailed in keeping it outside the Maastricht process. The newly independent Bank of England took over inflation targeting from 1997. But the British government was still relatively free to mix strategies of revenue and expenditure based consolidation.

The evolution of economic ideas also plays a role in explaining change in both the Irish and the British cases. In Ireland, the case for curbing public spending commitments acquired the status of received opinion. The low-tax model and the FDI-based growth strategy were viewed as linked; the orthodox economic view that a large public sector is inherently a drag on growth gained broad credence. In Britain, the dispiriting experience of repeated electoral losses between 1979 and 1997 drove the Labour Party to undertake not only organizational modernization, but also radical modification of many policy commitments in a bid to reposition itself more favourably with the electorate. From its origins as a left of centre party, New Labour came to adopt many elements of neo-classical economic orthodoxies, which made it possible for it to accommodate an expenditure-driven adjustment by the late 1990s (Hay 1999).

Greece and Spain: revenue-based adjustment

In contrast to Ireland, Greece can be regarded as a paradigmatic case of revenue-based consolidation. Indeed, three out of four of the episodes of fiscal adjustment that Greece underwent in the post-authoritarian era were based on increasing structural revenues (Mulas-Granados 2006, p.28). Figure 5 shows that public sector expanded by almost 60% between 1980 and 2000, funded by a revolution in the revenue-raising capacities of the state. Total revenues increased by more than fifteen points of GDP.

Figure 5 here

Successive Greek governments faced the challenge of having to adopt measures to enforce fiscal discipline. Indeed, as Table 1 showed, Greece was the European country most likely to be involved in a fiscal adjustment process. Most of these were based on raising revenues rather than cutting primary spending, but consolidation measures appeared difficult to institutionalize stably. The average public deficit between 1970 and

2000 was second only to Italy's among the EU15 (Mulas-Granados 2006, p.28). Figure 5 shows the trajectory over time.

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

Greece's fiscal trajectory has to be understood in the context of the commitment to economic growth, starting from a low base in the 1970s. The newly democratic state inherited a weak administrative capacity and fragmented and politicized economic interests, but the first socialist governments of Andreas Papandreou in the late 1970s presided over political as well as economic stabilization. During the 1980s, there was strong popular demand for more public sector employment and welfare expansion, giving rise to the creation of new services such the national health system in 1984, funded by increased taxation and improved tax administration.

In the 1990s, the same socialist party, this time led by Kostas Simitis, faced a radically different set of political economy constraints, both domestic and international. The government recognized, however reluctantly, that the freer spending environment of the 1980s had led to populist excesses that needed to be curbed. This paved the way for a more modernizing and technocratic approach to policy-making, which was in turn externally enforced by the incentives embedded in the Maastricht convergence criteria. But expenditure-based adjustments have been the exception rather than the rule in Greece (European Commission 2000; von Hagen et al. 2002). The significant consolidation effort of the late 1990s only occurred in the context of a singular mix of incentives, not least the sense of urgency brought about by EMU conditionality.

Persistent fiscal indiscipline reflects a weak governance system arising from features of state structures on the one hand and the profile of organized interests on the other. Policy-making in Greece features ‘systemic weaknesses deriving from the institutional capacity of the state, the regime of disjointed corporatism, and cultural practices of clientelism and rent-seeking’ (Featherstone 2005, p.223). Government’s capacity to generate coherent policies that command sufficient consent among civil society is poor, and the administrative system’s capacity to implement decisions is weak. It is what some have termed ‘une société bloquée’.

Party politics is highly confrontational both between and within parties, and clientelist electoral politics is well established. But civil society is weakly organized, and the trade unions are highly politicized. The scope for social dialogue in Greece is limited (Tsarouhas 2008). There is little scope for creating stable structures integrating organized interests into administrative routines of consultation and coordination. Economic policy-making is constrained by ‘the reproduction of a pattern of power relations relying on a weak and asymmetrically penetrated state apparatus’ (Lavdas 2005, p.309). Governments are obliged to undertake fiscal consolidation measures without the legitimating support of union and employer consent. This leaves open the further risk of populist lobbying from potentially disadvantaged sectors, which in turn reinforces a politically destabilizing clientelism, as governments seek to shore up their electoral support base.

