The politics of fiscal adjustment in small European states:

The eurozone crisis in Ireland and Portugal

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List of abbreviations

ACC	American Chamber of Commerce in Ireland
CAP	Confederação dos Agricultores de Portugal
CCP	Confederação do Comércio e Serviços de Portugal
CDS-PP	Centro Democrático e Social – Partido Popular
CEE	Central and Eastern Europe
CGTP	Confederação Geral dos Trabalhadores Portugueses – Intersindical Nacional
CIF	Construction Industry Federation
CIP	Confederação Empresarial de Portugal
CPE	Comparative Political Economy
EAP	Economic Adjustment Programme
EC	European Commission
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EEC	European Economic Community
EMU	Economic and Monetary Union
ESAME	Estrutura de Acompanhamento dos Memorandos
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IBEC	Irish Business and Employers Confederation
IBRC	Irish Bank Resolution Corporation
ICTU	Irish Congress of Trade Unions
IMF	International Monetary Fund
IMPACT	Irish Municipal, Public, and Civil Trade Union
IMSE	Irish Small and Medium Enterprises Association
MNC	Multi-National Corporation
NAMA	National Asset Management Agency
NESC	National Economic and Social Council
NPRF	National Pensions Reserve Fund
NRP	National Recovery Plan
OECD	Organisation for Economic Co-operation and Development
PEC	Pacto de Estabilidade e Crescimento (Stability and Growth Pact)
PPP	Public-Private Partnership
PS	Socialist Party
PSD	Social Democratic Party
R&D	Research and Development
SFA	Small Firms Association
SGP	Stability and Growth Pact
SIPTU	Services, Industry, Professional, Technical Union
SMN	Statutory Minimum Wage (Portugal)
SOE	State-Owned Enterprise
UGT	União Geral de Trabalhadores
VAT	Value Added Tax
VoC	Varieties of Capitalism

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Summary

In the context of the euro crisis, several member states of the Eurozone were forced to implement so-called Economic Adjustment Programmes. The implementation of these programmes was supervised by a troika consisting of the European Commission, the European Central Bank, and the International Monetary Fund. Fiscal adjustment was one cornerstone of these adjustment programmes. The aim of the programmes was to reduce previously soaring public deficits and to stabilise and reduce public debt in the long term. All programmes primarily aimed at cutting government spending. Increasing government revenues was to play only a secondary role. However, a look at the adjustment programmes for Ireland and Portugal shows a striking difference in the fiscal adjustment strategies. Different Irish governments pursued an adjustment strategy with a focus on expenditure cuts. By contrast, Portugal's adjustment strategy changed over the course of the programme and was increasingly driven by increases in revenues. How can we explain these differences?

To answer this question, my dissertation provides two in-depth case studies of the adjustment programmes for Ireland and Portugal. I argue that fiscal adjustment strategies are determined by the activity of coalitions of different economic actor groups at the domestic level. These actor groups have different fiscal policy preferences. On the one hand, they differ in terms of their preferred level of redistribution and the economic risks to which they are exposed. On the other hand, sectoral actor groups have different preferences based on their prioritisation of international competitiveness and domestic demand. Actor groups with similar preferences form coalitions to influence the government's policy-choice. Two logics determine which coalitions ultimately prevail. On the one hand, some coalitions are involved in policy-making through social pacts and other institutional arrangements. On the other hand, sectoral coalitions are influential due to their importance for economic growth. Although national coalitions have decisive influence, governments in a globalised world are constrained in their actions by international financial market actors.

In Ireland, coalitions that favoured an adjustment strategy with a focus on spending cuts were more assertive. This is mainly due to the Irish growth model, which has been based on exports and foreign direct investment for more than two decades. Trade unions that would have preferred an alternative adjustment strategy were not able to prevail against the influential coalition of export-oriented actor groups and high-skilled workers. In Portugal, such a coalition was unthinkable. Here, trade unions and actor groups exposed to high economic risks were successful in preventing several attempts to cut public spending. In the face of this resistance, the government increasingly decided to resort to alternative revenue increases.

These results show, on the one hand, that domestic political processes were crucial for fiscal adjustment during the euro crisis. On the other hand, it shows that these processes differ greatly due to different national growth models and different economic dynamics.

Chapter one: Introduction

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Fiscal adjustment in small European states

1.1. Starting point: The eurozone crisis

In the first half of 2011, the eurozone's chiefs of state anxiously anticipated the results of the general elections in both Ireland and Portugal. The two small states at the currency union's periphery had been moving to the centre of attention: they had fallen victim to Greece's economic-financial crisis contagion and lost access to private market funding. In April 2010, the Greek government had turned to the troika—formed by the European Commission (EC), the European Central Bank (ECB), and the International Monetary Fund (IMF)—for financial assistance. The European sovereign debt crisis had taken full effect and would haunt the eurozone for years to come. When the Irish banking sector was about to collapse amidst the turmoil that had befallen international financial markets, Ireland's government also requested troika help. Portugal followed only a few months later as it edged closer to sovereign default. For the crisis countries to receive loans from the IMF and European funds, borrowers and lenders would negotiate the policy conditions the latter had to meet to fulfil for those funds to be disbursed. The result of those negotiations would then be written down in a so-called Economic Adjustment Programme (EAP). Over three years, the EAP's implementation was to be monitored regularly by the troika and its provisions adapted if necessary.

Neither in Ireland nor Portugal did the government, which had requested financial assistance and negotiated the EAP, remain in office for long. In both cases, early elections brought about new coalition governments. Both were eager to publicly demonstrate their commitment to the EAP: to reform their economies and straighten out their public finances. Portugal's new prime minister went as far as to promise to change the country's 'statist paradigm' (Diário de Notícias, 2011). Ireland's new government was equally outspoken about the necessity for economic adjustment but at the same time promised that it would curb the 'harshness' of its predecessor (Financial Times, 2011g). Both governments were largely successful in concluding their EAP, but they failed to live up to their promises when they assumed office. Although they were subject to enormous external pressure and faced similar demands by their international lenders, ultimately, the two borrower governments' economic adjustment and fiscal consolidation strategies differed immensely. Ireland's fiscal adjustment strategy was primarily based on expenditure cuts, whereas revenue increases played a much more important role in Portugal. How can we explain this difference?

This dissertation argues that domestic politics was decisive for policy-making during the eurozone crisis. The conditionality attached to the EAPs constituted a strict framework but did not automatically translate into policies. International pressure was crucial when deciding *whether* the crisis countries had to adjust—

but *how* they adjusted was determined at the national level. Coalitions of economic actor groups, whose preferences and political strength differed from country to country, substantially influenced the decision-making processes of national governments.

A total of four countries implemented EAPs. Greece received two additional programmes after the first one had failed miserably. Given the negligible size of its economy, Cyprus' programme was only a side note to the eurozone crisis. I therefore substantiate my argument by analysing the cases of Ireland and Portugal. Given that these 'small states' (Katzenstein, 1985) were in a politically much weaker negotiating position than their creditors, it could be expected that their room for manoeuvre would be limited when negotiating and implementing their EAP (Stallings, 1992; Frieden, 2015). This makes the differences between the two cases all the more puzzling.

Fiscal policy took centre stage in all programmes. The question was not only if austerity was the right cure for the periphery's fiscal problems (Blyth, 2013a). The composition of fiscal consolidation also had significant economic and political implications (Alesina et al., 2019). To reduce the national deficit, governments rely on a combination of revenue increases or expenditure cuts. I focus here on the composition of fiscal adjustment. In Ireland, fiscal policy-making before the EAP rested on a broad political consensus favouring an adjustment strategy based on expenditure cuts. This consensus was upheld during programme implementation and relied on coalitions of dynamic and export-oriented economic actor groups. In Portugal, by contrast, programme implementation was politically much more contested as a series of planned measures clashed with against domestic opposition. Here, trade unions and other established coalitions representing domestically-oriented businesses served as the defenders of the status quo. To a much larger extent, Portugal's consolidation efforts ended up being based on revenue increases.

Before I lay out my analytical framework in more detail, the remainder of this introduction illustrates the broader plan of the book. The following section explains when and why governments are forced to adjust and how being a member of a currency union changes the dynamics of fiscal consolidation. Section three provides a short overview of my theoretical approach and its main elements. I then identify a series of gaps in the comparative political economy (CPE) literature on fiscal policy-making and show what can be learned from addressing them. A final section concludes by outlining the structure of the book.

1.2. 'There is no alternative': When governments are forced to adjust

The governments of Ireland and Portugal tried to delay their request for financial assistance as long as possible. However, both ended up calling on the troika for funding and accepting the obligation to implement an adjustment programme. This begs two questions. First, could the programme countries expect any alternative to fiscal adjustment? Second, if fiscal consolidation was inevitable, how was it to be achieved?

Excessive public spending or insufficient revenues were not the sole cause of the sovereign debt crisis. The crisis also exposed the eurozone's institutional weaknesses. It is beyond the scope of this dissertation to analyse these weaknesses in detail or to suggest solutions (for an extensive discussion, see Matthijs and Blyth, 2015). However, as a general assessment, it has important implications for understanding the kind of external pressures the crisis countries faced and the potential alternatives they could choose from. The eurozone member states in crisis did not only experience fiscal problems but also suffered from balance-of-payments crises. Simply put, they were consuming more than they could produce themselves. As a result, the current account was in deficit. Such a deficit is not necessarily problematic. If current account deficits emerge only temporarily, governments can finance them without addressing the underlying problem (Walter, 2016: 843-844). Yet, the crisis revealed that the current account imbalances between the eurozone's member states were structural and persistent. Furthermore, the international financial crisis and contagion effects from the Greek crisis made financial markets panic and government bond rates skyrocket (De Grauwe and Ji, 2012). As a result, the eurozone's most severely hit crisis countries could no longer refinance their deficits. This left them with two alternatives: external or internal adjustment (Walter, 2016: 844). An external adjustment strategy aims to reduce the nominal exchange rate by devaluating it. This way, the prices of goods and services a country produces decrease relative to those of other countries, making exports more competitive and imports more expensive. However, in a currency union, the nominal exchange rate is fixed. External adjustment is therefore not a viable alternative.

If they wanted to avoid leaving the Economic and Monetary Union (EMU), the crisis countries had no option but to adjust internally. Internal adjustment aims at improving international competitiveness by reducing relative prices internally (Frieden and Walter, 2017: 378). To this end, domestic demand was to be curbed via fiscal austerity or structural reforms. A potential alternative, namely that EMU member states with current account surpluses would take steps to *increase* their relative prices—and hence temporarily accept higher inflation rates—was highly unlikely given the distribution of bargaining power between creditors and debtors (Frieden, 2015: 7). What is more, exiting the eurozone to regain control over their exchange rate was not a viable option for the crisis countries. It was not politically feasible as countries, such as Germany, did not want the eurozone to break apart but to solve its problems on its own. Discussions on a possible Greek exit from the eurozone did not start until 2012. They were swiftly muted by Germany's Chancellor Angela Merkel and the US government amidst concerns about the potential repercussions on the US economy (Henning, 2017: 163).

The crisis countries had no viable alternative to internal adjustment. After lengthy discussions, the eurozone's heads of state agreed upon a structure that would provide funding in exchange for implementing an adjustment programme monitored by the troika. It was unprecedented that the IMF would provide lending to advanced economies and in close cooperation with European Union (EU) institutions. The EU and the IMF had practised their collaboration before when they supported several countries in Central and Eastern Europe in the immediate aftermath of the global financial crisis. Given that the eurozone at that time constituted the world's largest economy besides the US, the stakes now were even higher. Still, to

understand the composition of fiscal adjustment that the crisis countries implemented, we have to analyse political processes on the domestic level.

1.3. The argument in brief: The constrained coalitions approach

The crisis countries faced enormous external pressure to adjust their national finances swiftly. My dissertation argues that domestic factors were still decisive when it came to *how* they consolidated their finances, that is, which fiscal adjustment strategies they adopted. This focus results from empirical observation but is also a conscious decision on the analytical perspective I explore. This is not to say that international factors were irrelevant; rather, a focus on the international level would pose different questions than the ones I intend to answer here.

Empirically, international pressure did not automatically translate into domestic policy-making. EMU membership set quite general parameters, such as the non-availability of currency devaluation and the necessity to cut the budget deficit. The EAPs' specific policy provisions resulted from negotiations between the respective borrower government and the troika. Here, all three troika institutions—but especially the IMF—drew on blueprints of solutions they had developed over time (Lütz et al., 2019a). But they were also forced to be flexible. They had to account for changes in the macroeconomic environment and could not simply ignore or even override domestic opposition. Although some authors argue that the EAPs' intrusiveness in national politics was unprecedented (Theodoropoulou, 2015), the troika was eager to avoid the impression that it was infringing on state sovereignty or domestic policy-making processes. Over the course of the Greek programmes, the troika's monitoring became increasingly tighter. But in general—and especially in the other cases—the borrower governments were able to act strategically and pursue their own preferences (Lütz et al., 2019b).

Analytically, a country-level comparison of domestic political processes yields different insights compared to a study that zeroes in on the international level. On the one hand, the latter already was conducted comprehensively by Henning (2017), who conceptualised the troika as a 'regime complex' and analysed in detail the role different state actors played in this complex. On the other hand, domestic politics are still decisive irrespective of the importance of factors located at the international level in explaining political outcomes in the eurozone. Comparing the EAPs for Ireland and Portugal allows us to learn more about how implementation processes play out in various political and economic contexts. This dissertation analyses how domestic politics brought about specific fiscal adjustment strategies in light of the constraints constituted by international financial market actors.

In brief, I argue that fiscal policy choice results from national governments meeting the policy demands of different domestic actor groups. Those groups form class-based and sector-based preferences rooted in their material interests and compete for political influence. Class-based actor groups differ in terms of the level of redistribution they prefer and the economic risks they are exposed to. Sector-based actor groups

vary concerning their exposure to international markets and their prioritisation of domestic consumption versus international competitiveness. To influence fiscal policy-choice, actor groups whose preferences are closely aligned enough form coalitions. Two logics determine which coalitions ultimately prevail. On the one hand, processes of social concertation directly involve some coalitions in decision-making processes. On the other hand, the importance of different sectors for economic growth also affects the political influence of coalitions. However, in a globalised world, economies are not isolated from developments at the international level. In small states, policy-choice is therefore also constrained by investors and other international financial market actors constrain.

Labour and capital constitute the most basic economic actor groups. My analytical framework draws upon a fundamental assumption made in the CPE literature, namely that workers and their employers principally have opposing preferences (Korpi, 2006; Paster, 2015). When it comes to fiscal policy, employers and business owners are assumed to oppose redistributive policies and therefore to prefer a lower level of state spending financed by low taxes. Workers, by contrast, are assumed to prefer taxes on higher incomes to finance higher state spending, which serves the purpose of redistributing wealth. Yet, fiscal policy not only redistributes wealth but also provides insurance against a series of economic risks. Economic actors face high economic risks if an individual has lower skills than sought after on the market or if a company faces cheaper international competition. These groups prefer the state to provide some form of insurance or compensation in case those risks materialise. This implies that preferences may align *across classes* if employers and employees face similar risks, such as losing out to international competition. At the same time, differences in the endowment with skills between workers implicate the potential for diverging preferences *within* labour (Wren and Rehm, 2013, 2014). This is because higher-skilled workers face lower economic risks than low-skilled workers and thus are more likely to prefer lower levels of state spending.

In addition to these class-based preferences, economic actor groups also form policy preferences depending on their exposure to international markets. Actors, that is, workers and businesses in sheltered sectors are mainly concerned with the effect of fiscal policy on domestic consumption. Therefore, they likely support higher levels of state spending that bolsters disposable incomes. The opposite holds true for actors located in the exposed sectors of the economy. They can be expected to prefer expenditure cuts since high levels of state spending can impair the economy's international competitiveness.

In a second step, my analytical framework shows how economic actor groups form coalitions to influence fiscal policy-making and how the preferences of those coalitions translate into policy-choice. Assuming that they have a genuine interest in specific policies and want to get re-elected, politicians are unlikely to propose policies that run counter to the preferences of crucial economic actor groups. Fiscal adjustment is a controversial agenda, and governments that intend to implement it need their consolidation package to get through all 'spheres of political contestation' (Barta, 2018: 18).

Coalitions do not form automatically. Actors create them when their preferences align closely enough and if they can expect to successfully exert political influence. Furthermore, coalitions usually do not form

spontaneously. Economic actor groups do not always have to start from scratch to wield political power. They can often rely on already established coalitions that can easily be activated—trade unions or business associations being the most prominent examples. On the other hand, an economic crisis has the potential to shatter established institutions and to put novel policies on the agenda. This opens the possibility for new coalitions that either have a long-term time horizon or are simply issue-based.

I identify two major logics of how coalitions influence policy-making. First, there is a distributional dynamic based on the persistent importance of traditional coalitions' institutionalised involvement in the policy-making process. These processes—often subsumed under the terms 'social concertation' or 'corporatism'—play a key role in most eurozone member states, although to a variable extent. Social concertation usually privileges long-established organisations at the expense of other, under-represented groups. What is more, those coalitions often have ideological links with political parties. Whereas trade unions have traditionally been affiliated with social democratic and other left-leaning parties, the preferences of business associations are usually represented by conservative and economically liberal parties. However, there is a second logic of influence that sometimes contradicts the class-based preferences and organisations. Just as preferences can be sectoral, coalitions and their influence can also result from the importance of different sectors for the economy. To illustrate this logic, I draw on the concept of growth models, which is the differentiation of economies based on their main drivers of economic growth—most importantly exports and trade or domestic consumption (Baccaro and Pontusson, 2016). It follows that coalitions based in sectors that are pivotal for economic growth are more influential than those of secondary importance. The more pronounced a growth model, the less contested is economic policy-making and its orientation towards the model's main sectors.

Processes of globalisation and de-industrialisation have affected both logics of influence in recent decades. High-skilled workers used to be located in sheltered sectors and the public sector in particular. This has changed as those workers have moved into high-end services, which have increasingly become traded. That means that the former cornerstones of domestically-oriented coalitions, in favour of higher state spending, have become more likely to prioritise international competitiveness over the redistributive aspects of fiscal policy. Low-skilled workers, by contrast, used to be located in traded sectors, most notably manufacturing. However, traditional manufacturing industries have lost significance in most advanced economies. What is more, low-skilled workers increasingly moved into sheltered low-end services. While these developments have decreased the potential for coalitions across skill levels, they have reinforced the preferences of low-skilled workers for higher levels of state spending.

My dissertation relies on a qualitative approach, namely the comparison of two in-depth case studies. In these case studies, I carefully trace processes of fiscal-policy making and how they were influenced by coalitions of economic actor groups. My analysis leans on a broad set of empirical sources. Most importantly, I conducted 30 interviews with representatives from governments and domestic interest groups in Ireland and Portugal. As part of a broader research project on the eurozone crisis, I participated in another 42 interviews with representatives from the troika and other creditors. I complemented the inter-

views with an in-depth evaluation of primary documents from the troika institutions as well as the two borrower governments. Finally, I rely on an extensive analysis of newspaper articles and secondary sources to complete the empirical picture.

1.4. Contribution: What can we learn from analysing the composition of fiscal adjustment?

My dissertation makes three major contributions. First, it deepens our understanding of the composition of fiscal adjustment strategies, thus addressing an empirical research gap. Second, it engages with recent contributions to the CPE literature and provides analytical insights into the determinants of economic policy-making more generally. Finally, it contributes to the discussion about the future of fiscal policy in an increasingly integrated EU.

Although the concrete effects of fiscal policy on the economy are widely debated, there is no doubt that designing, prioritising, and implementing the state budget is one of the most essential tasks of any government (Romer, 2012; Alesina and Ardagna, 2010). This holds especially true in times of crisis, when 'patterns unravel, economic models come into conflict, and policy prescriptions diverge' (Gourevitch, 1986: 17). When resources are scarce, budgets need to be adjusted. Fiscal adjustment inevitably produces winners and losers and therefore is an intrinsically political issue. Previous work has focused on two central aspects of the politics of fiscal consolidation. Politics influences the timing of fiscal adjustment and the sustainability of budgetary consolidation.

Regarding questions of timing and delay, Alesina and Drazen's seminal contribution conceptualised fiscal consolidation processes as a 'war of attrition' between different social groups which only ends 'when one group concedes and bears a disproportionate share of the burden' (1991: 1170). Drawing upon this argument, Barta (2018) finds that debt accumulation continues, and fiscal adjustment is delayed when the structure of fiscal policy is polarised, and the economy's exposure to international markets is limited. Hübscher (2016) states that governments strategically decide on the timing of budget consolidation and are more likely to proceed with it during the early phase of their term in office. Finally, Walter makes the case that timing is determined by the vulnerabilities of voters to different forms of macroeconomic adjustment (2013). Focusing on the second aspect, Haffert emphasises 'competing fiscal policy coalitions' (2019: 1043) and their influence on the sustainability of budgetary surpluses in OECD countries. Analysing 15 EU member states between 1960 and 2004, Maroto Illera and Mulas-Granados (2008) identify a series of factors that impact the durability of fiscal consolidation. On this point, they find political factors to be more influential than economic variables.

These contributions share the fact that they largely ignore the composition of fiscal adjustment. Rather, these approaches are 'agnostic about the mix between welfare or other spending cuts and revenue increases in stabilization packages' (Barta, 2018: 42). I intend to address this gap by emphasising 'the determi-

nants of specific mixes of adjustment policies in more detail' (Walter, 2013: 226). In doing so, my dissertation opens 'the black box of fiscal consolidation, explaining the logic and composition of alternative "strategies of fiscal adjustment"' (Dellepiane-Avellaneda, 2010: 456).

Here, I provide a midrange theory of fiscal policy-choice which speaks to a broad set of scholarly debates. First, I draw upon the growth model approach as one of the most recent additions to the literature on comparative capitalism. The main innovation of the growth model approach is to shift the theoretical focus from supply-side institutions to aggregate demand and its various components. At the same time, its leading proponents acknowledge that there is a need for politics to be more systematically integrated into this framework (Baccaro and Pontusson, 2016: 200). Furthermore, their macroeconomic approach does leave aside questions about monetary or fiscal policy (Hope and Soskice, 2016: 220). I address this gap as I develop an analytical framework that integrates actor preferences with regard to the redistributive aspects of fiscal policy and how they relate to different growth models. In conjunction with my conceptualisation of the formation of coalitions and their influence on policy-making, my framework takes a crucial step toward an improved understanding of the politics of growth models.

Consequently, my contribution identifies political fault lines and their potential effect on fiscal policy-making. Isabela Mares (2003) has pointed out two issues that studies of actor coalitions should consider. She argues that it would be desirable to know more about the specific policies where labour and business organisations may agree and to 'distinguish these from issues which continue to remain distributionally divisive for capital and labor' (Mares, 2003: 257-258). Furthermore, she deems it essential to incorporate the factors that affect the formation of cross-class coalitions and which can explain differences in the political influence of these alliances (Mares, 2003: 258). I share these notions, and my analytical framework attempts to meet both requirements; indeed, it allows for actor coalitions to take centre stage and form within and across classes.

Regarding the first point, I take fiscal policy as the dependent variable and thus as the focal point of actor coalitions. I, therefore, follow a recent suggestion made by Jacob Hacker and Paul Pierson. Rooted in American political development, the two scholars make the case for political science to emphasise the importance of public policies. Since policies are the most consequential output of government activity, they are 'the "prize" for many of the most enduring political players, especially organized interest groups' (Hacker and Pierson, 2014: 643). This holds especially true for fiscal policy-making. Fiscal policy usually is high contested (Pierson, 1994) because it redistributes wealth and directly and indirectly affects economic growth. Regarding the second point, the eurozone's member states are advanced economies that have witnessed far-reaching structural changes in recent decades, albeit to different degrees. In addition to focusing on traditional class-based actor groups, I also show how these coalitions have been affected by globalisation and de-industrialisation processes. The growing reliance of advanced economies on services instead of traditional manufacturing and the concomitant increase in skill levels have important implications for coalition formation. It can potentially dissolve traditional constituencies and their class-based voting behaviour (Gingrich and Häusermann, 2015) and preferences (Häusermann et al., 2012). However,

these developments have not been equally pronounced in all eurozone countries, and the comparison between Ireland and Portugal highlights that.

Finally, the crisis laid bare the institutional weaknesses of the eurozone. I intend to highlight three aspects of the crisis here. First, the strict austerity promoted by the EU and its 'Northern' Member states arguably deepened economic inequality between the eurozone's member states and within European societies. Fiscal adjustment during the crisis increased inequality in the programme countries, as well as Italy and Spain, although those countries did not receive a full EAP (Perez and Matsaganis, 2018). In addition, the crisis reversed the trend of convergence between the eurozone's periphery and its core which had taken place in the early 2000s (Matthijs, 2016). Second, fiscal policy gained greater importance over the course of the crisis as the ECB's monetary policy was stretched to its limit. Save for a short period of fiscal expansion as a means to combat the crisis, monetary policy was 'the only game in town' during the early phases of the crisis. As the ECB's official interest rates reached the 'zero lower bound', the eurozone became deprived of one of its main instruments of economic policy-making (Romer, 2012), which resulted in 'a shift in emphasis from monetary to fiscal policy' (The Economist, 2020). The eurozone's economic future thus depends even more than before the crisis on the fiscal policy of its member state.

Discussions about the future of the EU and the eurozone have mirrored this emphasis on fiscal policy. Whereas early debates focussed on strengthening the EU's macroeconomic surveillance and the Stability and Growth Pact (SGP), recent debates have revolved around fiscal integration. Fiscal autonomy in an increasingly globalised world—and especially an increasingly integrated eurozone—is therefore another empirical question this dissertation addresses. The characteristics of different models of capitalism and how they impact economic policy-making has always been of scholarly interest. Most recently, the Varieties of Capitalism (VoC), as well as the growth model literature, have offered distinct takes on these questions. Notwithstanding their respective emphasis on institutional complementarities and drivers of the economy, both approaches acknowledged that eurozone membership has consequential implications for the diversity of economic models. Whereas the VoC approach poses questions 'about the viability of different development models within one economic zone' (Hancké et al., 2007: 3-4), proponents of the growth model literature ask if 'European *monetary* integration is incapable of accommodating diverse policy responses to the Euro crisis' (Johnston and Regan, 2018: 146).

The eurozone crisis has accentuated the importance of fiscal policy given its effect on economic growth and inequality as well as its implications for future integration processes. My analysis shows that national governments have substantial wiggle room when implementing fiscal adjustment strategies, but that there is a set of policies precluded by the parameters set by the eurozone's institutional architecture. I address an empirical gap in the literature, namely the determinants of the composition of different fiscal adjustment strategies. In doing so, I draw on recent additions to the CPE literature, which explore different models of economic growth and changing actor coalitions in advanced economies.

1.5. Structure of the book

The remainder of this book is structured as follows. Chapter two spells out how the framework developed here fits in with the existing CPE literature and where it differs from established approaches. My approach stresses the importance of explanatory factors on the domestic level. Contrary to the recent CPE literature's 'electoral turn' (Beramendi et al., 2015: 4), it prominently features interest group coalitions and their involvement in and influence on policy-making processes.

Chapter three develops my analytical framework and its different components. First, it turns to fiscal policy as the dependent variable. Fiscal policy has short- and long-term effects that directly affect economic growth and the distribution of wealth—and even opportunities in a society. My analysis takes a closer look at situations when governments are forced to adjust fiscal policy and consolidate public finances. The analytical framework then provides a detailed explanation of fiscal adjustment politics and its different elements. It identifies class-based and sectoral coalitions as the main economic actor groups and illustrates the foundations of their potentially conflicting policy preferences. It then shows under which circumstances governments take the preferences of those groups into account and how international financial markets constrain this process.

Governments face two logics of policy-demand. Economic actor groups located in the exporting sectors and actors facing low economic risks can be expected to call for an expenditure-based adjustment strategy to boost international competitiveness. Actor groups that thrive on domestic consumption and those who face higher economic risks prefer a revenue-increasing adjustment strategy that implies higher state spending. On this basis, I formulate distinct expectations of how I assume the politics of fiscal adjustment to play out empirically. The chapter then concludes by outlining a series of methodological considerations.

Chapter four introduces the empirical analysis of my dissertation and sets the scene for the case studies of Ireland and Portugal that follow. It gives an overview of the composition of domestic actor groups and their influence on fiscal policy-making before the global financial crisis. In both countries, processes of social concertation directly involved trade unions and employer organisations in economic policy-making. However, the movement of high-skilled workers into exposed services has been more pronounced in Ireland than in Portugal. It has reinforced the already strong coalition of international investors and other supporters of Ireland's export-led growth model. In the run-up to the crisis, the Portuguese economy relied on private and public consumption but performed below the eurozone's average. De-industrialisation and globalisation processes have been less pronounced in Portugal than in Ireland. In conjunction with the economic risks faced by large sections of Portugal's businesses and low-skilled workers, this gave rise to a robust and domestically-oriented coalition that defended the status quo of the country's high level of state spending. The chapter concludes by illustrating how the global financial crisis turned into a life-threatening challenge for the eurozone and, finally, describes the technicalities and objectives of the EAPs.

The two case studies in chapters five and six follow a similar structure. They briefly analyse how fiscal policy has performed since both countries joined the eurozone and assess how their fiscal stances turned sour once the global financial crisis hit. Although Ireland's government had accumulated budgetary surpluses for several years in a row, its finances were heavily impacted by the crisis. On the one hand, the surpluses were driven by property-related tax revenues that imploded when the Irish property bubble burst over the global financial crisis. On the other hand, the government committed enormous sums in support of Ireland's ailing banking sector. In the Portuguese case, the absence of economic growth and escalating spending on public sector wages were the primary source of fiscal deterioration.

This synopsis is followed by the case studies' main section. It reproduces the economic developments and the political processes, which resulted in the Irish government pursuing an expenditure-based adjustment strategy, and Portugal's government adopting a revenue-based one. In both cases, the government that had requested financial assistance and negotiated the EAP shortly thereafter was voted out of office. The new governments both were elected on an austerity platform and were eager to implement their respective programmes because of enormous external pressure to adjust. But there were significant differences between Ireland and Portugal regarding how domestic politics played out to determine the adjustment strategy eventually chosen. The troika's preferred approach, namely fiscal consolidation based mainly on expenditure cuts, met the preferences of the most important actor groups in Ireland. The Irish government had already pursued such an adjustment strategy before the EAP. Its more left-leaning successor did not significantly change this. A strong political consensus was supported by actor groups central to Ireland's well-established growth model driven by exports and foreign direct investment (FDI). By contrast, trade unions and other groups representing economic actors exposed to high economic risks and arguing against expenditure cuts could not assert their preferences. These groups were much more influential in the Portuguese case. They were not counterbalanced by economic interests located in the exporting sectors, which would have given priority to issues of international competitiveness. As a result, the implementation of the EAP was politically much more contested in Portugal than in Ireland. Powerful trade unions and other traditional organisations located in the sheltered sectors successfully opposed expenditure cuts on several occasions.

Chapter seven compares my findings and summarises the commonalities and differences between the two cases. It then relates those findings to the broader scholarly debate and shows how they contribute to the CPE literature. It then concludes by summarising what can be learned from the analysis and looks ahead to critical domestic and international developments. Most importantly, the ramifications of the crisis shook political systems globally—and even more so in Europe. As a result, new political coalitions formed in Ireland and Portugal, which only a few years before were deemed unimaginable. Finally, the spending surges in the context of the COVID-19 pandemic again poses questions about fiscal consolidation in the long term.

Chapter two: Literature review

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The constrained coalitions approach in perspective

In this chapter, I evaluate the broader CPE literature and its ability to explain fiscal policy choice. Section one clarifies how my approach relates to the standard distinction of interests, institutions, and ideas as the fundamental categories of CPE analyses. The second section zooms in on the determinants of policy-choice that can be found in the literature. Finally, section three provides an overview of previous works that researched the eurozone crisis. In doing so, this chapter identifies a series of gaps that my dissertation addresses. Analytically, I turn away from the CPE literature's focus on supply-side institutions and towards the demand side of the economy. I also show that most CPE accounts only gradually incorporate recent globalisation and de-industrialisation processes and their effect on the dynamics of domestic policy-making. Empirically, I focus on small European states, which most examinations of national models of capitalism disregard. Finally, although the eurozone crisis is well-researched, most authors so far have neglected domestic politics and the composition of fiscal adjustment.

2.1. Interests, institutions, and ideas: The roots of the constrained coalitions approach

Based on the seminal books by Shonfield (1965) and Zysman (1983), the identification, classification, and explanation of different 'national models of capitalism' was and still is one of the central undertakings of CPE research (see Baccaro and Pontusson, 2018: for an extensive discussion). For example, different authors scrutinised the strategies of small European states to manage and stabilise the economy (Katzenstein, 1984, 1985), the role of state intervention (Hall, 1986), the interaction of party politics and labour market institutions (Garrett, 1998b), differences between production regimes (Soskice, 1999), or 'Varieties of Capitalism' in general (Hall and Soskice, 2001b). What these and similar contributions have in common is that they rely on—to a variable extent—interests, institutions, and ideas as the three core elements of comparative analysis (Hall, 1997).

The basic assumption of my analytical framework is that economic actors are motivated by economic and material considerations. From this perspective, political decisions are made in view of those considerations and policy preferences can be discerned from actors' positions in the economy. Economic actor groups oppose policies that may worsen their economic position and demand policies likely to improve it. Actors are more likely to rely on market mechanisms and prefer lower levels of government activity when their skills and resources allow them to achieve high payoffs on the market. By contrast, they can be expected

to turn to the government for intervention in the economy, and for fiscal support, if their skills and other resources inhibit them to be successful on the market (Beramendi et al., 2015: 18). Actor groups form coalitions if they have similar material interests. This line of reasoning is often portrayed as contradictory to approaches that take ideas as their main explanatory variable. However, authors who follow the 'ideational turn' in CPE do not necessarily downplay the significance of interests or institutions (Blyth, 1997). Instead, they argue that there is a causal relationship between ideas, norms, and political outcomes—and that these ideas interact with both the institutional context and the material interests of actors (Hall, 2005: 130). This perspective has been coined 'Economic Constructivism' (Blyth, 2003a). It postulates that interests and identities are not objectively given but that actors socially construct them in relation to their environment.

Several authors have applied this perspective to illuminate changes in national models of capitalism or to explain European integration. Kathleen McNamara, for instance, highlights the significance of macroeconomic paradigms and the development of a neoliberal consensus between European policy-makers for the EU's monetary politics (1998). In a similar vein, Nicolas Jabko shows how the EC strategically framed a shared understanding of the role of the market in the EU's path towards EMU to reconcile diverging economic and political interests (2006). Mark Blyth, finally, traces back how economic ideas have impacted institutional transformations in the US and Sweden over the course of the 20th century (2002).

I do not intend to downplay the importance of economic ideas. If anything, the global financial crisis has given every reason to see them as important causal factors and to call into question some of the macroeconomic paradigms that have governed economic policy-making in the run-up to the crisis (Blyth, 2013b). However, I still base my analysis on the assumption that actors are driven by material considerations. Even if incorporating ideational considerations into my framework would complement this assumption and add empirical richness, my analysis shows that it is not necessary to understand and explain fiscal policy choice. The exclusion of ideas and norms is an analytical decision that serves to keep my theoretical approach as parsimonious as possible.

Having clarified this distinction, we can now turn to more detailed accounts of preference formation. One of the most influential formalised models of fiscal policy preferences was developed by Allan Meltzer and Scott Richard in the early 1980s. The two political economists argued that voters with incomes below the median favour more redistribution financed by higher taxes. In contrast, voters above the mean prefer lower spending levels and less redistribution (Meltzer and Richard, 1981). Over time, Meltzer and Richard's model has become 'the basic "workhorse" political economic model for preferences for redistribution' (Alesina and Giuliano, 2009: 4). Most authors have accepted the presumption that lower-income groups are more supportive of redistributive fiscal policies than those with higher incomes. But it also has been proposed that it was necessary to go beyond this 'simple, perhaps simple-minded, view of politics' (Kenworthy and Pontusson, 2005: 457; see also Kenworthy and McCall, 2008).

Some contributions have therefore taken a closer look at individual income groups and their preferences. Alberto Alesina and Eliana La Ferrara, for example, further developed the model, stating that the effects of fiscal policies are more complex than the linearity suggested by Meltzer and Richards (2005: 901). They claim that individuals' expectations about the effect of redistribution on their future income are a much more precise predictor of fiscal policy preferences. Focussing on the US, a similar study finds that affluent Americans have distinctively more conservative fiscal policy preferences than the general public (Page et al., 2013). Supposing that the wealthy are politically more influential than lower-income groups, this does have significant implications for democratic fiscal policy-making, even if these findings do not necessarily translate one-to-one to European countries. Others have identified a variety of scope conditions on how redistributive conflicts play out. Pablo Beramendi and Philipp Rehm, for instance, argue that 'when progressivity is low, and tax contributors and benefit recipients overlap, redistributive struggles become politically less salient' (2016: 529). Low-income groups arguably are most likely to demand redistributive fiscal policies (Alesina and La Ferrara, 2005: 900). Recent analyses have further refined our understanding of fiscal preferences by incorporating the exposure to economic risks as another key determinant (Cusack et al., 2006; Rehm, 2009, 2016).

So far, I have only considered the domestic level. Incorporating the global economy, and its influence on nation states, further broadens the perspective on processes and determinants of fiscal policy preferences. It acknowledges that external factors, such as capital mobility, also have distributive effects (Frieden, 1991: 433) and introduces 'sectoral interests' (Frieden, 2002) into the equation. By the same token, the argument can be made that trade has far-reaching effects on domestic political alignments (Rogowski, 1989). National models of capitalism, and thus domestic politics, are not isolated from international developments. This implies that the preferences of economic actors are potentially influenced by two factors. Proponents of the power resources theory argue that a redistributive struggle takes place between groups with different incomes or different endowment with factors of production and skills (for example, Huber and Stephens, 2001; Bradley et al., 2003; Korpi, 2006). Other authors find that economic actors can also have sectoral preferences that may trump their redistributive considerations (Pontusson and Swenson, 1996; Swank and Martin, 2001). In my dissertation, I argue that it is not necessary to side with one of the two perspectives but that it is possible to incorporate both.

However, even if we accept this line of reasoning, material interests arguably are not objectively given but context-dependent. For this reason, the CPE scholarship and particularly works on national models of capitalism, ascribe major importance to economic and political institutions. Institutions have two different effects. First, institutions affect preferences in that they impact how individual actors *calculate* their material interests. The Varieties of Capitalism (VoC) framework developed by Peter Hall and David Soskice (2001a) has been the most prominent and influential publication on this issue in recent decades. It is the point of departure for most comparative analyses of advanced economies and has since spawned a fruitful debate on the importance of institutional complementarities and mechanisms of institutional change. A central question the debate revolves around asking if advanced economies over time have been converg-

ing to one model and now look increasingly similar or if differences between them persist. Hall and Soskice arrive at the conclusion that the latter is accurate. In their reading, institutions govern how companies resolve a series of coordination problems. They identify two different ideal types, namely liberal and coordinated market economies which are based on different institutional complementarities and, in turn, augment the differences between the two models (Hall and Soskice, 2001a: 17). In terms of economic preferences, 'strategy follows structure' (Hall and Soskice, 2001a: 15). That is, preference formation does not take place in a vacuum but always in relation to the institutional environment that economic actors are dealing with.

In the wake of the reignited debate on the institutional foundations of national models of capitalism, a variety of criticisms has been issued vis-à-vis VoC (for an overview, see Hancké et al., 2007: 7-8). On the one hand, it has been argued whether VoC's dichotomy was a mere reproduction of Germany and the US as its two main case studies (Crouch, 2005), if it was providing 'enough variety' (Allen, 2004), if it was necessary to introduce a third variety of 'state capitalism' (Schmidt, 2002, 2009), or if there was the need for even more diversity (Amable, 2003). But more importantly, some critics pointed out that VoC was highly functionalist and deterministic and, thus, unable to account for economic and institutional change. From this point of view, institutional complementarity implies overly stable and path-dependent institutional settings which change only in the face of profound economic or political crisis. But this conception did not correspond with the reality of highly dynamic capitalist societies. As opposed to the radical change that VoC would expect to occur at certain 'critical junctures', other authors focused on instances of 'incremental' or 'gradual' institutional change, such as displacement, layering, drift, or conversion (Streeck and Thelen, 2005; Mahoney and Thelen, 2010). This was echoed by others who understood institutions 'not only as constraints on particular courses of action, but also as resources for new courses of action that (incrementally) transform those institutions' (Deeg and Jackson, 2007: 149).

These critiques have another sub-theme in common, namely how the role of politics and the state should be conceptualised in the comparative analysis of capitalism (Jackson and Deeg, 2008). The importance of the state, as a major economic actor, has been especially neglected by parts of the CPE literature as it understood the state to be 'just the political economic setting that structures the actions of private political economic actors' (Schmidt, 2009: 517). I agree with the notion that the state should be conceptualised as playing an active role in the economy and as directly interacting with other economic actors. This blind spot is one reason why VoC and other prominent CPE proponents mostly neglected the economies on Europe's periphery, where the state plays a central role. Most comparative studies were confined to a handful of essential European cases—most commonly France and Germany, Sweden and Denmark, as well as the United Kingdom and the US (for example, Hall and Soskice, 2001a; Schmidt, 2002; Thelen, 2004; Streeck, 2009; Fioretos, 2011; Martin and Swank, 2012; Thelen, 2014; Baccaro and Howell, 2017). Although there have been attempts to analytically subsume South European countries such as Spain or Italy under the term 'mixed market economies' (Molina and Rhodes, 2007), such studies are the exception rather than the rule (Herrmann, 2005).

These arguments guide us to the second major effect of institutions. Institutions translate actor preferences into policies in that they have a bearing on the relative influence and strength of competing social classes and coalitions of economic actor groups (Swank, 2002: 7). That is, policy-choices 'cannot be directly inferred from individual preferences' (Cusack et al., 2006: 366). Instead, political and economic institutions moderate the competition between different actor groups for political influence. One seminal model is the conceptualisation of fiscal adjustment as a 'war of attrition' between socio-economic groups (Alesina and Drazen, 1991). On this reading, consolidation measures are delayed as long as possible and implemented only when one group ultimately triumphs and the other groups give way. However, as parsimonious as such econometric models may be, the often are rather apolitical or overly simplify political dynamics. Similar analyses, for example of the correlation between government size and economic openness (Rodrik, 1998) or of the effect of fiscal adjustment on electoral success (Mulas-Granados, 2004), are surely well-equipped to find precise correlations between different variables. By contrast, my own approach focuses on developing a more nuanced understanding of individual and context-dependent processes of policy-making. In this way, it speaks to a recent contribution by Zsófia Barta (2018) who translated the formal war of attrition model into a more qualitative approach that emphasises fiscal polarisation and international exposure as its main explanatory factors.

Societal coalitions of economic actor groups take centre stage in contributions inspired by the war of attrition model. Here, economic and political institutions do not solely govern the coordination of firms or influence economic actor preferences. They also provide the 'rules of the game' in that they privilege some groups and disadvantage others. The role actor coalitions play in everyday politics can be conceptualised in two ways. Some authors view politics mainly as an electoral competition between political parties and individual office-seekers (Beramendi et al., 2015). Others, in turn, state that policy-making is influenced to a larger extent by organised interest groups (Hacker and Pierson, 2014). The latter approach does not necessarily imply that governments are the mere agents of these interest groups. Instead, it is talking to a well-established body of CPE literature that stresses the importance of economic actor groups and the coalitions they form as the decisive supporters or opponents of economic reform (for example, Katzenstein, 1985; Gourevitch, 1986; Rogowski, 1989; Häusermann, 2010; Walter, 2016; Frieden and Walter, 2017; Barta, 2018). Governments may pursue their own reform agenda, but the successful implementation of economic reforms needs the support of large actor coalitions—especially in times of crisis and austerity (Häusermann, 2010: 7). Again, I argue that these two approaches are not mutually exclusive. Rather, as I will show later, it makes sense to integrate both conceptualisations in one framework.

Finally, VoC has also been criticised for its functionalist understanding of institutions and their effect on economic actors. From this perspective, institutions should not be viewed as simply 'facilitating coordination for actors to achieve joint gains' but as the outcome and object of (historic) processes of societal contestation (Streeck and Thelen, 2005: 11; Streeck, 2016). The growth model approach is the most recent addition to the body of CPE scholarship that attempts to provide a more dynamic framework for the analysis of the similarities and differences between national models of capitalism (Baccaro and Pontusson,

2016). This line of reasoning shifts the centre of attention from institutions to the drivers of macroeconomic demand. It finds that a focus on institutions implies a prioritisation of the supply-side of the economy as the main determinant of economic performance. However, priority should be given to the 'demand drivers' of growth' (Baccaro and Pontusson, 2016: 185; see also Schwartz and Tranøy, 2019). Accordingly, different growth models can be identified, driven by trade or domestic household consumption, for instance. Growth models by implication rest on or are challenged by different coalitions of economic actor groups. The intuition that those coalitions often form across classes (Baccaro and Pontusson, 2016: 200), goes beyond the notion of the classical power resources approach mentioned above and its emphasis on working-class power. It instead picks up on what a large group of researchers has elaborated on, namely the potential—and prerequisites—of sectoral cross-class coalitions, most prominently using the example of the welfare state's historical development (Swank, 2002; Swenson, 2002; Martin and Swank, 2012).

As welcome as this realignment of the comparative capitalism literature is, the 'implications of growth models for partisan politics and macro-economic policy choices' are still underdeveloped (Baccaro and Pontusson, 2016: 201). Furthermore, although the focus on coalitions of economic actor groups implicates a dynamic understanding of politics, the CPE literature still arguably suffers from a 'manufacturing bias' (Blyth, 2003b: 222). It tends to assume that the preferences of the traditional manufacturing industries are representatives for business as a whole (Thelen, 2014: 28) or to neglect the expansion and increased exposure of services and its effects on the formation of policy preferences and coalitions (Wren, 2013; Wren and Rehm, 2013).

This present work draws upon a broad range of CPE approaches to address a series of research gaps. First, I adopt an understanding of actor preferences as being based on material interests. These interests and the resulting coalitions can be redistributive, that is class-based, or they can be sectoral. Second, I depart from VoC's overly static and functionalist focus on supply-side institutions and turn towards the demand-side of the economy. Most importantly, I provide an argument about the relationship between growth models, coalition formation, and policy-choice that incorporates recent innovations in the analysis of post-industrial economies.

2.2. Determinants of fiscal policy-choice

Having discussed the general guiding principles of the CPE literature, I now turn to contributions which provide alternative accounts of how (fiscal) policy-choice can be explained. I first show how CPE scholars have incorporated economic actor coalitions and political institutions in their theoretical frameworks. Second, I discuss a body of literature that specifically deal with the phenomenon of fiscal policy—particularly in the EU and the eurozone.

2.2.1. National models of capitalism, coalitions, and policy-choice in comparative perspective

The CPE literature tends to centre upon social and welfare policy as the most important aspects of fiscal policy. This is most prominently exemplified by Paul Pierson's work on welfare state retrenchment (Pierson, 1994, 1996, 1998). Pierson's principal argument is that welfare state retrenchment is an especially difficult political endeavour (Pierson, 1994). The reason for this is that 'welfare states have created their own constituencies' (Pierson, 1994), which are willing to fight back against attempts to cut back social policy programmes. Furthermore, the costs of social spending are much more widely distributed than the often very concentrated benefits. Pierson is 'placing politics in time', and argues that the timing and sequencing of events matter and, furthermore, that taking them seriously improves our understanding of the outcome of political decision-making processes (Pierson, 2004). This reasoning is closely related to the concepts of 'path dependence' and 'critical junctures' (Pierson, 2000). Economic or political institutions provide economic actors with increasing returns which bring about positive feedback processes. The result is that it becomes very difficult to reverse 'particular courses of action' (Pierson, 2000: 251) as actors progressively become invested in existing institutional environments (Beramendi et al., 2015: 3). The ensuing equilibria may only be shaken up at certain critical junctures, that is during '*relatively* short periods of time during which there is *substantially* heightened probability that agents' choices will affect the outcome of interest' (Capoccia and Kelemen, 2007: 348). These arguments echo what the discussion above has already suggested, namely that VoC and other historical institutionalism accounts have the tendency to overemphasise 'structural constraints and continuity' (Streeck and Thelen, 2005: 6).

Yet, there is clearly a lot to learn from such historical accounts. This holds especially true when it comes to comprehensive explanations of different institutional configurations and their historical origins. Peter Swenson (2002), for example, traces the development of the US and the Swedish welfare state and the involvement of cross-class alliances in this process. Duane Swank and Cathie Jo Martin highlight the role of employers in the evolution of societies that rely on cross-class cooperation and comparatively low levels of economic inequality (2001). By the same token, Martin finds a relationship between differences in how employers are represented in industrial relations and party systems and the evolution of tax regimes (2015). As already discussed, these works also tend to revolve around a handful of cases, most prominently Sweden and Germany as the pivotal 'coordinated market economies'.

These cases are also commonly used when it comes to answering the classical CPE question: has 'globalisation' resulted in an inevitable convergence of coordinated economies to a global model of neoliberal organisation of capitalist societies (Pontusson, 2005b)? In this reading, globalisation undermines the economic and political autonomy of nation states as they compete for increasingly mobile capital and firms that immediately punish 'excessive' state spending (Garrett, 1998a: 791-793). As a result, capital's looming exit option forces 'national tax authorities to compete for, rather than to impose on, taxable assets and activities' (Genschel and Schwarz, 2011: 340). Nation states that try to curb this development face a series of coordination problems (Rixen, 2011) and tend to be more effective in curbing individual rather than

corporate tax evasion (Hakelberg and Rixen, 2020). These kind of claims can be subsumed under the term 'capital mobility hypothesis (Andrews, 1994). Its proponents argue that mobile financial capital is attracted by low tax rates which eventually causes a race-to-the-bottom (Lierse and Seelkopf, 2016b: 148).