Post-authoritarian stabilization policies need not take this form, as a brief comparison between Greece and Spain reveals. These countries share common economic development patterns, welfare state profiles, processes of modernization through Europeanization, and a Southern European political culture. Yet despite these similarities, the two countries have undertaken contrasting policy paths in many areas, which we may explain with reference to the consensus-seeking capabilities of party politics and interest intermediation.

Spain enjoyed certain advantages in the form of highly-disciplined political parties and a *pactista* tradition that had successfully facilitated the democratic transition (Pérez-Díaz 1993). The Spanish socialist party made determined efforts to converge on the new economic orthodoxy of austerity and market liberalization, while the Greek socialists continued to hold to the older model of economic expansionism and populist distributionism into the late 1980s (Pagoulatos 2004). Spain was able to manage the transition to 'modern' class and interest-based civil society organization, even though still characterized by separate partisan affiliations, facilitating a basis for consensus-oriented bargaining(Avdagic, Rhodes and Visser 2005; FitzGerald and Hore 2002).

The role of ideas in shaping the range of feasible options was also different in Greece and in Spain. Greek government circles perceived relatively few domestic or external constraints on high-spending economic policies during the 1980s. In contrast, the prevailing belief structures in Spain created the conditions for a strong endorsement of the European project. This further strengthened the commitment to administrative modernization and the prevalence of technocratic criteria in budget formation (Pagoulatos 2004).

Policy implications: are expenditure-based adjustments better?

The fiscal crisis in European countries since 2008 has generated renewed interest in the earlier phase of fiscal consolidation. If policy-makers seek to draw lessons, it is best to be certain that we have fully understood what we are learning from. The conventional wisdom is that 'corrections that are mainly based on current primary expenditure, in particular the government wage bill, are more likely to be successful than corrections relying on higher revenues or cuts in investment expenditure' (European Commission 2007, p.196). Expenditure-based adjustments, that is, spending cuts to secure deficit reduction, are held to have an expansionary effect on economic growth, without incurring adverse electoral consequences. The case for expenditure-based fiscal adjustments has acquired the status of a 'policy paradigm' (Hall 1993).

The scale of the current crisis among the four countries under consideration is apparent from Figure 6 below. All four had fiscal deficits in 2010 that were significantly worse than the European average.

Figure 6 here

Painful fiscal adjustment was clearly on the cards for all four countries, but the conditions under which they had to address this were somewhat different (OECD 2009). Ireland, Greece, and Spain, as members of the Eurozone, were required to return to the conditions of the Stability and Growth Pact, to get their deficits down to 3% of GDP and their debts below 60%; Britain had no such external constraint. Their starting points differed in that Ireland's debt position had worsened most dramatically, from 25% GDP in 2006 to an expected 95% in 2011. Greece entered the crisis with a debt already standing at about 95%, and this was expected to reach 135% by 2011. Spain, with expected accumulated debt of 74%, and Britain with 88%, were less severely challenged (European Commission 2009).

Under conditions of recession, tax increases were difficult for all in any case, so recommendations of spending cuts may seem obvious. But this path out of fiscal crisis is difficult for four reasons. Firstly, spending cuts needs to be supported by wage moderation and the defusion of distributive conflict, if the strategy is to secure domestic legitimacy. This proved difficult in Ireland, though it did embark on sharp spending cuts; but almost impossible in Greece, where open street protest made the government's commitment to fiscal stringency seem implausible. Securing social agreement to severe cuts in public spending is particularly difficult against the backdrop of massive bank bailouts. The legitimacy of the distributive spread of adjustment is challenged as never before.

Secondly, it is now clear how important a role was played by devaluation and some easing of debts through inflation in securing stable expenditure-based fiscal consolidation during the 1990s (Alesina and Ardagna 1998, p.516). Ireland's experiences in the late 1980s have been cited as a classic instance of non-Keynesian expansionary fiscal adjustment (Giavazzi and Pagano 1990). But the fiscal disciplines alone did not secure renewed growth. The combination of wage moderation with devaluation, against a backdrop of international economic recovery, increased competitiveness, improved the terms of trade, and boosted export opportunities (Barry 1991). This is no longer possible for members of the Eurozone, making de facto devaluation much more painful as the distributive costs have to be absorbed domestically. If widely adopted, domestic deflation could risk pulling Europe into the very recession it seeks to avoid (Blanchard, Dell'Ariccia and Mauro 2010; Krugman 2010). Greece’s travails have highlighted the problems of running a single currency in an imbalanced trading area with no redistributive capability to complement its monetary policy, dangers foretold but still unexpected in their realization (McKay 1999).