Against the notion that nation states are steadily losing their economic sovereignty amidst unfettered international markets, Geoffrey Garrett argues that governments still have significant room to manoeuvre to implement 'interventionist policies' (1998a: 823) and that left-wing governments were still incentivised to engage in expansionary fiscal policy (1998b: 45). Jonas Pontusson also states that there are persistent differences between 'Liberal America' and the social market economies of continental and particularly Northern Europe (2005a). Going forward, he argues that there is potential in Europe for progressive fiscal reforms based on concessions made by employers and businesses (Pontusson, 2005a: 216).

Wolfgang Streeck (2009) comes to a different conclusion as he investigates institutional change in Germany's model of capitalism. Behind apparent institutional stability, he identifies profound institutional changes towards a more liberal and uncoordinated economy. A similar argument is made by Lucio Baccaro and Chris Howell who take industrial relations as an example (Baccaro and Howell, 2011, 2017). Analysing fifteen advanced economies between 1974 and 2005, they identify substantial, liberalising changes irrespective of apparent institutional stability (Baccaro and Howell, 2011: 521). Diving into more detail, Kathleen Thelen also observes a long-term liberalising trend, implying higher economic inequality and less 'strategic' employer coordination. Although, she argues that these changes follow various trajectories in different models of capitalism (2012, 2014).

What then explains economic success and how do small states fare in such a contested international environment? Nation states are not necessarily at the mercy of uncontrollable globalising forces. Rather they can behave strategically and gain competitive advantages over other economies. For example, Orfeo Fioretos (2011) scrutinises the sustainability of different economic models. He finds that for national models to be sustainable and internationally competitive, they need the ability to reform and sometimes even transform their national model of capitalism (Fioretos, 2011). However, he also takes the usual suspects—namely the UK, Germany, and France—as his case studies. Small states, and the strategies they pursue to safeguard their economic well-being in a global economy dominated by much larger and more powerful states, are in need of an individual perspective. Peter Katzenstein (1985) is probably the most prominent proponent of this strand of research. He finds that strategies 'of international liberalization, domestic compensation, and flexible industrial adjustment' (Katzenstein, 1985: 39) were decisive for the management of the challenges posed by globalisation. He views this form of corporatism, which is less prevalent in larger states, as being central to the successful management of those challenges (Katzenstein, 1985: 9).

These issues were in the spotlight again in the lead-up to EMU. In the light of progressing European integration, small states were forced to find ways to adjust their economy to the newly introduced Maastricht criteria. This new form of social concertation was coined 'competitive corporatism' (Rhodes, 1998, 2001).

Facing mounting external pressure on their welfare states and labour markets, small states attempted to agree on a negotiated form of flexibility coordinated on the societal level (Rhodes, 1998: 190). Eric Jones, by contrast, acknowledges that competitive social concertation indeed has achieved a series of economic successes. At the same time he suggests that these consensual arrangement were 'self-destructive' (Jones, 2008: 10) as the 'costs of this adjustment have been skewed against increasingly large sections of society' (Jones, 1999: 159).

These developments did not only feed into the literature on the effects of international economic liberalisation on domestic policy-making, but they also brought about further scholarly interest in social pacts (e.g. Fajertag and Pochet, 2000; Molina and Rhodes, 2002; Hancké and Rhodes, 2005). The focus shifted from structural factors to actors and their dynamics (Avdagic et al., 2011: 6). Three aspects are central to this newfound interest in social pacts, namely the reasons for national variation, the determinants of individual negotiation outcomes, and the prerequisites for their institutionalisation over the long term (Avdagic et al., 2011). Further contributions on these issues examined individual case studies and elaborated on the willingness of politically weak governments to engage in social concertation with well-organised and politically strong trade unions and employers (Baccaro and Lim, 2007; Baccaro and Simoni, 2008). Conversely, they looked at the role of ideas and their effect on the willingness of trade unions and employers to partake in social pacts (Culpepper, 2008).

Since the introduction of the euro, another important issue came to the fore. By depriving its member states of a central macroeconomic instrument—namely exchange rate devaluation—the eurozone was assumed to further constrain economic policy-making capabilities. On the other hand, it was possible that individual countries would 'take advantage of their relaxed current account constraints and strengthened creditworthiness to run excessive deficits' (Jones, 2003: 219). The interaction between these two developments arguably produced an 'imbalance of capitalism' between export- and consumption-led growth models (Johnston and Regan, 2016: 33). A growing number of researchers therefore shifted their attention to the performance of social pacts and other labour market institutions in such an environment. These contributions focused especially on ability of different economies to constrain wage inflation. Alison Johnston and Bob Hancké, for example, argue that coordinated wage bargaining institutions provided countries such as Germany with a competitive advantage the eurozone's periphery as they tied wages of workers in sheltered sectors to their counterparts in the exposed sectors (Johnston and Hancké, 2009; Johnston et al., 2014; Johnston, 2016).

Social pacts were not the only institutional arrangements that affected the fiscal and economic performance of EMU member states. Arguably as important are the institutions and processes whereby governments coordinate budget decisions. Focussing on fiscal sustainability as the main criterion for fiscal policy outcomes, a group of political economists has tested the effect of different forms of fiscal governments on fiscal performance (Hallerberg et al., 2009; see also, Hallerberg, 2004; Hallerberg and Yläoutinen, 2010). For example, budgetary reforms are less likely to succeed in countries with many institutional or partisan veto players (Tsebelis and Chang, 2004). Another line of thinking observes that politi-

cal institutions, such as the electoral system, profoundly impact the formation of economic actor coalitions and their influence on fiscal policy-making in the long term (Hays, 2003; Iversen and Soskice, 2006, 2009, 2015a).

Historical accounts of the politics of welfare state adjustment constitute the most substantial body of literature that has dealt with fiscal policy-choice. This approach has been criticised as being overly static, but it still provides substantial insights into the coalitional dynamics of fiscal consolidation. Furthermore, it has been argued that the increasing integration of international markets significantly constrains domestic policy-making and inevitably leads to neoliberal convergence. I take from this the necessity to incorporate processes of globalisation but disagree with the notion of inevitability. Finally, there exists a variety of accounts of the performance of different economies within EMU's macroeconomic constraints. However, they focus mostly on the effect of (supply-side) institutions and also mostly disregard policy-making strategies in small European states.

2.2.2. Fiscal policy and the eurozone crisis

The literature on the eurozone crisis has mushroomed in recent years. For the sake of brevity, I will touch upon a set of studies that I consider to be representative of four broader debates. To begin with, there exists a long-running debate in economics on the implications of different adjustment strategies for future growth. The predominant camp in orthodox economics makes the case for expenditure cuts as it finds them to be more effective than revenue increases when it comes to debt stabilisation and economic recovery (Alesina and Ardagna, 2010; see also Alesina et al., 2019). This is challenged by heterodox economists who argue that the effectiveness of different adjustment strategies is context-dependent, since in some OECD countries revenue-based adjustment have successfully reduced debt and deficits (Boltho and Glyn, 2006: 411), and that debt reduction is most likely to be successful when expenditure cuts are combined with revenue increases (Baldacci et al., 2012: 369). The former stance has been termed 'expansionary austerity'. It claims that expenditure cuts are paralleled by increased activities in other areas of the economy which compensate for the decrease in public spending (Alesina et al., 2019: 5). The term gained political prominence over the course of the eurozone crisis. While it was debated if excessive state spending indeed was the main cause of the crisis (Johnston et al., 2014), some authors stated that 'expansionary austerity' was a particularly 'dangerous idea' used to further neoliberal paradigms (Blyth, 2013a; Schmidt and Thatcher, 2014).

Excessive state spending was not the only suspect when it came to identifying the causes of the crisis. Shortcomings in the architecture of the common currency were deemed equally important. First, the foundation of the eurozone may have lulled international financial market actors into a false sense of security. From this point of view, both the convergence of government bond rates to a very low level as well as their explosive growth after 2009 indicated a 'serious mispricing of risk' (De Grauwe and Ji, 2012: 871). Going one step further, Mark Blyth and Matthias Matthijs attribute the eurozone's problems to the common currency's 'lack of "embeddedness" in truly supranational European financial, fiscal, and governance

institutions' (2015: 1). Others saw the need for institutional reforms that would allow for market discipline to act as a more effective constraint on national fiscal policy (Hallerberg, 2010). Waltraud Schelkle, on the other hand, views the eurozone's 'limited capacity to share and diversify risks' as its main problem (Schelkle, 2017: 2). Others are less critical of the institutional architecture of the eurozone and instead state that it was mainly policy-makers making a series of fatal mistakes that led to the crisis and its far-reaching repercussions on member states (Sandbu, 2015: 9).

Furthermore, the political reaction to the crisis became an object of investigation as well. A large body of analyses has focused on the regulation of international financial markets in the aftermath of the global financial crisis (for example, Fioretos, 2016; Helleiner, 2014) as well as on changes to the institutional architecture of the eurozone and the EU (for example, Schimmelfennig, 2015; Schwarzer, 2015). When it comes to the troika institutions, several findings are noteworthy. The IMF, for example, engaged in self-criticism over the course of the crisis, especially regarding the performance of its macroeconomic surveillance in the run-up to the crisis, stating 'that a number of factors undermined the quality and effectiveness of surveillance' (IEO, 2016: 22). The EU's and the IMF's forecasting models were equally flawed. This not only negatively affected the EAPs, but also undermined the trust of investors and member states in the competence of these institutions (Costa et al., 2016; Lütz et al., 2019a). Michael Breen and colleagues echo this notion and identify a 'lack of coherence between EU and IMF surveillance' (2020: 435) which confronted member states with sometimes contradicting policy conditions.

There are several reasons for the differences between the EU and IMF, which also affected their cooperation during the crisis. Taking a realist approach, Henning finds the troika's rather complex design to be the deliberate 'consequence of a strategy of key states to manage agency drift' (Henning, 2017: 33). Pivotal member states would make use of situations of conflict between the international organisations to promote their own preferences. The different policy stances of the troika's members can be explained by taking into account differences in their political cultures and bureaucratic practices (Lütz and Kranke, 2014; Lütz et al., 2019a). Over the course of the crisis, these positions changed incrementally (Moschella, 2016) or were the subject of contestation between the international organisations (Lütz and Hilgers, 2019).

Finally, policy reactions to the crisis on the domestic level were also researched extensively. A large body of studies focused on how the crisis and the EAPs' supposed neoliberal bias affected (social) policy in the programme countries. Sotiria Theodoropoulou, for instance, finds that the EAPs were 'unprecedentedly intrusive in national social and labour market policies' (2015: 29). This finding is echoed by Sotirios Zartaloudis, who states that the programmes resulted in 'an unprecedented wave of cuts, tax rises and labour market reforms' (2014: 430). There are other authors who also emphasise the role of domestic politics when it comes to understanding the implementation and performance of the EAPs. However, instead of focussing on domestic actor coalitions, they investigate the influence of clientelistic linkages between voters and political parties (Afonso et al., 2015; Trantidis, 2016), a lack of state and administrative capacity (Featherstone and Papadimitriou, 2013), or the activity of domestic veto players (Tsebelis, 2016; Lütz et al., 2019b).

Scholarship has provided us with essential insights into four different aspects the eurozone crisis, that is the effect of fiscal policy and of different adjustment strategies, causes of the crisis at the international level, the behaviour of the troika institutions, and the domestic effects of the EAPs. However, two important questions, which my dissertation addresses, remain unanswered thus far. On the one hand, there has been attention given to developments at the international level which has disregarded the determinants of domestic (crisis) policy-making. On the other hand, fiscal policy has mainly been scrutinised with regard to its effects. This has taken the composition of fiscal consolidation out of consideration.

2.3. Wrap-up: Unwilling to adjust—or unwilling?

To sum up, there exists a large variety of CPE perspectives on the processes of preference formation and the potential of economic actors to influence policy-making. Each of these perspectives to different degrees incorporate interests, institutions, and ideas as explanatory factors. What they have in common, however, is that none of them states that implementing fiscal consolidation is an easy endeavour. Actors that profit from welfare and other forms of state spending constitute powerful constituencies which develop the political influence to obstruct certain cuts. The (external) pressure to adjust plays out differently in different national models of capitalism and does not automatically result in a form of neoliberal convergence. Especially in small European states, governments may want to try to negotiate an adjustment strategy and consult a wide range of economic actor groups. The success of fiscal consolidation also depends on the structure of the budgeting process or on the political system more generally. Finally, governments may refrain from implementing harsh adjustment measures because of the fear of being punished at the polls.

These factors make the analysis of the EAPs particularly worthwhile. If there are enough financial resources, increased state spending in favour of one group does not necessarily imply a disadvantage for others. In times of austerity, however, resources are scant and 'politics take on the character of a zero-sum game, which sharpens distributional conflict' (Häusermann, 2010: 81). This holds especially true when an adjustment programme puts virtually every budget item to the test. In order to not to waste political capital on battles they cannot win, actor groups then must decide on which policies they want to focus on.

I analyse the dynamics of political contestation by focussing on the processes and institutions which allow different economic actors groups to assert their fiscal policy preferences. Although institutions play an important role for my analysis, I take a less long-term approach than proponents of historical institutionalism would. I also depart from VoC's focus on supply-side institutions and rely on the recently developed growth model perspective. Despite the considerable influence of international financial market actors, I see domestic politics as decisive and thus subscribe to arguments that disagree with the supposedly inescapable convergence of national models of capitalism. I draw upon the literature on corporatism and social concertation and intend to show that this approach of small states to the management of external challenges is still relevant. Here, I take a stance that is clearly rooted in the CPE literature, but not highly

formalised or purely quantitative. Rather, I am providing an in-depth study of two cases. Before turning to the empirical analysis, the next chapter spells out my analytical framework in more detail.

Chapter three: Analytical framework

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The constrained coalitions approach

3.1. The object of investigation: Fiscal policy

To analyse policy-choice, we need to develop 'a typology of policy alternatives' (Gourevitch, 1986: 35). This subchapter therefore provides a more detailed definition of fiscal policy. Section one conceptualises fiscal policy as a government activity that manages the economy to meet different objectives. Second, I describe the budget process in more detail, that is how fiscal policy is planned, decided, and implemented. I then illustrate the potential short- and long-term effects of government spending and revenues. In section four, I show why and when governments are forced to adjust state finances. The final section concludes by comparing two ideal-typical strategies of fiscal adjustment, which are either based on expenditure cuts or revenue increases.

3.1.1. Fiscal policy as a government activity

Most fundamentally, fiscal policy refers to the management of the economy by means of government revenues and expenditures. Besides monetary policy, fiscal policy is the main tool for managing the macroeconomy (Hallerberg, 2004: 2). Since the eurozone countries have delegated monetary policy to an independent ECB, the budget is the most important economic policy decision to be made by national governments and parliaments. Fiscal policy is traditionally viewed as having three functions, namely allocation, distribution, and stabilisation (Gaspar et al., 2017: 5). The first function refers to efficient use and allocation of resources. Here, fiscal policy assigns financial resources to different parts of the economy and thus 'influences industrial organization as well as output on the firm and sectoral level' (Haffert and Mertens, 2019: 5). The second function entails the redistribution of wealth and other resources in order to achieve higher levels of economic equality. Finally, fiscal policy attempts to stabilise different elements of the economy—for example, prices or the level of employment—notably to counteract recessions. These three objectives do not only have economic but also political implications—and societies prioritise them differently. When it comes to spending public resources, it is a political decision which sectors of the economy and what segments of society are to profit and which ones may be ignored when allocating resources. It is at least as controversial which level of inequality is deemed to be acceptable in an economy. The same applies to discussions about how much, to which precise end, and at which cost governments should intervene in the economy. With regard to the revenue side of fiscal policy, governments have to take decisions which are likely to be equally contested, namely decisions 'about the *level* of revenue collect-

ed, the *form* of revenue collection (i.e. income, capital, consumption and property) and the degree of *progressivity*' (Martin 2015: 35). All these decisions are political. In the end, it comes down to deciding which parts of society are to be burdened with taxes, and which parts of society are to benefit from spending.

Irrespective of country-specific peculiarities, the domestic budget processes can typically be divided into three different phases, namely planning, adoption and implementation (Hallerberg et al., 2009: 53-56). First, a budget needs to be drafted and planned. During this phase, econometric forecasts are used to project future spending and revenues in relation to economic growth and other economic key figures. Resources are allocated to different ministries, which then may spend them to different ends. Some of those budget items—expenditures as well as revenues—are discretionary, while others are not. Usually, budgets are planned not only for one year but consist of 'multiyear policy packages involving immediate policy changes, announcements for the future, and implementation of past announcements' (Alesina et al., 2019). For the decision-making phase, these plans and forecasts are translated into a budget law that the government then presents to parliament. Here, it is subject to more or less extensive negotiations and public debates between governing and opposition parties. The degree to which the latter are granted a say in this process vary. In any case, the budget must usually be adopted in parliament. In other cases, parliament can reject or demand revisions of the budget law before eventually adopting it. Finally, when the budget has been passed by parliament, it has to be executed and adhered to by the government and its ministries and agencies, which have different degrees of autonomy in doing so. Over the course of the implementation phase, the budget may be amended by modifying or adding new measures in the event of unforeseen crises or when spending and revenue forecasts have to be adjusted (Hallerberg et al., 2009: 55).

Fiscal policy has short- and long-term effects on the economy. How these effects are assumed to work, and how they are evaluated is a controversial question (see, for example, Alesina and Ardagna, 2010; Romer and Romer, 2018). Its answer is a result of often ideological disputes between the proponents of more extensive state intervention in the economy and those which argue for the government to exercise restraint. In any case, fiscal policy can be either expansionary or contractionary. Expansionary fiscal policy is based on higher expenditures and/or lower taxes and aims at stimulating economic activity and investment by increasing the disposable income of consumers or by cutting corporate taxes. Contractionary fiscal policy, by contrast, is based on expenditure cuts and/or revenue increases in order to dampen economic activity. Budgets can be either counter-cyclical—that is, running deficits to finance spending hikes during recessions and running surpluses during boom phases—or pro-cyclical. A portion of fiscal policy is always counter-cyclical. This is the case when so-called automatic stabilisers are operating, for example when unemployment insurance expenditures automatically increase during an economic downturn. In the long-term, expansionary fiscal policy tends to increase domestic prices and therefore to result in an appreciation of the exchange rate (Frieden, 1991: 448). This effect potentially impairs the international competitiveness of an economy. Depending on how it is financed and how it redistributes wealth, fiscal policy in the long-term also positively or negatively affects economic inequality. Although there are examples of long-standing budgetary surpluses, governments run deficits more often than not (Haffert, 2019). This is

not necessarily a problem, as long as the accumulated debt grows at a lower rate than the economy, thus keeping the ratio of debt to gross domestic product (GDP) in check.

Mounting sovereign debt has two implications. Although policy-makers may try to delay it as long as possible, at a certain point fiscal adjustment may become inevitable (Barta, 2018; Walter, 2013). Nevertheless, it is hotly debated if and how high public debt levels impede economic growth. This debate gained prominence over the course of the eurozone crisis, when an analysis by Reinhart and Rogoff (2010) found a relationship between high levels of public debt and economic growth, which was later cited as a justification for austerity (Amann and Middleditch, 2020).

Policy-makers are incentivised to delay harsh adjustment measures, because their electorate may be vulnerable to them (Walter, 2013, 2016), because they are facing elections in the near future (Lütz et al., 2019b), when fiscal policy is especially polarized (Barta, 2018), or as the result of a 'war of attrition' between different socioeconomic groups (Alesina and Drazen, 1991). However, at a certain point, fiscal adjustment becomes inevitable. When this point is reached, it is the result of an interplay between domestic and international factors. This holds especially true in the context of the eurozone crisis, where fiscal and balance-of-payment crises in several countries met panicked international markets (De Grauwe and Ji, 2012, 2013). In any case, mounting debt and persistent national deficits stem from the interaction of three factors. First, they can be the result of governments continuously running excessive deficits and thus allowing sovereign debt to constantly increase over long periods of time (Barta, 2018: 11). Second, an economic downturn can also significantly damage public finances. During an economic crisis, automatic stabilisers put pressure on state spending whereas revenues collapse. Finally, deficits can also arise when revenues or spending turn out to be worse than expected, for example when the tax system is based on indirect consumption taxes and domestic consumption suffers a setback. If a country does not want to default, there are two ways to reduce national indebtedness. Since debt is usually accounted for as a percentage of a country's GDP, a government can either attempt to increase its GDP or reduce its debt pile. The former needs growth rates to be higher than the costs of servicing debt. This requires an economic environment that allows for economic expansion. Alternatively, a government can turn to austerity—or internal adjustment—which means cutting expenditures and/or increasing revenues.

3.1.2. How do countries adjust? Expenditure cuts and revenue increases

A national deficit occurs when a government's budget balance—that is, the difference between revenues and spending—is negative. Deficits that are not closed immediately are financed by issuing bonds and finding investors who buy them. Governments pay an interest on these bonds. The interest depends on the duration of the bond and on the investors' assessment of the risks attached to it. Taken together, these liabilities form a government's debt. Both deficit as well as debt are usually represented as their share of GDP. It follows that governments have two options when they want to bring down the public deficit. They can either choose an adjustment strategy based on expenditure cuts or an adjustment strategy based

on revenue increases. De facto, there is usually a mix of both strategies being employed. Fiscal policy is not the result of perfectly well-planned long-term processes that lead to a specific adjustment strategy. More often, short-term compromises determine the composition of fiscal consolidation (Alesina et al., 2019: 65). Still, fiscal adjustment strategies can be differentiated by means of their focus, meaning if they are *primarily* based on expenditure cuts or on revenue increases. That being said, fiscal adjustment strategies have to be set apart from fiscal-structural reforms. Fiscal adjustment refers to only those measures which—immediately or over time—*directly* affect the public deficit. Fiscal structural measures, by contrast, refer to reforms such as streamlining or centralising the budget process, strengthening the competences of the minister of finance, or establishing a supervisory fiscal council. Even if these kinds of fiscal institutions can be assumed to have an effect on budgetary outcomes, they do so only *indirectly*. Measures of this kind affect budgetary and fiscal discipline and their effectiveness is closely related to the political system they are supposed to operate in (Hallerberg et al., 2009; Hallerberg and Yläoutinen, 2010).

Fiscal policy involves different kinds of expenditures and revenues. Expenditures can be classified into three categories: current spending, capital spending, and transfers (Alesina et al., 2019: 25). The latter refers to transfer to the private sector and especially welfare state spending, such as unemployment benefits or social security. The main difference between current and capital spending is the implied timeframe. Current spending refers to short-term spending, for example, on public sector wages. Capital spending, by contrast, involves long-term investment in infrastructure and other assets. Government revenues can be categorised equally broadly. The OECD (2011a: 61), for example, distinguishes taxes and social contributions. Grants and other revenues represent a third category which is, however, relevant only in states whose revenues rely to a large extent on natural resources or commodities. Generally, taxes other than social contributions constitute the bigger part of state revenues—although this varies from state to state. Taxes can be levied either directly or indirectly. The textbook example of a direct tax is the personal income tax which an individual immediately pays to the state on its income. In contrast, the value-added tax (VAT) on consumption, for example, is an indirect tax collected by the owner of a store or similar entity and then later paid to the state. Most commonly, taxes are levied on income and profits, social security, payroll, property, and goods and services.

Finally, individual spending or revenue measures affect the deficit over varying time horizons. When it comes to deficit reduction, policies that have a permanent effect over the long-term such as permanent pension cuts or a VAT increase are most sustainable. Such measures, however, can also be temporary, in that they expire at a certain point in time or are taken back later. Finally, one-off measures are usually not the preferred option when government deficits are to be cut sustainably. However, sometimes government resort to one-off cuts—such as a one-time levy on personal income or pensions—or one-off revenue increases, as in the sale of a licence or privatisation. Fiscal adjustment strategies do not necessarily have to be based exclusively on either expenditure cuts or revenue increases. They can be depicted on a continuum; indeed, fiscal adjustment is mostly based on a mix of both. They are also dynamic. Over time, a government may change its approach due to changed economic circumstances or increasing domestic

opposition. Different adjustment strategies allocate resources differently and have varying effects on the economy and on redistribution. Thus, the next subchapter will show both that and how expenditure cuts and revenue increases meet the policy demand of some social actor groups while being at odds with others.

3.2. The explanation: The constrained coalitions approach and its elements

The previous subchapter established fiscal policy as a central government activity and described the technicalities of budgeting, as well as the potential effects of fiscal policy on the economy. In principle, governments can choose from a broad set of potential alternatives when they bring about fiscal policies. Economic crises drastically reduce the set of feasible policies. At a certain point, fiscal adjustment becomes inevitable. Irrespective of the necessity to adjust, politicians must take two key decisions. First, how should the burden of adjustment be distributed within society? Second, should fiscal adjustment measures focus more on government expenditures or on public revenues? Questions of redistribution and the choice between expenditure cuts and revenue increases are intertwined in that both can be designed in ways that spare some societal groups while hurting others.

Taking these considerations into account, I develop a theoretical framework here to explain 'choice among policy alternatives' (Gourevitch, 1986: 35). Policy-making processes can be conceptualised as the interplay of policy supply and policy demand (Beramendi et al., 2015: 2). Policy supply describes strategically behaving politicians offering suitable solutions to a political problem. Policy demand refers to societal actors expressing their preferences with respect to those solutions. To assert their preferences, actors whose interests coincide form coalitions. These processes take place within a context of external constraints: global financial markets affect the range of policy supply as well as the assertiveness of policy demands.

In this subchapter, I describe the individual elements of my approach in greater detail. Policy supply must contribute to meeting the requirements of fiscal adjustment, and ultimately fulfilling programme targets. But its implementation must also be politically feasible, that is, it has to meet domestic policy demand. To understand the latter, it is necessary to identify relevant actor groups and their preferences. I start by identifying capital and labour as the most important economic and societal actor groups. When it comes to fiscal policy, these two groups can be assumed to be mutually antagonistic. Simply put, capital prefers lower taxes, whereas labour has preferences for larger spending. Within sectors, however, there is also potential for preference to line up across classes. For example, workers and employers in the exporting sector of the economy may view their international competitiveness impeded by higher government spending which, on the other hand, benefits sheltered sectors.

But simply mapping policy supply and demand is not enough to explain policy-choice. Policy-makers need societal support to implement controversial fiscal adjustment measures. To be sure, group-based preferences do not automatically translate into policies. This is where social coalitions come into play. Social coalitions are formed by individual actors or groups whose preferences are similar enough to pool forces in order to support or oppose a certain policy—or even an entire adjustment strategy. In the resulting political contestation, long-established traditional coalitions and those representing the main sectors of the economy have the best chances to prevail.

Without being directly involved in these processes, global financial markets have a considerable bearing on domestic policy-making. Rising bond yields and downgraded credit ratings increase the adjustment pressure on governments. Often these developments are the result of global financial market actors assessing ongoing or announced fiscal adjustment measures, thus rendering some policy-choices more viable than others. Increasing capital mobility may also tilt the domestic balance of power in favour of capital as opposed to labour. Therefore, financial market actors can be assumed to reward spending cuts while being sceptical towards revenue increases.

The remainder of this subchapter is divided into six sections, each revolving around a specific aspect of my theoretical framework. Section one illustrates which policy solutions (regarding the problem of fiscal adjustment) governments can generally consider as viable in light of domestic and international constraints. Second, I identify the relevant societal actor groups that constrain policy-making on the domestic level. I then spell out the foundations of their fiscal policy preferences. Fourth, I argue why policy-makers need the support of social coalitions, how they are formed, and what factors determine which coalitions eventually prevail. Fifth, I show how global financial markets limit domestic policy-making. A final section concludes.

3.2.1. Political supply: Governments as constrained strategic actors

The term *policy supply* refers to the policy alternatives a government realistically might be able to implement (Beramendi et al., 2015: 24). In so doing, governments are directly constrained by coalitions of domestic actor groups and indirectly by international financial market actors. If they want to resolve the fiscal problem without jeopardising their chances to get re-elected, governments need to strategically approach both constraints. When a government requests financial assistance, it knows that the number of fiscal tools at its disposal is going to be limited. Most obviously, this means it will not be able to deploy fiscal expansion to aid its ailing domestic economy. Rather, it is forced to reduce spending or increase revenues in order to eventually close the national deficit.

A borrower government's adjustment strategy is negotiated with and must be approved by its international lenders. Furthermore, the borrower government is under close scrutiny by international financial market actors. Both actor groups regularly review the government's efforts to consolidate its state finances. On

the domestic level, governments may face opposition to their planned adjustment measures by some economic actor groups. At the same time, other economic actor groups may also publicly support some measures or demand alternatives.

On both levels, chiefs of government may aim for striking political deals. This means that, at the international level, politicians can ask for concessions with regard to one set of measures by proposing alternatives or overachieving the targets in another policy-area. Entering into negotiations with domestic actor groups, government leaders may win over those actors whose consent is crucial by compensating them to ensure that a specific measure is eventually applied. Compensation has been identified as a valuable means for small states to safeguard political stability when faced with increasing exposition to world markets (Katzenstein, 1985) and can also serve as a feasible strategy when dealing with external adjustment pressure. Domestic actor groups can be convinced to accept one measure in exchange for another measure being dropped or being promised direct compensation in the near future, when additional funding is available again after programme exit. Finally, policy-makers can attempt to 'engineer' coalitions (Häusermann, 2010) and to forge alliances by designing adjustment proposals in a way that aligns the goals of some actor groups with those of others.

3.2.2. Actors: Who are they?

3.2.2.1. Labour and capital: Low- and high-income groups

Fiscal policy affects everybody. Individual voters are directly affected by fiscal policy in at least one of two ways. First, most members of society pay taxes. Revenue increases—e.g. in the form of tax hikes or increased fees or social security contributions—therefore directly decreasing the disposable income of taxpayers. Second, many citizens are direct or indirect recipients of state spending. Thus, when government transfers and other expenditures are cut, this also diminishes disposable income for a potentially large group of beneficiaries. In many cases, both consequences are relevant. The indirect long-term effects of fiscal policy have equally important implications not only for society as a whole but also for individual voters.

However, fiscal policy does not affect everyone equally. This holds true not only on the individual level, but also on the societal level. Social groups are the building blocks of what I described earlier as policy demand. It goes without saying that individual voters have significant political influence via elections. But they can be conceptually subsumed under broad groups representing different social strata. The most basic conceptualisation of social groups is class-based and distinguishes between labour (workers and employees) and capital (business owners and other employers). It can be argued that labour and capital can be affected differently by and therefore have distinct fiscal policy preferences.

Furthermore, capital and labour form different organisations to represent their interests and have an ideological proximity to different political parties. Most fundamentally, workers arguably face higher economic

risk over their lifetime and tend to have lower resources individually (Korpi, 2006: 168). As a result, they seek government activity in the form of social policy to alleviate those risks. Employers are expected to reject these demands since social policy programmes usually are financed by taxes on wages or by social security contributions. This in turn increases labour costs, thereby reducing profits (Paster, 2015: 19). Consequently, labour—and other members of low-income groups—prefer an activist and interventionist state which redistributes wealth. Whereas capital owners, and other members of high-income groups, prefer a smaller state and tend to refuse redistribution (Lierse, 2012: 212). In terms of state revenues, lower income groups are assumed to favour progressive taxes, which stands in contrast to higher income groups and their preferences for regressive taxes (Haffert and Mertens, 2019: 3).

'The asymmetric distribution of power resources in capitalist society' (Bradley et al., 2003: 197) initially provides capital with a privileged position in the market as well as in politics. However, depending on the national context, labour organising in trade unions may rebalance this disparity and counteract the political clout of capital owners and their business associations. These arguments also expand to the area of class-based party politics, where there are ideological linkages between labour, social-democratic, other left parties. Conservative and other right-wing parties, on the other hand, have closer (ideological) connections to higher income groups and thus are much more reluctant when it comes to intervening in the economy (Garrett, 1995, 1998a).

3.2.2.2. Global financial market actors: FDI and other investors

Globalisation and increased capital mobility have arguably changed the political and economic calculus of domestic policy-makers and economic actor groups. The bearers of mobile assets can exert political power by threatening to defect to another jurisdiction in case the local tax load supposedly becomes too high (Bates and Lien, 1985). Global financial market actors undoubtedly wield influence on domestic policy-making and even more so when a country is under severe fiscal stress. However, there is an important difference between two distinct sets of global financial market actors. Multinational corporations and other providers of foreign direct investment can be assumed to be more heavily involved in the domestic politics of their investment destinations than international financial market actors. The latter describes investors in government bonds and other assets who take a more short-term perspective. They usually 'consider only a small set of government policies when deciding how to allocate their assets' (Mosley, 2000: 737). But during the crisis, global financial market actors put all eurozone member states—and especially those implementing an adjustment programme—under much closer scrutiny. When I make an explicit distinction between those two groups, in the following I term those actors who invest only in government bonds or other assets and bonds as 'global financial market actors'. I distinguish them from international investors that invest in an existing or creating a new domestic business entity—so-called 'green-field investment'. The latter I term 'direct investors', or I refer to them with the term 'FDI'. When referring more generally to both groups, I use the term 'international investors'.

To sum up, I argue that labour and capital are the prevalent societal actor groups that influence fiscal policy-making. As shown in the next section, however, economic preferences are not solely based on class but can also be distributed according to economic sectors. Moreover, domestic policy-making is also affected by international investors. Depending on the scope of their investment, these actors have more or less detailed preferences for specific fiscal policies as well.

3.2.3. Political demand: What do they want?

The distinction between labour and capital is the starting point for further considerations about the fiscal policy preferences of influential social actor groups. In this section, I derive and describe the preferences of these actor groups based on their position in the economy and the effects fiscal policy has on them. I start with the direct effects of fiscal policy as an instrument of redistribution. I then proceed to open up the dichotomous class-based approach. I acknowledge that there is also potential for preference overlap across classes and potential for conflicts between sectors and elaborate on the role of international investors. Finally, I show how developments on the international or global stage can impact preference formation domestically. I start, however, with some more general reflections on the formation of economic preferences.

3.2.3.1. A short primer on economic preference formation

As is to be expected, no one enjoys bearing adjustment costs, especially not by themselves. Actors may be indifferent to spending cuts or revenue increases—or more generally, to the composition of fiscal adjustment—as long as they affect others. As evident as that may be, both scenarios seem to be unrealistic, especially when deficit reduction is as profound as it was during the eurozone crisis. Ultimately, it is in the hands of the respective government leader to decide on the specific fiscal adjustment strategy and which actor groups to burden and which to spare. In doing so, they meet the preferences of some actor groups and ignore or neglect others.

As I will show below, these preferences analytically can be 'linked to salient political cleavages' (Cusack et al., 2006: 366). Support for or opposition to a specific adjustment strategy cannot only be attributed to individuals but to actor groups. I argue that most measures, on overage, affect members of one actor group in a similar way and much differently than the members of other groups. For each group, it is possible to identify a preferred adjustment strategy. Such a preferred adjustment strategy has two elements. The first aspect concerns those fiscal policies which are supposed to be maintained. This implies the structure of government spending and state revenues, which both may directly benefit a certain group. The second aspect relates to preferences regarding which other groups should be burdened instead and contribute to fiscal adjustment. Must fundamentally, this subchapter provides answers to the questions of what different actor groups want the state to spend its money on and to how these groups prefer this spending to be funded.

3.2.3.2. Fiscal policy, redistribution, and risk insurance: Class-based preferences

Labour and capital are have different amounts of resources and they prefer different macroeconomic policy goals to be realised by the political parties that represent their interests. The basic argument is that (material) inequality in capitalist societies is the outcome of a redistributive conflict between labour (low-income groups) and capital (high-income groups). The distribution of power resources determines who prevails in this conflict. However, the endowment of capital implicates a privileged and unique position 'because it is concentrated in the hands of the few' (Bradley et al., 2003: 197). This results in an asymmetry of power in society. Labour now has two ways to organise itself in order to tilt this balance of power in its own favour. First, it can pool forces in trade unions to directly engage with capital in the market; and secondly, labour can organise in political parties which represent and assert its interests in the political realm.

Labour's main interest lies in decommodification, that is to be able to 'command resources and access to welfare independently of market exchange' (Esping-Andersen, 1985: 31). Only when this is ensured to a certain degree, can labour strive for further concessions from capital without having to fear immediate negative repercussions. Although trade unions and other labour organisations may cater to social services, such as unemployment or health insurance themselves, a public welfare state is the primary means to achieve decommodification. In addition to that, the welfare state is also a means of income redistribution, especially when it is funded by taxes on capital and other levies that largely affect higher income strata. Higher government spending is argued to be opposed by business and other members of the capitalist class for the same reasons labour supports higher government spending. Decommodification reduces the dependence of workers on wage labour which in turn increases reservation wages. Government spending, in the form of social policy, therefore reduces the authority employers can wield over workers (Paster, 2015: 10). What is more, higher reservation wages are 'especially problematic for profits' (Korpi, 2006: 199). This effect is aggravated when funding the welfare state also weighs heavily on profits.

Political parties mediate the public articulation of preferences (Huber and Stephens, 2001: 17). In this reading, political parties act as the vehicles of class-based preferences (Hibbs, 1977: 1467). Left-wing, and especially social democratic parties are ideologically and politically close to labour (Esping-Andersen, 1985; Garrett, 1998b), whereas conservative parties and other right-wing parties are supposed to represent the interests of capital and those who are materially better off.

Parties therefore pursue different macroeconomic policy goals. The most important one for labour and its social democratic allies is the promotion of employment. Unemployment is largely an issue of the working class, and does not only imply material hardship. High unemployment also negatively affects labour's political clout as it increases the dependency of individual workers on paid work. As already discussed, the latter problem can be tackled by a well-funded welfare state. However, these interests are at odds with the preferences of employers. Conservative parties therefore can be expected to advocate different policy goals. From their perspective, a system of unemployment insurance which is supposedly too generous may not only keep workers from taking up unattractive jobs, but it may also generally affect the price-level

of wages. The latter impairs price stability, which is an important interest of capitalists, as inflation is arguably especially problematic for high-income groups (Rueda, 2005: 63).

These considerations can be extended to state spending as an instrument of redistribution more generally. Not only do left- and right-wing parties differ in relation to the extent of redistribution they are willing to support or allow. They also differ regarding how redistribution is to be financed. I will turn to this issue in more detail below. For now, it suffices to say that left-wing parties tend to tax high-income members of society as well as corporations and other capital-intensive activities. Right-wing parties, however, can be expected to seek to reduce these kind of financial burdens which weigh on their core constituencies (Hallerberg and Basinger, 1998: 337-338). Taxation for left-wing parties therefore is not only an instrument to finance state activities, but it also serves as a more general means of redistribution. That is, left-wing governments are usually 'associated with increases in public expenditures, especially in public transfers, and, thus, they are also associated to revenue-based strategies of adjustment' (Mulas-Granados, 2006: 205). This echoes the different growth strategies identified by Quinn and Shapiro (1991), namely that left-wing parties tend to support growth driven by (public) consumption, while the growth strategies of right-wing parties are based on investment (see also Boix, 1998). Whereas the former strategy requires higher state spending and lower taxes on consumption, the latter implies lower taxes on capital to incentivise investment.

To conclude, labour and capital can be conceptualised as political antagonists with conflicting macroeconomic policy demands. Applying this line of reasoning to the issue of fiscal policy, the following expectations can be formulated. Labour fundamentally prefers higher levels of state spending, and capital a lower tax burden. When fiscal adjustment is inevitable, labour is therefore more likely to support adjustment based on revenue increases, especially in the form taxes on capital and other taxes that put the burden on high-income groups. Capital, by contrast, is more likely to support adjustment based on expenditure cuts, especially in the area of social policy. If there is any fiscal wiggle room to induce growth, labour can be expected to strive for expenditures that buttress consumption as opposed to the investment incentives preferred by capital.

Government spending in general, and welfare state spending in particular, does not only redistribute wealth but it also has an insurance function. Preferences for redistribution are not solely determined by class affiliation or by the distribution of income in a society (Kenworthy and McCall, 2008), but also by an actor's or a group's exposure to economic risks (Cusack et al., 2006). Workers and low-income groups, as well as businesses, are all subjected to economic risks, albeit that they take different shapes.

There are various sources of risk in capitalist societies, but I will focus here on two that are perhaps the most relevant as they are especially prevalent in small open economies (Rehm, 2016: 5). First, globalisation, as the integration of the domestic into global markets, poses a risk especially to those economic actors who are likely to lose out to international competition. Second, de-industrialisation also increases the demand for risk insurance, especially since skills that correspond to industrial manufacturing work are not

easily transferable to the growing services sector. What globalisation and de-industrialisation have in common is that they amplify differences between mobile and immobile actor groups (Rodrik, 1997: 4). These two developments primarily affect low-skilled workers and those engaged in industries which are exposed to international (price-)competition. Lower skills are not only associated with a higher risk of being unemployed, but also with lower earnings (Rehm, 2016: 27; see also Swank, 2002: 39). Finally, 'low-skill workers in high-skill economies […] suffer most from globalization' (Dancygier and Walter, 2015: 134).

Globalisation has increased demand for state intervention. Governments deploy a series of policies in order to protect their economies from risks that stem from the exposure to global competition or to at least provide compensation for these risks (Cameron, 1978: 1260; Garrett and Mitchell, 2001). Integration into world markets—for goods and services as well as for capital—increases insecurity and volatility on domestic markets (Iversen and Cusack, 2000: 317). Companies may be put out of business by cheaper or better competition from other countries. Workers may lose their jobs due to outsourcing to countries with lower wages. Finally, small open economies are also more exposed to changes in global market sentiment. As a result, actors that these processes negatively impact may ask for state intervention to compensate for their losses or to at least mitigate their effects. Government spending insulates them from global markets and protects them against external shocks as it increases the state's share in the economy (Rodrik, 1998: 1011). In particular, this pertains to small open economies, which have no control over the international markets they are exposed to (Katzenstein, 1985). Since government spending provides direct support to those who can be expected to lose out the most from globalisation, it also has a politically stabilising effect. By redistributing economic wealth, as well as risk, governments may be able to mute domestic opposition to globalisation by those affected most by it. In doing so, compensating for the negative repercussions from free markets may have the side effect of increasing political support for them (Garrett, 1998a; Garrett and Mitchell, 2001). Demands for compensation may come from workers as well as from businesses. For the former, the welfare state is the most important instrument of risk insurance. Businesses may also turn to the state to protect their economic position when they are exposed to international competition. Especially businesses whose investments are specific to a particular location are more likely to turn to the state for protection (Iversen, 2005: 10; Alt et al., 1999). The same holds true for businesses located in exposed sectors that face declining demand (Frieden and Rogowski, 1996: 41).

De-industrialisation also increases labour market and other economic risks. Whereas in the years after the Second World War where agriculture and industry dominated European economies, the services sector has steadily gained in importance since the 1960s. Changes in the employment structure associated with this development have increased demand for government spending for two reasons (Cusack et al., 2006; Iversen, 2001). First, although this shift has taken place at varying speeds and scopes in different countries, it has resulted in massive labour market dislocations comparable to those caused by globalisation. Second, it increases labour market risks because skills acquired for works in the industrial (and the agricultural) sector are not easily transferable to the service sector, or at least only with considerable drawbacks

regarding pay and labour market power (Iversen, 2005). Reacting to these changes, governments face a trilemma 'between budgetary restraint, income equality, and employment growth' (Iversen and Wren, 1998: 508). Given the productivity gap between manufacturing and most services (Wren et al., 2013), employment growth in the services sector can only be achieved at the cost of higher levels of (wage) inequality. Since there is only limited potential for productivity gains, lower wages become the most important driver of the employment generation in the services sectors (Iversen and Wren, 1998: 512). Governments can counteract this development and employ workers in the public sector at comparatively high wages (Iversen and Wren, 1998: 513). However, this approach impedes budgetary restraint. Policies that attempt to reduce economic risks, resulting from de-industrialisation, are most likely to attract support from workers with lower skills and incomes. Meaning, these workers can be expected to prefer an adjustment strategy based on revenue increases which leaves risk-insuring spending policies intact. For them, insurance mechanisms in the form of state spending—for example, social benefits or unemployment insurance—are much more relevant than for their high-skilled counterparts. I will turn to these differences later in more detail. For now, it is important to note that the significance of the insurance function of state spending decreases as incomes increases. Workers with higher skills and correspondingly higher 'earnings-power in the market' (Häusermann et al., 2012: 228) benefit less from welfare state spending. This is because the difference between their market income and what they can expect to receive from the state—if they become unemployed—is relatively large (Wren and Rehm, 2014: 411). That is, they can be expected to have stronger preferences for lower state spending and taxes and, thus, for an adjustment strategy based on expenditure cuts.

To sum up, fiscal policy does not only redistribute wealth, but also insures against economic risks. These risks stem from two major developments, namely globalisation and de-industrialisation. The losers in both developments are likely to demand higher (welfare) state spending as a form of compensation or insurance against the risks they confront. Low-skilled workers, who have the most to lose from globalisation and de-industrialisation and also tend to have lower incomes, can therefore be expected to be the firmest supporters of a revenue-based adjustment strategy. Although both groups may request state spending to insure them against potential and compensate them for eventuating risks, there is still a difference between labour's preference for welfare state spending and capital's preferences for protectionism.

The discussion so far has established the argument that different social classes have different preferences when it comes to the redistributive and the insurance functions of fiscal policy. However, it has also shown that there is the possibility of similar preferences across classes and diverging preferences within classes. I will take account of both aspects in more detail below. But before doing so, I will first turn to how different economic actor groups prefer public expenditures to be financed.

There are two basic groups of economic actors when it comes to state spending. On the one hand, there are the net beneficiaries of government spending which, *ceteris paribus*, should be in favour of maintaining spending programmes. On the other hand, there are the net contributors to public revenues which, *ceteris paribus*, should advocate for cutting spending programmes. Regarding the net beneficiaries, this distinction

so far has been made based on class affiliation or risk exposure. Class-based considerations can also be taken as the starting point for thinking about preferences for or against specific revenue structures—for instance, based on direct against indirect or on progressive against regressive taxes. Furthermore, I here show that developments, such as the increasing mobility of capital that strengthens the political power of businesses, cannot completely be separated from processes of preference formation.

State revenues are no less controversial than government expenditures. To put it bluntly, 'people hate taxes' (Steinmo and Tolbert, 1998: 167). No one enjoys paying taxes and everyone tends to think that their tax burden is excessive. A closer look, however, reveals that tax structures differ significantly with regard to whom they affect most and how they govern the economy to different ends. Taxes are instruments of income distribution but also intervene with various degrees and in different ways in the economy.

First, taxes can be regressive or progressive. They are progressive when the tax rate, for example on personal income, increases as the taxable income increases. A regressive tax is doing the opposite, here the tax rate decreases as the amount of taxable increases. From the class-based perspective developed above, this implies that labour and low-income groups ought to strive for progressive taxation as it is more redistributive and puts the tax burden mainly on higher-income groups and capital. For the same reason, capital can be expected to endorse a regressive tax system that leaves the bulk of their wealth untouched. However, tax progression and regression is also influenced by what is being taxed. To take an obvious example, a levy on luxury cars would likely affect higher income strata almost exclusively. The general VAT, on the other hand, is much more regressive since those with lower incomes tend to spend a higher share of their income on consumption than high-income earners. Therefore, it should be 'the preferred tax of business as well as conservative and pro-business parties' (Haffert and Schulz, 2020: 439).

The VAT is a good example for the second aspect of taxes discussed here, namely that it has a potentially 'distortive' effect on markets, although this effect is assessed differently by labour and capital. From the latter's point of view, taxes intervene in market functions and create distortions that negatively affect the incentives of market participants. Market distortions may take different forms. For example, it can be argued that social security contributions reduce the incentives to provide or take up work if they are set too high. The general assumption is that capital opposes redistributive taxes because progressive tax systems and high levels of social policy spending are supposed to go hand-in-hand (Swank, 2002: 24). By contrast, consumption taxes are argued to be less distortive than taxes on personal income and especially corporate taxes (Johansson et al., 2008).

Third, taxes can either be collected on incomes and especially on corporate incomes and then be redistributed to lower incomes in order to boost consumption. Or a tax system can be designed in a way that it affects corporate profits only to a smaller extent and therefore creates incentives to invest. As I will detail below, capital's preferences are driven by two factors. On the one hand, companies exposed to international competition can argue that direct taxes on profits—but also taxes which increase labour costs and thus only indirectly affect profits—increase domestic prices and therefore in the long run impair the com-

petitiveness of domestic business as compared to its international competitors. On the other hand, capital can argue that direct taxation on corporate profits has more negative than positive effects on the economy as it may drive investors and business owners out of the country.

To conclude, I have argued so far that capital generally favours a smaller state—namely, lower government spending to be financed by lower taxes. However, there are more specific differences between the preferences of labour and capital when it comes to state revenues. They are, again, related to the redistribution of wealth and income. What is more, capital does not only oppose direct taxes on corporate profits or higher incomes. It also opposes labour's demand for low (indirect) consumption taxes. Capital's considerations here include the potential of taxes to distort markets and to disincentivise investment, but also the potential for international tax competition.

3.2.3.3. Fiscal policy and aggregate demand: Sectoral preferences

The story so far has been one of clear-cut class antagonisms. In this interpretation, it depends on labour's organisational strength if it is able to overcome capital and establish a strong welfare state based on high government expenditures and direct, redistributive taxes. If business managers then consent to social and other spending policies, they do so only unwillingly and because they lost out to labour. However, workers and employers do not only receive and finance government spending. They are also dependent on economic growth. Workers need jobs and wages. Employers need markets and consumers to sell their products. Fiscal policy indirectly affects the overall economy. Hence, economic policy preferences cannot only be derived from analysing differences in the endowment with production factors (labour versus capital). Sectoral differences also play an important role (Frieden, 1991: 436; Frieden and Rogowski, 1996; Frieden, 2002; Paster, 2012: 9-11; Iversen and Soskice, 2015b).

There are two major causes of conflicts between sectors that imply an alignment of preferences across classes. First, businesses which are exposed to international market pressure potentially have different fiscal policy preferences than those solely serving domestic markets. In other words, the business-owner and manager exposed to international competition 'often have more in common with their workers on issues of social investment than with inward-looking domestic producers' (Swank and Martin, 2001: 892). Second, de-industrialisation also implies potential for conflict because employers and employees in service sectors conceivably have different preferences than their counterparts in the traditional industrial sectors (Thelen, 2014: 25-26). Workers and business owners located in the same sector do not necessarily come to an agreement on the redistributive aspect of fiscal policy. However, they can be expected to agree on the allocational effect that fiscal policy has on the economic activities (such as trade or consumption) they rely on (Haffert and Mertens, 2019: 6).

Traditional manufacturing is usually conceptualised as representing the exposed sectors as a whole, whereas service sectors are usually understood as being principally sheltered from international competition (Blyth, 2003b). Yet, two developments cut across this understanding. First, as services are becoming increasingly traded, they cannot be automatically assumed to be sheltered from international competition. Second, skills also play a critical role when accounting for fiscal policy preferences as well as when it comes to the tradability of services. These complex interactions make it necessary to go beyond a simple class-based approach and further analyse the indirect effects of fiscal policy and how it pertains to different groups of economic actors in different sectors of the economy. This section therefore opens up the 'black box' of the aforementioned actor groups in order to draw a more complex picture and show when and how fiscal policy preferences may be sector-based and not solely class-based.

Developments at the global level affect the prosperity of domestic actor groups. At the same time, economic policies impact the ability of economic actor groups to compete on world markets. Since international competitiveness is not equally relevant for all sectors, it is realistic to view policy preferences as being based on sectoral considerations and not only on class affiliation (Frieden, 1991, 2002; Frieden and Rogowski, 1996). Exposed sectors are those sectors of the economy which produce tradable goods and services. As this and the following two sections will show, employers as well as workers located in the manufacturing and other exposed sectors have fiscal policy preferences that differ from those of their sheltered counterparts. What is more, the tradability of services correlates heavily with skill-levels. The latter therefore also has implications for the fiscal policy preferences of economic actor groups. The rapid development of information and communication technology in recent years has allowed high-skilled services—for example, finance, communication, or business consulting—to be provided across borders more easily (Wren, 2013; Wren and Rehm, 2013, 2014).

The classical approach of examining the impact of global developments on domestic politics and preferences is the Heckscher-Ohlin model of international trade. It focuses on the domestic scarcity or abundancy of factors and especially labour and capital (Frieden and Rogowski, 1996). It corresponds to the argumentation presented above, namely that economic policy preferences are class-based. However, it is perhaps more realistic to assume that international economic developments affect mainly sectoral actors rather than factor-based classes (Frieden, 1991: 436). Not all sectors are equally exposed to global markets. Those companies who produce goods to be exported—and those who work for these companies—are much more sensitive to price changes and other international trade indicators than those who produce solely for domestic markets.

The exchange rate heavily affects the competitiveness of the export sectors of a country. Fiscal policy, therefore, is relevant for those economic actors exposed to global markets as it affects the exchange rate (Alesina et al., 2019: 27). In essence, an expansionary fiscal policy results in the appreciation of the exchange rate (Frieden, 1991: 448). The same holds true for increased interest rates, actors in the exposed sectors view as 'raising the exchange rate and generating unemployment' (Iversen and Soskice, 2012: 47). Expansionary fiscal policy increases aggregate demand on the domestic level and thus increases domestic

prices. Furthermore, fiscal expansion needs to be financed. It has the potential to increase government borrowing and, hence, interest rates (Alesina et al., 2019: 27). As a result, governments in export-oriented economies tend to rely on a much tighter fiscal policy stance than economies where domestic consumption plays a more central role (Hope and Soskice, 2016). Given that public sector wages also impacts domestic prices, 'fiscal restraint has been important in holding down public-sector wages to avoid raising taxes' in those countries (Iversen and Soskice, 2012: 47). When they adopted the common currency, the eurozone's member states ceded political authority over two important instruments to improve their international competitiveness—namely, monetary policy and the ability to manipulate the exchange rate—and delegated it to the ECB. Arguably, this only elevated the importance of fiscal (and labour market) policy for exposed economic actor groups (Johnston and Regan, 2018; Perez and Matsaganis, 2019).

When it comes to fiscal adjustment, export-oriented economic actors consequently likely prefer expenditure cuts over revenue increases for several reasons. First, spending cuts, such as cuts to public sector wages, decrease the domestic price level as lower public consumption decreases domestic demand. Therefore, expenditure can be assumed to improve the international competitiveness of exporting industries and services. This benefits both employers as well as workers in the exposed sectors. Second, spending cuts tend to be more long-term than revenue increases because the latter does not affect policies that automatically increase entitlements, such as pensions (Alesina et al., 2019: 4). Spending cuts hence decrease market volatility and increase the predictability of price developments, which is especially important for the producers of traded goods. Third, 'firms in exposed sectors have greater difficulty passing wage costs on to consumers' (Martin and Swank, 2012: 229), which is another reason they oppose extensive government spending. The preferences of economic actors already involved in the production of export goods and services solidify over time, as those firms—and their employees—have a competitive advantage over firms that produce mainly for domestic markets but intend to expand their production globally. (Frieden and Rogowski, 1996: 39).

Of course, the public sector is clearly a sheltered one. Public administration, education, or welfare services are sheltered from the global economy in that they are not intended to be traded *per se*. This has two implications for my argument. On the one hand, a loss of international competitiveness does not concern public sector workers and employers—i.e. the government—as they are not dependent on producing their goods and services at internationally competitive prices. Hence, they are not affected by the potentially negative effect of increased government spending on the exchange rate. If anything, they view an increased exchange rate mainly as a decrease in import prices (Iversen and Soskice, 2012: 47). Secondly, the public sector profits directly from government spending, either in the form of higher wages or an expansion of public services. The latter may signal more public sector employment or more competencies for this sector. The same applies to workers located in sectors such as health or education. Although they are not necessarily employed directly in the public sector, they 'might nonetheless regard their employment and incomes as heavily dependent on government spending and subsidization' (Wren and Rehm, 2014: 430). Spending cuts mirror this kind of fiscal expansion and may come to bear on public sector workers.

This is because wage cuts and layoffs are an obvious means to reduce state expenses. Revenue increases, however, usually do not have a special effect on public sector workers. This holds especially true when, for example, public servants have their own scheme of social insurance and pensions.

Yet, the public sector is not the only sector sheltered from international competition. Most services—for example, accommodation, restaurants, or retail trade—are based on interpersonal interactions. Usually, the service's producer and its consumer must be physically present in the same room. Furthermore, the barriers to trading those services at all often are too high or trading them is just not profitable. As aforementioned, new information and communication technology has lowered these barriers for some of the more sophisticated services. But there is still a range of services which are not traded and therefore sheltered from international competition. Consequently, they do not thrive on global markets but rather on domestic demand. Prices, therefore, do not play the same role for sheltered sectors as they do for exposed sector companies and workers. Producers in sheltered sectors face only domestic price competition; they do not have to be aware of a potentially cheaper competitor from abroad. As a result, they can pass on wage costs and other costs more easily to their customers than their exposed counterparts (Martin and Swank, 2012: 229). They are therefore less averse to government spending and its potential to raise domestic prices. If anything, they profit from government spending as it potentially increases the disposable income of domestic consumers and thus boosts aggregate demand (Hope and Soskice, 2016: 222). This is even more the case for state spending that benefits the lower-income strata of society; they are prone to spend a larger share of their income than those with higher incomes.

It follows that producers and workers are likely to support those forms of fiscal adjustment which least harm disposable income, and therefore consumption. This applies to spending cuts as well as revenue increases. Fiscal adjustment has a high probability to suppress consumption. However, it can be designed in a way that moderates this effect. On the revenue side, increases of indirect taxes, such as the VAT, arguably do greater harm to consumption than direct taxes on production. Just as the preferences of their counterparts in the exposed sectors, the preferences of economic actors involved mostly in the production of domestically consumed goods and services are also likely to solidify over time. Not only do these actors profit from state spending, but they also face high adjustment costs when trying to produce for and compete in international markets. They therefore can be expected to 'to resist being thrown into the international marketplace' (Frieden and Rogowski, 1996: 39).

To sum up, employers and employees operating in sectors sheltered from the global markets, which produce goods and services chiefly for domestic consumption, have the tendency to prefer revenue increases to spending cuts when fiscal adjustment becomes inevitable. This is especially the case when state spending buttresses the income disposable to domestic consumer. However, not all revenue increases spare domestic consumption. Especially indirect taxes, such as the VAT, presumably meet opposition from economic actors located in sheltered sectors.

3.2.3.4. Skills and sectoral preferences

The rise of the post-industrial knowledge economy has significantly affected the dynamics of preference formation. Just as sector-based preferences can complement class-based preferences, skill-levels also influence economic interests. Three important trends have profoundly changed the role of different skill-groups in the economy since the 1970s (Wren and Rehm, 2013, 2014; see also Wren, 2013). First, the supply and demand of high-skilled workers with tertiary education has grown significantly. Second, high-skilled workers that used to work in sheltered sectors—mainly the public sector—are increasingly engaged in jobs exposed to international trade, especially traded services. Third, and in contrast to this, low- and medium-skilled workers used to be employed in manufacturing and other traditionally exposed sectors. As part of de-industrialisation trends in most advanced economies, this has changed in that those workers are now more likely to work in sheltered sectors—primarily nontraded services.

The services sector has not only gained in importance more generally, but services have also increasingly become traded internationally (Wren, 2013). Exposure to international trade has not affected all service workers equally (Wren and Rehm, 2013, 2014). 'Dynamic services', such as information and communication technology or finance and insurance, have become exposed to global markets and are provided mostly by high-skilled workers. By contrast, low-skilled workers mainly provide 'non-dynamic services', such as wholesale and retail trade, accommodation, and other personal services, which are still largely sheltered from international competition.

These developments have resulted in a growing disparity of preferences within the services sector. In general, high-skilled service workers face lower economic risks than their low-skilled counterparts. Thus, they profit much less than low-skilled workers from welfare state spending, while contributing a much higher amount in the form of taxes. Furthermore, higher taxes to support higher state spending also have the potential to impair the competitiveness of internationally traded services. The concern about international competitiveness is to some degree shared by lower-skilled workers in the traditionally export-oriented sectors. But the movement of low-skilled workers into nontraded services only reinforces their already strong preferences against welfare state retrenchment and other expenditure cuts (Wren and Rehm, 2013: 249). This development is paralleled by a move into traded services by higher skilled workers, which before had shared the (social) policy preferences of low-skilled workers to a certain degree (Wren and Rehm, 2014: 411).

As a result, the fiscal policy preferences of high- and low-skilled workers are in flux. High-skilled workers who move from sheltered sectors into traded services sectors likely also change their preferences to support spending cuts as opposed to revenue increases as a means of fiscal adjustment. Low-skilled workers which, by contrast, move from traditionally exporting sectors into sheltered services, can be expected to increasingly support revenue increases as opposed to spending cuts. Whereas these developments mainly reinforce the preferences of low-skilled workers, the change at the upper end of the skill spectrum is more

consequential. However, how pronounced these new skill-based dynamics are differs from country to country.

Skill-related arguments can also be made with regard to employers (Martin and Swank, 2012: 229-230). Companies in exposed sectors with a largely high-skilled workforce are not very likely to support state spending. There are two reasons why they cannot be expected to endorse broader welfare policies for lower-skilled workers. First, these firms are not dependent on low-skilled employees. And second, such spending runs the risk of impairing their competitiveness. On the other end of the skill-spectrum, in advanced economies there are only few companies left that rely mainly on low-skilled workers and still compete in international markets. These tasks usually have moved abroad. However, where such companies still exist, one than expect them to have class-based preferences while at the same time demanding (fiscal) protection by the state.

Firms in sheltered sectors with a largely low-skilled workforce have reasons to support state spending only when it boosts domestic consumption. However, those companies typically rely on low wages and highly flexible labour markets. Thus, it is rational for them to oppose forms of social spending that aim at changing these labour market conditions. In most countries, the government is the most important employer of high-skilled workers in sectors that are not exposed to international competition (Visser, 2019). When fiscal adjustment is inevitable, public-sector employers face a hard choice between giving in to demands of their employees and other groups in favour of revenue increases, and the demands of those social actors who would prefer expenditure cuts.

To conclude, skill-related arguments about fiscal policy preferences do not necessarily contradict sectoral or class-based arguments. However, changes in the skill-structure of most advanced economies still bring about new political dynamics that have significant implications for fiscal policy. An important group of supporters of higher levels of state spending—namely, high-skilled public sector workers—have steadily moved into sectors in favour of lower amounts of government spending. Here, their preferences correspond to those of their employers. At the same time, low-skilled workers from traditionally exposed sectors—particularly industry—are now increasingly located in sheltered service sectors. Thus, they are more likely to demand higher state spending. As a result, their preferences presumably are at odds with the preferences of their employers.

3.2.3.5. The difference between FDI and other investors: The political demands of global financial market actors

As this section will show, investors are generally like-minded when it comes to their fiscal policy preferences. They demand stability and predictable policies and prefer credible political signals and expenditure cuts over revenue increases. This policy stance is shared by the troika institutions which have similar preferences for expenditure-based adjustment. However, investors buying government bonds and other global financial market actors are usually less involved in domestic politics than those who directly invest in an

economy. For this reasons, it has been said that the latter group has more complex and contextual preferences than the former (Shambaugh, 2004: 285-286; Garrett, 1998a: 804).

If global financial market actors invest in a country's bonds or economy, the value of their investment depends not only on economic conditions but also on domestic economic and fiscal policy. The policies and activities of a government have 'a significant impact, directly and indirectly, upon the costs of doing business, the incentives of private investors, and the information environment in which investors operate' (Sobel, 1999: 38-39). When a government alters its policy stance, this impacts the calculations of investors. In some cases, the impact on the investors' costs and benefits may be negligible. In other cases, domestic policy changes—or the absence of them—may force investors to reappraise and shift their engagement to other areas. Especially in times of financial crises, this involves costs or even losses. This is one of the reasons why investors prefer credible policy signals by domestic governments. Investors usually dislike volatility and unpredictability. This holds true not only for sudden and significant fluctuations in exchange rates (Frieden, 1991: 444-445; 2002: 839) but also for domestic policy. Investors are therefore interested in and pressure for credible policy signals which reduce uncertainty in that they 'stabilize expectations and reduce the political component of risk' (Sobel, 1999: 43).

Credible signals are not sufficient, if the policies signalled do not correspond to what investors demand with regard to fiscal policy. The assumptions made above on domestic preferences can be extended to capital's counterparts at the international level. If a government increases spending, or at least does not cut it down, this increases labour costs, profits and investments decline, and 'investment declines as well' (Alesina et al., 2002: 572). Fiscal adjustment based on revenue increases does not adequately address the concerns of international investors because they fear that constant tax increases would become necessary to match the continuing increase of expenditures (Alesina et al., 2019: 114). From this perspective, adjustment plans which chiefly rely on expenditure cuts, increase the confidence of investors and are more likely to meet their preferences.

The expectations formulated above hold true for both groups of investors: direct investors and those solely invested in government bonds or other assets. However, as mentioned, international investors differ with respect to how much they are affected by and involved in domestic politics. Global financial market actors discriminate between different groups of countries when making their investment decisions (Mosley, 2000, 2003). Investors in government bonds of advanced economies consider only a limited number of macroeconomic indicators, for example: 'overall inflation and government budget deficit levels' (Mosley, 2003: 17). More specific micro-level economic policies are usually not considered. In doing so, global financial market actors are only concerned when there are 'large shifts in government policy affecting performance on these key indicators' (Mosley, 2000: 747). Developing nations, on the other hand, are subjected to much closer scrutiny. Here, investors factor in a much broader range of political developments, such as spending and revenue structures or elections (Mosley, 2003: 39-40).

Yet, I argue, during times of exceptional economic and fiscal crisis, that global financial market actors include a much broader set of indicators of domestic policy and politics even when they are dealing with advanced economies. In such a crisis, uncertainty is increased significantly, and investors lose trust in the usual macro-economic indicators (De Grauwe and Ji, 2012). In the case of the eurozone crisis, this resulted in several countries being cut off from international bond markets. These countries were only able to return to private funding after implementing and accounting for a detailed economic adjustment programme that was closely monitored—not only by the troika but also by global financial market actors.

When assessing the creditworthiness of sovereign borrowers, investors not only rely on their own information but also on statements by credit rating agencies. Rating agencies provide regular reports on the economic conditions and policy-making of essentially all of the world's countries and publish a rating score for each of them. In this way, they can be expected to reinforce the preferences of international investors for spending cuts over revenue increases. A detailed analysis of the reports of Standard and Poor's—one of the most important rating agencies—revealed that these agencies have a neoliberal bias when assessing sovereign debt (Barta and Makszin, 2020). This means that rating agencies favour measures that reduce spending, such as the privatisation of pensions or the reform of welfare policies. What is more, at least Standard and Poor's 'systematically comments on both politics and policy' (Barta and Makszin, 2020: 21), thus taking a very detailed approach to the analysis of fiscal adjustment. Those preferences are shared by the troika which, like the EU's view on economic and fiscal policy-making, is predominated by a neoliberal paradigm (Schmidt and Thatcher, 2014). Over the years, the EU has been 'promoting a one-size-fits-all fiscal policy model', aimed at changing the size and the composition of national budgets (Ferreiro et al., 2010: 347). In a similar vein, subsumed under the term, the 'Washington consensus', the IMF promoted an equally orthodox macroeconomic policy-agenda, which has been shifting only recently (Lütz and Kranke, 2014).

In contrast to global financial market actors, direct investors do not only care about bond yields and policy stability but also about the specific economic environment a potential investment destination offers. Moreover, these kinds of investors take a longer-term perspective as the investment in an existing or soon-to-be business cannot be changed as easily as the investment in bonds or other financial assets. Direct investors are therefore much more involved in domestic politics as they do not only evaluate the suitability of potential investment destinations *ex ante*, but also express their policy preferences after having made their investment. However, direct investors bring with them traditions and practices of commercial activity (see, for example, Collings et al., 2008). Their preferences are therefore not completely congruent with those of domestic businesses.

Most certainly, direct investors prefer investment locations which tax their business activities comparatively low. It is confirmed by quantitative analyses that 'by and large, foreign direct investment reacts negatively to high effect tax rates' (Genschel, 2002: 254). However, tax rates are not the only indicator that impacts FDI decisions (Steinmo, 1994: 14). These kind of decisions are also influenced by factors such as productivity, infrastructure, skill-levels, or market access (Garrett, 1998a: 801; Genschel, 2002: 254). Because of

this, the preferences of direct investors cannot only be distinguished from more short-term oriented investors. Rather, and analogous to their domestic counterparts, sectoral differences also exist when it comes to FDI (Mosley, 2005: 361). Some direct investors use an investment destination as an access point to other markets. While some are engaged in labour-intensive manufacturing and are in search of a low-wage environment, others invest in the production of more elaborate products such as semiconductors or traded services. The specific policy preferences of direct investors are therefore much more context-dependent than those of other investors.

Ultimately, international investors share a set of fundamental fiscal policy preferences, irrespective of whether their engagement takes a short-term or a longer-term approach. Both groups of investors demand credible signals of policy stability and their preferences are more likely to be met by expenditure cuts than by revenue increases. Yet, the investment decisions by direct investors are much more influenced by specific economic and political factors than those of other global financial market actors.

3.2.3.6. Summing up: Fiscal policy preferences – conflicts and commonalities

This subchapter has explored the formation of fiscal policy preferences. It argued that these preferences can be derived from the material interests of specific economic actor groups and their position in the market. My starting point has been to understand preference formation as being based on class-affiliation and the resulting redistributive struggle between labour and capital. In this line of thinking, labour—and other low-income groups—support higher state spending because it has redistributive effects. If fiscal adjustment is inevitable, these groups can therefore be expected to favour revenue increases which burden their capitalist counterparts and maintains government spending. This is especially the case when fiscal adjustment is financed by redistributive taxes on higher incomes, business activities, and capital income. Actors representing capital have contrary preferences, meaning that they strive for lower state spending and less redistribution. This is best achieved by relying on expenditure cuts. State revenues should not be financed by progressive taxes that redistribute wealth but by more regressive indirect taxes, for example on consumption.

Class-affiliation, however, is not the only explanatory factor for fiscal preferences. Fiscal policy does not only have a redistributive aspect but also fulfils an insurance function. Those who are exposed to larger economic risks have an interest in state spending, which insures them against these risks. Indeed, economic risks have increased as a result of globalisation and de-industrialisation processes. Workers and businesses facing different economic risks therefore may turn to the state for insurance and compensation and thus prefer an adjustment strategy that maintains the respective spending programmes. Yet this does not necessarily imply that their preferences are aligned. Finally, differences in workers' skill sets open up the possibility of diverging policy demands within classes seeing as higher skilled workers face less economic risks than their low-skilled counterparts.

Potential disagreements within classes become very concrete if we also allow for economic actor groups to prioritise sectoral over class-based preferences. One way to conceptualise an economy is to divide it into the sectors exposed and sectors sheltered from the global economy. Actors in the former, that is sectors that produce tradable goods and services, compete on international markets. They can be expected to support expenditure cuts over revenue increases because increased government spending and revenue has the potential to impair their international competitiveness. Their sheltered counterparts, that is those who produce goods and services for domestic markets, do not have to produce at globally competitive prices. Instead, they are dependent on those forms of government spending that boosts domestic consumption. For these actors, revenue increases are preferable over expenditure cuts as long as fiscal adjustment does not substantially reduce the disposable income of domestic consumers.

De-industrialisation and globalisation do not only increase the demand for governments to provide insurance against economic risks. They also change the very skill sets and occupational orientation of workers. When it comes to the side of labour, two recent developments are of particular importance. On the one hand, low-skilled workers are moving from exposed sectors—especially traditional exporting sectors such as manufacturing—to sheltered low-end services. This reinforced their preferences for redistribution and against welfare state retrenchment and other spending cuts. On the other hand, high-skilled employees who used to work in sheltered sectors—and especially in the public sector—are moving into advanced services sectors which become increasingly traded. As a result, they tend to favour spending cuts which potentially improve the international competitiveness of traded services.

Firms with largely low-skilled workers in sheltered sectors have reasons to support state spending only when it boosts domestic consumption. However, these companies usually rely on low wages and highly flexible labour markets. Thus, they support cuts to social spending programmes that aim to change these labour market conditions. The most important employers of high-skilled workers in sheltered sectors are located in the public sector. When it comes to fiscal adjustment, public sector employers must choose between giving in to demands of their employees and other groups in favour of revenue increases and the demands of those social actors who would prefer expenditure cuts.

As a result of globalisation processes, global financial market actors and direct investment from abroad have gained importance as well. Direct investors are closely involved in domestic economies and therefore can have become more involved in domestic politics than those investors who only hold government bonds and other assets. In doing so, direct investors bring with them practices from their own country of origin but also have sector-specific preferences. Global financial market actors do not typically get involved in domestic politics as they base their decisions and preferences on a set of broad macroeconomic indicators. In times of crisis, however, those investors scrutinise fiscal adjustment with a much closer eye. Irrespective of their specific preferences, both investor groups demand credible policy signals from the governments of the countries they are dealing with. They have a clear preference for expenditure cuts as opposed to revenue increases. Table 3.1. summarises the logics and mechanisms of the formation of fiscal policy preferences.

This subchapter has shown that fiscal policy preferences depend on different factors that are not necessarily mutually exclusive. I took class affiliation as a point of departure to argue that the fundamental economic interests of workers and employers differ and contradict each other. This holds true for preferences for and against redistribution as well as for the risks economic actors are exposed to. However, processes of preference formation are more complex than this: sectoral considerations also play an important role. If economic actors prioritise sectoral considerations, preferences can potentially align across classes and diverge within classes. For instance, the policy preferences of workers in the exposed sectors may be more aligned with their employers than with other workers in sheltered sectors. Finally, recent developments in post-industrial societies also influence the interests of economic actor groups. Taking these changes into consideration, I have argued that the sectoral composition of different skill-levels also has a significant impact on fiscal policy preferences.

The form these new political dynamics take differs from country to country. It is therefore an empirical question how these conflicts ultimately play out. However, before turning to the empirical analysis, the next subchapter develops a series of theoretical proposition regarding how these conflicts may resolve, and which actor groups are likely to prevail in the end.

Basic logic	Political and economic dynamics	Fiscal policy logic	Policy preferences
Class-based		*Redistribution of wealth and income*	
	Power struggle between classes	– Capital: against redistribution as state spending and taxation decreases profits and business authority over workers – Labour: in favour of decommodification resulting from redistribution	– Capital in favour of spending cuts and regressive indirect taxes – Labour in favour of revenue increases and progressive direct taxes
		Insurance against/compensation for economic risks	*In addition to above:*
	Exposure to economic risks increasing due to globalisation and de-industrialisation processes depending on the sector of the economy and skill-levels	– Capital: uncompetitive businesses facing international competition – Labour: low-skilled labour facing risk of unemployment	– Capital: spending cuts, except for protectionism and subsidies – Labour: revenue increases in order to maintain welfare state spending
Sector-based		*Fiscal policy affects international competitiveness and domestic consumption*	
	Capital and labour both need economic growth and are exposed to or sheltered from competition on global markets	– Exposed sector: state spending impairs international competitiveness and price stability – Sheltered sector: state spending boosts disposable income and domestic consumption	– Exposed sector: spending cuts to increase competitiveness – Sheltered sector: revenue increases to maintain disposable incomes
	Changes in the skill-based composition of sectors as low-skilled workers move from exposed to sheltered service sectors and high-skilled workers move from sheltered sectors to increasingly traded services	– High-skilled ➔ state spending impairs international competitiveness and price stability – Low-skilled ➔ state spending boosts disposable income and domestic consumption	– High-skilled ➔ expenditure cuts to increase competitiveness – Low-skilled: revenue increases to maintain disposable incomes and welfare state
Investors	Investors with different time horizons and political involvement expecting credible policy signals	– FDI: closely involved in domestic economy and, to a certain extent, in domestic politics – Investors in government bonds: shorter time horizon and focus on return on investment	– FDI: depending on the sector of the economy; procedures and practice – Investors in government bonds: spending cuts

Table 3.1.: The formation of fiscal policy preferences

3.2.4. Coalitions: How preferences translate into policy-choice

So far, I have identified different societal actor groups and how they form their fiscal policy preferences. The next step is to develop a theoretical account of how these preferences translate into policy-choice when fiscal adjustment is inevitable. The approach presented here focuses on coalitions as the decisive actor groups. This subchapter therefore answers three questions. First, why do political decision-makers need the support of coalitions when they aim for want to bring about fiscal adjustment? Fiscal adjustment is not a political programme endorsed by many. It takes privileges from some parts of society and spares others. Supposing that office-holders have an interest in getting re-elected, the implementation of measures that go against the political demands of important actor coalitions is not feasible—or at least politically risky.

Second, what are coalitions and how they are formed? A formal organisation is not a necessary precondition for a relevant actor coalition. However, for individual actors or societal group to form a coalition, their policy preferences need to be similar enough for them to agree on mutual political demands. Such a coalition can be formed on the basis of already existing and traditional groups—e.g. trade unions or business associations—or they can form rather spontaneously as a reaction to planned policy measures or adjustment strategies.

Third, which coalitions ultimately prevail and fulfil their demands? Here I identify two important dynamics. On the one hand, there is a redistributive dynamic involving traditional coalitions, namely labour and other low-income groups, one the one side, and business and other high-income groups on the other. Traditional organisations representing these interests can rely on well-established channels of political mobilisation and influence. On the other hand, there is a growth dynamic based on sectoral coalitions and their importance for a society's economic success. In both cases, groups with different political demands compete for influence. The outcome of these conflicts eventually determines the policy outcome.

3.2.4.1. Who needs coalitions anyway?

Conceptualising governments as being 'driven by both a policy-seeking and a vote-seeking logic' (Bonoli, 2012: 100; see also Pierson, 1994) helps us understand why they need the support of social coalitions if they intend to use fiscally adjust. On the one hand, politicians can be viewed as having a genuine interest in negotiating and implementing an EAP that improves the fiscal and economic situation of their country. On the other hand, even if they may have an intrinsic motivation to pursue a certain adjustment strategy, politicians also want to be re-elected. In general, they tend to refrain from choosing policies that endanger this objective and to rather adopt policies that meet the political demands of key potential voters. Notwithstanding country-specific variations (Duch and Stevenson, 2008), voters make their electoral decisions mainly based on the condition of the economy as well as their own economic situation, especially during economic and financial crises (Bartels, 2014). Voters hold their governments accountable for their (fiscal)

policy-choices. Implementing fiscal consolidation measures is politically costly. Although this effect weakened after the Maastricht Treaty introduced stricter fiscal monitoring on the transnational level (Mulas-Granados, 2004), during the eurozone crisis, 'voters significantly shifted their assignment of responsibility for (economic) policy outcomes from the EU to the national government' (Kosmidis, 2014: 1136).

It is not an easy task to balance both logics during a severe economic crisis. Following the policy-seeking logic can involve unpopular measures that directly impair the incumbent's chances to get re-elected. Furthermore, the positive effects of potentially growth-inducing policy measures often materialise only with some time delay so that it becomes difficult to reap their electoral profits. However, there are two important strategies that policy-makers can adopt to deal with the dilemma described above, namely credit claiming and blame avoidance. To claim credit for fiscal retrenchment, however, is difficult (Pierson, 1994: 18). Most voters do not profit directly from achieving the relatively abstract objective of budgetary consolidation. By contrast, they are directly affected by fiscal retrenchment in the form of higher taxes or spending cuts. What is more, when making their electoral decisions, voters are more likely to consider the losses they suffered as a result of fiscal adjustment rather than the (potentially) materialised gains. For this reason, avoiding blame for unpopular policies—for example, by trying to delay their direct effects on voters or by blaming other actors—is the more obvious strategy for political decision-makers (Weaver, 1986).

These arguments are most accurate for governments confronting 'permanent austerity' (Pierson, 1998). This term accurately characterises the run-up to the crisis. Albeit, when fiscal adjustment is impossible to avoid due to the severity of the crisis, the political environment slightly changes. First of all, in such a situation, the two logics of policy- and vote-seeking may be compatible if retrenchment becomes more popular than inactivity (Bonoli, 2012: 102). That is, governments may not necessarily be more successful when trying to avoid the blame for the policies they (must) implement. On the contrary, facing such a crisis, politicians may even be better off presenting themselves as and claiming credit for 'doing what has to be done'.

Even if credit claiming is a feasible strategy under these circumstances, policy reforms are not easily accomplished. Notwithstanding a publicly accepted necessity to reform, adjustment is not popular. Since changes to fiscal policy produce losers whose privileges are taken away, the implementation of extensive consolidation measures is still likely to stir political conflicts (Barta, 2018: 14). Affected actor groups then can organise themselves to try either to avoid or to shift the burden of adjustment onto others. As a result, governments must decide strategically what reforms are feasible, that is, which reforms meet their political and economic obligations but at the same time are likely to be carried out. In other words, governments need to 'construct agreement from among officeholders, civil servants, party and interest group leaders, and economic actors in society' (Gourevitch, 1986: 20). Only then can fiscal retrenchment be implemented against political opposition (Barta, 2018: 18). Coalitions mobilise, organise, and channel political support as well as opposition and are therefore a constitutive element of the policy-making process. Here, governments can be expected to design their adjustment strategy so that its core constituencies are affect-

ed as little as possible and to shift the burden of adjustment to the opposition's voter groups and non-voters (Walter, 2016: 845).

3.2.4.2. What are coalitions how and do they form?

For my conceptualisation of social actor coalitions, I draw on Barta (2018: 18), who defines them as 'constellations of different socioeconomic groups whose interests can be sufficiently reconciled in a given policy reform to secure their backing'. Coalitions do not emerge 'out of thin air'. Rather, I argue, there are two preconditions for social actors to engage in the formation of a coalition. It is necessary that their preferences are aligned to some extent, and it is sufficient that they view themselves as having (good) prospects to influence domestic politics.

The first element, the alignment of preferences, does not mean that the actors forming a coalition have completely congruent interests. It implies that actors with similar preferences need to make compromises to achieve common goals. This can also involve dissimilar groups of actors coming together in support of or against a specific measure which usually do not have similar preferences. Or it can involve more complex negotiation processes where different groups reciprocally make concessions to promote or avoid a measure or a set of measures that would affect all of them. To be sure, the formation of more dynamic and issue-specific coalitions is not the only way for social actors to push through their demands. More often they are well-established traditional coalitions, such as trade unions and business associations, which consolidate the preferences and political influence of broad groups of social actors.

The second aspect, the plausible prospect of successful exertion of influence on fiscal policy-making, undoubtedly involves an element of power. On the one hand, this refers to the point where a coalition needs at least some relevance to consider itself to potentially influence political outcomes. Potential coalitions, which cannot expect to have any means to exert political influence, are either not being formed in the first place or are not relevant for the analysis here. On the other hand, power also refers to the ability of one coalition to win against other coalitions. Political decision-making is usually contested by several groups that often have diverging interests. It is rare that only a single group of actors actively attempts to force its preferences. Hence, political power does not only imply that a coalition is heard by a government but that it speaks louder than its competitors.

Individual economic actors affected by an adjustment measure or an adjustment strategy have three basic options to engage in political activity. First, they can decide not to react at all and just accept their fiscal burden. The reasons for such a behaviour may be the result of the inability to find allies with similar preferences or the inability to form a coalition that has a viable perspective to wield influence on policy-making at all. The former alternative does not seem to be realistic: fiscal adjustment measures are usually not tailored to single individuals but almost always impact larger groups of people. The latter alternative is much more plausible. In every society there are underprivileged actor groups that do not have means to influence policy-making despite going to the ballot box. Sometimes, they even are deprived of this basic

right. The next subchapter will illustrate several reasons why some coalitions win out over others. But in every society, there are groups that do not even enter the competition.

Second, there are existing and often well-established coalitions that consolidate broad actor groups. Traditionally, they correspond to what we have identified above as the class-based preferences of capital and labour, even if they are often organised sectorally. Actors who view such a coalition as adequately representing their interests, can support or join it relatively easily—if they are not already a member. An economic crisis and the drastic policies associated with it may also serve as an opportunity for actors to reactivate or rebuild a coalition that already exists but whose political clout has waned in the past. The advantage of established coalitions is that they have proven mechanisms to reconcile preferences and find compromises amongst its members. Furthermore, it is easy to anticipate their preferences as they are mostly based on a long-established political stance. Lastly, traditional coalitions often have a proven record of political influence that makes them an obvious reference point for many economic actors who want their preferences considered.

Third, there are several motives for attempting to create a novel coalition. On the one hand, this may come at the cost of existing coalitions (Gingrich and Häusermann, 2015). In some cases, established organisations lost their political clout and are no longer considered relevant political actors. In other cases, traditional constituencies may have changed to such an extent that they do not feel represented by established coalitions anymore and rather change their coalitional behaviour. As opposed to these relatively long-term developments, there are also coalitions with shorter temporal horizons. For example, there is the possibility of a 'coalition of coalitions', meaning a coalition of actor groups that generally do not cooperate or are even antagonistic. Those groups may both view the extensive adjustments or individual measures made over the course of an EAP as threatening enough to overcome their disputes—at least for a short length of time. Such a course of action may especially occur within the context of joint protests or other more spontaneous forms of cooperation since it does not necessarily resolve the underlying conflicts.

How and when economic actor groups make recourse to established or form new coalitions can be assessed against the backdrop of elements presented above, namely the alignment of preferences and the prospect of political influence. To start with, trade unions representing labour and business associations, which represent capital, are the most prominent coalitions in advanced economies. Trade unions and business associations are often organised based on sectors or industries and globalisation. The dynamic and complexity of preference formation has been increased in recent decades. Still, 'class remains significant in ordering preferences' (Dancygier and Walter, 2015: 134). Traditional coalitions are the relevant actors in framing class-based redistributive preferences and are also important in terms of demands for insurance against economic risks.

However, globalisation and de-industrialisation processes have brought about new coalitional dynamics. This holds true for potential coalitions within—and across—classes. First of all, complementarities be-

tween low- and high-skilled labour provided low-skilled workers with solid bargaining power during Fordism (Wren and Rehm, 2014: 431). Due to labour's high degree of organisation, governments and businesses were forced 'to achieve trade union cooperation' if they successfully wanted to manage the economy (Hassel, 2015: 245). As a result, it was 'possible to forge distributive compromises between high- and low-wage unions' (Wren and Rehm, 2014: 431). However, the potential for such compromises waned with the rise of the knowledge and service economy (Iversen and Soskice, 2015a: 220). As a result, the complementarities between low- and high wage workers also cease to exist. As skill gaps continued to grow, the preferences of low- and high-skilled works became increasingly disconnected and diverging (Rehm, 2016: 210). This development is accentuated as services become increasingly traded. High-skilled workers in sheltered sectors, especially the public sector, used to be the cornerstone of cross-skill coalitions favouring higher levels of redistributive state spending (Wren and Rehm, 2014: 410; Iversen and Soskice, 2015b). However, as high-skilled services become increasingly traded, it significantly reduces the capacity to form cross-skill coalitions. As I have argued above, the fiscal policy preferences of high-skilled workers in exposed (services) sectors differ from those of their low-skilled counterparts. The evolving preferences of economic actor groups in post-industrial societies also affect the dynamic of coalition formation in these societies. This distinguishes them from economies where skill levels are lower and traded services still play only a secondary role.

Finally, the formation of cross-class coalitions has also changed over time. In the 1970s, protectionist economic policy directly responded to coalitions between labour and capital in sectors that were most prone to losing out against international competition (Pontusson and Raess, 2012: 30). This has changed for a series of reasons, so that 'the business allies of unionized workers seeking protection or compensation simply are not there any more' (Pontusson and Raess, 2012: 30). The number of businesses that depend on an open economy and integration in world markets has increased significantly. Conversely, the number of businesses in favour of protectionist policies has decreased. This makes cross-class coalitions (such as between high-skilled service workers and their employers) that prioritise international competitiveness much more likely than cross-class coalitions that favour compensatory or protectionist fiscal policies.

To sum up, there are relevant options available to economic actors affected by fiscal adjustment. They may join or reactivate traditional coalitions, most prominently trade unions and business associations. Alternatively, they may attempt to form novel coalitions that bring together actors whose preferences have changed or who no longer feel represented by traditional coalitions. Albeit to a variable extent, globalisation and de-industrialisation have changed the coalitional dynamics in advanced economies. The successful activation or formation of a coalition, however, does not automatically translate into influence on policy outcomes. The determinants of the latter are therefore discussed in more detail in the next subchapter.

3.2.4.3. Who prevails?

This section answers two questions. First, when and why are economic actor coalitions and their preferences taken into account by policy-makers? Second, if we accept that coalitions compete against each other for political influence, which coalition prevails and ultimately is heard? The answers to these two questions are pertinent, because 'policies cannot be directly inferred from individual preferences' (Cusack et al., 2006: 366). As I have argued before, coalitions are important because they aggregate individual preferences. Yet, those aggregated preferences do not automatically translate into policy-choice. The political demands brought forward by different coalitions often are conflicting and can therefore not all be taken into consideration by policy-makers.

I argue that there are two relevant factors that determine which coalitions succeed, and ultimately are able to assert that their preferences, are reflected by the policies actually implemented. On the one hand, in every economy there are distinct institutions that regulate how interests are voiced and how political influence is allocated in the policy-making process. These institutions often privilege established coalitions—that is, trade unions and business associations—by, for instance, granting them a say in the policy-making process or by consulting them in important policy-decisions. The consultation of social partners has played a central role over the course of the eurozone crisis, albeit to varying degrees. Even if particularly trade unions have lost political significance in recent decades, I argue that traditional coalitions are still able to make use of corporatist institutions and their capacities to mobilise economic actors. Another channel for traditional coalitions to influence policy-making, often institutionalised over the long term, is their affiliation with certain political parties. As illustrated in the previous subchapter, there are ideological ties between labour and social democratic and other left parties as well as between capital and conservative parties. However, the links between these core constituencies and political parties have changed in recent decades (for an overview see Häusermann et al., 2012). As described above, globalisation and de-industrialisation processes have created new dynamic coalitions as challengers of established coalitions.

On the other hand, politicians cannot solely rely on traditional coalitions when facing an economic crisis. Because their re-election arguably depends mainly on economic success, they also need to turn towards coalitions representing those sectors which have the potential to contribute to economic growth. Promoting these sectors then becomes 'a valence issue not a partisan one' (Iversen and Soskice, 2015b: 76). This sectoral perspective references what I identified before as the preferences of exposed and sheltered sectors. Most fundamentally, advanced economies can be categorised as pursuing specific growth strategies—or 'growth models' (Baccaro and Pontusson, 2016; Johnston and Regan, 2018)—which are based either on exports or on domestic consumption. The sectors that are important for export-driven growth are different ones than the ones driving economic growth based on domestic consumption.

It is an empirical rather than a purely theoretical question, which of these two potentially conflicting logics prevails. Nevertheless, a few general assumptions can be made about the workings of the traditional and the sectoral logic. The two logics may imply a similar political thrust, if the traditionally strong coalitions

are also those that represent the sectors most capable to boost (prospective) growth. However, in many cases the two coalitional logics are in conflict. Traditional coalitions often represent sectors that are in decline but still politically powerful enough to influence policy-making to their advantage. In other cases, new economic and political dynamics have bolstered new sectors and their representatives.

To distinguish these two logics and how they operate, I first elaborate on the logic of traditional coalitions and how their influence has been institutionalised in different contexts. I then turn to the sectoral logic of political influence.

In its broadest sense, corporatism describes a mode of voluntary social concertation between governments and organised interests in the governance of the economy (Molina and Rhodes, 2002). Most commonly, it refers to institutionalised processes of governments consulting or involving traditional class-based (peak) organisations when making important economic policy decisions. The role of corporatist agreements has significantly changed since the heydays of Fordism and Keynesian macroeconomic policy-making (Molina and Rhodes, 2002: 317-318; Traxler, 2010: 57-58). First, there has been a policy shift from the demand side and the distribution of economic surpluses to the supply side. Second, trade unions have become increasingly pressurised by governments and businesses who viewed them mainly as 'obstacles for supply-side reforms, flexible adjustment, and competitiveness' (Hassel, 2015: 246). What is more, due to a decline in their degree of organisation and the parallel rise of economic orthodoxy, trade unions by now have much more to lose if they are excluded from social concertation than their negotiation partners, namely government and business organisations. Third, corporatist arrangements have become less dependent on the partisan composition of government. As negotiations have become more focused on issues of reform and competitiveness, conservative governments are equally likely to rely on social concertation as are their counterparts on the left. Fourth, employers were able to increasingly decentralise bargaining structures and make them more flexible. Finally, over time more and more policy issues and new actors were included in corporatist agreements—for instance, in education, health, and environment policy.

These changes were also a reaction to mounting internal and external challenges. Adjusting to the single market and EMU, as well as the effects of internationalisation and de-industrialisation have rendered it increasingly difficult to combine growth and redistributive economic policies (Rhodes, 2001). A form of 'competitive corporatism' (Rhodes, 1998, 2001)—agreed upon in so-called 'social pacts'—has now become the dominant form of social concertation for the member states of the eurozone.

Most importantly, social pacts and other forms of corporatist negotiation provide traditional coalitions with an institutionalised opportunity to influence policy-making. Yet, a few qualifications are necessary before turning to the next point. Only when they view it as advancing their interests will trade unions, business organisations, and governments engage in social concertation. This applies irrespective of whether those actors are trying to defend their interests against each other or to actively promote them. Even if an institutional arrangement exists for the negotiation of a social pact, not every actor group involved sees participation as yielding them a profit. Therefore, they may forgo its participation. This is especially the

case when a coalition believes that it can better promote its redistributive preferences outside of a corporatist arrangement. Furthermore, when a social pact is unable to cope with the political and economic challenges it is supposed to resolve, it also loses its usefulness for the actors involved.

A second way in which traditional coalitions may influence economic policy-making is their affiliation with political parties. As I have already noted, political parties can be said to rely on class-based core constituencies (Hibbs, 1977: 1467). On the one hand, the affiliation between class-based coalitions and political parties, in many cases, has given way to a more complex picture of conflicts of interest which 'spread differently across the constituencies of political parties, trade unions, and employer organisations' (Häusermann, 2010: 7). On the other hand, class-based organisations still have an effect on electoral behaviour and thus influence the strategic behaviour of political parties (Beramendi et al., 2015: 25). Yet, political parties are not simply translating the redistributive preferences of major interest groups into public policy. The fragmentation of traditional coalitions also implies the possibility to engineer issue-based coalitions (Häusermann, 2010) and 'to carve out different profiles of support groups' (Beramendi et al., 2015: 25). Political parties typically still rely on different core constituencies whose preferences they take into account. However, the increasing complexity of post-industrial dynamics implies that the effects of individual policies potentially become more compartmentalised.

Overall, corporatist structures supply trade unions and business associations with political influence. How strong this influence is and who ultimately gains from it depends on the institutional features of the process and its participants. Social pacts do not necessarily promote particularistic interests but can also result in finding socially acceptable solutions to macroeconomic problems. Collective actors do not always represent entire social classes but also sectoral groups and their specific preferences. There are still links between left-wing parties and labour and between conservative parties and business. However, these links have been loosening in recent decades. Moreover, governments cannot only answer to their specific class-based constituencies but also must take into account economic growth.

The contestation of fiscal policy-making is not only characterised by redistributive conflict between class-based coalitions but also by 'allocational conflict between cross-class coalitions that have made specific investments into different sectors of the economy' (Haffert and Mertens, 2019: 5). Cross-class coalitions located in various economic sectors can therefore also be expected to also exert significant influence on domestic policy-making. Their power depends on the importance of the respective sector for the overall economy. This is because governments of developed countries 'are deeply concerned with promoting the high value-added sectors of their economies' (Iversen and Soskice, 2012: 37; see also Iversen and Soskice, 2015b). If sectoral coalitions complement or challenge traditional coalitions, depends on the dynamics of economic growth in a country and on the characteristics of the globalisation and de-industrialisation dynamics described above.

These considerations correspond to 'the growth model perspective' (Baccaro and Pontusson, 2016). National growth models can be identified 'based on the relative importance of different components of ag-

gregate demand' (Baccaro and Pontusson, 2016: 176). A variety of growth models is conceivable, such as ones that are driven by government spending or private investment. However, I limit my analysis to household consumption and exports as the empirically most relevant drivers of economic growth. As my discussion of sectoral policy preferences has already indicated, the macroeconomic foundations of national growth models vary widely as export-led growth often curbs consumption-led growth and vice versa (Baccaro and Pontusson, 2016: 180). This translates into the political realm in that growth models rest on entangled 'electoral and producer group coalitions' (Johnston and Regan, 2018: 155) and rely on the support of 'coalitions of social forces, typically straddling the class divide' (Baccaro and Pontusson, 2016: 200).

The political influence of sectoral coalitions depends on their importance for economic growth. Some coalitions 'that can legitimately claim to represent the "national interest"' (Baccaro and Pontusson, 2016: 200) given that the sectors they represent are of 'systemic relevance' (Baccaro and Benassi, 2017: 90). On the one hand, the economic importance of a specific sector can translate into political power (Haffert and Mertens, 2019: 10). On the other hand, 'political elites internalise the preferences and interests of their growth model' (Johnston and Regan, 2018: 155). In other words, the influence of sectoral coalitions is economic as well as political. As a result, the more distinct these growth models are, the less room there is for political contestation. If an economy is clearly based on export-led (or consumption-led) growth, policies promoting the interests of exposed (sheltered) sectors become 'non-partisan' (Iversen and Soskice, 2015b: 81), where redistributive conflicts play only a secondary role (Iversen and Soskice, 2015b: 77). This follows from the policy-seeking and vote-seeking logics I have postulated earlier. The best way to sustainably reduce the fiscal deficit is to induce growth. Policies that weaken the potential of those sectors most likely drive economic expansion are therefore self-defeating. The same holds true for policies that go directly against the preferences of strong sector-based coalitions. Sectoral coalitions do not only represent growth potential, but also the potential to mobilise voter groups.

Two caveats are in order here. First, a point can be made that the EU's institutional setup 'favours export-led growth models whilst it penalises and discourages domestic consumption-oriented growth paths' (Johnston and Regan, 2018: 145). This bias may strengthen the corresponding domestic interest groups and add to the already high external pressure to reduce state spending. However, there is no automatism here that renders futile any attempt by consumption-oriented interest groups to exert political influence. A government that intends to pursue a fiscal strategy in favour of export-led growth may still face substantial opposition by domestically-oriented coalitions. Second, strong sectoral coalitions do not always represent the most dynamic sectors that have the highest growth potential. A growth model that had proved to be valuable in the past is not always well-equipped for future economic expansion. However, it may have brought about strong sector-based interest groups whose consent is essential for the implementation of fiscal policy reforms.

3.2.4.4. Summing up: The formation and assertiveness of economic actor coalitions

Fiscal adjustment is always controversial and contested. Governments therefore need the political support of established or strategically forged novel coalitions of economic actor groups. Coalitions unify socioeconomic groups whose preferences are aligned, and which view themselves as realistically being able to influence domestic policy-making.

Yet, the preferences of individual coalitions do not automatically translate into the implementation or rejection of fiscal adjustment measures. Rather, coalitions compete against each other for political influence. At the same time, policy-makers can strategically 'design reform proposals that bring diverse interests together' (Haffert and Mertens, 2019: 2). The power of coalitions has two elements. On the one hand, institutions of social concertation and consultation involve traditional, class-based coalitions in the policy-making process in many advanced countries. Furthermore, ideological links exist between political parties and class-based core constituencies. On the other hand, sector-based coalitions also wield political influence. Their influence can be linked to the composition of economic growth based on either exports or domestic consumption. The more pronounced a national growth model is, the less room it leaves for political contestation.