Thirdly, during the 1980s and 1990s, expenditure-based cuts secured credibility gains for governments in the context of credit market imperfections. Spending cuts signalled a commitment to economic orthodoxy: lower public spending, better resource allocation and lower interest rates would trigger consumption and investment booms through non-Keynesian channels. But the current crisis has been preceded by surge in the availability of credit and a long period of low interest rates, so spending cuts as a credibility-securing mechanism are now at best questionable. But not all expenditure-based efforts are credible in any case, if they provoke electoral resistance and societal conflict (Dellepiane-Avellaneda 2005). They may even risk incurring credibility losses, not gains, through undermining coalition support and increasing political contestation, leading in some cases to the breakdown of the governing coalition – precisely the experience of Argentina in 2001, and the danger that hovers over Greece. The bond markets’ slow response to fiscal stringency in Greece reflects precisely these uncertainties.

Fourthly, adjustments that target primary expenditures are said to be electorally unproblematic. This is far from uncontested (Mulas-Granados 2004). But even if true, it is unclear why. It may be that voters anticipate a future credit and consumption boom. It may be that a perception of crisis induces a passive if grudging acquiescence to unpleasant policy choices. In either case, the success of a stabilization plan is a function of credibility, which needs be generated through the mobilization of costly institutional and political resources. It is a high-risk electoral strategy that can come unstuck at many points. The fact that many governments (even right-wing coalitions) have avoided expenditure-driven adjustments suggests that fiscal conservatism is less attractive than suggested by the literature on consolidation.

Conclusion

This paper has argued that conventional analyses of fiscal consolidation based on segmenting episodes and analysing them as discrete observations are less than satisfactory. They fail to capture the dynamic and path-dependent evolution of fiscal consolidation strategies. We argue for a new approach to fiscal consolidation that locates politics in time: much can be gained by looking at pathways to consolidation rather than episodes of change. We wish to renew interest in the core issues of political economy, including the role of interests and ideas, the domestic politics underpinning the legitimation of fiscal adjustment policies, and the changing context of the international political economy.

Our case studies point toward four conclusions. Firstly, the politics of interest intermediation is important in securing stable consolidation. Where it is possible to secure the legitimacy of wage moderation through social pacts, cost-based adjustment is likely to be more durable, as in Ireland and Spain. Britain's governance mechanisms are more unbalanced as they rely more heavily on links with employer and financial interests than with the representation of union interests. This reduces the need for wage-managing negotiations, but increases the need to attend to electoral legitimation. Where interest intermediation is weakly institutionalized, politicized and conflictual, as in Greece, the destabilizing potential is significant.

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

Thirdly, we argue that the international dimension has been underestimated in conventional analyses. The option of devaluation to ease a consolidation strategy proved crucial for both economic and political reasons in the era prior to European Monetary Union. This is no longer available to Eurozone members, and globalization makes it costlier to other countries too. The manner in which national economies are embedded in the international economic system shapes their evolving development models and growth strategies, in ways that are rarely conceptualized let alone modelled in conventional analyses.