These two logics potentially conflict. For example, a reform proposal may meet the redistributive preferences of some workers but at the same time clash with the preferences of those employed in the exposed sector. Class-based demands of some employers for expenditure cuts may conflict with the preferences of other businesses located in sheltered sectors. First, the influence of sectoral coalitions cannot be assessed solely on a snapshot view of the economy. Governments that attempt to change the composition of an economy probably meet stronger political opposition than governments that promise the continuation of a well-established growth model. Second, processes of globalisation and de-industrialisation have significantly changed the dynamics between redistributive and sectoral coalitions. The integration of domestic economies into world markets has decreased the potential for cross-class coalitions in favour of protectionist fiscal policies. There are less complementarities between low- and high-skilled workers located in the same sector. Finally, the movement of high-skilled workers from the public sector into traded services has deprived formerly strong coalitions opposed to welfare state retrenchment of a major cornerstone. The evolution of these developments has progressed in some economies more than in others. Therefore, it is ultimately an empirical question how contradictions between those two logics play out.

3.2.5. International constraints: The influence of global financial market actors on domestic policy-making

3.2.5.1. Globalisation, tax competition, and capital mobility

Global financial markets influence domestic fiscal policy-choice. Not only that, but capital mobility has been increasing significantly in the past few decades and 'systematically constrains state behaviour by re-

warding some actions and punishing others' (Andrews, 1994: 197). That is, when conducting fiscal policy, 'governments must sell their policies not only to domestic voters, but also to international investors' (Mosley, 2003: 7). Capital mobility incentivises government to engage in tax competition. Arguably, it becomes difficult for governments to sustain a large welfare state financed by high taxes since it ultimately would make highly mobile businesses and investors leave the country and settle in jurisdictions with lower taxes. Furthermore, today's advanced political economies are dependent on having access to global financial markets to re-finance existing debt and to finance deficits by issuing sovereign bonds. In doing so, they are under close scrutiny by investors who make their investment decisions based on the economic prospects and policies of the bond issuer. This holds especially true in times of crisis when investors factor in fiscal policies with greater attention.

As already discussed, both factors increase pressure on domestic policy-makers to turn to expenditure cuts rather than revenue increases. International markets limit the policy-alternatives available to national governments. With a few exceptions—the US or Germany, for instance—those constraints pertain to almost all advanced economies and even more so to the eurozone's smaller members. Before the crisis, investors viewed the government bonds of those countries much more positively than those of non-members. Later, their government bond rates escalated almost in parallel. Ultimately, market sentiments dictated 'the timing and the intensity of the austerity programmes' (De Grauwe and Ji, 2013: 40; see also De Grauwe and Ji, 2012).

3.2.5.2. How global financial market constrain domestic policy-making

Increased capital mobility tilts the domestic balance of power in two ways, based on an economic as well as a political logic (Swank, 2002: 4-5). From an economic perspective, those who hold mobile assets (of which capital is the most mobile) search the market for the highest return on investment. Taxes and levies reduce the return on investment. As a reaction, investors may therefore transfer their investments from a jurisdiction with high taxes to one with lower taxes. If a government intends to keep or even attract investments in the country, it must lower taxes. Ultimately, governments may engage in a severe competition for investments by lowering taxes and cutting spending (Genschel and Schwarz, 2011). From a political point of view, capital mobility may strengthen the already privileged position of business owners. Especially businesses with a credible exit option can assert pressure on governments and lobby them to reduce expenditures and taxes 'by citing adverse welfare state effects on profits, investment, and employment and the advantages of foreign investment environments' (Swank, 2002: 4-5). The owners of less mobile factors, particularly workers, cannot credibly issue comparable threats and are therefore politically less powerful.

With regard to fiscal policy, this means that the effects of capital mobility and the influence of global financial market actors have two implications. For one thing, capital mobility tends to exert a downward pressure on general government spending. Faced with the decision to either increase revenues or cut

spending in order to cut the deficit, a government that is under pressure from mobile asset holders may turn to the spending side to generate savings. By the same token, if a government is forced to increase revenues, this argument implies that immobile rather than mobile assets are being taxed (see also Swank and Steinmo, 2002).

Globalised financial markets constitute the context within which fiscal policy-making in an interconnected global economy takes place. Although 'governments increasingly engage in tax cooperation to reign in tax arbitrage and competition' (Genschel and Schwarz, 2011: 339), there is still considerable pressure exerted by global financial market actors. This pressure may not directly translate into policy-choice, but it limits the set of policies available.

Global financial market actors do not only influence domestic fiscal policy-making in their capacity as holders of potentially mobile assets but also as providers of financial resources in the form of sovereign debt. In normal times, the prices of government bonds are formed by investors based on their assessment of domestic fiscal and economic policy-making. In doing so, investors 'are most concerned about macropolicy outputs and least concerned about supply side decisions' (Mosley, 2000: 766; see also Mosley, 2003; 2005). Governments must accommodate these general concerns, but they do not affect the details of fiscal policy decision-making. This changes in the event of a severe fiscal crisis. Investors now take a much closer look at individual policy measures and their adequacy when it comes to the reducing government debt. As aforementioned, international investors generally consider expenditure cuts to be adequate. They do not only rely on their own mechanisms of information collection, but also on agencies that rate sovereigns' creditworthiness on the basis of a larger number of indicators. These already relatively detailed rating reports became even more granular over the course of the financial crisis and now are mostly 'consistent with a neoliberal view of policy' (Barta and Makszin, 2020: 9). Rating downgrades almost automatically result in higher bond yields, meaning that borrowing becomes more expensive for the respective governments if its fiscal policy is not evaluated positively by investors and rating agencies. If anything, De Grauwe and Ji (2012, 2013) have shown that this effect is amplified in a currency union given the potential, panic-driven contagion effects of sovereign default.

International financial market actors exert pressure on national governments. Investors and rating agencies put those governments under close scrutiny not only regarding their general economic development but also by assessing their adjustment strategy in more detail. We can expect both actor groups to push for expenditure cuts rather than revenue increases. If governments still increase their revenues, the influence of global financial market actors may sway them towards more regressive indirect taxes as opposed to direct taxes on, for example, capital (Lierse and Seelkopf, 2016a).

As already discussed, these constraints affected all eurozone countries but even more so on the smaller member states. They did not directly induce individual measures and adjustment strategies. Rather they represent an economic and political context that tilts the domestic balance of power towards capital and limits the room to manoeuvre for domestic policy-makers.

3.2.6. Summing up: Explaining policy-choice

Why do governments choose one fiscal adjustment strategy over another? To answer the central question of this dissertation, I developed an approach that focuses on coalitions of domestic actor groups. When choosing a fiscal adjustment strategy, governments face a broad range of policy demands by different economic actor groups. Those groups have class- and sector-based fiscal policy preferences. Provided that their preferences are aligned, different economic actor groups form coalitions in order to influence the government's policy choice. The power of these coalitions depends on their involvement in institutions of social concertation and their significance for future economic growth. This process is constrained by global financial market actors assessing the fiscal stance of national governments.

Starting from the conceptualisation of fiscal policy resulting from a redistributive conflict, I have identified labour and capital as the pivotal socioeconomic actor groups. In parliament, these class-based core constituencies are represented by social democratic and conservative parties. Labour favours higher state spending due to its redistributive effects, whereas it is opposed by capital for the same reason. The same holds true for progressive direct taxes on higher incomes or business activities supported by labour. Capital, by contrast, prefers regressive indirect taxes on activities such as consumption that more heavily impact low-income groups. Regardless of higher or lower levels of redistribution, class-based actor groups also demand different forms of insurance or compensation against potential economic risks they are exposed to. These considerations have two implications. On the one hand, there is potential for preferences to align across classes if workers and employers are subjected to similar risks, for example stemming from international competition. On the other hand, there is potential for preferences to clash within classes.

These implications become more concrete if we allow for sector-based preferences. Actors located in traded sectors exposed to global markets may prioritise the effects of fiscal policy on international competitiveness instead of its redistributive implications. By contrast, actor groups located in sheltered groups that thrive on domestic consumption can largely ignore such concerns. Whereas the former opposed higher state spending because it potentially impairs international competitiveness, the latter support it as it increases consumers' disposable incomes.

Governments cannot expect to easily implement policy measures that clash with the policy demands of major societal coalitions. To carry out far-reaching fiscal adjustment, policy- and vote-seeking politicians need the political support of domestic coalitions of economic actor groups. Faced with a certain supply of policies that meet or conflict with their preferences, actor groups assess their political position. If they find allies with similar preferences and consider themselves powerful enough to influence policy-making, they may want to form a coalition in support of or against a single or even a whole set of planned measures. In doing so, they compete with other coalitions for political influence. However, social actor groups do not always have to form new coalitions. The more common case is that they can rely on already established coalitions.

When it comes to determining who ultimately prevails in this contest, in some contexts, well-established coalitions have an advantage over novel ones. In many advanced economies, institutionalised forms of social concertation and consultation involve, in the policy-making process, traditional coalitions that contest the redistributive aspects of fiscal policy. In addition to their ideological ties with political parties, those institutions provide traditional coalitions with direct political influence. Furthermore, there is the logic of influence by sectoral coalitions contesting the composition of economic growth. Given that economies can be conceptualised as being either export-led or consumption-led, different sectors are of varying importance for economic growth. Politicians therefore do not only have to consider the policy-demands of traditional coalitions, but also those of sectoral growth coalitions.

Both logics have been subject to substantial changes in recent decades. Advanced economies have become more open to international trade and their skill-structure has shifted, albeit to varying degrees. First, low-skilled workers who used to work in traditionally exposed manufacturing industries have become employed largely in sheltered, low-end services. This has reinforced their class-based preferences for redistributive fiscal policies. At the same time, it has weakened the potential for coalition-build between low- and high-skilled workers in the exposed sectors. Second, workers with higher skills transferred from sheltered sectors, most importantly the public sector, to services that have increasingly become traded. This decreased the number of high-skilled workers in sheltered sectors, which had been a cornerstone of sector-based coalitions opposed to redistributive government spending.

Finally, during times of fiscal crisis, domestic policy-supply is constrained by global financial market actors. Those actors, which in general prefer expenditure cuts over revenue increases, exert political influence in two ways. First, the holders of mobile assets such as capital can threaten to exit a jurisdiction in search of higher returns of investment elsewhere. Second, governments facing fiscal strain depend on positive evaluations by international investors and rating agencies in order to finance deficits and refinance debt.

3.2.6.1. Expectations

Starting with preference formation, I have identified two different logics. First, class-based preferences largely concern the redistributive and risk insurance aspects of fiscal policy. In general, labour can be expected to prefer an adjustment strategy based on revenue increases. Such a strategy would maintain important social spending programmes and directly tax higher income groups. Capital, by contrast, can be expected to argue for an adjustment strategy based on expenditure cuts. Such a strategy would reduce redistributive government spending and, if at all, increase indirect taxes on lower income groups. Workers and businesses do not only have preferences for certain levels of redistribution, but they are also exposed to different economic risks due to processes of globalisation and de-industrialisation. Workers who do not possess the skills sought after on the market or businesses that lack international competitiveness may turn to the state for compensation. Both labour and capital face such risks and can therefore be expected

to demand fiscal adjustment to leave intact the respective spending programmes which may have to be financed by revenue increases. However, this does not necessarily imply an alignment of preferences between those two groups. Rather, demands for risk insurance complement class-based preferences in favour or against redistribution. Sector-based preferences constitute the second logic of fiscal policy demand. Actors located in sectors that are exposed to global markets usually prioritise an expenditure-based adjustment strategy. Such a strategy would aim at improving international competitiveness. By contrast, actors located in sector sheltered from international competition usually prefer an adjustment strategy based on revenue increases. Such a strategy would aim to maintain disposable incomes and to utilise public consumption as a replacement for private consumption until the latter picks up again.

When it comes to choosing a specific adjustment strategy, governments are thus confronted with two potentially conflicting logics of policy demand. Which logic ultimately prevails depends on the characteristics of the economy and the composition of growth. In 'non-dynamic' economies, where globalisation and de-industrialisation processes have not yet taken full effect, I expect traditional coalitions facing high economic risks and demanding a revenue-based adjustment strategy to be most influential. By contrast, in 'dynamic' economies, where high-skilled workers face lower risks and become increasingly opposed to high levels of government spending, I envision novel coalitions in favour of an expenditure-based adjustment strategy to be most influential. The more high-skilled workers become exposed to international markets, the less willing they are to support coalitions in favour of higher (welfare) state spending. Finally, depending on government partisanship, ideological links between traditional coalitions and political parties can shift the balance of power between labour and capital.

In economies where growth is mostly consumption-led, I expect coalitions favouring a revenue-based adjustment strategy to be more influential. The opposite holds true for export-led growth models where I see government to be more responsive to the demands by exposed sector coalitions and to rely on an expenditure-based adjustment strategy. The more pronounced the national growth model is, the less it is likely for fiscal adjustment to be politically contested and the more influential I the respective sectoral coalitions is. By the same token, fiscal policy-making is likely to be much more controversial in countries with a less distinct growth model.

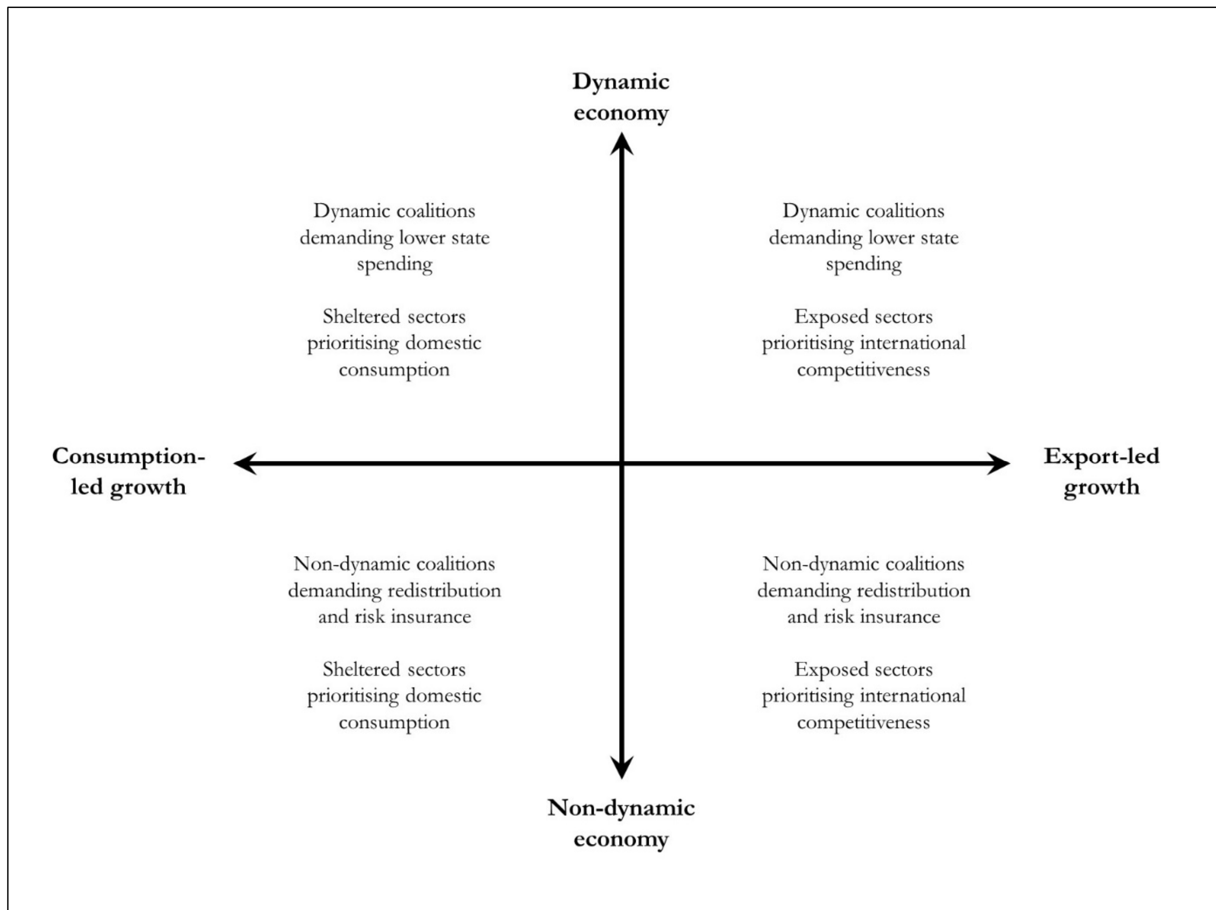

Figure 3.1.: The dynamics of fiscal policy demand

Figure 3.1. illustrates and summaries these considerations and the potential interactions between redistributive and growth-oriented coalitions. Consumption-led economies, where traditional coalitions still play an important role politically, can be located in the lower left quadrant. Here, I expect class-based and sectoral coalitions both to demand an adjustment strategy based on revenue increases which aims at maintaining redistributive and consumption-oriented fiscal policies. Export-led economies, where novel coalitions have been forming, are located in the upper right quadrant. Here, I expect dynamic and sectoral coalitions both to demand an expenditure-based adjustment strategy that aims to keep state spending in check while potentially improving international competitiveness. By contrast, export-led economies, where traditional coalitions are still strong, are located in the lower right quadrant. Here, I expect strong coalition of actors in favour of state spending on risk-insurance, but also a strong sectoral coalition demanding cost-cutting adjustment measures with the potential to improve international competitiveness. Finally, consumption-led economies, where novel coalitions have been forming, are located in the upper left quadrat. Here, I expect strong dynamic coalitions in favour of expenditure cuts, but also strong sectoral coalitions demanding consumption-enhancing fiscal policies.

Governments implementing fiscal adjustment, in the context of internationalised markets and mobile capital, face the problem of how to balance different and potentially conflicting policy-demands. How they resolve this problem is the object of investigation in this study.

3.3. Methodological considerations

This subchapter presents the methodological considerations that underlie the theoretical framework of this dissertation. First, I reflect on the ontological and epistemological basis of my overall approach regarding theoretical and empirical analysis. Second, I define the universe of cases and discuss my case selection. Third, I introduce the method of process tracing that I use to develop causal arguments. Finally, I illustrate my approach towards data collection.

3.3.1. A midrange theory of fiscal adjustment

My main research interest is to explain fiscal policy-choice. My approach is y-centred in that I intend to explain a specific outcome. I assume that a set of causal mechanisms contributed to this outcome and, therefore, I identify the political factors that brought about different fiscal adjustment strategies. Above, I formulated a series of theoretical expectations. Those presumptions will be tested in the subsequent case studies.

It is often argued that case studies are not well equipped for theory testing (Gerring, 2009). Yet, case study research can do more than solely develop new theories. Detailed case studies are also able to provide the evidence necessary to test those theories. A researcher relying on a small number of case studies can investigate those cases more thoroughly than large-N analyses. Small-N research ‘allows for a closer matching of conceptual intent and empirical evidence’ (Rueschemeyer, 2003: 318). The desire to test a theory, however, lends itself to a specific methodology. Process tracing systematically collects evidence from one or more case studies, which then can be checked against the theoretical assumptions made in order to assess their plausibility. This makes process tracing ‘the only case study approach within political economy capable of testing as well as developing theory’ (Trampusch and Palier, 2016: 439).

Before turning to the specifics of this method and the selection of cases, I offer a few clarifications regarding my dissertation’s fundamental approach. It is already evident that my research is of a qualitative and not quantitative nature. The application of qualitative methods implies ontological assumptions, which differ from methods such as regression analysis. Bothering to invest the time and energy to collect extensive qualitative evidence is only useful if one assumes that context matters (see Falleti and Lynch, 2009). By contrast, quantitative, variable-oriented research usually assumes that research units are homogenous in the sense that any change in the independent variable will, *ceteris paribus*, cause the same change in the dependent variable in all cases (Hall, 2003: 382). Again, the focus on fine-grained factors (and how they play

out in different cases) connotes process tracing as the method of choice. This is because causal relationships are being analysed in the light of their specific institutional and historical contexts (Trampusch and Palier, 2016: 448).

There is a second aspect of ontology that impacts how empirical evidence is classified and interpreted. Cases can be analysed based on either a determinist or a probabilistic understanding of causality (Trampusch and Palier, 2016: 439). The former resembles what has been said before about statistical methods in that it postulates that a specific causal mechanism always brings about a specific outcome. By contrast, I rely on a probabilistic understanding of causality, which implies that the outcome produced by a causal mechanism is context-dependent (Falleti and Lynch, 2009: 1147). Process tracing as a method is especially well-suited for such a '"holistic" analysis and […] "thick" description of events' (Gerring, 2009: 106). I take this stance because I am convinced that such a complex matter as fiscal adjustment strategies cannot be explained by the variations of a single factor. The actor preferences that my study concentrates on are mainly based on the material interests of economic actor groups. When choosing a fiscal adjustment strategy, governments meet some of those preferences and dismiss others. How exactly this process plays out is contingent on context and the strategic behaviour of actors (Blatter and Haverland, 2012: 92).

This begs the following question: Can we identify the causal mechanisms that underlie those processes, and if so, how? At an abstract level, given their intensive and extensive analysis of detailed empirical material, in-depth case studies 'make it possible to draw causal inference in cases in which variable-scoring observations and datasets would not allow any logical conclusion' (Blatter and Haverland, 2012: 107). The argument put forward here features a highly complex process in a small universe of cases that is not easily quantifiable. However, it is researchable when taking a closer look at actors, their preferences, and the political context within they operate. I state neither that there is an 'objective' reality, which theoretical models can contribute to unravel, nor that empirical analysis is solely based on shared interpretations.

3.3.2. The universe of cases and case selection

3.3.2.1. What are the EAPs cases of?

Case selection is an key step towards any comparative research design as it directly impacts the representativeness and generalisability of the findings made. First, I define the—rather manageable—universe of total cases and give reasons for choosing eurozone member state in crisis as my main unit of analysis. Second, I delve into the concrete selection process.

Most fundamentally, case study research examines a small number of cases in order to gain insights into causal relationships that also apply to a number of other cases (Gerring, 2007a: 86). Consequently, it is necessary to explicate what a single case is in the abstract, what a single case is concretely and what the potential larger population of cases looks like. For the first definition, I rely on George and Bennett as pivotal exponents of the methodological literature on case studies, who state that a case is 'an instance of a

class of events' (George and Bennett, 2005: 17). This conceptualisation does justice to the fact that cases are not 'objectively' predefined but that their boundaries always depend on the concepts and categories applied by the researcher (Bennett and Checkel, 2015: 8).

Taking the nation state as the unit of analysis is a well-established and uncontroversial approach. This comprehensive unit of analysis can be narrowed down meaningfully to individual cases by focusing on the political processes that played out during the implementation of an EAP. The latter therefore represents such an 'instance of a class of events'. It may be argued that Greece's three EAPs each should be considered individually, but this is an empirical and rather than a theoretical question. Decisions made at an earlier stage in the programme surely influence decisions made further down the line. However, those developments are coherent in that they are part of a single EAP and, thus, arguably follow a fundamentally similar logic. Rather than breaking the EAPs down further, I take each of them as an 'account of one complex historical development' (Rueschemeyer, 2003: 320). That leaves us with a total of only four cases of countries that implemented an EAP during the eurozone crisis. And it prompts the question if and how such a limitation is adequate. That being said, there is an empirical and an analytical rationale for my choice.

Empirically, I argue that times of crisis make a difference when it comes to the processes and determinants of policy-making. Furthermore, the eurozone crisis was an event of global proportions, given its potential financial and political repercussions. This makes choosing crisis countries as the object of investigation a worthwhile endeavour. Another important criterion, that should not be disregarded, is the accessibility of the cases (Blatter and Haverland, 2012: 102). In the context of a multi-year research project on the eurozone crisis, I was able to collect extensive and detailed empirical evidence on the crisis countries. This has deepened my understanding of the cases themselves as well as the context of the crisis. Furthermore, it eventually allowed to access a much broader range of information and empirical material than would have been possible for other countries.

Analytically, I chose those cases because of their implications for the theoretical framework. Specifically, the case selection strategy was guided by my intention to test if my theoretical expectations were accurate. My argument focuses on the domestic politics of fiscal adjustment. I argue that the EAP countries fulfil the criteria of being the least-likely cases since the probability that my presumptions pertain here is comparatively low (Rohlfing, 2012: 84). Given the enormous external pressure that weighed on those countries' governments, it is reasonable to assume that domestic politics would play a secondary role in comparison to the decisions made on the international level. Furthermore, the programmes involved strict policy conditionality and close monitoring by the troika. Some authors even argue that the troika was merely the instrument of the eurozone's most powerful member states and the crisis brought about 'a burden-sharing and institutional design that reflected German preferences predominantly' (Schimmelfennig, 2015: 177; see also Henning, 2017). It is therefore likely that international politics and the preferences of the crisis countries' major creditors would at least implicitly trump domestic politics. This holds even more true considering that the crisis countries are all small states located at the eurozone's

periphery. This has certainly contributed to their low bargaining power vis-á-vis their creditors (Frieden, 2015). For these reasons, I come to the following conclusion. If my framework applies here, and the respective adjustment strategies indeed can be traced back to the influence of domestic economic actor coalitions, it can be assumed to also be an accurate description of the determinants of fiscal policy-making in 'a larger population of cases'.

Although I examine the potential generalisability of comparative case studies below in greater detail, I want to reflect here on which countries my findings may be applicable to. As I have shown in the analytical framework and literature review, there is a specific logic to the comparative political economy of small open economies (Katzenstein, 1985). Thus, an obvious next step would be to apply the analytical framework of this dissertation to other small states in the eurozone, regardless of whether they have been in crisis or not. Fiscal policy-making in times of crisis times is obviously more challenging than in 'normal' times. Deciding who to burden financially is much less appealing than distributing financial resources as part of an expansionary budget. Still, I argue that the same political logic pertains to both scenarios. In both cases, economic actor groups are incentivised to influence policy-making regardless of whether they aim to increase their share of the pie or prevent it from shrinking. In other words, a fiscal crisis is not a necessary condition for my theoretical framework to be accurate. Beyond that, my knowledge of the comparative political economy of emerging markets is too limited to make a clear statement about the applicability of my theoretical approach to these countries. Furthermore, countries outside of the eurozone do not face the same limitations with regard to the non-availability of external adjustment strategies. On the other hand, the countries in Central and Eastern Europe, which served as the 'training ground' for the EU's cooperation with the IMF, work as cases of application given that political decisions on the exchange rate also have distributional and sectoral implications.

3.3.2.2. Why Ireland and Portugal? What are these two countries cases of?

Having established the admittedly small universe of cases, I now turn to the case selection for my in-depth analysis. Choosing cases for a cross-case study is inevitably a kind of balancing act. On the one hand, studying more than one case allows the researcher to 'trace multiple paths of causation' (Rueschemeyer, 2003: 324) and to make analytical statements based on the comparison of those cases. On the other hand, the number of cases cannot be increased indefinitely without losing the advantages of a case study, namely the attention to detail and the profound examination of political and social processes.

I chose to confine myself to two case studies, namely the EAPs for Ireland and Portugal, for a number of reasons. First, it allows me to strike a workable balance between the two issues described above. An extensive and detailed analysis of two cases is a feasible endeavour within the context of a dissertation project. In view of the still all too frequent 'mistaken identification of a single case with a single observation' (Rueschemeyer, 2003: 318), it cannot be emphasised often enough that two cases already can provide a

large number of insightful observations. This allows for a constant conversation between empirical observations and theoretical expectations, checking the former against the latter.

As I will show in the next chapter, Ireland and Portugal differ regarding the explanatory factors that my theoretical framework focuses on. This directly relates to the method of process tracing in its 'configurational thinking', which is based on the assumption that social outcomes are not monocausal but caused by a combination of factors (Blatter and Haverland, 2012: 80). According to this approach, it is analytically more beneficial to choose cases that represent different configurations of the explanatory factors than to attempt to isolate one or two variables and to hold them constant. Ireland and Portugal fulfil the former criterion as they represent two different configurations of growth models and economic dynamism. They also present diverse outcomes. Carefully tracing the processes and identifying the causal mechanism that brought about these outcomes enables me to show if and how my analytical framework is accurate.

Irrespective of my probabilistic and configurational approach, there are still some empirical similarities between Ireland and Portugal that allow me to hold constant a series of alternative explanatory factors. I have touched upon some of them already in the literature review section, but I want to highlight them here again. Not only are Ireland and Portugal both small states at the eurozone's margins , but they are also about the same economic size. In 2008, the two economies each represented a little less than 2 per cent of the eurozone's GDP. If we take economic significance as a proxy for political power, this means that both countries were dwarfed by their counterparts on the creditor's side. This suggests that we can expect the same amount of external pressure to weigh on both countries. Moreover, the two countries both applied for financial assistance within a six-month period. This means that they were dealing with a similar institutional and macroeconomic environment. Both aspects speak against choosing different cases. The programme for Cyprus took place at a much later stage of the crisis and was tailored to a much smaller economy. The Greek case is an outlier as it comprised a total of three programmes whose domestic and international circumstances constantly changed (Lütz et al., 2019a).

Putting the international level aside, we observe more similarities at the domestic level that directly relate to the analytical framework. Both countries came up against a serious fiscal crisis that had to be dealt with. Although Ireland's crisis was rooted in the financial sector, there also existed underlying fiscal problems that were not directly related to the government bailing out Irish banks (Honohan, 2019: 282). When it comes to politics, there had been a long-established practice of social concertation with traditional coalitions in both countries. This implies that trade unions and business associations were part of similar institutional context that directly involved them in economic policy-making. Finally, both EAPs were requested and negotiated by governments in the shadow of upcoming snap elections that they were likely to lose. In both cases, new governments were elected that could have distanced themselves from the programme. Rather, and this is a fascinating difference to conclude with, both governments were remarkable with regard to the expectations formulated above and thus further substantiate that Ireland and Portugal are suitable cases. Portugal's prime minister was an exceptionally liberal figure who made public his intentions to transform the economy, whereas Ireland's new government was formed by Fine Gael and an exceptionally

strong labour party. That is, there are good reasons to expect that both new governments would have policy preferences running counter to what we would expect to be the prevalent fiscal policy stance.

3.3.3. Methods

3.3.3.1. Causation and process tracing

In this section, I look closely at the advantages and peculiarities of comparative case studies and how they relate to my underlying epistemological assumptions. I then turn to my understanding of process tracing as a method of analysis and how I intend to apply it.

To begin with, my dissertation takes a 'mechanismic worldview', which recent social sciences scholars have increasingly referred to as an alternative to approaches that take 'little notice of their assumptions about causation' (Gerring, 2007b: 162). This worldview is associated with a specific understanding of epistemology in which process tracing lends itself as the method of choice to identify fundamental mechanisms that bring about the processes and outcomes of interest (Bennett and Checkel, 2015: 10). In addition to its focus on causal mechanisms, such an explanation is often 'built around contiguity and sequencing of events' (Bennett and Checkel, 2015: 10). Time and timing are important elements of such an approach, as it is part of the argument that the sequence of events itself has explanatory power. Simply put, an event taking place earlier affects how subsequent events play out later (Trampusch and Palier, 2016: 439).

Before providing a general definition of the concept of causal mechanisms, I want to make a short point about temporality. Temporality and sequences are implications for comparative historical analyses that cover long periods of time (Hall, 2003). I do not make such a long-term historical argument in that my study focuses mainly on the relatively short three-year timeframe of an EAP. The sequencing of events still has implications for the outcome I am interested in. Thus, I will refer to it in the case studies wherever it provides analytical added value, but I will not make it an argument on its own. When it comes to fiscal adjustment, the sequencing of events matters in two ways. Without a doubt, decisions made at an earlier programme stage have a direct effect on programme implementation at a later stage as expenditure cuts and revenue increases are usually not one-offs but are long-term measures. Furthermore, fiscal crises do not take place in isolation but are the result of a series of decisions made over an extended period.

My dissertation aims to identify the causal mechanisms that were at the basis of the political processes that resulted in diverging fiscal adjustment strategies. I rely on Gerring's very basic definition that describes a causal mechanism as 'the pathway or process by which an effect is produced' (Gerring, 2007b: 161). Placing special emphasis on causal mechanism suggests an explanation that is actor-centred (Blatter and Haverland, 2012: 96). There is an extensive discussion about if and how those mechanisms ultimately are observable or purely hypothetical (see Gerring, 2007b: 166-168 for a review). However, I side with those

who argue that a very fine-grained analysis enables researchers to at least approximate the underlying mechanisms.

To this end, process tracing is the method of choice here as it searches for causal mechanisms in an attempt to unravel them (Trampusch and Palier, 2016: 437). Essentially, process tracing can be defined as the 'analysis of evidence on processes, sequences, and conjunctures of events within a case' (Bennett and Checkel, 2015: 7). This definition shows that the application of process tracing to a larger number of cases faces a series of challenges when it comes to determining what level of attention to detail is feasible. In order to fully make use of this method's potential, I confine myself to two cases. Here, the method's main objective is not to quantify the effects of single variables or to find the 'ultimate causes' of a specific outcome, but show *how* the causal variables bring about this outcome (Hall, 2008: 306). This also means that process tracing lends itself as the method of choice when similarities between cases are less similar than looked-for. This is because it is a method that takes a closer look at the causal chains and mechanisms that connect individual observations in different contexts (Blatter and Haverland, 2012: 79). Eventually, such a step-by-step analysis produces a narrative account where the most important events of the relevant political processes are comprehensible and stand up to the reader's scrutiny (Blatter and Haverland, 2012: 111).

Finally, systematic process analyses of two cases provides insights that allow us to generalise and abstract from the two examined cases. There are some limitations to this, but they are not as grave as some proponents of quantitative methods would claim. Surely, the representativeness of such an analysis is limited because it its very definition implies a relatively small of total cases (Gerring, 2009: 101). But there is still a lot to be learned about how accurate a theory is and how it may or may not apply to additional cases. Despite its emphasis on specific processes and how they unfold in specified contexts, case study research still provides findings that can be translated to other contexts as well. The goal here is to 'specify the set of causal configurations […] that make specific outcomes "possible".' (Blatter and Haverland, 2012: 136). Provided that there is a sensible explication of case selection and theoretical assumptions, an analytical framework based on process tracing applied to a small number of cases can be reproduced and further tested in other contexts as well.

3.3.3.2. Data and transparency

Any method is only as good as the data that supports it. It follows from the definition of process tracing above that the observations made by the means of this method are not mere data points. Rather, they always should have a procedural and causal element in order to allow the researcher to unfold each individual step that brought about a specific outcome. The detailed description of events, actors and procedures relies on a broad set of empirical material that is often quite compartmentalised. The bulk of this material is qualitative in nature and draws on data sources such primary documents and expert interviews, but also press coverage and secondary literature with similar objects of investigation.

The recent so-called 'transparency revolution' emphasises the importance of transparency when it comes to explicating the collection, selection, and presentation of data (Moravcsik, 2014). Most fundamentally, my approach was to collect and assess initial data as systematically as possible to capture a comprehensive picture of the two cases. I would then complement it in case it was necessary to further investigate individual observations that seemed to be decisive for explaining the outcome. In a first step, I focused mainly on primary documents and newspaper articles. Regarding the former, I evaluated the EC's and IMF's entire body of programme documents. This encompasses the initial EAPs as well as the reports of the quarterly review missions. These reports usually contain a comprehensive assessment of the programme's progress, discussions of individual policy conditions, and detailed plans for upcoming programme measures. Furthermore, I also analysed the troika institutions' post-programme surveillance reports, evaluation documents, public statements, and other press releases. These documents contain extensive analyses of the programme's implementation record in relation to domestic politics and economic circumstances. In the case of Ireland, I also had access to the minutes of the IMF's major decision-making body, the executive board, which also contain fine-grained analyses of the borrower countries as well as individual programme measures. The minutes regarding the Portuguese programme unfortunately were not publicly available. This allowed me to identify the most important events and policy discussions as well as potential sources of conflict between troika and borrower governments. In addition, I analysed the full press coverage of the programmes by the *Financial Times*—a leading international newspaper with a special focus on financial markets and economic policy issues—to check for additional important events that may not have been accounted for in the programme documents.

Based on this material, I compiled a detailed timeline that served as the foundation to identify the most important sequences and processes that took place during the programmes. In a second step, I then conducted an analysis of those events in relation to my analytical framework. Since groups of economic actors are central to my explanation, publications and other activities by those actor groups were pivotal to my case studies. In this instance, 'by comparing the statements and actions of those [actors], the process analyst can often establish the relative influence various factors had over them' (Hall, 2008: 314). I therefore prioritised public statements and other primary material by economic actor groups to assess their preferences. I complemented these documents with publications by the EU's Eurofound foundation. Eurofound provides an extensive body of articles on individual policies, social partnership, and other important aspects of domestic politics. In most cases, these articles directly quote governments and economic actor groups. Finally, I relied on publications by the borrower governments, such as party manifestos, government programmes, and publications in the context of the European Semester. Parallel to that, I consulted secondary literature for further analyses or quotations of primary material.

A large set of expert interviews conducted between 2015 and 2017 constituted an equally important data source. These interviews originated from a research project on the eurozone crisis to which I contributed together with two colleagues. I personally conducted a total of 30 expert interviews with representatives from governments and domestic interest groups in Ireland and Portugal. I further participated and con-

tributed to another 42 expert interviews with representatives from the troika and other creditors. When I quoted or paraphrased one of those interviews, I cite it in the text. I compiled a list of all the interviews referenced in the text, which can be found annexed to the bibliography. Since most of my interview partners asked for anonymity, I quoted them not by name but assigned each a code. Furthermore, I show the affiliation of each interview partner and when and where the interview was conducted. The advantage of interviews is that they provide insider information that would not have been possible to obtain otherwise. However, they are highly subjective, and the interviewee can choose to hide or withhold certain information. It was usually possible to compensate for this by asking different actors about their perspective, for example by interviewing the troika's mission chiefs as well as their counterparts on the respective government's side. For example, a member of Portugal's government stated that the government crisis resulted in fresh momentum for programme implementation, whereas an EU representative maintained the contrary. In any case, interviews provide important contextual information about actors and their motivations. It is then the researcher's task to contextualise these statements with supplementary material.

To sum up, my dissertation applies a midrange theory of fiscal adjustment to two case studies and tests if the empirical evidence meets the theoretical expectations. The EAPs for Ireland and Portugal form the two cases I will analyse below. The two countries represent least-likely cases for the importance of domestic politics compared to the influence of factors located at an international level. Process tracing lends itself as the method of choice for such a research approach. Finally, my analysis relies on a broad set of primary and secondary data.

Chapter four: Setting the scene

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The Economic Adjustment Programmes

Ireland requested financial assistance on 21 November 2010 and exited its programme in December 2013. The Portuguese government applied to the troika on 7 April 2011 and remained under programme surveillance for three years. It exited its EAP in June 2014. Over course of their programme, both governments implemented fiscal adjustment measures amounting to around 10 per cent of GDP (Kopits, 2016: 26). Table 4.1. shows the composition of their adjustment strategies.

Table 4.1.: Fiscal adjustment during the EAP

	Ireland	Portugal
Primary balance, projection	10.9	8.9
Primary balance	10.5	9.5
Revenue (excluding interest)	1.1	4.7
Expenditure (excluding interest)	-9.4	-4.8

Notes: Per cent of GDP. Based on calendar year data (2009–2013 for Ireland, 2011–14 for Portugal) which do not completely correspond with the programme period. In the case of Ireland, 2009 was used as the base year for the calculation, rather than 2010 when primary expenditures included the one-off capitalization of the banking sector.
Source: Kopits (2016: 26).

Two things are notable here. Portugal's government adjusted its primary balance by 0.6 per cent of GDP more than projected at the outset of the programme, whereas Irelands actual adjustment turned out to be 0.4 per cent of GDP lower than initially designed. It is striking that Ireland's adjustment strategy was largely based on expenditure cuts. The Portuguese EAP planned to implement mainly expenditure cuts, which were supposed to amount to more than two thirds of total adjustment (EC, 2011e: 35). Over the course of the programme, however, revenue increases gained importance and balanced out spending cuts.

Programme implementation was much more contested in Portugal than in Ireland. Initially, both EAPs were based on a broad societal consensus and supported by all major parties on both sides of the political spectrum. Protests emerged only at the end of the Irish programme in relation to the rather minor issue of water charges. In Portugal, by contrast, 'the political consensus in support of the program became increasingly fractured' (IMF, 2016: 16) at an early stage of the programme and the socialist opposition swiftly party recalled its parliamentary collaboration with the conservative government. Implementation was also

met with a variety of protests, most of which were organized by the country's two leading trade union confederations.

Ireland and Portugal faced an equally high amount of external pressure to restructure their public finances by means of an expenditure-based strategy. However, the actual implementation of fiscal adjustment in the two countries differed significantly. I will show in the following that this holds true not only in the aggregate, but also for individual policies. The two in-depth case studies of Ireland and Portugal substantiate my claim that this outcome cannot be explained by factors located internationally. Rather, the fiscal adjustment strategies chosen by these two governments is the result of specific configurations of societal actor coalitions and their involvement in domestic policy-making processes.

The remainder of this chapter is structured as follows. The next section briefly illustrates how the global financial crisis developed into the eurozone crisis and how the EAPs were developed. Section two then describes distributional conflicts and growth dynamics in the cases before the crises. Based on this account, the third section formulates forward-looking expectations about actor preferences and the assertiveness of social coalitions when it comes to fiscal adjustment. Section four concludes and outlines the international and domestic constraints the CoGs of Ireland and Portugal faced as they carried out their EAPs.

4.1. Setting the international scene: From the global financial crisis to the EAPs

Before turning to the actual case studies, it is important to understand the international background against which the EAPs were designed and conducted. The global financial crisis, which broke out in 2007 and culminated in the meltdown of US high street bank Lehman Brothers on 15 September 2008, did not immediately result in the eurozone crisis. It first spread to Central and Eastern Europe (CEE). Hungary became the first EU member to receive joint fiscal assistance by the EU and the IMF. In May 2010, the crisis finally hit the eurozone. The first part of this subchapter gives short overview of how the global financial crisis affected Europe and how the troika and the EAPs were chosen as the means to combat the eurozone crisis (for a comprehensive account of these events, see Bastasin, 2012; Blustein, 2016). The second part then sets out in more detail the technicalities and objectives of the EAPs.

4.1.1. How the global financial crisis turned into the eurozone crisis

Four developments following the outbreak of the global financial crisis sparked the eurozone crisis. First, the 2007 US banking crisis, which had its roots in the US mortgage market, resulted in a massive global recession especially in the advanced economies, which reached its peak in 2009. Second, because there was no workable European mechanism for the support and resolution of ailing banks, the banking crisis also

induced a vicious circle between banks in need of financial assistance and their sovereigns whose national finances became increasingly pressurised by global financial market actors. Third, several states in CEE cracked under this pressure and received joint IMF-EU lending between 2008 and 2010. Those balance-of-payments programmes were the EAP's precursors. Finally, the eurozone governments and the troika institutions agreed on the EAPs as the instruments to combat national debt crises.

Ensuing from a crash on the US property market, the 2007 financial crisis swiftly developed into an economic crisis of global scale (for an extensive account, see Posner, 2010). Economic growth had already slowed down significantly in 2008 and completely collapsed in 2009 when the world economy went into recession. The economic downturn was especially severe in Europe due to the linkages between the European and US financial markets (Tooze, 2018: chapter 3). According to IMF data, the EU's GDP fell by more than 4 per cent in 2009. The great recession turned out to be particularly disastrous in the eurozone. Nearly all of its peripheral member states faced three crises at once (Shambaugh, 2012). These countries did not only suffer from the global economic slump. They were also forced to intervene in domestic banking sectors although most of them lacked fiscal leeway. European banks had been engaging in cross-border trade and investment on the EU's common market while 'supervision, support, and resolution remained at the national level' (Howarth and Quaglia, 2016: 26). Initially, there was no workable solution for ailing banks at the European level and bank bailouts had to be performed by national governments (Grossman and Woll, 2014; Woll, 2014). What is more, most of the EU's smaller economies had built up large current account deficits, which mirrored the surpluses accumulated by export powerhouses such as Germany.

During the early years of the euro, the European periphery profited from large capital inflows from high-income countries. However, the global financial crisis 'prompted a reassessment of asset prices and growth prospects, especially for those countries that displayed macroeconomic imbalances' (Lane, 2012: 55). This resulted in a sudden stop of capital inflows and even capital outflows. In some cases, in Greece for instance, this only increased the interconnectedness between domestic banks and governments because the former, already holding considerable amounts, acquired even more state debt. Sovereign debt was assessed as being increasingly risky to hold as investors associated it with the mounting risk of holding the debt of ailing domestic banks (Howarth and Quaglia, 2016). In other cases, such as in Ireland, it was the sheer amount of government assistance to domestic banks that made investors call into question the sustainability of public debt.

Pressure on the EU's periphery increased as rating agencies began to downgrade sovereign debt and bond rates skyrocketed. The spreads between German and most peripheral ten-year government bond rates had been closing steadily since the inception of the. In 2008, they began to diverge again and government financing on private bond markets became increasingly unsustainable. This development first affected Hungary and Latvia. But as the year 2009 came to a close, Eurozone bond rates had followed suit, raising to unsustainable levels first for Greece and soon afterwards for both Ireland and Portugal. In October 2008, Hungary was the first country to apply for financial assistance. It was also the first country to receive

joint lending from IMF and EU and thus 'served as ground-zero for IMF–EU cooperation' (Piroska, 2017: 807).

Europe's heads of governments reacted much slower to the eurozone fiscal crisis than to the problems of the CEE countries (Bastasin, 2012; Tooze, 2018). For the latter, the EU could tap its balance of payments assistance facility, which had been established in 2002. Such an institution did not exist for the eurozone countries. Finding a solution for troubled member states was complicated by the EU's no-bailout clause, which proscribes for member states (or the EU as a whole) to be held responsible for the liabilities of individual member states. This clause—often invoked by Germany as a means to assert fiscal discipline—and its diverging interpretation by the member states, prevented a swift reaction to the eurozone crisis. It was decided that in order to not to infringe on the clause, financial assistance would be granted only as a last resort, if a member state was not able to refinance itself on the market (Henning, 2017: 41). Furthermore, EMU membership precluded external adjustment. Together with Europe's political fragmentation, this meant that the resolution to the eurozone crisis was prone to be 'a first-order distributional struggle' (Henning, 2017: 57). Since bargaining power was 'heavily weighted toward the creditors' (Frieden, 2015: 7), it was clear that the burden of internal—that is structural and fiscal—adjustment would fall on the smaller borrower states. This was reinforced by the macroeconomic ideology championed by Germany—arguably the biggest and most powerful economy in the eurozone—and its North European allies. These countries were unwilling to adjust current account surpluses of their mostly export-driven economies but advocated the necessity of strict austerity and sound public finances (Blyth, 2013a).

At the global level, providing large amounts of financial assistance to advanced economies proved to be much more politically controversial than the relatively small programmes for Hungary and Latvia. Still suffering from the negative repercussions of how it handled the Asian financial crisis in the late 1990s, the IMF was eager to regain its reputation and significance as a manager of the global economy. Yet, its involvement in the troika was contested from three sides. First, it was 'unprecedented in its almost 70-year history' (Lütz and Kranke, 2014: 311) that the IMF would mainly lend to advanced European economies. Second, the EC and several European heads of government—especially French President Nicolas Sarkozy—at first argued for an exclusively European solution opposed the IMF's inclusion. Eventually it was Germany that pushed through the Fund's involvement (Henning, 2017: 79-84; Tooze, 2018: chapter 14). Finally, the IMF's rules and regulations prescribed that 'exceptional access' to Fund lending could only be provided when the borrower's debt was either anticipated to be sustainable over the medium term or if it was to be restructured. The former was highly doubtful in the Greek case, and the latter vehemently rejected by European institutions and governments. To allow the IMF to participate in the programme for Greece, the exceptional access criteria had to be adapted (Blustein, 2016: 133-141; Lütz and Hilgers, 2019: 303). The sustainability of Greece's public debt, however, would remain a subject of continuous dispute between the IMF and its European counterparts (Lütz et al., 2019a).

Greek sovereign bond rates had come under mounting pressure in late 2009. In October, a new government was elected. Shortly thereafter, then Prime Minister Giorgos Papandreou announced that the previ-

ous governments projection of a deficit of 6 per cent of GDP had to be revised upwards to 12.7 per cent. In November 2009, Eurostat again revised the deficit upwards, which would amount to 15.4 per cent of GDP (Howarth and Quaglia, 2016: 36). The interest rates for Greek sovereign debt had been above average before the crisis already. In the immediate aftermath of the government's revision of the 2009 deficit, Greek public debt was downgraded by rating agencies and investors started to speculate against it. Greece faced increasing difficulties to finance itself on the market and on 2 May 2010 the first EAP was agreed upon.

Although Ireland's public finances were sound in the years before the crisis, its banking sector ultimately proved to be too much of a drag. In September 2008, the government had issued a blanket guarantee for the banking sector. Irish banks had been badly affected by the global financial crisis and were heavily invested in Ireland's property bubble, which had burst in 2007. Still, Irish government bonds were being priced at relatively sustainable rates. This changed in October of 2010 when Germany's chancellor Angela Merkel and Nicolas Sarkozy announced at the side-lines of the Deauville Summit that a bail-in of the private sector would be mandatory for future EAPs. Although this provision was revoked later, the damage was done and the markets reacted in panic. The programme for Ireland was agreed upon in December 2010. Portugal's banking sector had been exposed to the global financial crisis to a much lesser extent, but the Deauville declaration still put Portuguese bond rates under pressure. It turned out to be the final straw when it became clear that the first Greece programme was about to fail. Portugal followed Ireland and requested financial assistance from the troika in April 2011.

4.1.2. Technicalities and objectives of the EAPs

The eventual design and implementation of the EAPs was the result of a protracted political process that followed a 'pattern of two steps forward, one step back' (Henning, 2017: 69). The programmes for Hungary and Latvia had served as a training ground for this novel form of IMF-EU cooperation in several ways. When the most controversial political disputes between the major creditors were resolved, the EAPs' technical basis was set. All programmes had the same time-frame and provided for regular review missions and similar economic objectives.

An EAP's standard duration is three years. Within this time, it is supposed to fulfil two, closely intertwined objectives, namely to stabilise the economy and to allow the borrower to return to private market funding (Interview EC 14). The typical programme contains, first, provisions to restore the stability of the financial and banking sector. Second, it aims at fiscal adjustment and fiscal-structural reforms. And finally, it specifies structural reforms primarily for labour and product markets. The specific measures are the result of negotiations between the troika institutions and the borrower government. During these negotiations, representatives of the troika and the government constantly exchange views with their administrations and important stakeholders. Finally, the negotiation outcome is then ratified at the domestic as well as the international level and published in a programme report. Although the troika was eager to represent

itself as a unitary actor, both the IMF and EC each had their own documents to put down in writing the technical details and specificities.

EAPs set a fiscal deficit target that is to be met at the end of the programme. Honouring the provisions of the EU's SGP, which allows for a deficit of no more than 3 per cent, is an important point of reference here especially for the EC (Lütz et al., 2019a). Given that the programme countries are far away from meeting this target, an individual adjustment path is specified. It is usually based on a so-called 'front-loaded consolidation effort'. This means that the bulk of the adjustment is to be implemented at an early stage of the programme. The exact adjustment path is an outcome of the negotiation processes described above. It is based on projections and forecasts carried out by the government but also in the specialised departments of the troika institutions.

The adherence to the provisions set in the programmes and the implementation of the policy conditions is monitored on a regular basis. Roughly every three months, teams of representatives from all three troika institutions visit the borrower country during so-called 'review missions'. The missions involve negotiations, especially when readjustments of parts of the programme have become necessary. The adjustment path or individual deficit targets may be subject to change. This happens either when the economy and/or national finances develop better or worse than expected. Alternatively, governments may be unable or unwilling to implement one or several measures, which then may be substituted or modified. In any case, the troika understands the memoranda as 'living documents' (Interview EC 11), which are adjusted from review to review and where 'not everything is specified at the outset' (Interview IMF 08). The troika is not interested in forcing reforms on a country that are impossible to implement if the general objectives of the programme are not compromised. Furthermore, the national budget is one of the central aspects of state sovereignty and despite their preferences for spending cuts, the troika institutions accept proposed measures usually, as long as they meet the deficit targets and 'it all adds up' (Interview IMF 13).

To sum up, the global financial crisis had massive repercussions for Europe and the eurozone. This was not only the result of a crisis in the banking sector but of several crises hitting the eurozone at once. Due to bond spreads rising to unsustainable levels, Hungary and Latvia were the first countries on Europe's periphery to apply for financial assistance in 2008. Joint lending by the IMF and the EU served as a blueprint for what would later become the EAPs for struggling eurozone members. The EAPs were adjustment programmes negotiated between borrower countries and a troika consisting of ECB, EC, and IMF. Having set the international scene, I turn now to the domestic background against which programme implementation in Ireland and Portugal took place.

4.2. Setting the domestic scene: Politics and economic growth before the global financial crisis

This dissertation argues that national politics sheds light on the composition and implementation of fiscal adjustment in the eurozone crisis. It is therefore necessary to not only understand how the EAPs came about at the international level, but also to outline the relevant domestic societal actor groups and how they were involved in economic policy-making in the run-up to the crisis. The analytical framework has spelled out two major cleavages of fiscal policy preferences. Thus, this subchapter first identifies distributional conflicts between traditional and novel coalitions in Ireland and Portugal. I then describe the growth dynamics of the two economies and how sector-based actor groups relate to the distributional contestation of fiscal policy. In a second step, the following subchapter then formulates how I expect these dynamics to influence fiscal adjustment in Ireland and Portugal.

4.2.1. Distributional conflicts: Traditional and dynamic actor groups in Ireland and Portugal before the crisis

This section analyses the potential for redistributive conflicts between different coalitions in Ireland and Portugal. It focuses on non-dynamic coalitions defending state spending that aims to mitigate economic risks and dynamic actor coalitions in favour of cuts to government expenditures. I first identify major interest groups and the economic risks their constituencies are exposed to. Then, I summarise their central policy preferences and demands in the lead-up to the crisis. Finally, I show how these groups have been involved in political decision-making processes and how their demands resonate within the party system.

In both countries, trade unions and business organisations are influential political actors that have been involved in policy-making by institutions of social concertation. However, there are major differences between the two cases. The interest representation of Portuguese labour and business is characterised, to a larger extent, by class-based antagonism and is traditionally more adversarial than in Ireland. What is more, the core constituencies of Portuguese interest groups are exposed to higher economic risks than their counterparts in Ireland. Prior to the eurozone crisis, trade unions partaking in social concertation in Portugal were mainly concerned about promoting their preferences and maintaining redistributive policies. In doing so, they were at odds with both the business community and a government facing permanent austerity against a background of low economic growth. In Ireland by contrast, trade unions, business associations and governments were not only committed to a long-term idea of how to organise the economy but were also able to distribute the fruits of more than a decade of high economic growth. This became a non-partisan question, as nearly all political parties agreed on Ireland's growth model. Among other factors, a strong communist party, with close ties to the larger of the two trade union confederations, made such an agreement and common commitment impractical in Portugal.

4.2.1.1. Trade unions

Portuguese workers are organised in two different trade union confederations. The first is the *Confederação Geral dos Trabalhadores Portugueses – Intersindical Nacional* (CGTP). CGTP's roots can be traced back to the final years of the country's dictatorship. After the Carnation Revolution in 1974, CGTP initially acquired a monopolistic position (Schmitter, 1995: 299). Its monopoly came to an end when the *União Geral de Trabalhadores* (UGT) was founded a few years later. The two confederations pursue opposing strategies of interest representation and are based on distinct ideologies. CGTP largely represents a communist ideology and 'class-based unionism' (Dornelas, 2003: 131). It has traditionally pursued a conflict-based strategy of interest representation (Dornelas, 2010: 111). On the basis of its 'centralized, cohesive and disciplined culture' (Barreto and Naumann, 1998: 414), CGTP's activities are often directed towards strikes, protest and other forms of mass mobilisation. In some cases, it has been able to put its agitative class struggle rhetoric aside in favour of a more pragmatic approach towards industrial relations as well economic policy (Barreto and Naumann, 1998: 396). However, CGTP employs such pragmatism only on a case-by-case basis and only when it is obviously in its interest to do so (Campos Lima and Naumann, 2000: 323). UGT represents a more moderate approach in terms of 'a managerial form of trade unionism with the typical proposals of a bargaining unionism' (Dornelas, 2003: 131). It has been willing to enter negotiations with the government and employers' associations on a regular and more cooperative basis and has been viewed by these actors as a more welcoming alternative to CGTP (Barreto and Naumann, 1998: 403). It pursues 'strategies borrowed from the Scandinavian social-democratic model based on social bargaining' (Royo, 2002: 196). UGT resorts to protests only selectively and usually avoids CGTP's class-based rhetoric in favour of a more consensual negotiating approach (Campos Lima and Naumann, 2011: 163; Royo, 2012: 175). Finally, there exists a variety of independent unions, which are not willing to join any of the two confederations. These occupational unions on average only have 500 members and are mainly concentrated in the public service sector (Naumann and Stoleroff, 2000: 555-556).

Initially, relations between UGT and CGTP were conflict-laden as the two organisations did not maintain any formal relations (Dornelas, 2003: 131). The two confederations do not only represent different ideologies and diverging approaches towards political activism. The two confederations also differ regarding their total membership and their sectoral strongholds, although parallel unions in almost every sector—except for the financial sector—compete for members and support (Royo, 2002: 10). Most recent numbers, that is, for the year 2010, show that CGTP united 68 per cent of all trade union members, whereas UGT represents a little more than a quarter of organised labour (Visser, 2019). Exact numbers are scarce, but it can be said that UGT's has the stronger white-collar membership, whereas CGTP's has more blue-collar members (Magone, 2014a: 125). UGT has a monopoly-like position in the financial and banking sector, but failed to form vertically integrated, nation-wide industrial unions. It was more successful in occupying 'niches left by CGTP' (Naumann and Stoleroff, 2000: 555) or creating unions rivalling those of CGTP in certain areas. As a result, it remains dominant in the banking and insurance sectors as well as

some industries, services, and education. CTGP, by contrast, is especially strong in manufacturing, construction, transport, and the public sector (Royo, 2012: 146).

As opposed to the two fundamentally different and sometimes conflicting trade union federations in Portugal, the majority of Irish trade unions are organised in a single umbrella organisation. In 2008, the *Irish Congress of Trade Unions* (ICTU) represented 602.000 of a total of 613.000 trade union members (Visser, 2019). Its stance towards economic policy has been shaped significantly by the establishment of social concertation in Ireland (Culpepper, 2008). Industrial relations in Ireland were largely antagonistic and shaped by industrial unrest until the late 1980s. During that time, 'ICTU emerged as a central player in mobilizing public opinion' (Culpepper and Regan, 2014: 732). However, when faced with a severe economic crisis, trade unions did not only enter tripartite negotiations with their counterparts on the business and the government side in 1987. They also established their commitment to Ireland's export-oriented growth model and abandoned their stance that viewed insufficient domestic demand as the main cause of absent economic growth (Culpepper, 2008: 15). The behaviour of ICTU and its affiliated trade unions resembles what has earlier been termed 'competitive corporatism' in that they 'had accepted the logic of business imperatives, often in high-unemployment contexts' (Hardiman et al., 2008: 620). It was an expression of the unions' willingness to corporate with employers and to strive for mutual gains (Roche, 2007: 413). This approach became supported widely by its constituencies as contrasted with traditional antagonistic and conflict-based strategies (Roche, 2007: 411).

Although the total number of members has been increasing since the early 1990s, trade union density shrank over time as employment grew much faster than the number of union members (Donaghey and Teague, 2007: 24). A large amount of employment growth was driven by foreign-owned and especially US corporations. These companies bring with them their own traditions of industrial relations and often actively use their political clout to avoid trade union recognition (Collings et al., 2008; Gunnigle et al., 2005). Trade union density is highest in the public sector and especially low in agriculture, in hotels and restaurants, wholesale and retail trade, and other low-end services sectors (Visser, 2019). ICTU organises three main groups of individual trade unions, general unions, public sector unions, and craft unions (Donaghey and Teague, 2007: 26). Of those, the *Services, Industry, Professional, Technical Union* (SIPTU) is by far the largest, representing more than one third of ICTU's members (Elvert, 2012: 329). Finally, the *Irish Municipal, Public, and Civil Trade Union* (IMPACT) is the largest public sector union and represents more than 37.000 workers (Elvert, 2012: 330).

To sum up, Portugal's two large trade union confederation represent different core constituencies, different approaches towards industrial relations, and different stances towards economic policy-making. CGTP, the larger of the two, is based in blue-collar sectors and has a class-based and adversarial attitude vis-à-vis social partnership. UGT is much more open to negotiation and moderation and has more members with white-collar jobs. Irish trade unions, by contrast, are unified by one large umbrella organisation that is largely committed to Ireland's export-oriented growth model. The unions organised in ICTU have a broad membership but are especially strong in the public sector and weak in several low-end services sec-

tors. Multi-national corporations (MNCs), which form a main pillar of the Irish economy, largely elude the influence of trade unions.

4.2.1.2. Employers' organisations

Portuguese industrial relations are dominated by three major business confederations. First, the Confederation of Portuguese Industry (*Confederação Empresarial de Portugal,* CIP) mainly represents the manufacturing sector but also has members in the services sector. Second, the Confederation of Trade and Services of Portugal (*Confederação do Comércio e Serviços de Portugal*, CCP) organises employers in commerce and services. Finally, the Confederation of Farmers of Portugal (*Confederação dos Agricultores de Portugal*, CAP) is based in the agricultural sector. Political cleavages exist both between those organisations as well as within them. Externally, there is potential for sectoral as well as ideological conflicts (Dornelas, 2010: 112). Furthermore, Portuguese employers are not unified in an umbrella organisation, also due to several smaller business associations that are not affiliated to any of the larger confederations. Internally, the confederations incorporate 'multi-sector trade associations' (Barreto and Naumann, 1998: 407), which are politically very influential and represent the economic interests of business in general, and sectoral associations, which are usually organised regionally and perform industrial relations functions such as wage bargaining (Dornelas, 2003: 133). For example, CCP organises wholesale as well as retail trade companies with sometimes opposing interests (Barreto and Naumann, 1998: 408; Naumann and Stoleroff, 2000: 549).

Exact data on the representativeness and the degree of organisation of employers' confederations is not fully reliable. However, CIP is undoubtedly the most important of the three organisations and has always been 'the privileged interlocutor of government due to its high degree of representativeness among small, medium-sized, and large enterprises' (Magone, 2014a: 119). Most recently, CIP has been found to organise 29 per cent of employers' associations in the industrial sectors and CCP as combining 40 per cent of associations in the commercial and services sectors (Dornelas, 2003: 133). These numbers deviate from those more recently provided by the confederations themselves. According to them, 163,000 companies employing around 1.1 million workers are organised in CIP, that is around 50 per cent of enterprises and jobs. CCP states to represent 200,000 companies (80 per cent) and roughly 1 million employees (70 per cent) in commerce and services (Naumann, 2013).

The *Irish Business and Employers Confederation* (IBEC) is the counterpart to ICTU and serves as the main employers' association of Irish businesses. It has members in almost all sectors except construction, where the *Construction Industry Federation* (CIF) organises employers. Although IBEC represents all kinds of Irish corporations, it is dominated by export-oriented interests not least because it has a share of highly influential foreign-owned firms as members (O'Donnell et al., 2011: 104; Afonso, 2011: 717-718). In parallel, the American Chamber of Commerce in Ireland (ACC) represents a large number of US companies invested in the Irish economy and on its website proudly calls itself 'the Republic's most influential business lobby group'.

Before the crisis, IBEC as well as CIF were the two most important employers' associations directly involved in social concertation. IBEC's *Small Firms Association* (SFA) is rivalled by *Irish Small and Medium Enterprises Association* (ISME), which represents mainly small businesses (Roche, 2007: 405). The available data only describes the density of employers' organisation at the national level and not for individual confederations. By their own account, IBEC and the SFA in 2012 together represented 15,500 companies, whereas IMSE stated to have 8,750 members (Farrelly, 2014). Irish employers acted as staunch supporters of a exposed-led growth strategy based on exposed sectors as the backbone of the economy (Culpepper, 2008). Ultimately, employers and trade unions 'came to share a common view of Ireland as a small, open economy whose fortunes were ever more deeply implicated in those of the wider European economy' (Hardiman, 2002: 6). However, this is not to say that the relationship between Irish employers and employees were without tensions. What had been agreed upon was the general orientation of the economy and how to distribute the profits of Ireland's economic success. Industrial relations on the micro-level continued to be adversarial. At the workplace, social concertation 'rarely, if ever, altered the deeper cultural mindset that employers have a perceived right to rule within the firm' (McDonough and Dundon, 2010: 557).

To conclude, several employers' organisations exist in both countries. There is also a dominant business association in both countries, which represents the interests of employers within the context of social concertation. The main difference, however, is that employer and trade unions in Ireland were able to develop a common understanding in support of an export-driven growth model. Finally, IBEC has a substantial constituency of foreign-owned corporations, which play practically no role in Portuguese employers' associations.

4.2.1.3. Economic risks

Having identified the central actors representing labour and capital, we can now turn to the economic risks faced by these actor groups. Portuguese workers and businesses are exposed to much higher economic risks than their Irish counterparts. This is the result of differences in individual skill levels but also in the international competitiveness of the exporting sector. To illustrate these differences, I first show and contextualise the level and distribution of skills of the workforce. I then and outline how and why businesses in Portugal are less competitive than Irish corporations.

As already discussed, low-skilled workers and those working in industries, which are likely to lose out to international competition, face high economic risks. Figure 4.1. depicts the distribution of skills in eight countries in 2008. It includes the four countries which have implemented an EAP as well as Latvia and Hungary, which received joint IMF-EU lending, in comparison to CPE's two textbook examples of Germany and Sweden. Germany, Sweden, Latvia, and Hungary stand out as having the highest share of the working-age population with secondary education. These are also the countries with a high share of exporting industries that mainly rely on specially trained workers without needing them to have a university

degree (e.g., Estevez-Abe et al., 2001). Cyprus and Ireland have almost the same skill-profile, meaning a highly educated workforce with less than a third of low-skilled workers. Greece and Portugal, finally, show the lowest average skill level and a high working age population with only primary education.

In direct comparison, the difference between Ireland and Portugal becomes even more stark. Both are outliers. In Ireland, the share of high-skilled labour is the highest of all countries considered. On the other hand, Portugal has by far the most low-skilled citizens of working age. In the lead-up to the eurozone crisis, Portugal's working-age population faced much higher economic risks than Ireland's. A higher share of low-skilled individuals in the working-age population implies that there is a higher risk of having a lower income, becoming unemployed, and a lower probability to get re-hired after the crisis. Faced with an economic crisis and the necessity to fiscally adjust, we can therefore expect a large number of voters to position themselves against expenditure cuts, especially in the area of social and welfare policy. By contrast, the share of the working-age population with high skills is almost three times higher in Ireland than in Portugal. This implies an enormous potential for forming dynamic coalitions with preferences for lower state spending and especially lower tax rates. As a result, the support for expenditure cuts should be higher in Ireland than in Portugal.

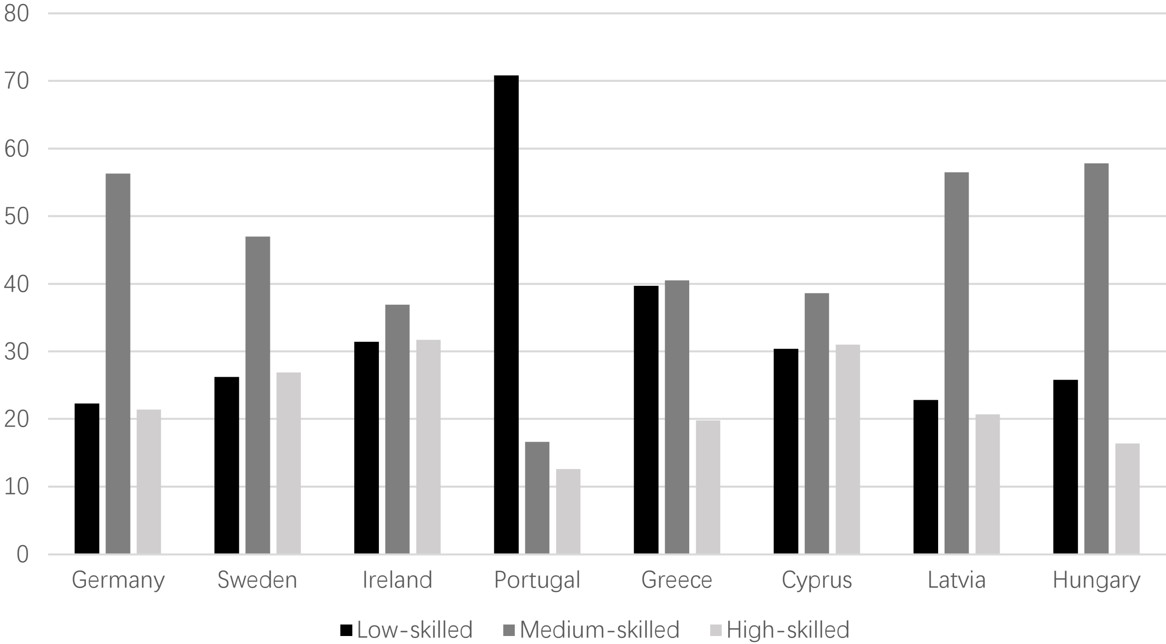

Figure 4.1.: Distribution of skill levels.
Notes: Year = 2008; Age = From 15 to 64 years; Low-skilled = Less than primary, primary, and lower secondary education, Medium-skilled = Upper secondary and post-secondary non-tertiary education, High-skilled = Tertiary education (ISCED 2011).
Data Source: Eurostat, Population by educational attainment level, sex, and age (per cent) - main indicators.

In both countries, high-skilled workers constitute the largest number of trade union members. However, taking a closer look at the data, a major difference emerges (Visser, 2019). Low-skilled members constitute

a group that is twice as large in Portuguese (31 per cent of total members) than in Irish trade unions (15 per cent). The opposite holds true for medium-skilled union members, who are more numerous in Ireland (38 per cent) than in Portugal (16 per cent). Portuguese trade unions represent low-skilled workers and their preferences for higher levels of state spending much better than their Irish counterparts. In addition to the generally low number of low-skilled workers in the Irish economy, this suggests that risk-based pro-spending preferences are less well represented by Irish trade unions.

The distribution of skills and how they are represented alone only tells us one part of the story about which economic interests we can trade unions to promote. As argued above, the distribution of skills across sectors and the exposure of those sectors to the world economy is another important piece of the puzzle. Drawing on Wren (2013) and Wren and Rehm (2013, 2014), table 4.2. details the cross-sectoral distribution of high-, medium-, and low-skilled workers. It shows the distribution of workers between sectors at each skill level. The first row includes manufacturing and other sectors that have traditionally been traded. The second row covers dynamic services that have become increasingly traded in recent years, such as financial or software services (for example, 11.5 per cent of all high-skilled in Ireland work in the traditional sectors). Taken together, these two groups constitute the sectors of an economy exposed to global markets. By contrast, the third group includes (personal) services that have been and are still mostly predominantly sheltered from international competition. Welfare services correspond to those working in the public administration, education, and the health and social work sector. Infrastructure services such as the provision of electricity are subsumed under 'other' services.

Table 4.2.: Cross-sectoral distribution of skills

	High-skilled		Medium-skilled		Low-skilled	
	Ireland	Portugal	Ireland	Portugal	Ireland	Portugal
Traditional	11.5	7.2	16.4	13.6	25.1	35.3
Dynamic services	27.5	26.8	17.6	25.7	15.8	11.1
Exposed	***39.0***	***34.0***	***34.0***	***39.3***	***40,9***	***46,4***
Non-Dynamic Services	18.4	13.3	35.0	32.7	29.2	28.3
Welfare services	34.3	48.5	15.7	22.5	12.4	12.1
Other	4.4	3.4	16.0	6.1	17.5	13.4
Sheltered	***57.1***	***65,2***	***66.7***	***61.3***	***59.1***	***53.8***

Notes: Year = 2008; Traditional sectors = agriculture, mining, total manufacturing; dynamic services sectors = transportation & storage, information & communication, financial & insurance activities, professional, scientific & technical activities, administrative and support service activities; non-dynamic services sectors = wholesale & retail trade, repair of motor vehicles, accommodation

and food services, arts, entertainment & recreation, other service activities; welfare services = public administration & defence, education, health & social work; other = electricity & gas, water & sewage, construction.

Data Source: EU KLEMS Growth and Productivity Accounts, September 2017 release, available at: www.euklems.net.

First, welfare services workers represent a core trade union constituency. The same is true for both Ireland and Portugal, where they constitute almost half of all trade union members (Visser, 2019: 2013 data). As I argued in the analytical framework, high-skilled public sector workers are a vital pillar of left-leaning pro-welfare coalitions across skill-groups that can expect to oppose expenditure cuts (Wren and Rehm, 2013, 2014). The conditions for such a coalition are much better in Portugal than in Ireland as the public sector in Portugal employs a much larger share of high-skilled workers. 48.5 per cent of high-skilled workers in Portugal work in the welfare services sectors as opposed to less than 35 per cent in Ireland.

Second, the share of high-skilled workers that work in dynamic services (26.8 per cent) is only half of the share of those working in the welfare services sectors. In Ireland, this ratio is much more in favour of the former (27.5 per cent to 34.3 per cent). Irish dynamic services workers with high skills have been an influential economic actor group since the late 1990s, when skill and labour shortages became an economic problem (Hardiman, 2002: 10). By contrast, the relatively small group of Portuguese high-skilled workers in increasingly exposed dynamic services sectors requires allies if it wants to form an influential coalition in favour of an expenditure-based adjustment strategy. There are two groups that could be deemed as potential allies for exposed high-skilled workers in Portugal. Yet both are comparatively weak.

As opposed to Ireland, the share (and number) of highly qualified individuals working in the traditionally exposed sectors is relatively low (11.5 against 7.2 per cent). That is, even if they had preferences similar to their counterparts in the dynamic services sectors, the resulting coalition would likely be too small to have any significant bearing on fiscal policy-making. Low-skilled workers in the traditional sectors are another group that would potentially prioritise the implications of lower levels of state spending for international competitiveness over its redistributive effects. However, as I will show below, in the Portuguese case the fiscal policy preferences of this group are strongly influenced by their exposure to economic risks. This is because they run the risk of losing their jobs to international competitors and cannot expect to easily transfer or improve their skills in a way that would allow them to work in the dynamic services sector. Here, the conditions exist to form a non-dynamic coalition in favour of higher levels, which would unite high-skilled workers in the public sector and a large low-skilled labour force exposed to high economic risks. Both actor groups are well represented by trade unions. The differences between young and old trade union members reinforce the potential for such a coalition. Portugal's trade unions have a comparatively low share of young members (Visser, 2019). One the one hand, older union members in Portugal are more likely to have protected employment relationships, which decreases their exposure to economic risks (Magone, 2014a: 135; see also Frieden, 2015). On the other hand, they have no reason to demand the dismantling of these privileges or other spending items, such as pensions. Furthermore, young people in

Portugal tend to be higher skilled than their older counterparts and therefore more likely advocate for lower levels of state spending and thus support an expenditure-based adjustment strategy.

In Ireland, by contrast, the preconditions for the formation of a dynamic coalition in support of spending cuts are much better. Not only is the share of high-skilled workers that work in public services comparatively low, but there is also a comparatively low number of employees with only primary education in general. Both the share and the number of people with tertiary education in exposed sectors both are higher in Ireland than in Portugal. At the same time, those exposed most to economic risk stemming from globalisation, namely low-skilled workers in the traditional sectors, form a much smaller group than in Portugal. This means that the most important actor groups bolstering traditional coalitions and their demand are comparatively weak in Ireland. High-skilled workers in exposed sectors, which tend to oppose higher levels of redistributive state spending, constitute a politically much stronger actor group. The increasing differences between low-skilled workers exposed to high economic risks and high-skilled workers in dynamic sectors suggest highly polarised fiscal policy preferences, which makes redistributive compromises between the two groups very unlikely.

Another source of economic risks concerns uncompetitive workers and businesses in exposed sectors. First, as already discussed, workers compete with workers in other countries who have higher skills and/or get paid lower wages. Second, companies may either lack the assets necessary to compete in advanced markets or their prices may be too high. Finally, companies may be engaged in the production of products or services that face declining global demand.

With respect to these points, economic actors in Portugal were positioned much worse than their Irish counterparts. They were therefore less likely to form an assertive dynamic coalition that supported spending cuts. As I will discuss below, Portugal's economy and its (manufacturing) exports had already been underperforming in the years before the crisis. Although dynamic services exports increased, their rate of growth was relatively low when compared to other small states in Europe (OECD, 2008b: 78). Portuguese exports were strong in sectors where international competition had become particularly intense. On the one hand, Portugal was highly specialised in low-technology industries—for example textiles—where producers outside of Europe had a significant cost advantage. On the other hand, Portugal's exports of medium-high technology—such as electrical machinery—faced strong competition from the EU's new CEE members (OECD, 2010: 25). This contrasts significantly with Ireland. In early 2000, almost 55 per cent of Ireland's exports stemmed from high technology sectors (Crespo et al., 2004: 788). What is more, during that time Portugal lost market shares in sectors where demand was dynamic, or at least growing slowly, and could increase its shares only in sectors where demand had been declining (Crespo et al., 2004: 785-786). It was not only workers who faced high economic risks, but also businesses in Portugal's exposed sectors. Regardless of fundamental class conflicts between labour and capital in Portugal, this implies the potential for a cross-class coalition in favour of higher levels of state spending that fulfils an insurance function against the further deterioration of their economic position.

Ireland, by contrast, does not have the preconditions for such a coalition. As we have already discussed, there is not much potential for a traditional coalition uniting labour. Economic risks are distributed differently in the Irish than in the Portuguese economy. This holds true not only given the generally higher skill level, but also considering the exposure of Irish businesses to economic risks due to globalisation. As a result of the 'Celtic Tiger' boom during the late 1990s, Ireland became one of the OECD's most open economies. In light of the economic success based on its export-led growth model, globalisation has been presented in the political discourse not as constituting an external challenge but as an economic opportunity (Hay and Smith, 2005: 136). Although the Celtic Tiger years produced a substantial decline of traditional manufacturing industries, for most economic actors this was more than substituted by 'an ongoing impetus toward increasingly knowledge-intensive and high-tech investments [and] the virtual elimination of unemployment' (Hardiman et al., 2008: 618). Irish exports to the EU increased mostly in those areas where demand was dynamic (Crespo et al., 2004: 785). As opposed to Portugal, this also meant that the EU's eastward enlargement worked to complement Ireland's exporting economy, rather than posing intensified competition (Barry, 2004). One outcome of the Celtic Tiger boom was a downturn in sectors based on lower wages and high labour-intensity, which was more than made up for by gains in sophisticated sectors such as pharmacy or software (Ó Riain, 2014: 194).

A large share of these developments, however, took place in foreign-owned companies and was driven by FDI. Although domestic workers and businesses profited greatly from the economy's FDI-driven boom, they were still exposed to greater risks than those working for foreign-owned which dominate high-technology manufacturing (Andreosso-O'Callaghan and Lenihan, 2011: 341). Furthermore, because those industries are concentrated mainly in urban centres, there existed regional disparities which had not been balanced before the crisis (Kirby, 2010). Yet, a strong cross-class coalition in support of higher levels of state spending is still highly unlikely in Ireland when compared to Portugal. This is not to say that economic actors in Ireland are not exposed to risk resulting from globalisation and de-industrialisation. But these risks are compensated for by the generally more positive outlook of these actors to grow out of the crisis and, as I will discuss below, by the political dominance of the Irish growth model that is likely to trump traditional redistributive requests.

To sum up, dynamics of coalition formation differs significantly between the two cases. The number of low-skilled workers facing high economy risks is generally lower in Ireland than in Portugal. Moreover, they are less well represented by Irish trade unions. The preconditions for the formation of a pro-welfare coalition across skill groups based on high-skilled public sector workers are better in Portugal than in Ireland. Conversely, high-skilled workers in dynamic services are a more influential group in Ireland than in Portugal, where they are less likely to find allies for a coalition advocating for an expenditure-based adjustment strategy. Finally, Portuguese workers and businesses face higher risks stemming from globalisation than their Irish counterparts. This makes a cross-class coalition in favour of higher spending levels more likely.

4.2.1.4. Policy demands

This section describes the policy-demands formulated by the economic actor groups identified above in the lead-up to the crisis. Three aspects are important here. First, basic attitudes towards globalisation and eurozone membership show how different groups relate to how these two developments impact the domestic economy. Second, workers and employers have distinct demands regarding economic policy in general. Third, government expenditures and revenues were controversially discussed before the crisis as well. This section contextualises the case study analysis of the policy demands issued by the same groups under the conditions of an austerity programme. It shows that the logic identified in the analytical framework also applies to the political dynamics before the crisis.

In the debate about Ireland's accession to EMU, a broad consensus existed among political parties. Most policy-makers shared a strong belief in the economic benefits and argued that accepting the Maastricht Treaty and joining EMU would have positive political effects as well (Hay et al., 2008: 183). In the wider public, the EU also had a positive image. The 2006 Eurobarometer survey found that 89 per cent of Irish respondents believed that the EU has a positive effect on the economy (Dobbins, 2008b). Irish businesses had an equally positive view on EMU except for the potential danger that the UK's non-membership could result in competitiveness losses for companies exporting mostly to the UK. Yet, these concerns did not carry great weight since Ireland's most dynamics sectors were not heavily exposed to the UK and its currency (Hay et al., 2008: 187). IBEC still presented globalisation as a source of competitive pressure that required greater autonomy for businesses to conduct managerial decisions (Dobbins, 2008b). The trade unions clearly did not share this position and, in general, were not unreservedly positive towards the EU and globalisation.

The referendum on the Lisbon Treaty in 2008 may serve as a case in point for these differences. IBEC, as the main representative of Irish employers, unequivocally argued for a vote in favour of the treaty. However, the trade union movement was undecided on this issue. The public sector unions as well as ICTU in general supported a 'yes' vote. SIPTU, however, asked the government for a guarantee to push for legal labour rights at the European level. As the government was not willing to provide this guarantee, in the end ICTU did not offer their members any recommendation on how to vote. When the treaty referendum ultimately was rejected, SIPTU's general president stated that 'workers' concerns about a downgrading of employment standards since EU enlargement in 2004 were manifestly evident in the "'no" vote' (Dobbins, 2008a). This discussion exemplifies the trade union's 'defensive posture when confronted with the impact of globalisation' (Dobbins, 2008b). While globalisation and EMU membership drove the success of the Irish growth model, trade unions still represented the class-based demands of their traditional core constituencies.

Social concertation has been the main mechanism in Ireland for finding agreements between unions and employers on questions of pay and wages. These issues had become more controversial in the run-up to the crisis for two reasons. On the one hand, cleavages emerged within the trade union movement between

public and private sector workers. Due to the regulations on how wages in the public sector are connected to wages in the private sector, some members of ICTU argued that wages in the private sector lagged wages in the public sector (Dobbins, 2005). On the other hand, trade unions repeatedly called for higher wages in low-end services sectors, such as in hospitality or wholesale and retail (Sheehan, 2008a). As early as 2002, disagreement between unions and employers on these issues intensified. The employers argued that pay increases were impairing the international competitiveness of Irish businesses (Sheehan, 2002). Foreign-owned and multinational corporations in Ireland generally agreed. They also clearly formulated their 'absolute rejection of any movement on the issue of trade union recognition' (Sheehan, 2002). Productivity and production growth had been larger in MNCs. Trade unions were therefore eager to show that the 'indigenous sector' was equally successful in order to strengthen their argument that further pay increases were necessary to bolster disposable income (Dobbins, 2004).

Fiscal policy discussions during the Celtic Tiger years mainly revolved around how to distribute the gains yielded from the economic boom. The trade unions had made their access to fiscal policy-making a pre-condition for their participation in social concertation as well as their commitment to wage restraints and industrial peace (Culpepper and Regan, 2014: 733). As a result, the 'exchange of tax reductions for moderate wage increases became an important feature of partnership' (O'Donnell et al., 2010: 196). Given the relatively high tax burden in the 1980s, 'tax reform was sought by trade unions and was not just a neo-liberal agenda' (O'Donnell et al., 2010: 194). Although Ireland's economic success over time made austere fiscal policy politically difficult to justify, the trade unions' commitment still implied a relatively low level of government expenditures. IBEC regularly tried to take advantage of this, for example by demanding a reduction of the employers' social security contributions amidst a slight economic downturn in the early 2000s (Dobbins, 2001).

In short, globalisation and the integration of Ireland in the eurozone were perceived as largely positive for the country's highly dynamic and export-oriented economy. The economic policy stances of Irish employers and trade unions were heavily influenced by their shared commitment to the export-led growth model in the context of almost 20 years of social concertation. Although this did not fully eradicate class-based antagonisms, the enormous success of the Irish economy in the 1990s and early 2000s made it easier for both groups to compromise. Employers repeatedly issued concerns for the economy's international competitiveness and demanded low spending and tax levels. Against the background of full employment, the trade union movement was able to settle for tax reductions as an instrument to increase disposable incomes and wage levels.

Cleavages between economic actor groups in Portugal in terms of globalisation and European integration can be traced back to the country joining the European Economic Community (EEC) in 1986 (Dornelas, 2003: 136). Employers, while concerned about some potential side effects, welcomed economic liberalisation. UGT also had been generally in favour of joining EEC and hoped that it would elevate living conditions in Portugal. CGTP, finally, rejected EEC accession and instead demanded a more extensive involvement of the state in the economy. UGT viewed the EU and its implications for further integration as

providing Portugal with more opportunities to converge to the living standards of rest of Europe. CGTP, by contrast, viewed European integration as implying '"hardline neoliberal dynamics", with the free movement of capital, liberalization of the economy, deregulation and forced flexibilization of the labour market' (Costa, 2012: 401). By the early 2000s, the employers had abandoned their slight scepticism. If anything, they were critical of what they viewed as the EU's 'dichotomy of jobs and growth vs social cohesion' that would sometimes hinder further liberalisation of the economy (Cristovam, 2000). The Portuguese public had some reservations with respect to EMU, which resulted also from the potentially increasing exposure to economic risks. Almost 20 per cent of respondents to the 2006 Eurobarometer stated that they feared adopting the euro would result in a loss of competitiveness. In Ireland, only 6.5 per cent shared this concern (Hay et al., 2008: 187). These sentiments were aggravated when several multinationals—mainly from the textiles and manufacturing sectors—decided to relocate their production away from Portugal in the early 2000s. Against this background, CGTP demanded that 'the government must work toward attracting investments that do not involve companies establishing themselves for a short period of time in order to take advantage of cheap labour' (Cristovam, 2001b). In contrast to Ireland, there existed no consensus on EMU and consequently no agreement on which policies to pursue in order to succeed in an increasingly integrated Europe (Royo, 2013: 210).

The policy demands made by Portugal's traditional, class-based coalitions correspond to the expectations formulated in the analytical framework. Since the early 2000s, the employers have been prioritising to reduce the role of the state in the economy and to improve international competitiveness (Royo, 2012: 156). CGTP has been located on the other end of the political spectrum, whereas UGT took a more moderate position. How best to improve living conditions in Portugal had always been a major issue between these groups. In the early years of the euro, trade unions argued that EMU did not meet their expectations. If anything, it had increased job insecurity. UGT argued for more social dialogue to address those problems, for example by publishing reports and other public statements. CGTP was much more critical and argued that 'neo-liberal policies are on the rise in the EU' (Cristovam, 2000). It regularly organised strikes and demonstrations, for example a 'national day of action to highlight increasing job insecurity and delays in fulfilling expectations of convergence with wage levels elsewhere in the EU' (Cristovam, 2001a) in 2001. Organised labour viewed wage growth as a central means to improve the living conditions of Portuguese workers, although CGTP's wage demands were usually significantly higher than UGT's (Stoleroff, 2001: 197). The discussions evolving around the minimum wage is another example of the differences between the two organisations. Both trade union confederations usually championed regular increases of the statutory minimum wage (SMN). In 2007, for instance, they sought compensation for 'relative losses in the SMN's buying power' (Campos Lima and Naumann, 2007d). CIP, by contrast, argued that excessive increases would impair profitability and lead to increased unemployment (Campos Lima and Naumann, 2007d). The same discussion took place again a few years later. Both trade union confederations demanded an increase of the SMN. The employers opposed the increase, on the grounds that it would impair international competitiveness, and argued that 25 per cent of Portugal's exports relied on low wages (Campos Lima, 2010c). They wanted to accept an increase only if it was accompanied by

compensating fiscal measures. When the government agreed to reduce the single social tax by one percentage point, CGTP stated that it 'considers it totally unacceptable and immoral that the government has to support employers with their contributions to the welfare system' (Campos Lima, 2010c).

The sustainability of the national budget and social policy budget had been a subject of constant public debate since Portugal had joined the eurozone. Regarding tax policy, CGTP was especially vocal and asked for a new 'development model' (Cristovam, 2001a) that would place special emphasis on tax fairness. This was echoed by UGT, which urged for an incomes and fiscal policy that 'will continue efforts to eliminate increasing inequalities in the distribution of wealth within the country' while CGTP demanded 'more progression in income tax rates' (Almeida and Cristovam, 2001). In 2001 and 2002, social security reform was hotly debated, also because Portugal was facing a severe budgetary crisis. In October 2002, this ultimately resulted in the first joint public sector strike of CGPT and UGT after more than 10 years (Cristovam, 2002a). Both unions were adamant in that they would 'not accept a reduction in social expenditure, pay or pensions' and claimed that there was 'a high level of tax evasion […] calling for fair taxes on wealth to rectify distortions' (Cristovam, 2002c). CGTP opposed any reductions in social security contribution rates (Cristovam, 2001c). CIP, by contrast, called for a slight reduction of the contribution rate for employers and refrained from signing the respective social pact as their demand was not fulfilled (Cristovam, 2001d). When the government finally proposed a social security reform law, CGTP criticised it on the grounds that it would 'jeopardise the principle of solidarity and reduce the social security system's capacity for redistribution' (Cristovam, 2002b). CIP, by contrast, viewed all their propositions as being included in the law (Cristovam, 2002b). As soon as the budgetary situation somewhat improved in 2003, trade unions urged the government to turn to more expansionary fiscal policies again, for example by reinstating a lower VAT rate (Cristovam, 2002d). Finally, in 2007, CGTP organised one of the largest demonstrations in recent years, which demanded more income redistribution and criticised 'the government's "obsession" with the budget deficit' (Campos Lima and Rego, 2007).

Portugal's largely non-dynamic and domestically-oriented economy resulted in economic actors assessing globalisation and European integration much more critically than their Irish counterparts. As opposed to Ireland, policy cleavages in Portugal before the crisis were much more clearly class-based. CGTP and the employers were largely positioned at the opposite ends of the ideological spectrum, while UGT took up a more moderate position. In this, employers focused mostly on issues of competitiveness while referring to the price-sensitivity of Portuguese exports in an increasingly integrated European economy. Their counterparts on the labour side emphasised the necessity of redistribution and progressive taxes while evoking the danger of European integration undermining those objectives.

4.2.1.5. Social concertation

Social pacts in both countries were established in the 1980s as an attempt to exit from fiscal and economic crisis, but they developed very differently (Schneider, 2017). In the years before the eurozone crisis, social

pacts in Ireland served the comfortable purpose of deciding collectively how to distribute the gains from the economic boom. By contrast, Portugal witnessed another fiscal and growth crisis in the early 2000s that both antagonistic industrial relations and a fragmented process of social concertation were not able to resolve.

Between 1987 and 2008, eight social pacts were signed in Ireland. Early phases of social concertation involved only the government, trade unions, employers' associations, and farmers. This group of participants expanded in the mid-1990s to also include civil society organisations (see Roche, 2007: 403-408 for a detailed description of the institutional architecture of Irish social concertation). The pacts initially focused on wage policy but were later extended to cover areas such as 'fiscal policy, tax, unemployment, monetary union, enterprise-level partnership, welfare, social exclusion, literacy, drugs, disability, and many more' (O'Donnell et al., 2011: 89-90).

Social partnership in Ireland has been described as 'a form of embedded neoliberalism' (Regan, 2012: 468). It has been conceptualised not as a strategy of (welfare state) adjustment but more as a kind of 'flexible network governance' (Hardiman, 2006), that is a means to manage a small open economy that is highly dependent on trading in the global economy and on FDI inflows. Social pacts during the Celtic Tiger era, most notably in 1990s, neither addressed inequality between different income groups nor the income growth of capital at the cost of labour (O'Donnell and O'Reardon, 2000: 243). Consequently, employers' associations and the trade unions in the public sector were the most outspoken supporters of the continuation of social partnership, whereas unions representing low-paid workers were the most critical (O'Donnell et al., 2011: 114). Although state and welfare spending did rise during the social partnership period, income inequality still grew. This was because average incomes rose faster than spending on social policy and taxation policy increasingly favoured higher incomes (Roche, 2007: 400). In addition to that, the quality of public services also lagged behind in comparison to other similarly wealthy economies (Hardiman et al., 2008).

Whereas these developments were in the interest of the representatives of capital, the question remains why trade unions were not able or willing to avert them. On the one hand, trade unions representing workers from the lower end of the income distribution were confronted with 'the neoliberal impulses of the rising class of internationalized professionals' (Ó Riain, 2004: 65) and the increasing political clout of this actor group. On the other hand, increases in economic inequality were at least partially compensated for by the absolute income growth as well as the rapid growth in employment numbers. Additionally, the Celtic Tiger boom allowed the social partners to agree on reduced tax rates instead of increased state spending to bolster private consumption. As wages and employment increased significantly 'Irish social partnership could be seen as operating in the interests of Irish workers without the presence of productivity or distributional coalitions' (Teague and Donaghey, 2009: 71). This is not to say that there were no critical voices within the Irish trade union movement, which would have preferred a more class-based and distributional approach towards (fiscal) policy-making. However, democratic processes within ICTU had become more centralised in the last two decades and thus have 'worked to keep these views on the mar-

gins' (Teague and Donaghey, 2009: 72). The permissive stance of the major trade unions extended also to the individual workplace-level, especially in the multinational companies located within the exposed sectors. The social pacts never really called into question that Irish industrial relations regulations and institutions did not pertain to international corporations investing in Ireland (Gunnigle et al., 2005: 253). Rather, social partnership has prioritised avoiding any measures that would potentially deter FDI (Teague and Donaghey, 2009: 65). The government retained a say about the content and outcome of social partnership and always had the last word on which issues were ultimately discussed (Hardiman, 2006: 348; Doherty, 2011: 375). Changes of government did not significantly affect these decisions, given the long-term 'cross-party political consensus on the economy' (Mac Sharry and White, 2000: 101). More generally, the leading parties in Ireland have cross-class votership bases and the Labour Party is the only party with a formal link to the trade unions (O'Donnell et al., 2011: 93-94). In comparison to other European countries, however, the Labour Party had only a small voter base (Hardiman et al., 2008: 619). As a result, Irish trade unions were open to cooperate on economic policy-making with any government irrespective of partisanship (O'Donnell et al., 2011: 95).

To sum up, Irish social partnership resembles what has been termed as 'competitive corporatism' (Rhodes, 1998, 2001). From the outset, the whole process had been aimed at the establishment of a liberal market economy that above all would be an attractive destination for external investment. The trade unions' traditional core constituencies profited from the economic success of this growth model, but at the same time the unions had to the accept its functional logic. The latter was based on weak industrial relations and labour regulations and fiscal policy focused on low taxes and, correspondingly, a comparatively low level of state expenditures and services. The implementation of the latter was further reinforced by the growing strength of dynamic coalitions, which opposed the redistributive objectives of their traditional counterparts.

Since the beginning of social concertation in Portugal in 1984, seventeen social pacts were concluded up until 2009. As opposed to Ireland, only a few were approved by all social partners. UGT on labour's side and CAP and CCP on the employers' side have signed all of them. CIP did not consent to two social pacts and CGTP, the most outspoken opponent of social concertation, endorsed only six (Campos Lima and Naumann, 2011: 148). Yet, only the pacts that were supported by at least one of the two major class-based actor groups, that is CIP or CGTP, were politically relevant and successful (Campos Lima and Naumann, 2011: 170).

Studies of social concertation in Portugal usually take a class-based perspective with a strong focus on power resources (Campos Lima and Naumann, 2011: 148). In this reading, the emergence and development of social pacts has been mainly a result of the different interest groups' organisational power, especially of CGTP as the pivotal trade union confederation. The employers, and CIP in particular, were more willing to make concessions and join social pacts when the trade unions demonstrated their political clout (Dornelas, 2003: 138) and even more so in cases when UGT and CGTP joined forces. The flipside of this antagonistic foundation of social concertation is that, unlike in the Irish case, Portuguese trade unions and

employers organisations hardly ever developed a shared understanding of economic problems and suitable policies (Dornelas, 2010: 132).

As I have already stated, social concertation in both cases had been born out of necessity and to cope with economic crises in the mid-1980s. In contrast to Ireland, Portugal did not have similar economic success. There, pacts consistently resulted from economic challenges or problems. If it was fulfilling the Maastricht criteria or resolving the fiscal crisis of the mid-2000s, Portuguese governments faced a high economic and political problem load and turned to the social partners in situations of (perceived) political weakness (Campos Lima and Naumann, 2011). Yet, the enormous problem load did not discourage trade unions and employers from pursuing their traditional class-based preferences. During the early stages of social concertation, CGTP steadfastly refused to even participate and instead relied on its antagonistic strategy of confrontation (Magone, 2014a: 124). The success of social pacts therefore depended heavily on UGT's commitment to social partnership and its continuing connections with the two major political parties (Afonso et al., 2015: 321). UGT's more moderate approach had a transformative effect on Portuguese industrial relations as it enabled the negotiation of social pacts in the first place (Royo, 2002: 94). In contrast to CGTP, UGT pursued an 'overall strategy of transforming social concertation into an effective mechanism of governance which would enhance its political influence' (Campos Lima and Naumann, 2011: 157-158). Over time, CGTP's approach became less adamant and although it did not sign most of the pacts, it still did participate in their negotiation (Magone, 2014a: 124). Here, its position is not only determined by its blue-collar core constituency but also by its close links to the communist party, which in Portugal plays a much bigger role than in most other European countries. Although these direct affiliations have weakened over time, there are still close institutional links between political parties and trade unions (Royo, 2012: 147). Finally, the employers' position, with CIP leading the way, had always been more pragmatic and less ideological. They usually assessed the pacts based 'on the compliance of the signatories with the agreement and the balancing of losses and gains for each party' (Campos Lima and Naumann, 2011: 170). However, Portugal's labour-friendly constitution never allowed for the employers to match the influence of their Irish counterparts (Royo, 2012: 173). The dynamic of social concertation in Portugal gave UGT power resources that exceed its actual mobilising and political power. Given CGTP's strong antagonism towards social partnership, both employers and government depended on UGT's consents if they intended to reach an agreement. In the 'shadow' of CGTP's radicalism, government and employers were willing 'to make concessions to the UGT that are disproportionally high given its actual power resources' (Campos Lima and Naumann, 2011: 171).