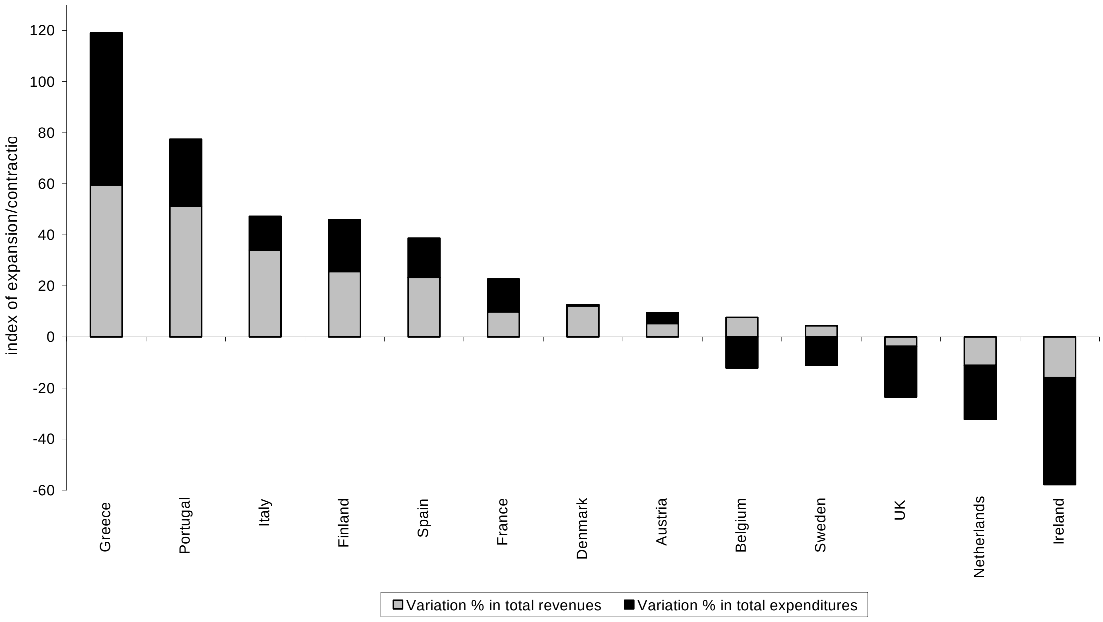
Finally, we have shown that the lessons from successful consolidations are less straightforward than often suggested. Without the option of devaluation, the pain of adjustment may be both politically and economically unmanageable. The older fiscal consolidation literature overlooked core issues in domestic political economy, including the role of interest representation, political legitimacy, and policy contestation. Without bringing politics back into the frame, the analysis of credibility and efficacy in fiscal consolidation policies is unlikely to deliver plausible policy advice.

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

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

Source: Mulas-Granados (2006)

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

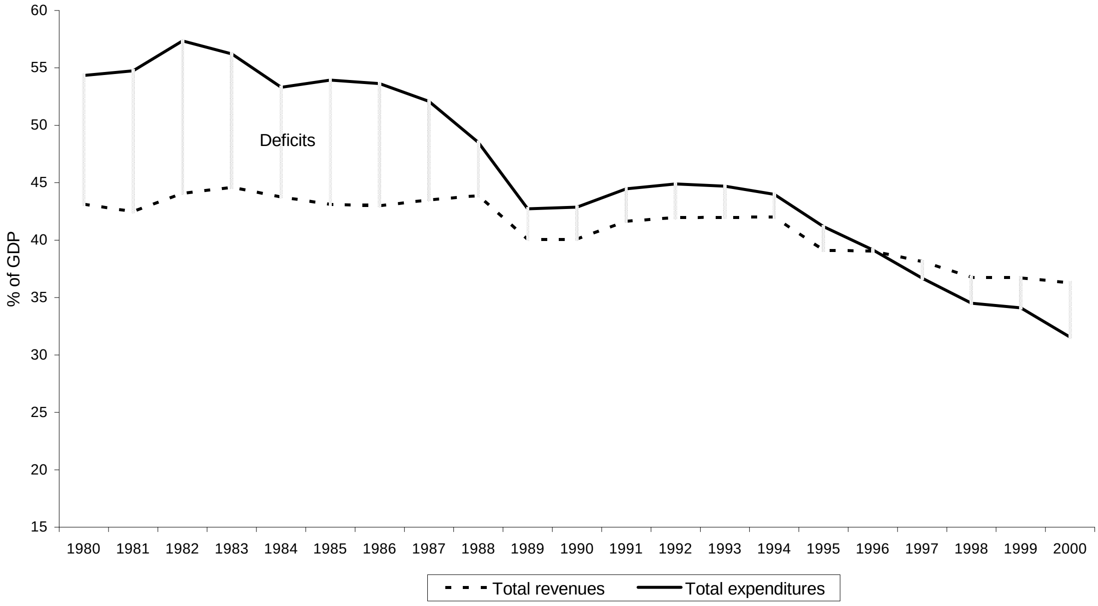


Source: Own elaboration based on *OECD Economic Outlook Database*. The index of expansion or contraction is the sum of the average variation of structural revenues and structural expenditures between 1980 and 2000 (both revenues and expenditures are measured as percent of GDP)