Unlike in Ireland, social concertation in Portugal did not rely on the social partners' shared understanding of a preferred economic model. Instead, it has been dominated by the antagonism of traditional coalitions whose power resources considerably determined policy-outcomes. This dynamic, which provided labour with relatively strong influence, took place against a high economic problem load, especially in the area of fiscal policy. Redistributive conflicts were not muted by economic growth but were central to the class-based conflicts between labour and capital.

This section described the political dynamics and the roles played by traditional and dynamic coalitions in Ireland and Portugal in the years before the eurozone crisis. Portuguese trade unions represent a large number of low-skilled workers who face high economic risks, whereas trade union membership in Ireland reflects the larger number of high-skilled workers in the Irish economy. Portugal's low-skilled workers are more likely than their Irish counterparts to find high-skilled allies in the public sector, which share their fiscal policy preferences for higher levels of state spending. By contrast, a large share of high-skilled workers in Ireland work in the increasingly traded dynamic services sectors and are part of a strong cross-class coalition that supports lower levels of state spending. The small number of Portuguese high-skilled in dynamic services suggests that they need allies if they want their preferences to be reflected by fiscal policy-making—which they are, however, unlikely to find. Rather, the high economic risks implied by globalisation and European for both workers and businesses in Portugal can lay the foundation for a cross-class coalition in favour of a revenue-based adjustment strategy. Such a coalition is highly unlikely to form in Ireland given the dynamic of its export-oriented economy.

Policy demands made by economic actor groups in the lead-up to the eurozone crisis reflect these dynamics. In Ireland, policy demands were made mainly based on the commitment of both trade unions and employers' organisations to the country's export-led growth model. This model was supported not only by domestic businesses, but it also led to increasing political influence for MNCs and other providers of FDI. Above-average growth numbers muted most class-based redistributive conflicts and resulted in a largely positive assessment of globalisation and European integration. By contrast, class-based antagonism dominated the relationship between labour and employers in Portugal. Economic integration was mainly assessed negatively given its effect on the exposure to economic risks of both actor groups. The same distinction can be made for social concertation which played an important role in both economies. In Ireland, it primarily served the purpose of maintaining political and economic stability and further developing the already well-established growth model. The social partners in Portugal lacked such a shared understanding of economic and fiscal policy. As a result, social concertation had been much more adversarial.

4.2.2. Growth dynamics: Consumption- and export-oriented actor groups in Ireland and Portugal before the crisis

This section illustrates growth dynamics and the potential for sectoral coalitions in Ireland and Portugal. First, I describe the growth models of Ireland and Portugal based on quantitative indicators and how they compare to other eurozone members. Second, I provide a condensed qualitative description of the two models and the way they developed in the run-up to the eurozone crisis.

Drawing on Baccaro and Pontusson's (2016) conceptualisation, the first indicator I show here is the importance of different components of aggregate for an economy (see figure 4.2.). I rely again on the comparison of eight country cases used above. First, Ireland and Hungary stand out as the two countries where merchandise trade constitutes a much higher share of GDP (more than 100 per cent) than in all

other countries. This holds true even in comparison to the export powerhouses Germany and Sweden, where merchandise trade amounts to around 60 per cent of GDP. What distinguishes Ireland from the other countries is the prominent role played by traded services, which corresponds to the growing importance of high-skilled service workers for dynamic coalitions in favour of expenditure cuts. Portugal and Greece are located at the other end of this spectrum. Only Germany and Sweden have equally low shares of services trade. Still, there are two differences between the two country groups. On the one hand, a cornerstone of Germany's economic model, in particular, has been the export of manufactured goods. Rather than being exported, services—low-end as well as high-end—largely played an auxiliary role for the success of the manufacturing industry (Baccaro and Benassi, 2017; Dustmann et al., 2014). Furthermore, a significant share of Portugal's and Greece's services exports stem from the tourism sector, which is usually associated with comparatively lower skill levels and more precarious working conditions.

Another commonality between these two countries, which separates them from Germany and Sweden as well as from Ireland, is the large role played by domestic consumption. In the run-up to the eurozone crisis, final consumption expenditure amounted to more than 60 per cent of GDP in Portugal and Greece. The only countries that also approached similar scores were two other programme countries, namely Cyprus and Latvia. In the other economies depicted here, the share of merchandise trade dwarfed or at least equaled that of domestic consumption. Again, Ireland stood out as its share of domestic consumption was by far the lowest, met only by Sweden's. That is, the Irish economy was singular in that the trade of merchandise and services both played a proportionally much larger role than household consumption. The same held true for FDI inflows. FDI inflows to Ireland and Hungary averaged more than 10 per cent of GDP. In Sweden and Cyprus FDI amounted to just under 8 per cent and in Portugal and Germany the share of FDI was below 5 per cent of GDP. FDI inflows to Greece, finally, were negligible and almost never reached more than 1 per cent of GDP between 1998 and 2007.

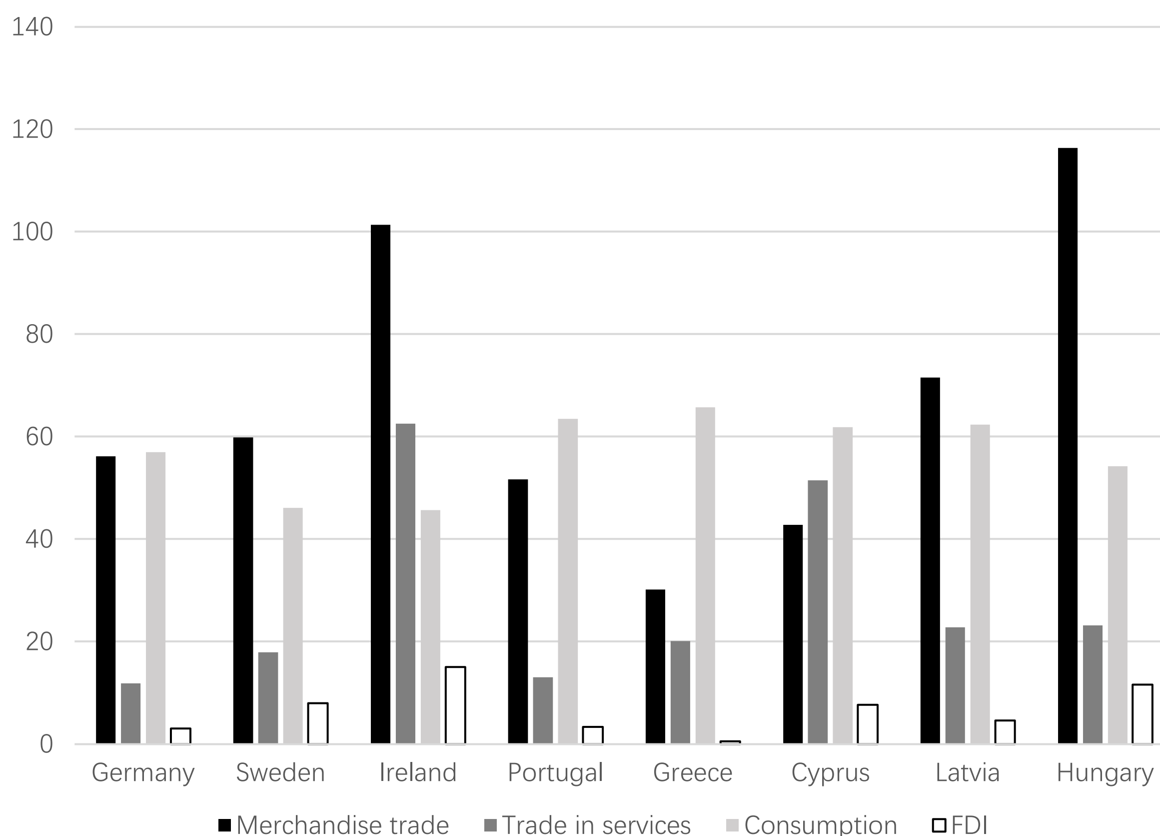

Figure 4.2.: Shares of trade, consumption and FDI.
Notes: Average, taken over 1998-2007; per cent of GDP; merchandise trade; trade in services; household and NPISHs final consumption expenditure; foreign direct investment, net inflows.
Source: World Bank World Development Indicators.

Trade and FDI play a much more central important role in Ireland than in the Portuguese economy. Ireland's exceptionally high share of traded services shows that there are potential overlaps between strong cross-class coalitions in the exposed sectors and dynamic actors, such as high-skilled workers, in traded services. The high share of FDI points to another important actor group with preferences for expenditure cuts. Portugal, by contrast, is a much less attractive destination for FDI than Ireland. What is more, its non-dynamic economy is more oriented towards domestic consumption than trade. Both indicators show that there is potential for cross-class coalitions between workers and employers in the sheltered sectors and actor groups facing high economic risks in favour of a revenue-based adjustment strategy.

Capturing the dynamics of different growth models, figure 4.3. shows the contribution of different components of aggregate demand to economic performance. Portugal and Germany stand out as the two economies with the lowest average growth. Germany was in recession in the early 2000s and at the time considered to be the 'sick man of Europe' (Dustmann et al., 2014). Only a few years later, this dubious title was ascribed to Portugal (The Economist, 2007). All other cases, which would later become programme countries, witnessed exceptional economic growth in the years before the crisis. This holds espe-

cially true for Ireland and Latvia where GDP increased by around 7 per cent per year. Sweden's record was also strong but less outstanding.

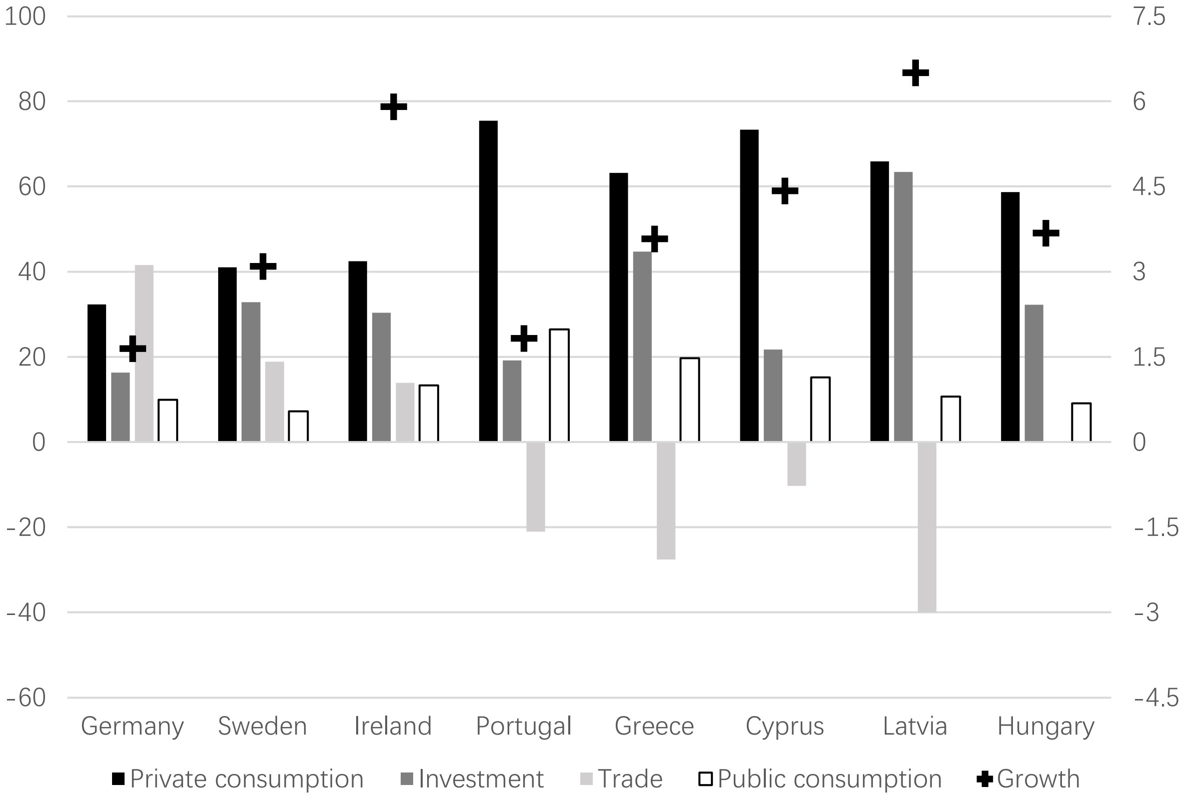

Figure 4.3.: Contribution to the increase of GDP at constant prices (left scale) and increase of GDP (right scale).
Notes: Average, taken over 1998-2007; per cent of GDP; private consumption, gross fixed capital formation; the balance of goods and services; public consumption.
Source: AMECO database.

Private consumption has been the most important growth driver in all countries but one. The success of Germany's purely export-led model gathered pace after 2005 and barely slowed down during the global financial crisis (Baccaro and Benassi, 2017; Dustmann et al., 2014). Still, there is variation as to how important the contribution of domestic consumption was for each economy. In most programme countries, growth was driven to around 60 per cent by domestic consumption, while its contribution to growth was almost 80 per cent in the Portuguese case. In Germany, Sweden, and Ireland it contributed only around 40 per cent. These three countries were the only ones where the effect of trade on growth was positive. Portugal, finally, is noticeable in that it is the only country where public consumption contributed more than one fifth of the increase of GDP.

These number show that there existed stark differences between the Irish and the Portuguese growth model in the run-up to the eurozone crisis. Trade in merchandise as well as in services played an exceptional role for the Irish economy, trumped only by FDI. Domestic consumption was of lesser importance. Portugal's economy relied to a larger extent on domestic private consumption, but growth was sluggish and low. Higher imports than export contributed negatively, whereas the significance of public consumption was exceptionally high.

The origin of Ireland's export-led and FDI-dependent growth model can be traced back to the 1950s (for extensive historical accounts, see Mac Sharry and White, 2000; Ó Riain, 2004). Yet, cross-class support for this model developed only in the mid-1980s. Before the economic and fiscal crisis in 1986, employers and workers openly disagreed about the true causes of Ireland's economic problems and how to solve them (Roche, 1994: 170). From the employers' point of view, excessive wages were causing inflation and unemployment, whereas the trade unions argued that domestic demand was too low and had to be bolstered by fiscal policy. These disagreements were resolved when the National Economic and Social Council (NESC), a tripartite advisory body, published an explicit commitment to an export-oriented growth model. This marked not only 'the first public disavowal by union leaders of their previously stated position that deficient demand was the cause of low growth and unemployment' (Culpepper, 2008: 15). It also allowed trade unions and employers to develop a shared understanding of Ireland's economic problems and the right economic policies to address these problems (Hardiman, 2002: 8). In the period that followed, this consensus brought about a series of social pacts that reinforced the support of but also the dependency of both actor groups on the success of Ireland's export-oriented growth strategy. Especially governments with small parliamentary minorities engineered coalitions between unions and employers to safeguard political support for the national growth model (O'Donnell et al., 2010: 192-193). Given the economic successes in the 1990s and early 2000s, trade unions and employers' association focussed on policies that would maintain the model's political stability. Economic policy-making had to improve or at least sustain the economy's international competitiveness. Since that precluded high increases in state spending, the model was mainly legitimised by a fiscal policy stance that exchanged income tax cuts for concessions in the form of wage restraint (Regan, 2012: 484). A 'broad cross-party commitment' (Dellepiane-Avellaneda and Hardiman, 2015: 201), that prioritised the attraction of FDI, further strengthened political stability.

Ireland's growth model depended on the political support of all relevant actor groups. The trade unions' long-term commitment to exports as the driver of economic growth, as opposed to domestic consumption, implied that they partially gave up pursuing their class-based preferences and, thus, showed the willingness to form a cross-class coalition with employers from the exposed sectors. The striving Irish exporting sectors—to a large extent MNCs and other providers of FDI—over time gained 'systemic relevance' as the whole economy became dependent on its prosperity. They predominated economic policy-making and exerted direct political influence through networks of 'business-state elites' in government and the FDI-led sectors (Brazys and Regan, 2017: 411; Regan and Brazys, 2018). The preferences of the exposed sectors for a lower level of state spending were approached by the domestic sectors, which depended on the economic success of their exposed counterparts (Afonso, 2011: 719). The expansion of sheltered services sectors developed from higher labour force participation rates and, to a much lesser extent, from a slowdown in manufacturing (Barnes and Wren, 2012: 298). Finally, the education system became increasingly sophisticated. Together with changes in the composition of FDI, the 'cluster effect of skilled labour' (Regan and Brazys, 2018: 224) thus created growth in the highly dynamic, traded services sectors. This development also had political effects: workers and businesses in the dynamic services sectors gained influence at the cost of traditional coalitions with preferences for higher levels of state spending. Given the

influence of the exposed sectors, trade unions that represented (low-skilled) workers in the sheltered sectors were particularly unable to form an assertive coalition in favour of expansionary fiscal policies.

Social concertation in Portugal was not based on a joint commitment to a specific growth model. From its outset it was characterised by class-oriented antagonism and disunity, especially on the trade unions' side. Even if a social pact was agreed upon—usually without the signature of the CGTP—its full implementation was still often prevented by conflicts across sectors as well as between unions and employers (Royo, 2002: 101). The social pact of December 2006 is a case in point when it comes to class-based preferences and the distribution of power resources trumping potential cross-class coalitions based on an eventual growth model. The pact foresaw an increase in the statutory minimum wage and was signed by all social partners and the government. While meeting the trade unions' preferences for redistribution, it was contrary to the demands issued by the employers. However, the latter still signed it as they strived 'to maintain their political role in social concertation at a time when their right-wing and centre-right party allies were in deep crisis' (Campos Lima and Naumann, 2011: 160). That is, the willingness of governments to engineer societal coalitions was not driven by a specific growth strategy but depended on the varying power resources of their social partners.

Class-based differences were not subdued by exceptional growth numbers as Portugal's economy had been performing below eurozone's average since the early 2000s. The Portuguese economy had been primarily exporting goods, the demand of which had been in decline, and also suffered from a loss of competitiveness vis-à-vis CEE and other low-cost competitors (Crespo et al., 2004). Between 1998 and 2008, Portugal lost roughly 2 per cent of export market shares per year to emerging and developing economies (Banco de Portugal, 2009: 112). Portugal at the same time lost attractiveness as a destination of FDI. The Eastern enlargement of the EU tightened this situation for the country. Most foreign companies moved to Eastern Europe, where they found the same comparative advantages in the form of low wages and high levels of structural funds while the general skill level was higher (Goucha Soares, 2007: 472). If at all, the economy had been driven by domestic consumption. Falling interest rates and fiscal expansion had bolstered domestic demand since Portugal had entered the eurozone. The impetus to rely on expansionary fiscal policy rested on a long-term tendency to provide state support to the economy and actively 'search for pro-employment correctives to market processes' (Fishman, 2011: 243). As domestic supply did not catch up with this development, domestic demand was met by a surge of imports resulting in large current account deficits (Royo, 2013: 211). Ultimately, this approach to fiscal policy-making brought about an increasing group of 'public and private interest groups seeking transfer from the state' (Macedo, 2003: 186).

Due to the absence of a distinct and successful growth model, economic and fiscal policy-making in Portugal was politically much more contested than in Ireland. The Portuguese economy lacked advanced sectors that had the potential to find broad political support and act as undisputed growth drivers. Rather, the formation of influential 'distributive coalitions' (Iversen and Soskice, 2015b: 77) was much more usual. No sector of the Portuguese economy had enough growth potential to provide the incentives for econom-

ic actor groups to develop common preferences that would cut across class-cleavages. Even if they were to form, these coalitions could not expect to be able to trump the powerful and well-established traditional coalitions. Furthermore, unlike in Ireland, neither the distribution of skills nor the structure of exports provided the conditions to form a dynamic coalition in favour of a smaller state. If at all, pro-spending coalitions were more likely to form, as private and public consumption were the main drivers of economic growth and a large share of workers and businesses were exposed to high economic risks.

The analysis of two important quantitative indicators has revealed the great differences in the composition of economic growth between Ireland and Portugal. Traditional merchandise exports and highly dynamic services exports both played a prominent role in the Irish economy, whereas in Portugal growth was mainly driven by private and public consumption. Another major difference here is that the Irish economy over the years profited from massive inflows of FDI, which were absent in the Portuguese case. Finally, the Irish growth model has been highly successful in the lead-up to crisis, while economic growth in Portugal remained sluggish and below the eurozone average.

Ireland's export-led growth model has its roots in the country's economic crisis in the 1980s, when trade unions and employers were able to develop a shared understanding of the economy's problems and the necessary political solutions. In the following two decades, the booming economy subdued redistributive conflicts. An important answer to the political demands by the trade unions were tax reductions instead of increased government expenditures. This allowed for cross-class coalitions in support of the growth model and kept the general level of government spending low, which was in the interest of the highly influential employers in the exposed sectors. The growth model's success led to a political consensus, and policies that met the preferences of the actor groups in the exposed sectors became an undisputed cornerstone of economic and fiscal-policy making. The increasing importance of FDI provided MNCs with significant political influence. High-skilled workers in the expanding dynamic services sectors also gained political clout. Ireland's economic success relied on a distinct and export-led growth model. A broad cross-class consensus sustained the growth model in its early years. This later resulted in domestic politics being dominated by actor groups in the exposed and FDI sectors, which had strong preferences for low levels of government spending.

The Portuguese government also induced a process of social concertation in the 1980s as a reaction to an economic crisis. However, class-based antagonism and the absence of economic success thwarted the development of a well-established growth model. A cross-class consensus on economic policy-making, or a shared understanding of Portugal's economic problems, was also not feasible. Domestic politics was dominated by redistributive conflicts between labour and capital. The comparatively low economic growth rates were sustained by capital influence and bolstered by increased government spending. While high levels of state spending were in the interest of the dominant trade union confederations, it resulted in further conflicts between labour and capital when the government saw itself forced to adjust the national deficit. In contrast to Ireland, the domestic economy lacked a clear driver of economic growth, which was

another obstacle to formation of cross-class sectoral coalitions. Consequently, fiscal policy-making was mainly influenced by domestically-oriented actor groups that favoured higher levels of state spending.

4.3. Expectations

Based on the analysis conducted above, I conclude this chapter by formulating how I expect imagine the politics of fiscal adjustment to play out in the context of the EAPs for Ireland and Portugal. Figure 4.4. draws upon the conclusion of the analytical framework and summarises the analysis conducted in this chapter. I locate Portugal in the lower left quadrant because its growth model is mainly based on domestic consumption and its non-dynamic economy is dominated by traditional, class-based coalitions. Ireland, by contrast, is classified in the upper right quadrant due its export-led growth model, which provides actor groups located in the dynamic sectors of the economy with increasing political influence. In the Irish case, I therefore expect strong political support for an adjustment strategy based on expenditure cuts.

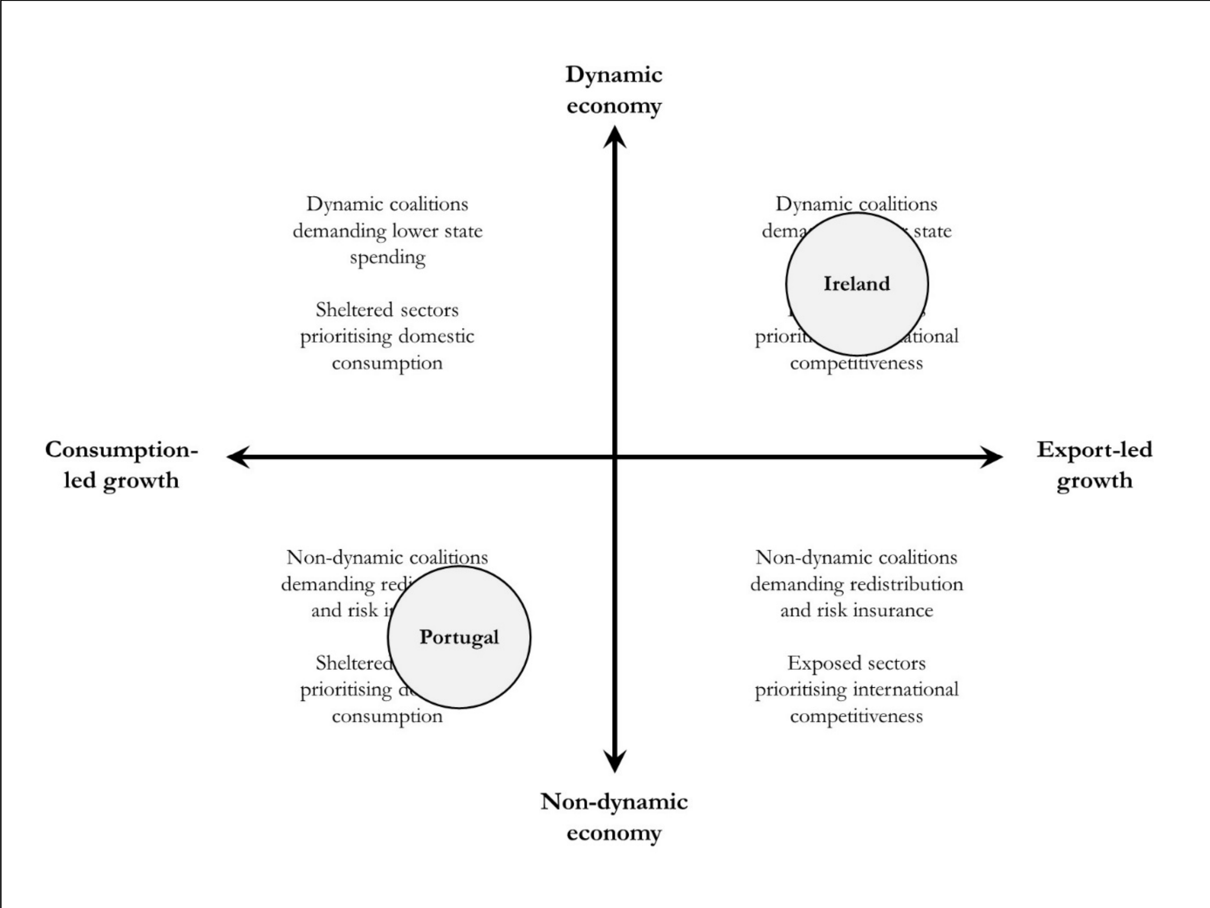

Figure 4.4.: The dynamics of fiscal policy demand in Ireland and Portugal

In the Irish case, I anticipate strong political support for an adjustment strategy based on expenditure cuts. Such a consolidation strategy meets the preferences of the most important actor groups in the exposed sectors, most importantly MNCs and other employers, as well high-skilled service workers. Traditional actor groups and actors facing high economic risks in favour of a revenue-based adjustment strategy are unlikely to challenge this coalition successfully. In Portugal, by contrast, I expect strong political support for an adjustment strategy based on revenue increases. Such a consolidation strategy meets the preferences of workers, employers who face high economic risks, and especially of the strong traditional coalitions promoting higher levels of state spending. I neither expect the formation of a cross-class coalition in the exposed sectors, nor think it likely that other actor groups lobbying for expenditure cuts are powerful enough to challenge the pro-spending coalition. Table 4.3. summarises my expectations regarding the dynamics of fiscal adjustment.

Table 4.3.: The dynamics of fiscal adjustment

Dynamic	Ireland	Portugal
Class-based	Cooperative	Adversarial
Exposure to economic risks	Low	High
Sectoral	Exposed	Sheltered
Expected adjustment strategy	**Expenditure cuts**	**Revenue increases**

The two case studies provide a detailed analysis of how the governments of Ireland and Portugal implemented their EAPs and how they dealt with the constraints they were facing. The case studies show that dynamic and export-oriented actor coalitions in Ireland supported an expenditure-based adjustment strategy, which had also been the troika's preferred approach. In Portugal, by contrast, traditional coalitions representing actors exposed to high economic risks and consumption-oriented coalitions were trying to defend the status quo of relative high levels of state spending. This ultimately resulted in an adjustment strategy that went contrary to the troika's preferences as it relied more on revenue increases.

Chapter five: Ireland

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Expenditure-based adjustment in an FDI-led economy

This chapter provides an in-depth case study of the Irish EAP and is structured as follows. Part one gives an overview of fiscal policy-making in Ireland before the crisis and the budgetary imbalances it produced. It then looks to the global financial crisis its impact on the Irish economy. The following subchapter two assesses how the Irish government reacted to the crisis before it turned to the troika for financial assistance. The main case study in subchapter three details how domestic actor coalitions with strong preferences for an expenditure-based adjustment strategy influenced fiscal policy-making. A final subchapter concludes.

Between the late 1990s and 2007, Ireland's state budget had been in surplus every year but one. The Celtic Tiger years yielded continuously rising state revenues and allowed the government to generously distribute the fruits of economic expansion. This pro-cyclical fiscal policy stance proved to be problematic when the global financial crisis hit the Irish banking sector and the inflated housing bubble burst. A collapse in revenues, which to a great extent had relied on property-related tax receipts, and the financial support provided to several Irish banks resulted in a primary deficit of almost 30 per cent in 2010. Between 2008 and 2010, the government launched a series of adjustment measures which mainly fell on the expenditure side. By the end of 2010, however, the deterioration of market sentiments had accelerated further and government borrowing costs had reached unsustainable levels. On 21 November, the authorities approached the troika and requested financial assistance.

The EAP rested on two main pillars. Ireland's banking sector was to be recapitalised and downsized and its supervision to be improved. To restore fiscal sustainability, the programme envisaged fiscal adjustment measures amounting to €15 billion. The EAP's fiscal part was based on the so-called 'National Recovery Plan' (NRP), which the Irish government had published in November 2010. More than two thirds of adjustment were supposed to be generated by expenditure cuts. Since Ireland's labour and product markets were already comparatively liberalised, structural reforms only played a secondary role. These measures were intended to 'snap the pernicious feedback loop between growth, fiscal, and financial instability' (IMF, 2010a: 4) and induce 'export-led recovery' (EC, 2011a: 19).

5.1. The crisis hits Ireland: A banking crisis turns into a fiscal crisis

The story of 'the rise and fall of Ireland's Celtic Tiger' (Ó Riain, 2014) has been told more comprehensively elsewhere (Kirby, 2010; Donovan and Murphy, 2013), however, here I very briefly answer two ques-

tions about the global financial crisis and its impact on Ireland. The first question concerns the economic imbalances that emerged prior to the crisis and the influence of domestic politics on the budget's composition. In the light of this problem load, the second question asks how the crisis affected the Irish economy. The answers to these two questions form the foundation of the subsequent analysis of the adjustment process during the programme.

5.1.1. Fiscal policy-making in Ireland before the global financial crisis

Joining EMU had far-reaching consequences for Ireland. Sovereign bond yield spreads, which had already been falling continuously in the years before, stabilised at a very low level after 2001. This involved a decline in the interest costs paid and the government's fiscal space increased significantly (Kopits, 2016: 4). Short-term interest rates also plummeted. Between 1999 and 2005 they went into negative territory and further fuelled a domestic boom of credit and household debt (Regling and Watson, 2010: 24). EMU membership implied that cheap credit would be permanently available. Capital did not only flow into manufacturing and other exporting companies but also into domestic sectors—particularly construction (Hardiman, 2010: 75).

Compared to most other European countries, Ireland is a 'low-tax, low-spend economy' (Regan, 2012: 483). Both revenues and expenditure as a share of GDP were below the eurozone average before 2008. Although in absolute terms government spending increased steadily in the early 2000s, as a proportion of real GDP it remained relatively stable due to the economy's exceptional growth. At the same time, personal income and other taxes were lowered. After 1997, the Irish government was able to consitently realise budget surpluses that reached almost 3 per cent of GDP in 2006. For the most part, they were based on revenues originating from the property markets, such as stamp duties driven by escalating house prices (IMF, 2007: 11; 2009: 21). In 2001, however, nominal current spending began to grow faster than GDP (Regling and Watson, 2010: 26). Above average economic growth and a developing bubble in the market for real estate masked 'a very large—and growing—underlying structural fiscal deficit' (Donovan, 2016: 12). The increase in government expenditures was driven by two developments. Between 2001 and 2008, the public sector workforce grew by 15.5 per cent (Regling and Watson, 2010: 26) and wages expenses increased by 12.5 per cent annually (EC, 2011a: 17). Furthermore, the Irish government boosted spending on social policy and education.

This expansionary approach was made possible by burgeoning pro-cyclical tax intakes. The Irish government used windfall gains to finance a broad set of tax cuts (Kopits, 2016: 5). For example, in addition to the routinely implemented reductions of the personal income tax burden, the tax rate on capital gains had been cut in 1998 from 40 to 20 per cent (Ó Riain, 2014: 200). The latter was one of several measures that fuelled the Irish property boom. A growing number of tax expenditures were introduced, many of which targeting the property sector, which resulted in decreased tax revenues (Donovan and Murphy, 2013: 122). Between 2001 and 2007, the share of the latter in total revenue dropped by more than six percentage

points and the share of property-related taxes soared up from eight to 18 per cent between 2000 and 2006 (Donovan, 2016: 13). Combined with corporation tax and stamp duties, pro-cyclical taxes amounted to almost one third of the total tax revenue (Regling and Watson, 2010: 26).

As a result, the national budget was extremely vulnerable to an economic downturn and especially exposed to the overheated property sector. How does this relate to our analytical framework? To start with, GDP per capita in 2007 was almost 2.3 times higher than in 1990. Irish governments could therefore focus on how to distribute the yields from the economic boom to the benefit of basically all social groups. In doing so, they did not face fiscal constraints as state revenues almost quintupled between 1990 and 2007. The overheated boom economy of the Celtic Tiger period muted some of the dynamics of a typical export-oriented economy as the expansionary policy stance initially produced no losers.

Fiscal policy still did follow its specific logic. Redistributive conflicts were subdued by economic growth while fiscal policy disproportionately benefitted businesses and high-skilled workers. Although government expenditures increased over time, the bulk of fiscal expansion took place on the revenue side as the social partners agreed on income tax cuts in exchange for wage restraint. Government spending and revenues were still low in comparison to other small European states (Regan, 2012). Public employment also remained relatively low when compared to other OECD countries (OECD, 2008a: 63). What is more, during the boom years the wage share of Irish workers fell (Ó Riain, 2014: 187). This trend was much more pronounced and reached a lower level in Ireland than in most other eurozone economies (Onaran and Obst, 2016: 1520).

Rather than redistributing wealth from higher income groups to those with lower income, fiscal policy 'evolved into a major source of tax avoidance for the wealthy' (Regan, 2012: 482). The Irish welfare state never approximated the likes of Sweden or Germany, as there existed no coalition strong enough to demand such a transformation. If anything, it resembled what Colin Crouch (2009) has termed 'Privatised Keynesianism' in that home ownership financed by private debt replaced government spending on the economy. In addition to the country's unique selling point, the 12.5 per cent corporation tax rate, low taxes remained a mainstay of Irish fiscal policy even in the expansionary boom years.

5.1.2. The global financial crisis and its impact on Ireland

Ireland's crisis is inextricably linked with the country's property bubble. Between 1996 and 2007, house prices quadrupled (Whelan, 2011: 5). The collapse of this bubble was fatal for the government's fiscal position. In the years before the crisis, the property sector accounted for a significant share of employment growth. Economic activity, particularly in the construction sector, came to a halt in late 2007. Unemployment escalated and boosted welfare spending. More problematic, however, was that Ireland did not have a usual property tax but charged a stamp duty which was to be paid in full when property was bought. Stamp duties—and other property-related taxes—accounted for more than 10 per cent of total

tax revenue in 2006. Between 2007 and 2009, total tax revenues amounted fell by more than 20 per cent and property-related taxes by almost 80 per cent (see figure 5.1.).

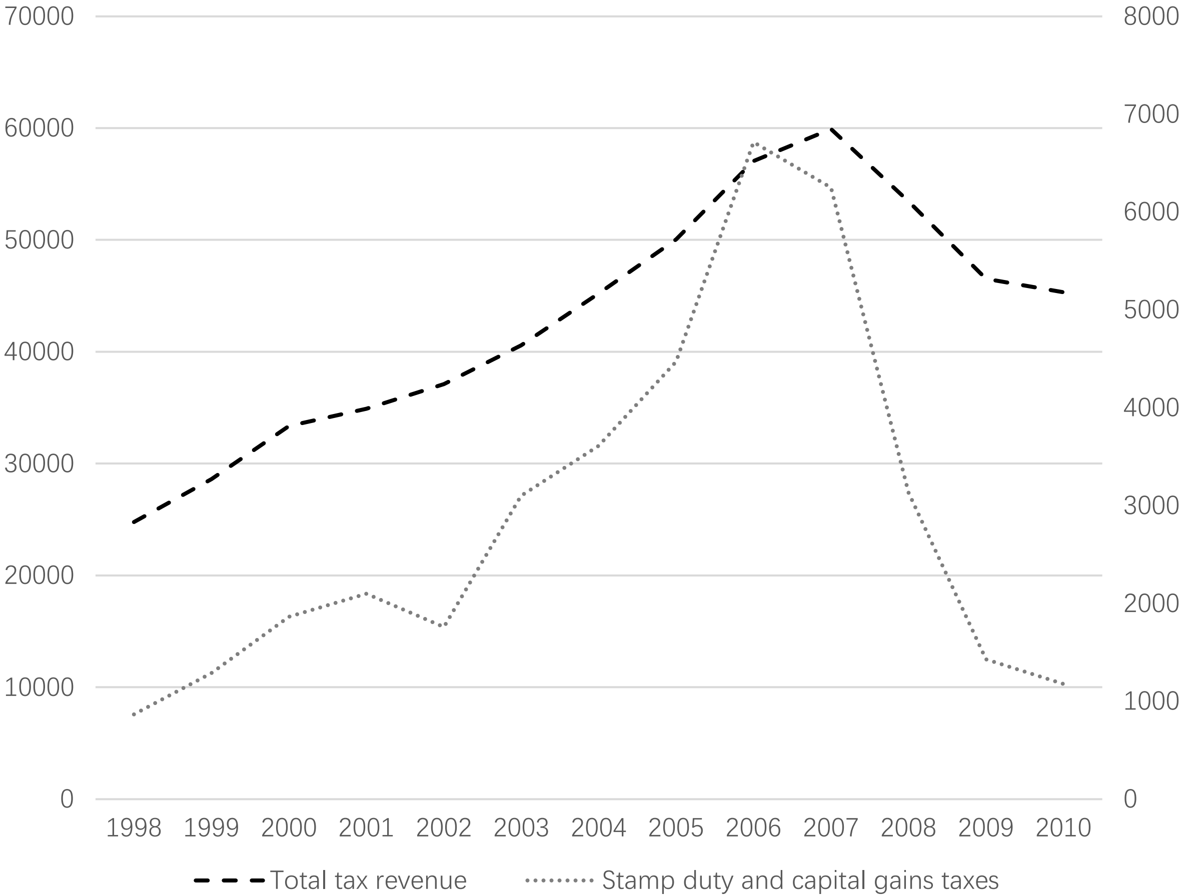

Figure 5.1.: Irish government revenues.
Notes: Total tax revenues (left scale) and taxes on capital gains of individuals and stamp duty (right scale); Euro, millions.
Source: OECD.

These ramifications were aggravated further by the Irish banking sector's dismal condition of the Irish banking sector after Lehman Brothers collapsed and the interbank market came to a standstill in September 2008. Irish banks had massively invested in domestic mortgage lending and thus were heavily involved in the housing market. A large share of this investment was financed by bonds sold to international investors. In 2003, Ireland's six largest banks had borrowed less than €15 billion abroad. This figure rose to almost €100 billion—and thus almost 60 per cent of GDP—in 2007 (Whelan, 2011: 8). As Irish banks experienced mounting difficulties to finance themselves, they turned to the government for help. The government answered and on 30 September 2008 issued a blanket guarantee covering for all Irish banks (Grossman and Woll, 2014: 586).

Ultimately, the Irish government committed bailout expenditures amounting to a staggering 327.7 per cent of GDP between 2007 and 2010 (Woll, 2014: 32). In 2010, the provision of funding to several Irish banks

and the nationalisation of two other banks culminated in a record high government deficit of more than 32 per cent of GDP. The sentiments of international financial market actors, which before had assessed Ireland's fiscal position comparatively positively, now finally turned sour.

5.2. General assessment

5.2.1. Fiscal adjustment in the global financial crisis

When requesting financial assistance in December 2010, the Irish government already had initiated a series of fiscal adjustment measures which amounted to almost €15 billion. The measures taken were born out of necessity but not chosen randomly. As we would expect, based on the analytical framework, the Irish government adopted an adjustment strategy based on expenditure cuts already before manoeuvring through the EAP's restrictive framework. Before turning to the latter in more detail, this subchapter provides an overview of the adjustment measures taken by the Irish government between in the run-up to the EAP.

Table 5.1.: Fiscal adjustment in Ireland 2008-2010

	Per cent of GDP
Expenditure	**5.7**
Current expenditure	*4.4*
Capital expenditure	*1.4*
Revenue	**3.5**
Total	9.3

Notes: measured as impact of 2008-10 measures on 2010.
Source: OECD (2011b: 48).

Table 5.1. summarises the fiscal adjustment measures taken by the Irish government between 2008 and 2010. This first phase of 'emergency responses' can be distinguished from the better prepared 'strategic cuts' during the programme (MacCarthaigh and Hardiman, 2018: 112). The enormous measures taken before the EAP already meet the expectations formulated in the previous chapter as more than 60 per cent of consolidation targeted expenditures.

Individual policies were adopted on five occasions between July 2008 and December 2009. In doing so, Ireland was one of the few eurozone country resorting to contractionary fiscal policy. As late as 2010, most other EMU members still relied on fiscal stimuli (IMF, 2010a: 21). Table 5.2. sums up the efforts of

the Irish government. Their emergency character becomes clear when taking into account that, aside from two regular budgets, three supplementary fiscal policy packages were put together within less than a year.

Table 5.2.: Budgetary measures in Ireland 2008-2010

	€ billion
July 2008 Expenditure cuts	1.0
Budget 2009 (October 2008) Revenue increases	2.0
February 2009 Expenditure cuts	2.1
Supplementary Budget (April 2009) Revenue increases and expenditure cuts	5.4
Budget 2010 (December 2009) Expenditure cuts and minor revenue increases	4.1
Total	**14.6**

Notes: Budgetary adjustments since mid-2008 – planned budgetary impact upon 2010.
Source: Government of Ireland (2010: 16).

The initial budget for 2008 was published in early December 2007. It was expansionary in that it slightly reduced personal income taxes and increased social welfare payments. Then Minister for Finance, Brian Cowen, acknowledged that 'the Budget is being framed against the background of significant uncertainty in the international economic environment' (Cowen, 2007). But the government still had rather optimistic expectations regarding economic growth and the creation of new jobs as it planned for a general government deficit of only 0.9 per cent of GDP. A few months later, the EC's economists downgraded this projection and forecasted a deficit of 1.4 per cent of GDP for 2008, and 1.7 per cent of GDP for 2009 (EC, 2008b: 221).

Even if the 2008 budget was based on a positive growth outlook, the government introduced 'an efficiency review of all administrative spending across the whole public service' (Cowen, 2007). A first set of measures, which was realised in July 2008 and worth roughly €1 billion of spending, was based on this review. Specifically, the public sector pay bill was reduced by 3 per cent, government agencies rationalised, and in 2008 and 2009 a range of steps was to be taken to improve efficiency and cut costs. The payroll reductions affected all areas of the public sector except for parts of health and education spending (Government of Ireland, 2008: 30-31; 2010: 56).

Only a few weeks later, the government struck an agreement with the social partners. The 2006 pact 'Towards 2016' was meant to serve as a 'ten-year framework agreement' (Department of the Taoiseach, 2006)

and to be reviewed in 2008 regardless. The review emphasised 'the need for continued adaption and flexibility to maintain and improve competitiveness and to increase productivity and employment' (Department of the Taoiseach, 2008a: 14). To this end, the negotiating parties agreed on pay clauses that would apply to the private as well as the public sector. Provisions for the public sector were stricter as pay increases were suspended for eleven months (against three months in the private sector). After the suspension, wages would rise by 3.5 per cent and by another 2.5 per cent six months later. The key aspect for the government was to boost the confidence 'of investors, savers, employers and consumers alike' (Government of Ireland, 2008: 32). The agreement negotiations had been difficult due to the increasingly diverging positions of IBEC and ICTU. Set against the backdrop of steadily worsening economic conditions, both actor groups formulated class-related preferences with regard to wage inflation as their fallback positions (Sheehan, 2008b).

Shortly thereafter, Lehman Brothers collapsed. Answering requests from domestic banks for financial assistance, Ireland's government issued a blanket guarantee for a period of two years. The fiscal implications of this decision made international financial markets suspicious of the sustainability of Irish government debt. Bond spreads slowly increased due to the entanglement of the Irish banking sector with the state's debt position. The recently agreed social pact was void as it became clear that the government would not be able to allow for public sector wages to rise any time soon.

Trying to calm international markets, the government decided to bring forward the decision on the budget from December to October 2008. Economic conditions were deteriorating further. The government now calculated with a deficit for 2009 amounting to 7 per cent of GDP. It implemented contractionary measures amounting to nearly €2 billion (or 1 per cent of GDP), which were focused solely on the revenue side. An income levy was introduced, applying a rate of 1 per cent on yearly incomes below €100,000 and of 2 per cent above that threshold, the VAT and excise duties were increased and some changes to capital taxes applied (Government of Ireland, 2008: 16; Lenihan, 2008). Vis-à-vis the EC, the government emphasised Ireland's 'pro-enterprise environment' (Government of Ireland, 2008: 22) and argued that the tax hike was appropriate and would not impair its export-oriented growth model as 'the tax burden remains low' (Government of Ireland, 2008: 16).

Although the overall effect of the budget was contractionary, the government found fiscal space to increase the tax credit on research and development (R&D) for companies from 20 to 25 per cent. It also maintained its 'very significant investment in promoting the knowledge economy and enterprise development' (Lenihan, 2008). Then Finance Minister Brian Lenihan justified this by referring to the Irish growth model and the necessity for a 'small open economy' to 'continue to compete aggressively for overseas investment' (Lenihan, 2008). If anything, the Irish economy would continue 'to attract a disproportionate amount of all foreign direct investment into the EU' (Lenihan, 2008). Ireland need to maintain the credibility of its tax system to remain the 'location of choice for foreign direct investment' (Lenihan, 2008). Speaking in parliament, the finance minister assumed that 'virtually all sides of this house will agree with me that our rate of Corporation Tax is essential to this' (Lenihan, 2008).

After the 2008 budget, the government turned to the public sector. Based on an OECD analysis of public sector performance in Ireland (OECD, 2008a), it published a report that identified several reform initiatives. It focused on typical goals such as increased flexibility, performance-based objectives, and the mobility of civil servants across sectors and occupations, arguing that these reforms were urgent due to the 'rapid deterioration in the economic and fiscal situation' (Department of the Taoiseach, 2008b: 7). In parliament, the finance minister aimed for the public sector and demanded that 'those enjoying protected status need to contribute in a broader sense to the greater good of the wider economy' (Lenihan, 2008). To this end, he appointed a so-called 'special group' of economists who were assigned to make 'recommendations for reducing public service numbers so as to ensure a return to sustainable public finances' (McCarthy et al., 2009: v).

Four months later, in February 2009, the Irish government adopted the first of a series of emergency measures. It began by implementing expenditure cuts totalling €3 billion, which targeted the public sector and were based on two main measures. First, €1 billion were generated by postponing the pay increases arranged for in the recently negotiated review of the 'Towards 2016' social pact (Government of Ireland, 2010: 16). Second, and more importantly, a levy on public sector pensions effectively cut net salaries by 7.5 per cent on average (Lenihan, 2009). Social partnership began to show cracks as the pension levy was pushed through by the government against strong opposition by public sector trade unions. A nationwide strike called by the unions, however, was cancelled after the prime minister re-invited them to further talks (The Irish Times, 2009c).

These measures proved to be a drop in the bucket as pre-budget data in April showed that the deficit would be about €5 billion larger than forecast in January (Lenihan, 2009). The government reacted by adopting the 'most severe budget in decades' (RTÉ Ireland, 2009) as a supplement to the 2009 budget. Fiscal adjustment amounted to a total of €5.4 billion, of which €1.8 billion were expenditure cuts (Government of Ireland, 2010: 56). Cuts were applied to current as well as capital spending and mainly affected spending on social welfare and the department of transport. On the revenue side, again, the 12.5 per cent corporate tax rate was to remain untouched, whereas personal income taxes and social contributions were increased significantly (IMF, 2009: 23). Presenting the budget to parliament, Lenihan emphasised that 'notwithstanding the increases today, our tax system remains competitive and pro-enterprise in character' (Lenihan, 2009). One major objective of the swiftly compiled budget was to restore investor confidence in government's problem-solving capabilities (Financial Times, 2009a). The government highlighted the willingness of Irish workers and businesses to rapidly reallocate resources to the sectors with the highest growth potential and advocated a 'return to being driven by sustainable export-led growth, rather than by domestic demand' (Lenihan, 2009).

The economic outlook improved during the year due to 'stronger export growth' (Government of Ireland, 2009: 8). The budget for 2010 still offered further consolidation measures as the government expected a deficit of 11.7 per cent of GDP in 2009 and a deficit of similar magnitude for 2010 (Government of Ireland, 2009: 14). Expenditure cuts contributed €4 billion of a total of €4.1 billion of adjustment

measures (Government of Ireland, 2010: 56). This approach proved to be 'broadly welcomed by employers' but difficult to swallow for the trade union movement as the majority of cuts affected the public sector (Dobbins, 2011). Based on the aforementioned McCarthy report, gross public service pay was further cut by 8 per cent on average (MacCarthaigh and Hardiman, 2018: 116). When the government renewed its commitment to the 12.5 per cent corporate tax rate and stated that 'we cannot tax our way out of this' (Lenihan, 2009), it made clear that it intended to refrain from further revenue increases.

The government was eager to show on several occasions that its fiscal policy was in line with the recommendations of the economics mainstream, relevant international organisations, and the preferences of international financial market actors. For example, the finance minister underlined in his financial statement on the 2010 budget not only that the government's measures were commended by the likes of the ECB, the EC, the IMF or the OECD, but that they 'also won the approval of the international markets' (Lenihan, 2009). This stance was repeated in the 2009 update of Ireland's Stability Programme—that is, a summary of the country's budgetary planning sent to the EC for assessment—where it was highlighted that the government 'took on board evidence from international organisations […] as well as the relevant economic literature' (Government of Ireland, 2009: 15). Finally, the NRP reiterated that the analyses by the IMF, the EC and the OECD were a cornerstone of Ireland's expenditure-based adjustment strategy (Government of Ireland, 2010: 18).

In December 2009, social partnership officially dissolved for the time being as the last agreement became unworkable for the government and parts of the employers. Nevertheless, the NESC initiated negotiations between the social partners shortly thereafter. In an attempt to overcome a standstill of the talks, Prime Minister Cowen sent a letter to the ICTU's general secretary. He emphasised the government's interest in finding an agreement but that also stressed that a precondition would be 'greater flexibility in the deployment of people and resources withing and where necessary across the public service boundaries' (Sheehan, 2009). The trade unions' following agreement to the expenditure cuts defined in the 2010 budget 'fundamentally shifted the balance of power away form a public investment strategy' (Regan, 2012: 485).

ICTU's public sector section subsequently developed a proposal that specified equivalent savings without significant cuts to public sector remuneration by relying on alternative reforms and improving productivity. The government rejected the proposal and IMPACT walked out of the negotiations. Leading figures of the trade union movement publicly accused the government and IBEC of pressing for public sector wage cuts as a means to deflate private sector pay (The Irish Times, 2009a). IBEC, by contrast, blamed the public sector unions for trying to avoid substantial reforms. IMPACT threatened to engage in industrial conflict but ultimately failed. It was not possible 'to achieve unanimity on the trade union movement' (Interview IE 16). Civil servants and their unions could not find allies in the private sector because many workers in the latter viewed the government's crisis response as stripping the public sector of excessive privileges (O'Malley, 2010: 1023). This was echoed by the media, which were highly critical of the public sector (Culpepper and Regan, 2014: 736). Finally, IBEC also backed out of the 'Forward 2016' agreement at the

end of the year. For the first time in more than two decades, there was no formal agreement between unions, employers, and government (Regan, 2012: 485).

It was still in the interest of the government to come to a negotiated agreement with the trade union movement, rather than imposing further cuts. Shortly after the collapse of social partnership, the government engaged in bilateral talks with public sector unions. Having implemented pay cuts of almost 15 per cent on average, the government was willing to make some concessions to safeguard political stability. After they had unsuccessfully threatened industrial action to get the government to reverse its last round of pay cuts, the unions embraced the opportunity (Sheehan, 2010b). In June 2010, the unions and government signed the 'Croke Park Agreement', which was supposed to remain in effect until 2014. Although not all union members viewed the deal as being beneficial, they ultimately agreed as 'we were not going to be able to win the war' (Interview IE 16). The government offered the public sector workers a guarantee not to make further direct pay cuts or redundancies and to give them a say in future reforms. In exchange, it got a guarantee that the unions would uphold industrial peace and contribute to the reduction of public sector staff by means of a voluntary early retirement scheme and to further cost-saving measures.

In the private sector, unions and employers also reapproached each other. IBEC signalled its general willingness to return to the bargaining table, but at the same time warned its members that they 'should not entertain claims for pay increases in 2010 [and] should be aware of the effect on their overall sector of any pay concessions they may make' (Sheehan, 2010a). The result was a voluntary pay agreement for the private sector between IBEC and ICTU in March 2010. It did not include any (legal) obligations but offered broad guidelines for wage bargaining which emphasised 'the economic, commercial, employment and competitiveness circumstances of the firm' (Sheehan, 2010c). Employers could easily agree, given that the voluntary character of Irish industrial relations had made it easy for them 'to shift from bargaining about redistributing the gains of economic prosperity, to aggressively negotiating or even imposing concessions in response to the current crisis' (McDonough and Dundon, 2010: 556). Moreover, as a leading executive of IBEC argued, Irish companies located in the exposed sector had already started to grow again by the middle of 2009. In 2010, exports reached a record high (Interview IE 02).

To sum up, between July 2008 and December 2009 the government implemented fiscal adjustment measures worth almost €15 billion. More than 60 per cent of adjustment came from expenditure cuts. Revenue increases primarily affected personal income taxes and social security contributions but maintained a comparatively low tax burden. Repeatedly, the government emphasised that it would leave the very low corporate tax rate of 12.5 per cent untouched, as it had 'become an international "brand", known the world over' (Lenihan, 2009) and a cornerstone of its export-led growth model. Three years later, it came to light that the government had introduced a set of exemptions from the withholding tax for multinational corporations after intense lobbying by the ACC. These exemptions allowed multinationals to transfer licence fees more easily to offshore tax havens (Financial Times, 2013a). On the expenditure side, the public sector was subject to the majority of measures except for some across-the-board cuts to current spending. Overall public sector wages were cut by almost 15 per cent on average. This also contributed

ultimately to the collapse of social partnership—which had characterised the Irish economy since the late 1980s—as government and public sector unions were unable to find an agreement on how to reduce government expenditures.

Ireland's adjustment strategy before the EAP meets the expectations formulated in the previous chapter. Adjustment was based largely on expenditure cuts and the overall tax burden remained low. The economic and political logic of an export-led growth model trumped any potential demands by the trade union movement. Most prominently, the public sector, an influential actor group in favour of a more redistributive and revenue-based adjustment strategy, was completely silenced.

Ireland's export-oriented growth model featured prominently every time the government announced new measures or justified the composition of fiscal adjustment. The model was politically not disputed. This became clear when the crisis hit and these sectors, which were not expected to directly contribute to the future success of the growth model (namely construction and the public sector), had to bear the brunt of adjustment. The first public statement by the Irish Central Bank's then governor is a case in point, arguing that the model was 'not re-invented, merely restored to where it was just a few years ago' (Irish Independent, 2009). Ireland's export-orientation was politically uncontroversial and, according to a leading trade unionist, changing the corporate tax rate 'was not even considered' (Interview IE 09).

Trade unions in general acknowledged the necessity of adjustment but publicly argued for an extension of 'the timeframe over which that adjustment is to take place' (ICTU, 2009: 7). When, in late 2009, they were asked to assess the governments record of reacting to the crisis, IBEC and ICTU predictably gave different answers. David Croughan, IBEC's economist, stated that tax increases would prevent the country from regaining its competitiveness and allowing the traded sectors to prosper again. His counterpart from ICTU argued that competitiveness was not only a question of labour costs but rather that the disposable income of the average Irish worker was too low to substantially induce growth (The Irish Times, 2009b). The unions would have preferred 'to ensure that there was a level of domestic demand which would keep the economy moving along' (Interview IE 04). However, the trade union movement was in no position to assert its preferences. One of ICTU'S leaders stated that 'nobody in the Ireland of 2009 or 2010 believed that we could win' (Interview IE 16). This held especially true for the public sector unions. The government benefitted from the opportunity when it implemented an expenditure-based adjustment strategy, even if it knew that the union's consent was unlikely (McDonough and Dundon, 2010: 558).

Following the collapse of social concertation, ICTU's general secretary concluded that 'partnership gave us access, but not a lot of influence' (The Irish Times, 2010). Cracks between private and public sector unions opened up when the crisis hit Ireland. Furthermore, the state was not any longer in immediate need of the unions but preferred to push its expenditure-based adjustment agenda through (Regan, 2012; Culpepper and Regan, 2014). Social partnership had been the go-to option for all actors involved when it came to redistributing the fruits of economic success. But when responding to the crisis, the government

'very quickly packed up the partnership tent' (Doherty, 2011: 376) as social partnership 'was not a mechanism to reach agreements on how to share costs' (Interview IMF 08).

5.2.2. Fiscal adjustment in the eurozone crisis

Three developments were decisive in bringing about Ireland's request for a troika programme in late 2010. After reaching a temporary peak in March 2009, Irish government bond spreads slowly decreased for more than one year. This changed when it became clear, in May 2010, that Greece would be the first country to receive financial assistance from the troika. Spreads soared again and in August exceeded the level of the year before. This trend was amplified by a series of capital injections into Irish banks. In December 2009, the National Asset Management Agency (NAMA) had been set up as a 'bad bank' that would buy property development and commercial loans from the largest and most distressed banks. Although NAMA ultimately would make profit, in 2010 it implied an enormous financial burden. Between March and August, the Irish government provided Anglo Irish and three two other property developers with almost €22 billion of capital injections (EC, 2011a: 13). Even without the injections that were to follow in December—totalling more than €13 billion—this was a heavy drain on the public finances. The losses covered were immediately counted against the public deficit which was forecast to reach a staggering 32 per cent of GDP (Whelan, 2011: 10). General government gross debt, standing at very low 23.9 per cent of GDP in 2007, was going to reach 86 per cent of GDP in 2010.

On the side-lines of a G8 summit in Deauville on 18 October 2010, Germany's chancellor Angela Merkel and France's then president, Nicolas Sarkozy, discussed future steps and reforms of the eurozone to tackle the crisis. The two political heavyweights argued in a political statement that the involvement of the private sector should become mandatory in future assistance programmes. Their announcement 'contributed to a sell-off in Irish and Portuguese government bonds' (Henning, 2017: 65) and Irish bond yields skyrocketed. Although the commitment to a mandatory 'bail-in' was later withdrawn, the damage was done.

The negotiations of the EAP for Ireland proceeded swiftly. The Irish authorities turned to the troika on 21 November 2010 and by mid-December the programme was adopted by the European institutions and the IMF. The Irish government had published an NRP on 24 November 2010 on which 'the home-grown program built initially' (IMF, 2015a: 9). Ireland became the troika's 'poster child'. In contrast to the other crisis countries, the IMF's Independent Evaluation Office described the Irish EAP as a 'considerable success' (IEO, 2016: 35) in terms of meeting economic objectives and individual programme targets. This was echoed by the EC, which assessed the programme equally positive (EC, 2015: 12). The NRP practically served as the blueprint for the programme's fiscal part and was changed only in that meeting the SGP's 3 per cent of GDP threshold was rescheduled from 2014 to 2015. The EAP provided for fiscal consolidation measures totalling €15 billion. Expenditure cuts were planned to contribute €10 billion (of which €7 current spending cuts), and revenue increases €5 bn (Government of Ireland, 2010: 19; EC, 2011a: 26-27; IMF, 2010a: 23-24). Since it expected the initial plan to be realistic and the Irish authorities to be commit-

ted to implementing it, the troika left it to the government to design the specific measures (EC, 2015: 64). In general, programme implementation unfolded smoothly and only a few issues caused controversy.

Domestic opposition arose mainly in view of the financial sector, the misbehaviour of some of its most prominent figures, and the amount of money deployed to save banks and credit institutions. Protests, generally, were not especially remarkable. But they were eventually sparked from an apparently minor issue, namely the introduction of water charges. To the bewilderment of many, water charges would become a controversial subject even during the election of 2016. Water charges were only to contribute a small amount of revenues to the fiscal consolidation and were mainly the EC's priority in its endeavour of EU-wide harmonisation (Interview IMF 08). The resulting protests were mainly an expression of austerity-fatigue and did not significantly affect the implementation record of the Irish government.

The fiscal part of the EAP for Ireland 'was based on a continuation of the key features; (EC, 2015: 64) of the Irish growth model. Its main objective was to return the country to export-led growth. This fit between programme and domestic economy was arguably one reason for Ireland's exceptional implementation record. The government prepared and implemented an EAP that focused almost exclusively on expenditure cuts. It was able to do so because this approach was consistent with Ireland's long-established growth model. Furthermore, traditional actor groups, who were in favour of a revenue-based adjustment strategy, were politically not strong enough to push through their redistributive preferences.

5.3. The EAP for Ireland

This subchapter presents the main part of the case study and deeply examines how the Irish government implemented the fiscal part of its EAP. It shows how the preferences of domestic coalitions influenced the government's policy reactions to Ireland's economic crisis. First, I describe the negotiations of the EAP, which took place in late 2010. Second, I turn to the early programme phase and the policy measures taken by the Irish government over the course of 2011. Two fifths of the fiscal consolidation had been front-loaded to the first programme year when the external pressure to adjust was highest. That is, 2011 was not only decisive for the eventual outcome in terms of economic growth, but also regarding the potential of further conditionality and additional measures. Third, I show the progress made by the Irish government in implementing the programme and how it defended its interests when meeting the troika's review missions as international pressure slowly waned. Ultimately, Ireland exited its programme as scheduled in December 2013.

5.3.1. Phase one: Negotiating the EAP – Tax sovereignty and the 'National Recovery Plan'

On 15 October 2010, Jean-Claude Trichet—then the President of the ECB—wrote a letter to the Irish Minister for Finance. In that letter, Trichet expressed the ECB's concerns about 'the *extraordinarily large provision of liquidity by the Eurosystem to Irish banks* in recent weeks' (ECB, 2010a). He also warned that the Eurosystem's liquidity would not be able to serve as a long-term solution for the problems of Ireland's ailing banking sector. The so-called 'bank funding cliff', resulting from the expiration of the government's blanket guarantee after two years in September 2010, was a major cause of concern for the ECB. Although the actual magnitude of the problem was disputed, it was clear that the ECB would have to help out in case Ireland was excluded from private market funding (Joint Committee, 2016: 337).

When the Irish government received the letter, it was already preparing its NRP. Discussions about Ireland's potential request for a bailout programme had loomed for some time and now intensified. Only a few days later, the infamous 'Deauville declaration' was published. In the words of a then member of the government, this 'killed the confidence in the country to raise funding' (Interview IE 15). As Ireland's government bond yields skyrocketed, the country became a major subject of discussion internationally. At the G20 summit in Seoul on 11-12 November, several countries voiced their concerns about the Irish banking sector and its potential implications for European and global economic stability. Preliminary discussions between EC and the Irish government on an eventual programme were initiated, became public, and speculations in the media gained pace (Joint Committee, 2016: 341).

The final breaking point arrived when Central Bank Governor Patrick Honohan publicly disagreed with the finance minister's statement that the government would not ask for financial assistance in a radio interview on 18 November 2010. The Minister reacted swiftly and declared that the country would apply for external help amidst the IMF's confirmation that a mission team was about to start its work in Dublin the next morning (RTÉ Ireland, 2010a). Trichet wrote a second letter on the following day. Again, he mentioned the large amount of liquidity provided by the ECB, but this time he held a gun to the Irish government's head. Trichet stated that liquidity would continue to be provided only if Ireland was willing to commit in writing that it 'shall send a request for financial support to the Eurogroup' (ECB, 2010b). Formal negotiations between the Irish government and the troika commenced on 21 November 2010.

Work on the NRP had already started in early 2010 when it was foreseeable that the measures taken so far would not resolve the crisis. The NRP was planned as a policy-programme with a multi-year horizon. However, due to the gravity of the problems and the economic and political demands imposed on the Irish population, the government did not complete the plan until November, when the external pressure to adjust reached a new peak (Interview IE 10). The plan was published on 24 November amidst the negotiations with the troika and became a central element of the EAP. Table 5.3. shows in more detail the exact composition of adjustment planned for implementation between 2011 and 2014.

Just as during the pre-programme phase, the government intended to generate two thirds of the adjustment based on of expenditure cuts. The NRP's overall adjustment path was highly ambitious. The trade union movement argued that the NRP was based on unrealistic growth rates. From their point of view, the assumed growth rates were unrealistic precisely because expenditure was cut too much and because the NRP did not leave any room for the support of domestic demand (Interview IE 04, see also Dobbins, 2011). When the NRP was published, the 2011 budget was pending. It was to be decisive as it had to deliver more than one third of the total adjustment. This emphasis on the 'front-loading' of measures was not only criticised by the trade unions (Interview IE 04) but was also a point of disagreement between the troika institutions in that the IMF demanded front-loading to be less pronounced than preferred by the EC and especially the ECB (Lütz et al., 2019a).

Table 5.3.: The National Recovery Plan 2011-2014

	2011	2012	2013	2014
General Government Deficit (% of GDP)	**9.1**	**7.0**	**5.5**	**2.8**
Total Consolidation (Full-Year Impacts)	**€5.3 bn**	**€3.6 bn**	**€3.1 bn**	**€3.1 bn**
Expenditure	***€3.9 bn***	***€2.1 bn***	***€2.0 bn***	***€2.0 bn***
Current	*€2.1 bn*	*€1.7 bn*	*€1.6 bn*	*€1.6 bn*
Capital	*€1.8 bn*	*€0.4 bn*	*€0.4 bn*	*€0.4 bn*
Taxation	***€1.4 bn***	***€1.5 bn***	***€1.1 bn***	***€1.1 bn***
General Government Gross Debt (% of GDP)	100	101	102	100

Notes: Forecast General Government Deficits and end-year Gross Debt Levels.
Source: The National Recovery Plan 2011-2014 (Government of Ireland, 2010: 19).

Front-loading was less pronounced on the revenue-side, but still more than 50 per cent of total tax increases were planned for the first half of the EAP. How the government chose to prioritise its revenue strategy is insightful. The NRP was its most important document regarding the fiscal aspect of the EAP and listed all the policies it scheduled in great detail. The first entry on the list of the planned revenue measures, however, boldly states that the government will 'maintain the 12½% corporation tax rate; this will not change' (Government of Ireland, 2010: 12). The NRP justifies the government's refusal by stating that the low corporate tax rate—and the low tax burden in general—as well as the related aspects of its tax regime constituted 'essential conditions for growth' (Government of Ireland, 2010: 23). The largest con-

tribution to higher state revenues was therefore to come from changes to the income tax, taxes on pensions and an increase in the VAT. On the expenditure-side, the government budgeted further harsh cuts to current spending, which represented 70 per cent of total cuts. The largest share of these cuts was again to come from adjustments made to public sector pay, pensions, and social welfare.

With the NRP and the EAP, Ireland entered into a phase of 'strategic cuts' (MacCarthaigh and Hardiman, 2018: 114) where it relied, to a lesser extent, on across-the-board cuts and its measures became more targeted. The Irish authorities prepared and published the NRP to have 'a very solid backstop' when negotiating the with the troika (Interview IE 10) and to make sure the EAP would be 'a continuation of that process' of adjustment which the government had initiated (Interview IE 01). In the end, this strategy was successful in that the troika focussed mainly on macro-issues, such as the general path of adjustment, and left detailed measures to the government (Interview IE 15). The troika institutions essentially 'did not touch the Irish national recovery programme' (Interview IMF 14). Eventually, the EAP was not 'an exact replicate of the initial government programme, but it was very closely related' (Interview IMF 08). Thus, most fiscal issues were resolved at the outset of the programme and 'there was not a huge degree of contention or disagreement around the fiscal element of the programme' (Interview IE 03).

Formally, the negotiations of the EAP for Ireland took only six days and were finalised on 26 November 2010. One day later the government officially adopted the programme. The EAP had a total volume of €85 billion. Irish sources, namely Treasury Cash Reserves and the National Pensions Reserve Fund (NPRF), contributed €17.5 billion. The argument in support of the NPRF's contribution was that it was more costly for the fund to hold liquid assets than using them for the programme, because 'the difference between sovereign funding costs and the return on the assets and cash reserve has increased' (EC, 2011a: 39). In addition, Ireland's finance minister argued that it was not 'credible to suggest we could have retained a sovereign wealth fund while expecting others to make resources available to us' (Lenihan, 2010).

Although the NRP served as a blueprint for the fiscal part of the programme, the latter still had to be slightly expanded because, from the EC's perspective, 'the fiscal challenge, the budgetary issues, were really massive' (Interview EC 02). One discussion revolved around the pace of adjustment and especially when Ireland should meet the SGP's 3 per cent deficit threshold. The NRP projected that the deficit would sink to 2.8 per cent of GDP in 2014 (Government of Ireland, 2010: 19). During the programme negotiations, the government initially stuck to that schedule. The EC's programme document, however, postponed meeting that target by one year because it felt the government's forecast was too optimistic (Interview EC 02; Interview IE 13). The IMF was even more pessimistic than its European counterpart and expected the deficit to still reach 4.8 per cent of GDP in 2015 (IMF, 2010a: 21). Postponing the 3 per cent target did not imply changes to the measures included in the NRP but, instead, the necessity of additional adjustment beyond the programme duration.

The government's focus on expenditure cuts was lauded by the troika. Quoting its own econometric finding 'that consolidation from the spending side is in general more effective than revenue driven consolida-

tion' (EC, 2010b: 180), the EC praised the Irish approach as being 'carefully designed based on past lessons of large fiscal consolidations' (EC, 2011a: 27). The IMF considered the NRP, and thus the programme, to contain 'a number of high-quality fiscal measures' (IMF, 2010a: 25). Ireland's growth model served as a major argument as the adjustment strategy was discussed. The IMF especially viewed Ireland's 'competitive business environment […] as being in little need of reform' (IMF, 2015a: 10). This assessment was shared in principle by the EC, even though the Irish authorities sometimes felt that the Commission 'almost wanted changes for the sake of changes' (Interview IE 10).

Evaluating the EAP's success, the EC acknowledged that the government's adjustment strategy served the purpose of re-establishing and further developing the foundations of the Irish growth model, namely a comparative low tax burden and the attraction of FDI. Consequently, the few revenue measures included in the programme solely served the minimum goal of closing gaps and stabilising tax receipts and did not provide for a significant change in the country's tax system. This also played an important role when the programme was discussed in the IMF's executive board. Presenting the programme to the Board, the Irish Executive Director Stephen O'Sullivan was eager to emphasise that the EAP would not 'call for a reorientation of economic or budgetary policies' (IMF, 2011a: 6). Rather, he argued, 'the key components of Ireland's growth model remain in place' (IMF, 2011a: 6). The IMF's mission team supported this position as it did not think it was 'the time to take some measures to change Ireland's economic model' (Interview IMF 08). These kinds of arguments would also be brought up by the government as well as the IMF when one of the most controversial aspects of the Irish growth model became subject of discussion at the international level, namely the country's low rate of corporate taxation.

In the lead-up to Ireland's EAP, controversies arose over three issues. First, a few creditors demanded an increase in the corporate tax rate. Second, the bail-in of senior bondholders would be brought into play by the government on several occasions. Finally, the costs and conditions of the loans provided by the troika institutions would also repeatedly become an object of dispute.

The EAPs' 'morality plays' (Blyth, 2013a: 1) had the connotation of being punitive. This was also the case when it came to Ireland. The country was viewed by many as having overreached by both turning its banking sector loose and by relying on a growth model that attracted FDI at the costs of others with the aid of an unduly low corporate tax rate. As soon as it became clear that Ireland would apply for an EAP, voices were being raised at the international level that financial assistance to Ireland should only be provided in exchange for an increase in the country's corporate tax rate. Germany, and particularly France, were the most outspoken proponents of this demand (Interview EC 02; GER 03; IE 01; IMF 14). A French official went as far as describing the Irish tax rate as 'almost predatory' and argued that a country in such dire need of funding would have to make concessions (Financial Times, 2010c). This position was echoed by German politicians from all sides of the political spectrum, who argued that Ireland benefitted from unfair tax competition and more generally would need to raise its revenues (Zeit Online, 2010).

During programme negotiations, however, the Irish government and troika staff firmly rejected these demands. Publicly as well as behind closed doors, Irish decision-makers and civil servants made clear that the corporate tax rate was a 'red line' (Interview IE 01; IE 07; IE 10) not to be crossed. Or, in the words of one senior official of the Department of Finance who was directly involved in the negotiations: 'we were not able to concede anything on that point and it could not be a condition of any programme' (Cardiff, 2016: 157). The main argument was that any increase to the corporate tax system would threaten the long-term stability of the Irish growth model and would take away 'a very important element in the future model' (Interview IE 03), namely the attraction of FDI (Interview IE 10). Presenting the potential programme to the executive board, the IMF's designated mission chief argued that the maintaining the low tax rate hinged on 'bi-partisan support' (IMF, 2011a: 65). This was expressed by parliament in late-2010 when 'all political parties in this House supported a motion calling for the maintenance of the 12½% corporation tax rate' (Lenihan, 2010). This held true even for the left-leaning Irish Labour Party. Visiting Ireland a few months after the adoption of the EAP, the fiscal policy speaker of the German Social Democrats was cold-shouldered when trying to convince its Irish counterpart of the necessity to increase the country's corporation tax (Interview GER 02).

The government's adamant stance arose not only from an economic imperative. In October 2009, Ireland had made a second attempt on a referendum on the Lisbon Treaty, which had been backed by the employers but left the trade union movement divided (Dobbins, 2008a). One major argument to gain popular support for the treaty was it would 'left intact Ireland's sovereignty in matters of taxation' (Financial Times, 2010a), which now was supposed to be under fire. The government's firm position was supported by IBEC, which praised the NRP and its focus on expenditure cuts as providing 'a growth strategy for the Irish economy' (Irish Examiner, 2010a). They took the same line as their coalition partner, namely the ACC in Ireland. The latter also referred to Ireland's growth model and stated the corporations in the country 'will be reassured, as the Government has now removed uncertainty concerning the 12.5% corporate tax rate' (Irish Examiner, 2010b). Obviously, it was important for the government not to alienate either of those groups by giving in to demands of its international creditors. The trade unions, on the other hand, simply accepted that 'the corporate tax rate was never going to be touched in the crisis' (Interview IE 09).

Ultimately Ireland's corporate tax was kept out of the programme, not only because the government did not want to give in to the demands made by France and Germany, but also because the mission teams of both EC and IMF argued against any increase. Vis-à-vis the IMF's executive board, they pointed out that Ireland's primary potential of growing out of its crisis 'is in the export sector, in the multinational sector' (IMF, 2011a: 57) and that changes to the corporate tax could impair this potential (Interview IMF 14). This position was echoed by the EC's staff that also did not want to 'jeopardise the possibility for Ireland to recover' (Interview EC 02). Finally, from the Irish point of view, diplomatic efforts and influence of the US did also play a role given 'the scale of the US investment in Ireland' (Interview IE 10).

Two other controversial issues did not directly influence the composition of fiscal adjustment but, rather, the amount. During the programme negotiations, the IMF suggested that the holders of senior bank bonds could be bailed-in to raise almost €17 billion. Although the government calculated with a much lower amount of about €2-3 billion (Véron, 2016: 18-19), it was still interested in saving 'significant amounts of taxpayer money by sharing losses with senior bank bondholders' (Cardiff, 2016: 189). In the end, the implementation of this plan was met with opposition by the US government and the ECB. Both voiced concerns about the implications for financial stability in the eurozone of a bail-in (Lütz et al., 2019a: 1198). Second, the costs and interest rates of the loans provided by the troika institutions were deemed by some observers as punitive. This was true especially for the EU as its loans included an additional margin on top of the lending costs in the market (Interview IE 11). These two issues had significant impact on Ireland's fiscal position and would become abiding themes rehashed by the subsequent government, which came to power in March 2011 and attempted to renegotiate parts of the EAP. Before this could happen, however, the 2011 budget had to be adopted in parliament.

Based on the NRP, the 2011 budget was approved swiftly. Parliament adopted the first budgetary measures less than three weeks after the EAP negotiations. Notably, it was already clear that snap elections would be taking place in early-2011. On the day after the programme negotiations were initiated, the Green party—the junior partner of the governing coalition with the liberal-conservative Fianna Fáil—called for early elections and argued that the government did not have enough political capital and public confidence to continue (Interview IE 15). It was decided that the general election would take place on 25 February 2011. The Greens claimed that this would provide the political stability necessary to get the economy back on its feet. They promised that they would not leave government before the 2011 budget adopted and the negotiations with the troika finalised (Irish Independent, 2010).

After the EAP had been negotiated, however, the parliamentary opposition increased its pressure on the government and claimed that the programme implied a loss of sovereignty for the country. As a result, the Green party declared that it would stay in government only until the budget measures for 2011 were decided upon (O'Malley, 2011: 1009). Despite the opposition's public criticism of the programme, there still existed a consensus about the necessity of fiscal adjustment and how it should be approached. Together with the Labour Party and Fine Gael—which were most likely to make up the next government after the upcoming election and to continue adjustment path taken—the incumbents formed an 'effective national government' (Interview IE 15). The budget was published on 7 December and a series of bills were passed in parliament in the weeks that followed. Although the yearly 'Financial Bill', which specifies the taxation part of the Budget, was typically not finalised before April, the government adopted it in collaboration with the opposition by early February (O'Malley, 2012: 143).

As envisaged in the NRP, the 2011 budget implemented fiscal adjustment measures totalling €5.3 billion plus one-off measures in the amount of €700 million. For 2011, this implied frontloaded measures amounting to 3.8 per cent of GDP (EC, 2011a: 27). The one-off measures resulted from negotiations between the Irish Minister for Finance and Olli Rehn, the commissioner for economic, monetary affairs,

and the euro. The latter demanded €6 billion of consolidation in the first year, whereas the minister set the limit at around €5 billion. Together with the ECB's Chief Economist Jürgen Stark, the two ultimately agreed that the gap could be covered by rescheduling some one-off revenues from a series of asset sales (EC, 2011a: 27), which the government had planned for later years anyhow (Cardiff, 2016: 134-137).

Although cuts to capital spending represented only 30 per cent of the aggregate expenditure measures, in the first programme year it was reduced by almost the same amount as current spending. For the year 2011, another €800 million of capital savings were added to the €1 billion already provided for in the 2010 budget (Government of Ireland, 2010: 83). The troika's main rationale for these cuts was that the Irish government was spending twice as much as the eurozone average on public investment and that it was therefore necessary to reprioritise and reduce capital spending (EC, 2011a: 26). In the eyes of the IMF, this would result in 'better value-for-money infrastructure procurements' (IMF, 2010a: 23). The Minister for Finance argued in parliament that the government was about to continue to 'spend significant sums' (Lenihan, 2010), but it was still clear that public investment would be reduced significantly. At the same time, however, the government was eager to show that this would not mean a departure from its growth model, but rather that it was a priority of its future investment to 'support direct job creation in world-class, export-oriented enterprises' (Government of Ireland, 2010: 85).

The EAP envisaged that current spending would be cut by slightly more than capital expenditures, that is a by total of €2.1 billion. Those cuts affected three major budget items. First, across-the-board reductions of intermediate consumption amounted to €0.9 billion. Second, several social welfare programmes were also slashed, most importantly child benefits and jobseeker allowances. Although this was already a significant number of cuts, the government announced that 'further reductions in social welfare spending [will be] unavoidable' (Lenihan, 2010). By contrast, in what could be interpreted as an attempt to save Ireland's from 'privatised Keynesianism' (Crouch, 2009), a stamp duty reform was supposed to 'stimulate activity in the ailing property market' (EC, 2011a: 27). Finally, the public sector was to contribute another share of savings. The government made clear that it would honour the Croke Park Agreement only if rationalisations would achieve the planned savings (IMF, 2010a: 23). Demanding that civil servants and their trade unions 'abide by their commitments to pursue flexibilities and reforms in every part and level of the public service' (Lenihan, 2010), the government carried out a series of cuts for 2011 to achieve savings of €0.3 billion. Those savings would come from a cut to public sector pensions averaging 4 per cent, a 10 per cent reduction of the salaries of those entering public service, and the voluntary reduction of the number of public sector workers.

Regarding the revenue measures of the 2011 budget, the government was eager to emphasise that it was only reluctantly increasing taxes since 'revenue is generated by economic activity: not by increased tax rates' (Lenihan, 2010). Consequently, tax revenues were increased by broadening the tax base and by abolishing a series of tax exemptions. Changes to the personal income tax were expected to generate an additional €1 billion of revenues and an increase in social contributions to realise €0.3 billion (EC, 2011a: 27). Furthermore, a highly contested measure was the introduction of the so-called 'Universal Social Charge'

(USC) that replaced both the income and health levy. It would soon become 'Ireland's most hated tax', loathed by trade unions and small business owners alike (Irish Independent, 2014). Based on an analysis conducted in 2011, the unions argued the USC would favour high-income groups (ICTU, 2011b: 10). When the EAP was negotiated, the government knew that the sheer magnitude of adjustment would imply 'significant tax increases for the low paid' (Cardiff, 2016: 134).

The government's rationale as it introduced the 2011 budget aimed solely at the sheltered sectors and the domestic economy. Export growth had been strong in 2010 and was therefore supposed to 'protect and expand high-value employment and stimulate domestically trading sectors of the economy' (Lenihan, 2010). One measure to achieve this objective was reducing the statutory minimum wage by €1 to €7.65. The minimum wage is paid primarily to workers in the low-end service sectors and its reduction therefore was supposed to 'remove a barrier to job creation' (Government of Ireland, 2010: 36). The revenue measures aimed at 'broadening the tax base at both ends of the income spectrum' (Government of Ireland, 2010: 90) and were intended to provide stronger (Lenihan, 2010). The Labour Party, by contrast, heavily criticised the measures because they argued it continued the government's approach to 'slash and burn' the welfare state (RTÉ Ireland, 2010b).

Economic actor groups examined the budget very differently. IBEC and the ACC had already praised the expenditure-focus of the government's general adjustment strategy. However, looking at the budget in more detail, there were a few critical points from the business standpoint. In the run-up to the programme, IBEC had urged that 'the bulk of adjustment must come in the form of current expenditure reductions' (IBEC, 2010b). Although the government delivered on that part, in view of future budgets IBEC still demanded a stronger focus on expenditures (IBEC, 2010a). IBEC supported the reduction of the minimum wage but criticised that other fiscal measures partly offset the reduction and gave 'a disincentive effort to actually adjust and to work' (Interview IE 02). This was an expression of IBEC's more critical view of the troika in the early stages of the EAP, when it argued against its negative evaluation of the Irish economy. From the employers' point of view, businesses had 'already taken care of what they need to take care of' (Interview IE 02). In addition to that, IBEC's representatives were anxious to draw a distinction between those sectors responsible for the Irish crisis. In particular, this was the banking and the property sector, as well as other businesses and especially the export sector, which 'was already super competitive when the Troika arrived' (Interview IE 02). Thus, it argued with respect to fiscal policy that the biggest threat to the performance of the Irish economy 'actually lies in the performance of the global economy rather than the risk to the domestic economy from fiscal austerity' (IBEC, 2010a).

Unsurprisingly, the trade unions saw this completely differently and argued that programme's biggest problem 'was the collapsing domestic demand' (Interview IE 04). At the outset of the EAP, however, the trade unions were in no position to influence fiscal policy in a way that would avoid that collapse. Rather, they could merely voice their frustration (Interview IMF 08). It was clear that the preferences of the trade union movement were not at all reflected in the programme and, as it was not possible for them to change that, the unions 'stayed off the pitch' (Interview IE 10). The unions' 'awareness of the nature of the Irish

economy, about how open it is and the sort of policies that we pursue' (Interview IE 10) has been cited by senior civil servants as well as academic observers as the reason why the programme was broadly accepted by all economic actor groups (Donovan and Murphy, 2013: 256).

There is surely some substance to this argument, but this does not necessarily suggest that all actor groups believe in a certain growth model. They also may not have the power to change it. In the words of a leading figure of both SIPTU and ICTU, it was not that Irish workers were 'imbued with the belief in the free market'. Rather, their stance was 'pragmatic' and conscious that, especially at the early stage of the EAP, they lacked the power to influence policy-making (Interview IE 16). Public distrust in the trade unions had collapsed between 2007 and 2010 and the media had blamed the unions for contributing to Ireland's crisis due to the role they played in the context of social partnership (Culpepper and Regan, 2014). Taking to the streets was therefore not a viable option because the unions 'had no industrial power' (Interview IE 16). The potential for another social pact on combatting the crisis also was very low. Indeed, meeting the unions' preferences would have implied 'basically doing everything that the programme was not' (Interview IE 10).

These findings directly relate to the analytical framework of this dissertation. When it comes to the distribution of economic risks, there were three different groups of workers that were quite differently affected by the crisis and the government's measures. The main focus rests with civil servants. Not only were they viewed as being partly responsible for the crisis and portrayed by the media 'as a public-sector cartel holding the government ransom' (Culpepper and Regan, 2014: 734). But it was also clear that the public sector would be one of the main sources of fiscal adjustment in an export-led economy. As I have shown above, public sector trade unions still faced significant pressure, even after having singed the Croke Park Agreement. There was no potential for any cross-class coalition as IBEC viewed the role of the public sector unions very critically. In their opinion, 'they had to be legislated around' and were not willing to contribute to the recovery of the Irish economy (Interview IE 02). However, a strong coalition between workers from different sectors was also unlikely to form. At around the same time as the public sector unions adopted the Croke Park Agreement, the exporting sectors started to show signs of strong growth again. Companies in those sectors were even planning to increase pay in 2011 (Interview IE 02) or did so anyway over the course of the crisis because they did not depend on low wages in order to be competitive (Interview IE 09). If anything, these workers experienced wage cuts due to the increases of the personal income tax in 2009 and the 2011 budget (Interview IE 16). The low-end services sector and especially construction workers faced a steep increase in unemployment while manufacturing maintained its position (Interview IE 16).

In other words, sector-based actor groups faced completely different economic risks. Risks ranged from direct wage cuts as a means to reduce government expenditure to indirect wage cuts as a result of revenue increases and finally to unemployment. The differences in economic risks also corresponded to the importance of the various sectors to the economic growth model. Public sector workers wanted to avoid further spending cuts, whereas workers in the exposed sectors had strong preferences for a stronger focus

on those very expenditure cuts. The unlikeliness of those two groups to form a coalition, and the much greater relevance of the latter for the Irish growth model, tilted the balance of power significantly towards expenditure cuts. This holds especially true given that another important membership in IBEC, namely national and multinational corporations in the exporting sector, also favoured an expenditure-oriented adjustment strategy.

As already described above, the 2011 budget had been adopted in parliament by a disintegrated government. But the governing coalition was still able to strike a compromise with the two main opposition parties in order to implement a first set of measures that were seen as decisive for the successful start of the EAP. In late 2010 and early 2011, Fianna Fáil—which had dominated Irish politics for decades and had been in government since 1997—had been steadily losing electoral support in opinion polls. This development accelerated in January 2011. On 22 January 2011, internal power struggles finally resulted in Brian Cowen resigning as the party's leader, although he intended to stay in office as Taoiseach (prime minister). This was the breaking point for Fianna Fáil's coalition partner. The Green party announced that it would withdraw from government—and its two ministers resigned. Amidst parliament adopting an additional set of fiscal measures, new elections were scheduled for 25 February (for a more comprehensive account, see O'Malley, 2012).

The main opposition parties had prepared early for new elections as it had been already foreseeable in late 2010 that the government would crumble. It was clear that the troika programme and the economy's condition would dominate the elections (Little, 2011; Stafford, 2011). All parties except for Sinn Féin committed to the programme and 'there was broad political agreement that we had a budget hole that we had to fix' (Interview IE 15). But there were different views on how to achieve this and exactly how the parameters of the EAP needed to be changed. Several critical aspects of the programme, which had been controversial during the negotiations in November already, now cropped up again.

The most prominent discussion revolved around the terms of the troika-loan, its costs, and how they could be re-negotiated (Stafford, 2011). It referred mainly to the European share of the loan since the IMF's loan conditions were the same as for any other IMF programme. Both European lending facilities added a margin of around three percentage points to the costs they faced when borrowing in the market. To the individuals directly involved on the Irish side, the reason for and purpose of these additional costs were not clear and made the loans 'utterly unaffordable' in the long term (Interview IE 11). On a related note, the idea to bail-in senior bank bondholders gained pace again as well. Fine Gael and Labour were especially vocal on these issues. Fine Gael's spokesperson for finance argued that the country was 'paying too much' (Financial Times, 2011i) for the EU's loans and Labour's leader described the conditions of the EAP as a 'straitjacket' a few days later (Financial Times, 2011b).

The two parties also both advocated for what became known in Ireland as 'burning the bondholders' (Véron, 2016: 18). In its manifesto, the Labour party intended to renegotiate the EAP agreement in order for it 'to share the debt burden with bondholders' (Labour, 2011a: 5). Taking the same line, Fine Gael

warned against the programme risking to fail 'unless the bail-out package is made more affordable' (Financial Times, 2011d). The idea of this exercise was to set the banks on a more solid footing and to save the sovereign significant amounts of money. Those calls were echoed by IBEC's chief economist, Fergal O'Brien, who argued that without a bail-in of bondholders, 'debt ratios will reach a tipping point' (Financial Times, 2011b). At the time of the campaign, Patrick Honohan informed both the sitting as well as the likely future finance minister about the potential of the ECB's position on that issue to change in Ireland's favour (Honohan, 2019: 268). The final critical issue was the ECB's demand that Irish banks swiftly get rid of some of their assets (Interview IE 01) as this would help allow the reduction of the banking sector's 'indebtedness to the central banking system' (Honohan, 2019: 265). The Irish government, by contrast, argued that this would imply hasty 'fire-sales' (Interview IE 01) of assets that would be much more valuable at a later point in time.

IBEC was equally critical of the fire sales as they had the potential to increase the need for additional income tax hikes, which unproportionally would affect 'businesspeople with higher incomes' (Interview IE 02). The interest rates and fire sales were one of the few points of commonality between business and labour. In their pamphlet for the 2011 general election, ICTU argued that it was wrong 'that scarce financial resources are being diverted to pay a punitive interest bill and repay bondholders who gambled on Irish banks' (ICTU, 2011a: 3). However, this is where similarities end. ICTU and IBEC drew vastly different conclusions from their critique of the EAP's framework conditions. From labour's point of view, those conditions translate 'directly into cuts in peoples' income and cuts in vital services' (ICTU, 2011a: 1). Furthermore, ICTU urged the prospective government to increase public investment and criticised the reduction of the minimum wage. To maintain the latter, by contrast, was a central demand by IBEC in the run-up to the elections to further 'reform the welfare system to incentivise work' (IBEC, 2011e) and 'further public expenditure cuts' (IBEC, 2011h).

How the political parties answered to these demands aligns with the expectations formulated in the analytical framework. When it came to fiscal policy and the preferred adjustment strategy, there was a clear left-right divide between Sinn Féin and Labour, on the one side, and Fine Gael and Fianna Fáil on the other (Stafford, 2011: 351). The central message of Fianna Fáil's campaign was that it would proceed with the path they had already been on. It was clear, however, that the party would suffer heavy losses and could not expect to be involved in government after the election. Sinn Féin—by some commentators described as 'the only Eurosceptic part with seats in the Irish parliament' (Financial Times, 2011s)—was clearly the outlier of the four parties and showed the strongest opposition to the troika programme. Interestingly, not even Sinn Féin went as far as to question Ireland's corporation tax strategy. But it did criticise the outgoing government's policy focus on exports at the expense of the domestic economy (Sinn Féin, 2011: 15). Claiming that Ireland's 'sovereignty has been handed over to the IMF and EU' (Sinn Féin, 2011), it made three major points as related to the EAP and fiscal policy. First, it proposed to close the deficit two years later than anticipated by the EAP (Sinn Féin, 2011: 16). It shared this position with the trade union movement, which also called for an extension (ICTU, 2011a: 2). Second, the party pledged to introduce a

three year stimulus package focussing on employment and infrastructure worth €7 billion. The package would be paid for with funds from the NPRF and from increased 'revenue returns, social welfare savings and economy growth' (Sinn Féin, 2011: 18). Higher taxes, for example on second homes, and 'wealth taxes' on capital gains and capital acquisitions would generate additional revenue (Sinn Féin, 2011: 22). In conclusion, the manifesto argued that the Irish state 'does not have a spending problem in its structural finances; it has a tax-raising and retention problem' (Sinn Féin, 2011: 21-22).

Naturally, the Labour party also campaigned on a leftish platform and clearly voiced its critique of the EAP. It promised to renegotiate the troika programme 'to achieve fair and realistic terms for Ireland and for the Irish people' (Labour, 2011a: 9). During the campaign, Labour's leader portrayed the election as a decision between 'Frankfurt's way or Labour's way' (Little, 2011: 1308). Irrespective of its critical attitude towards the EAP, Labour did not challenge the general necessity of fiscal adjustment, let alone the Irish growth model. To the contrary, its manifesto praised the party for having introduced the low tax rate when in government and stated that 'Labour is committed to maintaining Ireland's 12.5% corporation tax' (Labour, 2011a: 88). The timeframe for achieving the 3 per cent deficit target was an issue for Labour as well although its sought to postpone it to 2016 'to allow adequate room for jobs and recovery' (Labour, 2011a: 13). In general, Labour position could be clearly identified as representing the interests of workers, but in doing so, its propositions were less drastic than Sinn Féin's and it stayed strictly within the parameters set by the Irish growth model. Labour was thus able to present itself as a clear alternative to the two dominating parties on the centre-right—without deterring potential voters as much as Sinn Féin's rather radical positioning tended to. It emphasised the competitiveness gains achieved since the outbreak of the crisis and that it would preserve them when in government. Referring directly to Ireland's export-led growth model, Labour's manifest argued that 'it is important that costs in the protected sectors of the economy do not undermine the capacity of the traded sector to compete' (Labour, 2011a: 17). However, the party wanted to make use of a slightly different toolbox than the two parties mentioned above without at all questioning the general economic framework.

On the one hand, it argued to reinstate the minimum wage on which the trade unions 'had got re-secured commitment from the Labour Party during the election campaign' (Interview IE 04). The party argued that 'wage competitiveness should not be confused with a low wage agenda' (Labour, 2011a: 17). In this way, the Labour Party was able to put a policy on the agenda that was very visible but did not pose a challenge to important economic actor groups, most prominently export-oriented businesses, whose prosperity did not directly relate to the level of the minimum wage. In other words, it would not negatively affect Ireland's dominant sector while decreasing the economic risks of one of their core constituencies, namely low-skilled workers in low-end services. Labour's 'Jobs Initiative' became a more controversial issues—although at the international level rather than domestically. Initially, it was to be called the 'Jobs Budget', but that idea was scrapped as it was likely to stir up a conflict with the troika (Interview IE 06). Referring again to Ireland's growth model, the basic idea was to make use of a '€500 million jobs fund to grow employment in sectors where Ireland already has a competitive advantage' (Labour, 2011a: 18). Although the

party's manifesto emphasised the necessity of fiscal adjustment, it argued for changes as it viewed the outgoing government's strategy as posing 'risks to medium and long-term economic growth and to social cohesion' (Labour, 2011a: 13). During its campaign, Labour also presented a series of revenue measures that would allow fiscal policy to be slightly more expansionary. Above all, these measures were intended to increase redistribution and boost consumption. In order to make the 'composition of the adjustment […] fairer and more balanced' (Labour, 2011a: 13), Labour relied on increased taxes for the more well-off while rejecting 'further impositions of income tax on people on middle and modest incomes' (Labour, 2011a: 14). Finally, and in contrast to its prospective coalition partner Fine Gael as well as the NRP, it intended to increase the VAT by only one percentage point rather than two (Labour, 2011a: 16). The manifesto contained only a few further references to domestic demand and rather targeted Ireland's potential for 'high export growth' (Labour, 2011a: 12). The public sector, finally, could not expect to be favoured by Labour since its adjustment strategy was 'based on a reduction of 18,000 in public service numbers' (Labour, 2011a: 15).

Fine Gael led opinion polls since the snap elections had been announced (Stafford, 2011: 353). Its programme was therefore likely to matter the most as it would enter negotiations with potential coalition partners on a strong footing. Fine Gael joined the ranks of those calling for a renegotiation of the EAP's framework conditions. The party was especially eager to highlight the close relationship between its leader Enda Kenny and Angela Merkel. This was so much the case that that a meeting between them in Berlin was integrated into the campaign (Little, 2011: 1308). But Fine Gael's demands were somewhat more restrained than Labour's. It also declared that it would be necessary to change the deal with the troika to 'reduce the interest rate and to ensure a fairer sharing of the cost of fixing Ireland's broken banks' (Fine Gael, 2011: 5). The manifesto also provided for the bail-in of senior bondholders who featured prominently in the programmes of the other parties. However, it was only to be conducted 'as part of a European-wide framework' (Fine Gael, 2011: 16) and not unilaterally. Given the ECB's public rejection of any such plans—regardless of the efforts by the governor of the Irish central bank behind the scenes (Honohan, 2019: 268)—this seemed to be the more viable approach (Financial Times, 2011c). At the same time, Fine Gael openly committed itself to the provisions of the NRP and the corresponding measures it helped to adopt in parliament as part of the 2011 budget (Interview IE 15). That is, it reemphasised its plans to reduce the public deficit to below 3 per cent by 2014 and to increase the VAT by two percentage points to 23 per cent, while allowing for a few exceptions for domestic services. The objective of the latter was to 'divert domestic consumer spending from import-intensive goods into labour-intensive domestic services' (Fine Gael, 2011: 65). More prominently, the manifesto featured business-friendly fiscal policies. It also pledged to maintain the country's low corporation tax. But beyond that, it declared that 'taxes on jobs'—in this case employers' social insurance contributions—and other direct taxes would not be increased (Fine Gael, 2011: 5). In general, the party made a strong case for an expenditure-based adjustment strategy in that it preferred 'budget cuts rather than job-destroying tax increases' (Fine Gael, 2011: 4). It denied that it preferred such an approach based on ideology and instead cited Canada and Sweden as successful examples of an expenditure-based adjustment strategy (Fine Gael, 2011: 5).