Figure 2. Typology of fiscal adjustment strategies

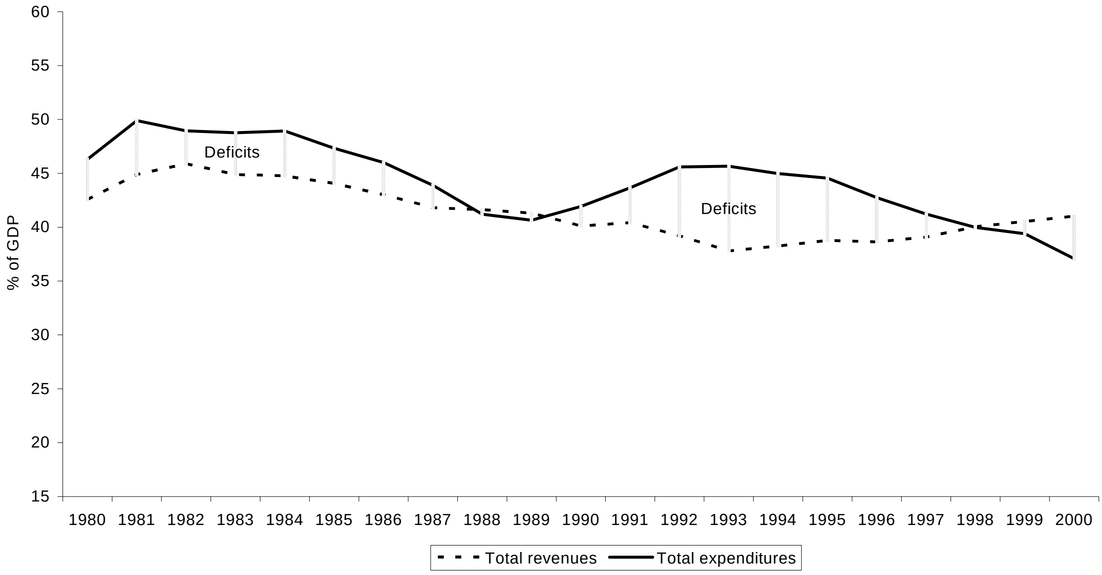
	Conflictual	***Consensus-seeking***
Revenue-based	Greece	Spain
Expenditure-based	Britain	Ireland

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



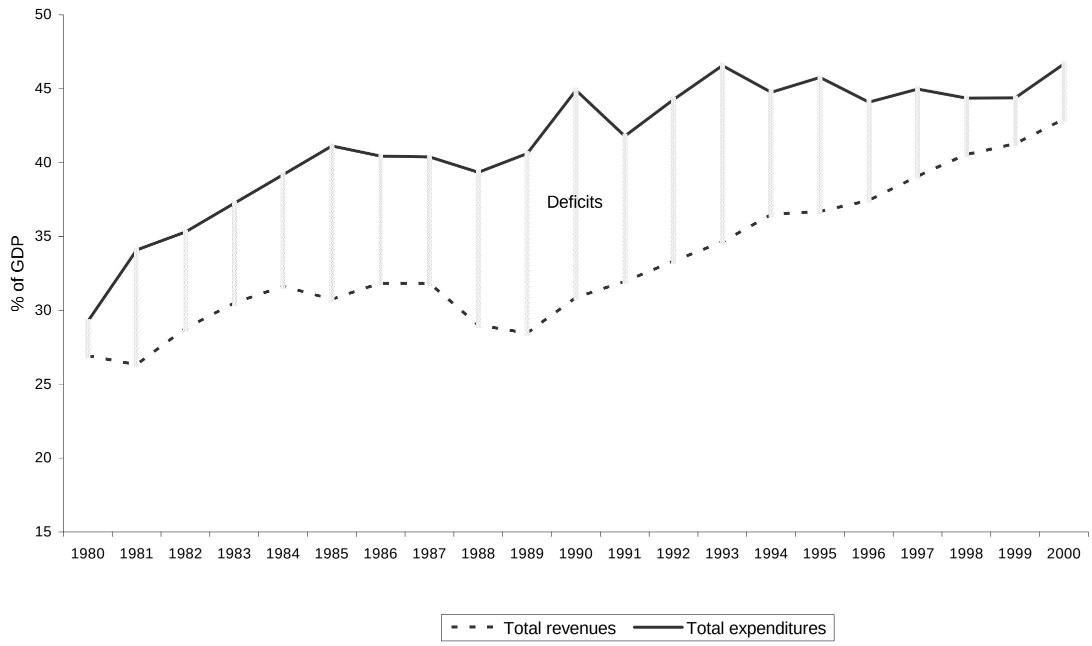
Source: Own elaboration based on OECD Economic Outlook Database

Figure 4. **Revenue and expenditure trends in the UK, 1980-2000 (per cent of GDP)**



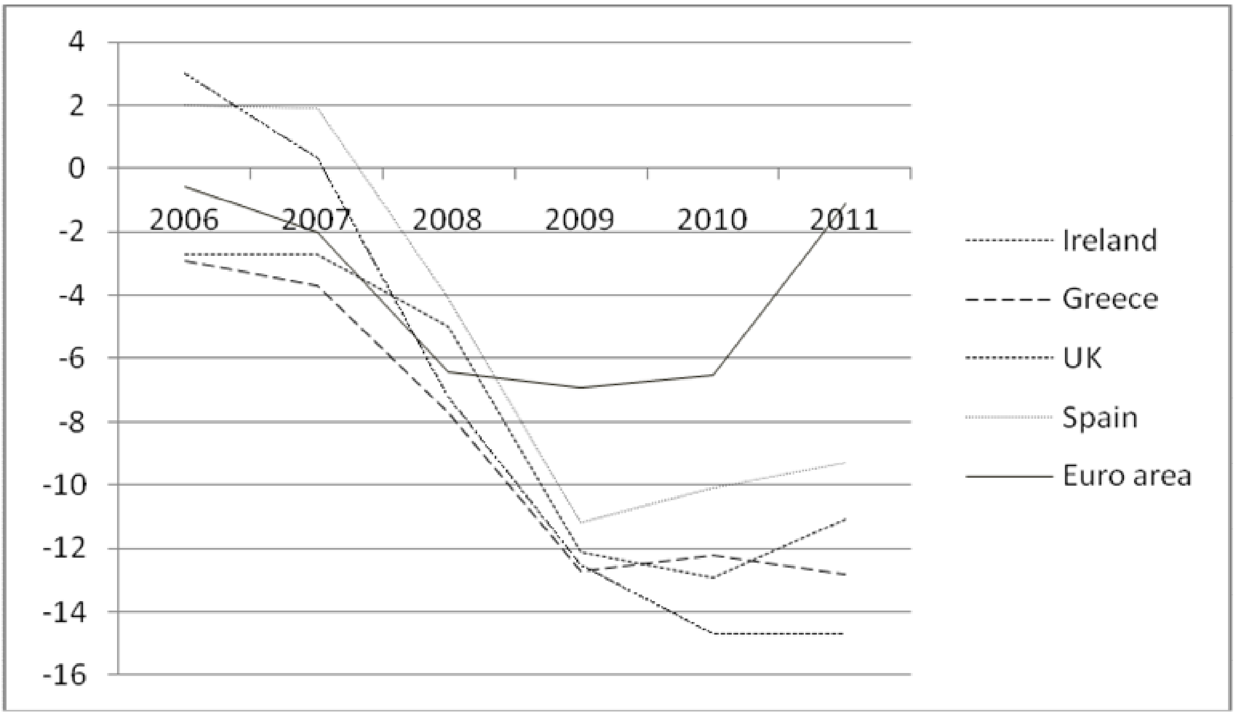
Source: Own elaboration based on OECD Economic Outlook Database

***Figure 5.* Revenue and expenditures trends in Greece, 1980-2000 (per cent of GDP)**



Source: Own elaboration based on OECD Economic Outlook Database

Figure 6. Fiscal deficits in European countries, 2006-2011



Source: General Government Balance % GDP, *EU Economic Forecast*, Autumn 2009

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