Fine Gael, the Irish Labour Party and, to a lesser extent, Sinn Féin were the three parties most likely to benefit from the collapse of the Fianna Fáil-Green government. Sinn Féin made the most radical demands, calling for a huge stimulus package and intended not to further draw down on the troika's loan facilities (Sinn Féin, 2011: 18). In the polls before the election, it constantly hovered at around 10 per cent. That is, despite the dire condition of the economy, the radical demands of the party did not find enough potential voters to challenge the established parties. Given its electorate based mainly on young working-class members, Sinn Féin was not able to break up the centrist Irish party system (O'Malley, 2008: 966). From the analytical framework's point of view, this is logical. The policies suggested by the party's campaign did at least partly call into question the strong focus of economic policy on exports and planned to alienate the countries' international partners by refusing further troika funding. In an economy with such a distinct growth model, this approach was not appealing to many voters. Moreover, Sinn Féin also lacked allies in domestic actor groups. Without any doubt, it was virtually inconceivable that IBEC or any representatives from MNCs would cooperate with Sinn Féin. The trade union movement's strong commitment to and involvement in the Irish growth model rendered it an unlikely ally as well especially since the Labour party, which has close links to the trade unions, had a good chance of entering government and therefore was in contact with ICTU prior to the election (Interview IE 04).

Labour and Fine Gael could not be expected to depart from Ireland's long-established economic growth strategy and, indeed, did not suggest anything like it in their manifestos. Although both parties announced to renegotiate the EAP, it was equally improbable that they would demand far-reaching changes. Both parties had shown their commitment to the EAP and the adjustment path taken by helping to implement the most significant share of consolidation in the 2011 budget (Interview IE 15). According to Philip Lane—a reputable Irish economist who later would become the governor of the Irish Central Bank—Fine and Labour would likely scale down their demands once in government 'as they know they will be the ones who will have to sort out the economy' (Financial Times, 2011a). Instead of casting doubt on the necessity of adjustment or on the main thrust of the programme, instead the two parties emphasised issues of independence and fairness. The former was closely linked to Ireland keeping its sovereignty over its tax system and especially its corporation tax. The latter primarily targeted the parameters of the programme—that is, the interest rates of the loans—while still adhering to the general adjustment strategy laid out in the NRP and the 2011 budget.

External pressures are an important explanatory factor to account for this. In mid-December 2010, Moody's, one of the three globally most significant important rating agencies, slashed Ireland's credit rating. Irish government bond spreads had been steadily on the rise during 2010 and then skyrocketed in the wake of its request for financial assistance and a series of rating downgrades. Moody's is exemplary in its assessment of the risks to Ireland's fiscal position, particularly the financial position of the Irish banking sector. It also stated that it was 'obviously monitoring the discussions' on a potential private sector involvement while noticing the commitment of the two main opposition parties to the fiscal adjustment path written down in the NRP (Financial Times, 2010e).

In other words, rating downgrades and exploding bond yields exerted enormous international pressure on the Irish government to fiscally adjust if it did not want to default. Due to Ireland's dependence on international trade and even more on FDI, the latter was never an option for any potential government. However, domestic factors were more important than external ones. This holds especially true when it comes to the content of fiscal policy. The differences between the parties are easily attributable to their core constituencies. Regarding the general strategy of adjustment, the four parties analysed here answered the expectations formulated in the last chapter. Sinn Féin's targeted working-class voters but deterred large parts of the rest of the population and was unable to find allies in the business community or the trade union movement. The latter relied on the Labour party to assert their preferences for a more revenue-based and redistributive consolidation process, as well as more employment-oriented economic policies. Fine Gael, by contrast, was much closer to the preferences of IBEC and the business community. It promised to carry on with an adjustment strategy based on expenditure cuts and argued that job creation would be achieved best by refraining from further increasing direct taxes. Fianna Fáil advertised the continuation of its right of centre economic policy approach—but it was foreseeable that the party would not remain in government.

The political significance of Ireland's well-established growth model is made apparent by the fact that none of the parties wanted to change the model's mainstays, particularly the corporation, and all of them stressed the importance of exports and FDI for future prosperity. Therefore, the preferences of one important actor group, namely MNCs, so far have been touched upon only lightly. Most of the policies proposed during the election campaign were either suited to reinforce the role played by MNCs or did not affect them at all. The discussions revolving around the reinstatement of the minimum wage can serve as a case in point here. This policy just did not play a role in the considerations of this actor group. MNCs rely mostly on high-skilled workers who are not getting paid the minimum wage as the latter is more important for workers in domestic low-end service sectors. Moreover, this trend has intensified over the course of the crisis (Brazys and Regan, 2017; Regan and Brazys, 2018).

The situation described above is an example of governments and political parties that 'have an incentive to promote the advanced sectors' irrespective of their partisan ideology (Iversen and Soskice, 2015b: 77). When it came to promoting policies that affect the low-skill sectors, ideological differences became more obvious. But they never cast doubt on the common understanding around the main drivers of future growth and economic prosperity. As detailed later, this turned out to be problematic when high growth numbers in the FDI- and MNC-sectors returned on paper but were felt in the real economy to a much lesser extent. Prior to this, however, a new government was given a chance to improve the economy while being tasked with implementing the majority of the EAP. This new government was the result of the most volatile election in Irish history (Mair, 2011).

This outcome was particularly dramatic for the two parties of the former government. The Green Party lost all of its six seats and entered a phase of rebuilding outside of parliament. It was the first election since the 1920s where Fianna Fáil was not the largest party; indeed, its vote share fell by almost 25 per-

centage points (O'Malley, 2012: 147). Although the result brought sweeping changes, its results were arguably neither surprising nor did it fundamentally change the party landscape. It had been expected that Fine Gael and Labour would come out on top, but eventually 'it was not an overwhelming victory' (Stafford, 2011: 354). Taken together, the two parties polled 55.6 per cent of votes cast. Three out of four voters did vote for the three political parties that were involved in implementing the 2011 budget and did not fundamentally challenge the EAP. These parties were strongly committed to Ireland's pro-business and low-tax growth model. Notwithstanding the large number of voters who changed their party preferences, 'they chose to do so while staying within the parameters of a party system and a political culture that has long been particular to Ireland' (Little, 2011: 1311). Sinn Feín, the party most critical of the EAP and the Irish growth model, scored less than 10 per cent of votes cast.

Although they had battled each other over the course of the election campaign, it became clear that Fine Gael and Labour would enter negotiations to form a coalition. It was clear that Fianna Fáil would go into opposition. A Fine Gael minority government supported or tolerated by some of the independent members of parliament would be too weak to preside over almost three years of programme implementation. The main idea was that a coalition between Fine Gael and Labour would have a large enough majority in parliament to push through unpalatable policies and a strong enough mandate to re-negotiate parts of the EAP. Fine Gael had explicitly spelled out its approach in its manifesto and Labour saw its main function as 'curbing the harshness of Fine Gael policy in government, not in opposition' (Financial Times, 2011g). On 5 March 2011, the two parties agreed on a common programme which, in Labour's case, was endorsed by large party conferences involving parts of the trade union movement (Little, 2011: 1310).

5.3.2. Phase two: A divided trade union movement and the return of export-led growth

On 9 March, Ireland's 31st Dáil met for the first time and elected Fine Gael's Enda Kenny to be the next Taoiseach. Due to Labour's exceptional election result, it received an above-average number of cabinet posts. Fine Gael filled ten out of 15 total posts. Besides the prime minister important positions were the Minister for Jobs, Enterprise and Innovation as well as Michael Noonan as the finance minister. Labour's party leader became Tánaiste (deputy prime minister). Further posts staffed by Labour were the Minister for Social Protection and the newly-established Minister for Public Expenditure and Reform. The latter was the result of the widespread view that the former Department of Finance had contributed to the fiscal crisis due to overly pro-cyclical fiscal policies and its neglect when monitoring the banking sectors (Interview IE 03). Founding this new ministry, the two parties lived up to their campaigns which had promised a financial administration reform. The finance department would take care of the revenue-side of fiscal policy as well as the banking sector. The newly found Department of Public Expenditure and Reform would manage the expenditure side of fiscal policy, the public sector—including industrial relations in this area—and have a strong mandate to control spending in other departments (MacCarthaigh and Hardiman, 2018: 118-119).

Based on their new government programme, the new government now wanted to follow through on its promises to re-negotiate the EAP. On the domestic level, the most important measures were the reinstatement of the minimum wage, the Jobs Initiative, a 'Comprehensive Review of Expenditure' (CRE) as well as a new approach towards the banking sector. On the international stage, two issues expectedly popped up again, namely the re-negotiation of the interest rates of the EU loans as well as the potential bail-in of senior bondholders. As we will see below, the latter involved much more protracted and controversial negotiations than the negotiations of the new government programme, which had passed off swiftly.

It was clear, however, that any changes would have to remain within the distinct parameters of the Irish growth models. The government programme therefore stated that 'Ireland's economic recovery must be export-led' (Labour, 2011b: 8). And again, the most prominent fiscal statement was that the government would 'keep the corporate tax rate at 12.5%' (Labour, 2011b: 16). The restrictiveness of the growth model's determining factors explains to a large extent why the government programme involved only minor provisions in favour of Labour's core constituency. Four of those measures stand out. Most notably, the cut to the minimum wage was to be reversed. A compromise was found on the SGP's deficit target, which Labour wanted to meet in 2016 and Fine Gael in 2014—but it was to be achieved now by 2015 (Interview IE 06). Regarding the reduction of the number of public sector workers, the two parties also met in the middle. Fine Gael's manifesto had wanted to reduce the public sector by around 10 per cent, that is 'an additional 12,000 over the 18,000 reduction set out in Labour's plan' (Fine Gael, 2011: 68). The reduction was now expected to reach between 22,000 and 25,000 by the end of 2015 (Labour, 2011b: 28). Finally, the campaigns of both parties called for an improvement of Ireland's employment situation, that is, the creation of new jobs and the preservation of existing ones. The key way to achieve this was the so-called '2011 Jobs Programme'. It entailed a small spending component with a focus on vocational training that was included by the Labour party. This, however, was the only measure that involved additional expenditures. Fine Gael had made a strong point in its manifesto for maintaining a low-tax economy and now ensured that this would be reflected by the Jobs Programme. The latter consequently included a reduction of the VAT for 'labour-intensive services' (Fine Gael, 2011: 53), notably tourism and hospitality. This was a supplemented by a cutback in the social insurance contribution for employers hiring workers on low wages to compensate for the minimum wage increase (IMF, 2011b: 18). By doing so, the new government 'shifted the burden of reducing the cost of minimum wage labour from workers onto the Exchequer' (EC, 2015: 83). For the two parties, this was a feasible compromise. Labour was able to present the measure as mitigating the impact of the EAP's austerity and Fine Gael could sell it as an success to its business constituency, because it reduced labour costs at the minimum wage level (OECD, 2014: 92). The costs of the Jobs Programme—amounting to around 0.2 per cent of GDP—were to be financed by applying a 0.6 per cent levy on private pensions funds in 2011-2014 (IMF, 2011b: 2).

The trade unions found that the government programme was, irrespective of the Labour Party's involvement, generally employer-friendly. In its handout for the general election, ICTU had evaluated the adjust-

ment strategy of the former government and stated that 'much of what we feared has come to pass' (ICTU, 2011a: 2). The trade union movement therefore mildly welcomed the new government as Labour's involvement gave them reason to believe that the new government would put more worker-friendly measures in place. However, the unions were also aware that it would not be easy for the Labour Party to push through their promises against Fine Gael (Interview IE 04). From their perspective, the Party's role in government would be to limit the damage for example by preserving 'the basic infrastructure of the social welfare system' (Interview IE 16). Initially, 'the only single influence' ICTU had on government policy was the minimum wage reinstatement (Interview IE 04). At this phase of the programme, this was the only way to push through a more solidaristic measure as similar demands were put on hold by considerations for the growth model or trumped by other powerful actor coalitions. Soon after the change of government, ICTU started a campaign that attempted to put 'improving the Irish skills system' on the agenda. It was focused on vocational training because it viewed Ireland's system of general education as performing rather well. In contrast to that, ICTU identified problems in further education at the upper second level and below and also pointed out the weak labour market outlook for those with lower skills. Here, the trade unions argued that 'workforce skills are cited almost as often as our low corporation tax rate as a driver of Irish competitiveness' (ICTU, 2011d: 18). Although the campaign's demanded only a slight increase in public funding, the unions were not likely to find allies for this concern. ICTU's high-skilled constituency in the public sector was still not in the position to have any political influence, however, was waging a defensive battle to avoid further cuts. Another influential group that was unlikely to support ICTU in its endeavour were the MNCs and their employees. In both the run-up and over the course of the crisis, the Irish growth model had become increasingly based on high-value services—e.g. software or finance—which relied on high-skilled workers with general skills (Regan and Brazys, 2018: 227). Those workers did not only come from Ireland but also from other EU labour markets (Brazys and Regan, 2017: 419). In any case, neither employers nor employees from those sectors had an interest in supporting ICTU's initiative.

A cross-class coalition between Irish employers and workers was equally improbable. This goes for not only for the trade unions' skills proposal but for the different fiscal policy stances of the two groups in general. Just as ICTU, IBEC also gave 'a measured welcome to the new Programme for Government' (IBEC, 2011h), however, for different reasons. The employers were clearly also interested in job creation and economic growth. Yet, they argued for a completely different way to achieve it than their counterparts on the labour side. In the lead-up to the elections, IBEC had already warned against reinstating the minimum wage and instead promoted fiscal austerity (IBEC, 2011e) and a 'relentless focus on reform, cost savings, competitiveness and the support of enterprise' (IBEC, 2011h). With regard to the government's Jobs Programme, it made clear that 'new measures must not be funded through increased taxation' (IBEC, 2011b). IBEC reiterated this position during a meeting with the Minister for Jobs prior to the presentation of the programme to the public, asserting that it 'should be revenue neutral' (IBEC, 2011g).

But before the new government could implement these policies, they had to be agreed upon by the troika. During the negotiations between Fine Gael and Labour, Patrick Honohan reminded the two parties that the troika would only make concessions if the government adhered to the EAP's fiscal adjustment path (Honohan, 2019: 282). As we have seen before, this was already in Fine Gael's interest and Labour grudgingly consented to most aspects of the programme. The banking sector, and how much funding it would ultimately need, was an issue still looming over the EAP and the Irish government (Honohan, 2019: 280-282). Between December 2010 and March 2011, bond spreads had risen by another percentage point and market actors demanded further assurance by the government that it would adhere to the fiscal path taken by its predecessor. The fiscal policy changes, and the Jobs Programme in particular, would have to be negotiated directly with the troika institutions as part of their upcoming review mission in early April.

With respect to fiscal policy, the new government was anxious 'to enhance international credibility; (Labour, 2011b: 16). In its programme it therefore reassured markets and troika that it would stick to the programme targets. Before the new government was even officially inaugurated, a conference call between the economic advisors of both parties and troika representatives was organised. During this conversation, the advisors wanted 'to ensure the mission chiefs that the government's intention was to work the programme' (Interview IE 06). They also pointed out that the government had a large parliamentary majority and would be able to approve controversial measures if necessary (Cardiff, 2016: 219). IMF and EC would later explicitly highlight the government's commitment 'to the programme's fiscal targets and overall objectives' (EC, 2011c: 3; see also IMF, 2011b: 19).

Government officials were certain that EC and IMF would accept some changes to individual measures so long as the overriding deficit targets were met (Cardiff, 2016: 218). These expectations were answered by the troika institutions as they did not see the necessity to 'negotiate measure by measure' (Interview IMF 08). Given its substantial autonomy, the new government was able to attain 'significant change in the programme between the one that was designed and the one that was delivered' (Interview IE 06; Interview IE 13). These and future negotiations were perceived by the Irish government as being conducted with more difficulty with the EC than with the IMF, which 'took the probably most dovish line' (Interview IE 13) and was 'much more capable of adjusting' (Interview IE 10). This perception proved to be accurate when the reinstatement of the minimum wage landed on the agenda. The EC did not only stress the fiscal implications of the cutback in social insurance contributions (EC, 2015), but primarily viewed the minimum wage as a structural reform issue (Interview EC 02; see also Lütz et al., 2019a). The IMF accepted this change more willingly as part of its focus on 'social conditionality' (Lütz and Kranke, 2014: 324). Regarding the Jobs Programme, the government 'did not ask permission' for it, but firmly presented it as an imperative (Interview IE 06). Given the new government's strong commitment to the fiscal targets of the programme, the troika ultimately accepted the initiative. Since the 2011 budget had already been adopted in parliament before the elections and the Jobs Programme would be fiscally neutral, the troika's first review mission found that the fiscal aspect of programme implementation was 'on track' (IMF, 2011b: 17).

In one concise paragraph, the EC acknowledged the governments compliance with all fiscal policy conditions (EC, 2011c: 15).

How to handle the Irish banking crisis, as well as the underlying costs of the EU's loans, proved to be more controversial than Ireland's fiscal performance in early 2011. Changes to these issues would not have immediate effects on budget execution but were still important for two reasons. On the one hand, there existed a certain feeling of unfairness towards Ireland in that the country had to bear the adjustment costs not only for its domestic banks but for the eurozone as a whole. From this perspective, the costs of the loans were punitive. Bailing-in senior bondholders and reducing the interest rates of the EU loans were supposed to somewhat alleviate those sentiments. On the other hand, the banking sector continued to be a drag on debt sustainability and was therefore assessed critically by rating agencies and other international financial market actors. During the election campaign, however, the ECB had clearly rejected the demands for re-negotiations, stating that 'a new Irish government could not "renege" on what was agreed and ratified in the Irish parliament' (Financial Times, 2011c).

Regarding the amount of costs to be carried by the Irish taxpayer, 31 March 2011 would be a decisive date. That day, the results of a previously conducted stress test of Ireland's largest banks and their additional capital requirements would be published. Based on the results of the stress test, the Irish government announced a three-part reform strategy to restructure, deleverage, and recapitalise the Irish banking system. The strategy was welcomed by the three troika institutions 'as a major step toward restoring the Irish banking system' (IMF, 2011b: 8). The exact amount the government would hand over for bank recapitalisation, however, was subject to debate. The Irish government was eager to allocate as little funding as possible for the banks in order not to impair debt sustainability, whereas the troika would have preferred Ireland to spend rather more than less. In the end, a total of €24 billion was agreed upon, whereby the sum actually used up for recapitalisation amounted to less than €20 billion (for an extensive account of the course of events see Cardiff, 2016: chapter 18). The most controversial issue of the negotiations had been the possibility brought up by the new government to bail-in senior bondholders. Labour and Fine Gael both had argued for such a step, in order to accommodate public opinion which 'was expecting, even demanding, some level of burden-sharing on these bonds' (Cardiff, 2016: 233). The IMF still supported a bail-in, but the ECB, again, not only put a stop to it but even went as far as to threaten to cut off the Irish banking sector from its emergency liquidity assistance (Lütz et al., 2019a: 1198). Parallel to that, behind the scenes discussions about the margin attached costs of the programme loans took place between troika representatives and the Irish authorities. Knowing that those negotiations would take time, the government 'had already begun to get rid of the margin from day one' (Interview IE 11). Ultimately, it was successful and the margin was reduced to zero in July 2011. This process had been overshadowed by renewed demands by the French government that Ireland had to increase its corporate tax rate, which the Irish government adamantly opposed (Financial Times, 2011e). Finally, the fire sale of bank assets was mentioned only on the side-lines of the 31 March announcement and subsequently 'the Troika's interest in the proposal withered and it was quietly dropped' (Honohan, 2019: 265).

The largely successful negotiations with the troika did not mean that the Irish government was no longer in dire straits. After it had published its plans for the banking sector, market sentiments improved temporarily only to change for the worse again shortly thereafter. In early April, Portugal eventually requested financial assistance and entered negotiations with the troika about an EAP, while the Greek programme derailed. Although international financial market actors generally assessed Ireland's banking sector measures positively, Moody's downgraded the country to only one notch above non-investment speculative grade. This was due not only to the potential increase in bank liabilities, the depressing effect of fiscal consolidation on domestic demand, but also uncertainties regarding the viability of the eurozone's crisis management. At the same time, Moody's cited 'the Irish economy's continued competitiveness and business-friendly tax environment' as the main reason why Ireland retained its investment grading (Moody's, 2011a).

Public revenues at that time exemplify the dichotomous development of the Irish economy. As part of its obligations in the context of the SGP, the Irish government published an upgrade to its Stability Programme in April 2011. The update contained an overview of the tax receipts in 2010. Income tax and VAT receipts turned out as low as or even lower than expected, whereas corporation tax receipts exceeded expectations (Government of Ireland, 2011b: 17). Primarily high-skilled industries such as fund administration, which had grown by 27 per cent in 2010 (Financial Times, 2011f), and other traded services—which surpassed merchandise trade for the first time in 2009—accounted for this development. For 2011, the troika thus expected a small current account surplus based on recovering exports (IMF, 2011b: 13). This recovery was possible because it was driven in a large part by FDI and (American) MNCs whose operations did not depend on the Irish banking system (Véron, 2016: 21-22). Against this background, the new government yet again stressed the stability of its tax system as a precondition for economic growth and argued that 'certainty is a key element desired by investors' (Government of Ireland, 2011b: 34). It thus did not only express its willingness to further foster its outwards-oriented growth model, but also to adhere more closely to the preferences of international financial market actors for expenditure cuts.

This renewed emphasis on stability on the revenue-side and its importance for the Irish growth model further consolidated the expenditure-based adjustment strategy. Still, in May the new government officially released its Jobs Programme, which involved slight increases of state spending on the matter. The reactions of the major domestic actor were mixed. On the one hand, employers and unions welcomed the government's focus on the creation of jobs. But both groups praised, as well as criticised, the initiative for different reasons. Unsurprisingly, the unions considered it as merely a first step in the right direction and asked the government to 'adopt a fairer approach to recovery' (The Irish Times, 2011a) that needed to be complemented by additional public spending on 'labour intensive projects outlined by government' (ICTU, 2011e: 2). The SFA commended the reduction of the employer's social contribution rate while rejecting the increase in the minimum wage, both of which had a direct effect on its constituency located in domestic low-end services (RTÉ Ireland, 2011). These two points were echoed by IBEC but it still generally agreed with the programme's impetus as providing 'an important signal that the unemployment

crisis is now at the top of the policy agenda' (IBEC, 2011f). Notably, ICTU and IBEC both offered criticism of the funding mechanism of the initiative, namely the levy on private pension funds, but for different reasons. ICTU stated that it would have preferred 'a small levy on top earners' (ICTU, 2011e: 2) over a levy affecting all funds equally. IBEC, by contrast, warned against 'any package which would be financed through taxation increases of any nature' (IBEC, 2011d: 2).

After the re-negotiation of the EAP and the presentation of the Jobs Programme, programme implementation went smoothly for several months. In their mid-summer reviews, both IMF and EC praised Ireland's 'strong fiscal performance' (EC, 2011d: 16), again stating that 'fiscal policy is on track'(IMF, 2011d: 17). Based on this performance, the 2011 deficit was forecast to be slightly lower than projected initially projected. The troika still kept up the pressure on the Irish government by pointing out that, in the second half of 2011, 'challenging political decisions needed to be made' (EC, 2011d: 16). Those decisions included preparing and publishing the budget for 2012 in December as well as concluding the CRE, which would serve as the basis for a medium-term fiscal adjustment plans for the years 2012 to 2014. The CRE had been one of the main initiatives by the Department of Public Expenditure and Reform and involved a series of reports prior to the discussions of the 2012 budget. A first report took a more structural-fiscal perspective and identified strategical measures and potential efficiency gains in the public sector and public service delivery (MacCarthaigh and Hardiman, 2018: 119-120). Further reviews focused more directly on fiscal consolidation and the government's medium-term adjustment strategy to reduce the deficit to less than 3 per cent by 2015 and set out concrete cuts to both current and capital investment.

When the troika's review mission arrived in October, it again slightly revised the deficit target for 2011 export-driven economic growth was exceeding expectations. For 2012, however, the outlook had worsened despite the reduction of the costs of the EU loans because Ireland's main trading partners showed signs of weakness (for a more detailed account see EC, 2011b: 5-10). The government was still committed to meet the deficit target for 2012 (8.6 per cent of GDP). To attain that target, it would need to implement adjustments totalling €3.8 billion, slightly above the amount envisaged in the NRP. Those consolidation measures were spelled out in more detail in the government's 'Medium-Term Fiscal Statement', one of the CRE reports. The statement also provided a comprehensive timetable of 'adjustment measures amounting to a total of €12.4 billion over the 4-year period 2012-2015' (Government of Ireland, 2011c: 4). One rationale in publishing a medium-term consolidation strategy was 'to bolster market confidence' (IMF, 2011c: 16) at a time when international financial market actors were still exerting substantial pressure.

The Irish government remained committed to its expenditure-based adjustment strategy as almost two thirds of the €12.4 billion were to come from spending cuts. Just as its predecessor, it justified its approach with evidence provided by international organisations and academic research. But it also made renewed recourse to Ireland's growth model, arguing that 'the scope for raising the overall tax burden in an economy as dependent on international trade and foreign direct investment as Ireland is limited by considerations of competitiveness' (Government of Ireland, 2011c: 5). Therefore, it stated, 'safeguarding and expanding the economy's export base will remain a critically important objective of overall economic

strategy' (Government of Ireland, 2011c: 5). Budgetary policy would be a key building block of this economic strategy and the provisions of the government's statement were planned to translate directly into the 2012 budget, which was due a few weeks later.

As opposed to the previous budgets, the 2012 budget was not conducted in a state of emergency but the result of a longer planning process. Of the four years that fell within the scope of the fiscal statement, 2012 was the year with the lowest share of expenditure cuts in total adjustment. However, this was mainly due to above average carry-overs from the previous year (EC, 2011b: 24); spending cuts were still planned to account for almost 60 per cent of the overall consolidation efforts. Assessing this approach, the trade unions, in their meeting with the troika in October, presented evidence collected by the Irish Economic and Social Research Institute 'that tax increases are more effective at reducing the deficit than reductions in public sector wages or employment' (ICTU, 2011c: 10). This stance clearly spoke to its core constituency in the public sector. But it did not resonate with the government, which found in its 'Comprehensive Expenditure Report 2012-14'—which had been part of the CRE exercise—that 'reductions in the public service paybill and staffing numbers will continue to play a part in expenditure consolidation' (Government of Ireland, 2011a: 10). ICTU nevertheless brought forward, vis-à-vis the troika demands, that revenue increases should make a more significant contribution to fiscal consolidation. It argued that the financial crisis had exposed the vulnerability of the country's '"low tax low spend" model' and found that the exchequer was too dependent on income and consumption taxes (ICTU, 2011c: 8). ICTU identified this model as 'a domestic policy choice' (ICTU, 2011b: 22), and in its pre-budget submission made a case for 'radical and progressive change' (ICTU, 2011b: 23).

ICTU's concrete fiscal policy recommendations, however, were not that radical and did not at all question Ireland's export-led growth model. It had neither the political clout to make such radical demands, nor would it be in the interest of a majority of its constituency to dismantle the country's main growth engine. Still, it saw potential for 'a gradual increase in taxes' (ICTU, 2011b) on higher incomes as well as for 'targeting expenditure on stimulating economy activity' (ICTU, 2011b: 5). This approach stood in stark contrast to the proposals brought forward by IBEC. The employers also considered the domestic economy as being in need of revitalisation, but rather than doing so by means of increased public spending, it suggested that, in addition to the support of private investment, 'a comprehensive communication strategy is need to give consumer the confidence to spend again' (IBEC, 2011c). The trade unions claimed that for meeting the 8.6 per cent deficit target for 2012 adjustment below the €3.6bn scheduled in the NRP was sufficient (ICTU, 2011b: 22). By contrast, IBEC asked the government to 'stick to [this] detailed fiscal plan' (IBEC, 2011c: 1).

The two groups also disagreed on the composition of adjustment. Regarding social policy, the employers' saw a need to 'deliver a stronger incentive to work' (IBEC, 2011c: 2), whereas ICTU rejected any additional cuts to social welfare rates (ICTU, 2011b: 21). IBEC advocated for an adjustment strategy based on an even larger share—namely 75 per cent—of expenditure cuts than envisaged by the government. To accomplish that goal, it urged the government to go beyond the Croke Park Agreement if necessary as the

latter 'should not be the upper limit of savings achieved from public sector reform' (IBEC, 2011c: 9). ICTU, by contrast, proposed a series of tax increases, especially on wealth and high incomes as well as temporary levy on corporate profits, and argued that the effective corporate tax was 'well below the top rate of 12.5%' (ICTU, 2011b: 15). These measures would then allow public investment to contribute to economic recovery and to diversify the growth model towards 'new products and services produced by innovative indigenous firms for the home and export markets' (ICTU, 2011b: 2). In principle, IBEC shared the opinion that 'the improvement in export activity is matched by a recovery in domestic demand' (IBEC, 2011c: 5). From the employers' perspective, this implied the necessity to make more private investment available, reduce domestic prices, and cut red tape. Most of its policy proposals still took Ireland's export- and FDI-led growth model as a starting point and were clearly influenced by its outwards-oriented and MNC membership. The corporate tax rate was therefore to be left untouched and any measures that would 'run the risk of damaging Ireland's reputation as an investment location' were to be avoided (IBEC, 2011c: 12). What is more, IBEC's budget submission addressed requirements, especially by international firms for tax credits for research and development, as well as a tax regime for intellectual property. Finally, it urged the government to maintain a competitive personal income tax system, as it was 'crucial to attracting and retaining mobile skills' (IBEC, 2011c: 14).

Eventually, the trade unions' concerns came to pass. The 2012 budget was presented to parliament on 6 December and met most of the employers' preferences. Still, it was apparent that it was the result of political compromises between the liberal Fine Gael and its left-leaning coalition partner. The budget introduced savings amounting to €3.8 billion. Revenue increases accounted for a little less than €1.1 billion and expenditure spending cuts for €2.15 billion. The residual of €0.6 billion was realised through revenues carried over from the 2011 budget (EC, 2011b: 26). More than two thirds of the revenue increases resulted from a VAT increase by two percentage points and a novel household charge. The bulk of cuts to current spending (more than 80 per cent) were realised by reducing expenditure on social welfare, health, and education. Capital spending was reduced by another €755 bn. With the aim to support 'low paid, part-time and seasonal workers in labour intensive areas like the hospitality sector and in farming' (Noonan, 2011), the exemption threshold to the USC was increased slightly.

In its 'Medium-Term Fiscal Statement', the government had already signalled that the design of its fiscal adjustment strategy had been influenced substantially by the economy's heavy reliance 'on international trade and foreign direct investment [and] the competitiveness of the exposed sectors' (Government of Ireland, 2011c: 17). 'Promoting international trade' was therefore the finance minister's first prominent speaking point when he presented the budget to the Dáil. From the government's standpoint, the budget's focus on creating new jobs was feasible so long as it conserved 'the package of attractions for inward investment' (Noonan, 2011). The Labour party was especially eager to provide for some worker-friendly measures and to support indigenous industries. These endeavours, however, were severely limited by the economy's bias towards exports and especially FDI.

Consequently, the trade unions' reaction to the budget turned out to be exceptionally critical. In the context of the presentation of the measures to parliament in December, SIPTU's president Jack O'Connor critically assessed the budget as increasing economic inequality and strictly refused 'any change in the Croke Park agreement' (The Irish Times, 2011b). Later, ICTU scorched the budget as being a 'failure on the jobs issue' (ICTU, 2011f: 3). This stance was echoed by ICTU's individual member unions. IMPACT was the most reluctant and, for the most part, welcomed the minor change to the USC. This reflects the schism in the Irish trade union movement at that time between public and private sector unions. The former did not have any interest in daring to come out and openly criticise the government's fiscal policy as they did not want to endanger the persistently fragile Croke Park Agreement (Interview IE 16). In the words of SIPTU's then president, 'Croke Park took the best organised section of the workforce out of the equation for social protest' (Financial Times, 2012j). By contrast, another trade union representing mainly workers in retail, argued that the budget 'failed to sufficiently tackle the unfair nature of the Universal Social Charge'(ICTU, 2011f: 3). Despite these minor differences between individual unions, the Irish labour movement was united in its critique of the budget being unfair and not solving the country's job crisis. As I have pointed out, however, the trade union movement was also united in its scant influence on fiscal policy.

The budget was much closer to IBEC's preferences. Yet, the business association also found points of criticism. From the employers' standpoint, the government's four-year fiscal plan and especially the budget for 2012 still overly relied on revenue increases. Furthermore, it demanded that cuts to public investment would have to be offset and that the government 'must maintain its ambition for the economy by seeking to raise an additional €2 billion per year through non-Exchequer sources' (IBEC, 2011a). That is, IBEC did not see all of its demands fulfilled with regard to the domestic economy but it praised a series of smaller measures that would 'help both the multinational sector and indigenous businesses seeking to develop export markets' (IBEC, 2011i). The ACC, finally, stated that the budget 'show[ed] foresight' especially with regard to the stability of Ireland's corporate tax system (Irish Examiner, 2011).

The year 2012 started out well for the Irish government. In January, the troika's mission teams found that Ireland would meet its 2011 fiscal target with high probability as the public deficit was now forecast at 9.9 per cent of GDP, an improvement compared to the previous review (EC, 2012c: 5). Furthermore, the government felt vindicated by the 2011 report by IDA Ireland—the semi-state agency responsible for attracting FDI to Ireland. IDA's report registered both a record number of investments for 2011 as well as a 20 per cent increase of FDI jobs created in comparison to 2010 (IDA Ireland, 2012: 3). Finally, Ireland in late January taped international capital markets for the first time since the beginning of the programme by swapping roughly €3.5 billion in government bonds (Financial Times, 2012c). This operation marked the beginning of a slow decline of Irish bond yields, which accelerated after Mario Draghi's famous 'whatever it takes' speech six months later. However, two challenging issues were about to dominate Irish politics in the first half of 2012. First, a referendum on the so-called 'Fiscal Compact' was to be held in May

after several months of campaigning, and secondly, Ireland's macroeconomic outlook deteriorated at the beginning of the year.

Since the beginning of the eurozone crisis, discussions took place on how to strengthen SGP's institutional framework by introducing tighter fiscal rules. At an eurozone summit in late January 2012, those discussion were finalised and the eurozone's heads of government agreed upon the so-called 'Fiscal Compact' (Henning, 2017: 65). In late February, the Irish government decided to hold a referendum on the Fiscal Compact in May. The outcome of the referendum would have important political implications at the domestic as well as the international level. Domestically, the government was not in favour of a referendum as it did not want it to end up as a vote on fiscal policy. Internationally, however, a referendum could serve as a bargaining chip as the country was still fighting off pressures from France to change its corporate tax (Financial Times, 2012b).

Amidst smaller protests against the Fiscal Compact, the European affairs minister set the government's agenda by stating, at the beginning of the referendum campaign, that 'by winning this referendum we will stabilise our economy and make Ireland an attractive place for investment' (Financial Times, 2012a). The employers shared this opinion and publicly backed the new treaty as it would implement 'part of the reforms needed to get the European and Irish economies back on track' (IBEC, 2012e) and 'reaffirm Ireland's commitment to a reformed, stable and sustainable European economic model' (IBEC, 2012i). It also argued that a vote for the Fiscal Compact would boost domestic consumer confidence as well as international investors 'in the Irish growth model' (IBEC, 2012g). IBEC's stance also reflected the preferences of its multi-national membership that supported the 'Yes campaign' financially, Intel being the most prominent example (Financial Times, 2012e). The trade union movement was undecided on the issue. After a protracted debate, ICTU decided to not give any recommendation on how to vote to its members, since 'we are damned if we do and we're damned if we don't' (Financial Times, 2012d). Apart from Sinn Féin—which at the time was the opposition party with the highest support rates—all political parties supported the adoption of the treaty (O'Malley, 2013: 105). In the end, a comfortable majority of more than 60 per cent voted in favour of the Fiscal Compact.

Ireland's economic growth model did not only have implications for the outcome of the referendum on the Fiscal Compact but also for the adjustment path to be taken over the course of the year. While praising the government for its strong implementation record, the troika's first review mission in 2012 warned of 'building external headwinds' (IMF, 2012c: 3). This chiefly referred to potential problems in the eurozone's financial markets as well as to weakening demand for Irish exports by its main trading partners (EC, 2012c: 4). It was clear that exports would be Ireland's main growth engine over the coming years and that fiscal policy would have to contribute to that. A first attempt to cope with this requirement was the government's 'Action Plan for Jobs' that it published in February 2012, which had the objective to 'make Ireland the best small country in the world in which to do business' (Government of Ireland, 2012a: 3). This met the employers' preferences who welcomed 'the commitment to improve competitiveness and make Ireland a more attractive location for key sectors' (IBEC, 2012h). Although the Action Plan had a

strong focus on the domestic economy, it did so with the objective 'to accelerate the journey of export led recovery' (Government of Ireland, 2012a: 43) and without referring to public spending as a means to increase the disposable income of consumers. If at all, consumer spending was to be bolstered by refraining from further tax increases. Rather, the Action Plan introduced measures that were clearly addressed to high-skilled workers, such as a tax relief for foreign employees earning more than €75,000 per year. The trade unions' reaction therefore was reserved at best. They especially disliked that 'the initiatives are heavily weighted towards supply side initiatives' (ICTU, 2012c: 3) and did not address the economy's main problem, namely its deficit of domestic demand.

After the early election in February 2011, a new governing coalition became responsible for implementing the EAP. Centre-right Fine Gael and the Labour party had won the election based on a campaign that promised significant change to the specificities of the programme while never calling into question the necessity to fiscally adjust. In general, however, the new government's approach was a continuation of the expenditure-based adjustment strategy of its predecessor. At the end of the first phase of the EAP, Ireland continued to be a low-tax, low-spending economy. This was a political decision made domestically, which reinforced a fiscal policy approach that served the purposes of a long-established, export-oriented growth model.

5.3.3. Phase three: External pressure subsides – Trade unions unheard, high-skilled workers spared

The day 26 July 2012 marked a turning point of the eurozone crisis. That day, Mario Draghi—then President of the ECB—stated in a speech that the ECB would 'do whatever it takes to preserve the euro' (Draghi, 2012). One of the speech's central objectives was to reassure international financial markets about the ECB's readiness and determination to resolve the crisis. Mario Draghi was successful in that government bond yields throughout the eurozone and particularly of the programme countries began to drop after they had been creeping up during the first half of the year. Within six months, Irish bond yields halved (ECB, 2021). This implied that the EAP's main objective, namely Ireland's return to private market funding by the end of 2013, was now within reach. The country had tested the waters in January already and in July and August it was able to successfully issue long-term government bonds.

The second half of 2012 would still be politically challenging for the Irish government. In its Medium-Term Fiscal Statement from November 2011, the government had committed to implement further fiscal consolidation measures totalling €8.6 billion for the years 2013 to 2015 (Government of Ireland, 2011c: 20). As early as March, the troika pressed for the Irish government to specify additional savings (IMF, 2012c: 18). These demands were reiterated three months later when the troika's mission teams 'encouraged the authorities to fully identify the measures to underpin the still-sizeable consolidation requirements

over the medium term' (EC, 2012a: 24). This had become urgent because Ireland's macroeconomic outlook had so deteriorated in the course of 2012. The economy had grown by 0.7 per cent in 2011, for the first time since the outbreak of the global financial crisis. This trend was supposed to continue in 2012 given improved 'near-term prospects for external demand' (EC, 2012a: 21). For 2013, however, the troika lowered its forecast from 1.9 to 1.4 per cent (EC, 2012b: 16). This meant that it could become more challenging to meet the deficit target of 7.5 per cent of GDP anticipated for 2013. The government therefore started to prepare the 2013 budget to 'reduce household and business uncertainty and to support market confidence in the consolidation path' (IMF, 2012a: 8).

To counteract negative growth implications, in July the Irish government had already introduced an 'Infrastructure Stimulus Package'. The package aimed mainly at improving road as well as educational and health infrastructure to boost job creation. Given the still tight budgetary circumstances, the government proposed and the troika accepted that the package would be fiscally neutral because it would be financed by private public partnerships. Funding would come from the NPRF, the European Investment Bank, domestic banks and the sale of some state assets (EC, 2012b: 22). The total investment amounted to €2.25 billion until 2016. Although the initiative targeted the domestic economy, the government was anxious to underline that this would not come at the cost of international competitiveness or any other aspect of the Irish growth model. Rather, it was emphasised that the package also had to contribute 'an export-led recovery' (Gilmore, 2012). The package was one of the few fiscal policies which were lauded by both employers and trade unions. Nevertheless, the two groups differed in their assessment of further steps. The trade unions' strategy was twofold. On the one hand, they approached the troika in their quarterly meetings, asking to postpone meeting the SGP's deficit threshold to 2017. On the other hand, ICTU made a case for more state investment of around €3 billion yearly to 'maximise opportunities for Irish companies and workers' (ICTU, 2012b: 2). The employers praised the initiative for its innovative funding structure and welcomed that the involvement of the private sector in financing the projects highlighted 'the significant improvement in how international investors see Ireland's growth prospects' (Irish Examiner, 2012). At the same time, IBEC unveiled its own 'Action Plan for Recovery', which contained '50 ideas to drive growth'. The plan focused on the improved availability of private investment, stricter conditionality linked to unemployment assistance, and an intensification of public sector reform (IBEC, 2012a). With regard to the latter, the employers stated that 'more needs to be done', and thus indirectly called the Croke Park Agreement into question (IBEC, 2012f). It also proposed a series of measures that lived up to the expectations of its multinational membership. IBEC noted that Ireland's competitiveness was not necessarily determined by its domestic wage level but rather that the government would have to take measures such as an 'improved tax offering for mobile investment, to ensure that we stay ahead of competitor jurisdictions such as the UK' (IBEC, 2012a).

The last point was taken up by the Taoiseach in a speech at the IBEC President's Dinner a few days before the publication of the plan. The dinner was hosted by IBEC in celebration of its new president, tellingly Microsoft Ireland's managing director. One of the main arguments made by the prime minister was

that 'improvements in our national competitiveness have boosted Ireland's FDI performance' (Kenny, 2012). More generally, the government's stimulus package was easy to accept for almost all economic actor groups in Ireland. The trade unions could sell it to those members who did not profit from the export boom as a political, albeit minor success. The employers were pleased by the initiative's reliance on non-exchequer funding. IBEC's exporting members would also profit from the investments without losing anything. This held even more true for employers as well as employees located in these sectors, since the export boom allowed for the implementation of wage rises already in 2011 (Sheehan, 2012b). That is, the stimulus package did not negatively affect exporting companies or their high-skilled employees.

The 2013 budget, by contrast, had more potential for political conflict. The Medium-Term Fiscal Statement expected consolidation measures amounting to €3.5 billion, €2.25 billion of which based on expenditure cuts (Government of Ireland, 2011c: 20). Despite the economic headwinds described above, government and troika still aimed for the initial 2013 deficit target of 7.5 per cent of GDP (EC, 2013a: 22; IMF, 2012b: 14).

In the first half of 2012, tax revenues—driven by income taxes, VAT, and corporate tax intakes—were significantly higher than expected. Yet, additional receipts were offset by cost over-runs in the health sector as well as increased spending on jobseekers' allowances (IMF, 2012a: 6). The government therefore introduced a series of emergency cuts to get spending back on track. These cuts became controversial between the two coalition partners. Parts of the Labour Party wanted to avoid further social and health policy cuts as the party's chairman, Colm Keaveney, argued that they were 'unacceptable and erode[d] political stability' (Financial Times, 2012f). The conflict wore on until December when the chairman voted against a bill that provided for comparably regressive cuts to social welfare provisions (O'Malley, 2013: 107). The vote did not keep the bill from being adopted in parliament. Furthermore, the government closed ranks and Keaveney was excluded from the parliamentary party. Labour's leader stated that adopting the budgetary measures had been a tough decision but argued that it was without any alternative and claimed credit that 'there were many other provisions that it didn't contain – options that were not taken' (The Irish Times, 2012).

The troika raised a second controversial point. Since June 2010, the Croke Park Agreement between government and trade unions had determined that fiscal adjustment in the public sector would mainly be achieved by reducing staff numbers. In the context of the 2012 budget, however, several Fine Gael ministers called the very agreement into question and argued for public sector pay cuts as a more viable option for fiscal consolidation (The Irish Times, 2011b). The Labour Party rejected these demands as it viewed the agreement as an important success for their trade union allies. Despite individual motions to change it, the government's official standpoint was that 'that the Croke Park agreement is delivering the envisaged savings whilst facilitating wider reform of the public sector' (EC, 2012a: 25). The government planned to reduce staff by 23,500 to a total of 282,500 by 2015 (EC, 2012c: 15). That number was at the upper end of the range agreed between Labour and Fine Gael and large parts were achieved by early retirement programmes which had exceeded expectations (EC, 2012a: 24-25). At the end of the first quarter of 2012,

total staff numbers were already 'about 1 percent smaller than the end-2012 target of 294,000, and 9 percent below the end-2008 peak' (IMF, 2012a: 7). In late 2012, the government announced another voluntary redundancy scheme for public sector workers to reduce staff numbers even more. This proposal was met with scepticism by the troika, which considered the scheme to be costly for the welfare budget, and argued that the Croke Park Agreement would allow for a more efficient assignments of human resources while maintaining service delivery (EC, 2013a: 26). During earlier review missions, the troika had already cast doubt on whether the stark reduction in staff numbers 'could risk jeopardising the delivery of public services' (EC, 2012a: 25). EC and the IMF on several occasions lobbied the government to either reconsider wage reductions (IMF, 2012e: 24) or at least to 'keep the effectiveness of the 'Croke Park' approach […] under continuous review' (EC, 2012c: 16).

In preparation of the 2013 budget, the government published an updated Medium-Term Fiscal Statement in November of 2012. The government highlighted the shift achieved within the Irish economy 'away from domestic demand and into the exporting sectors' and especially services exports (Government of Ireland, 2012b: 6). But it also renewed the commitment it had made in the previous year's statement to apply further consolidation measures amounting to €8.6 billion until 2015. It again emphasised that the design of its consolidation strategy would take into account 'the characteristics of a small open economy like Ireland's, which relies heavily on international trade and foreign direct investment' (Government of Ireland, 2012b: 13). It was clear that these considerations would determine fiscal policy until the end of the EAP and beyond.

In comparison to the statement, the composition of the final 2013 budget changed slightly. It now introduced expenditure cuts in the amount of €1.94 billion and revenue increases totalling €1.43 billion, as well as some intakes from state-owned enterprises. The main reason for this change was that the government had brought forward its planned Local Property Tax which would replace the short-lived household charge and was to come into effect on 1 July (EC, 2013a: 22). In the run-up to the budget, the employers had only two main demands. First, they demanded that expenditure cuts should contribute two thirds of fiscal adjustment. And secondly, IBEC stated that 'that the most important priority for Irish business is that Government does not place any additional charges on labour costs' (IBEC, 2012d: 1). Taking into account only new measures for the year 2013 and excluding carry overs, the 2013 budget met the former demand almost to a T (EC, 2013a: 25). The same holds true for the latter and IBEC, which would later acknowledge that 'employment costs have not been significantly increased' (IBEC, 2012b). Their applause was echoed by the Irish Exporters Association, which gave a 'strong welcome to the Budget measures to support the export industry' (RTÉ Ireland, 2012). IBEC's demands were rather reserved not because the employers felt weak but because their most important demands had already been met. Apart from most sheltered sectors, indigenous and multi-national enterprises in the exporting sectors had been experiencing economic growth for several quarters in a row. The government's reiterated statement that it 'remains 100 per cent committed to maintaining the 12.5 per cent Corporation Tax Rate' (Noonan, 2012). Furthermore, its substantiation of Ireland's export-led growth model in policy-terms made it clear that most preferences

of outward-oriented businesses would be taken care of. During the presentation of the 2013 budget, this was emphasised by the finance minister's statement that 'retaining Ireland's competitiveness for mobile foreign investment remains a central plank of this Government's export led recovery strategy' (Noonan, 2012).

The opposite held true for the trade unions, which still struggled politically as the 2013 budget was discussed. The doubts cast on the Croke Park Agreement by the troika, the employers, and some members of government increased pressure on the public sector unions to either adjust to the possibility of a new agreement or to get ready for industrial action. Both options, however, were not exceedingly attractive. The Croke Park Agreement had allowed the public sector unions to protect their core constituencies in employment from further wage cuts. Taking industrial action would not deprive the unions of their ability to engage with the government in order to 'prevent worse things from happening' (Interview IE 09). At this point in time, it was also unrealistic that they would find allies. Their counterparts in the private sector unions could not be expected to take to the streets in support of the public sector. Furthermore, the surge in services exports also increased the group of high-skilled workers who were thriving on recent economic growth and therefore also had no interest in the concerns of the public sector. Negotiating a new agreement was therefore most likely a pill the public unions would have to swallow. ICTU's pre-budget submission focused on a few key points, most of which it had already issued in reaction to the stimulus package. They demanded an additional further stimulus, more progressive income and wealth taxes, as well as an extension of the 3 per cent deficit target until 2017 (ICTU, 2012a: 1). However, none of those demands were met.

In its updated Medium-Term Fiscal Statement, the government had described its general adjustment strategy as 'identifying and implementing measures to improve the business climate in 2013 and beyond', with a special focus on SMEs as well as FDI (Government of Ireland, 2012b: 14). This approach clearly rejected the trade union's preferences for more redistribution and more state spending. It is also rejected one of the measures demanded by the unions, namely increases to the income tax or other wealth taxes. The government's central argument was that it was already 'striking the right balance between our income tax levels and incentivising investment and job creation in Ireland' (Noonan, 2012). The government thus accommodated demands by the employers who argued that any further increase in top income taxes would make the attraction of high-skilled workers more difficult. This demand had been made by Ireland's growing sector of exported high-tech services, which relied on the high-skilled workers from all over the EU (Regan and Brazys, 2018: 224; see also Brazys and Regan, 2017). More generally, the growing importance and influence of these workers is further supported by findings that, in terms of economic vulnerability, they had been able to sustain 'their relative advantages over time' (Whelan and Maître, 2014: 482).

Rather than increasing income taxes, the 2013 budget on the revenue side focused on the property tax, excise and car taxes, and broadened the base of social security contributions. The latter especially attracted the trade union's criticism as being 'a regressive measure which will disproportionately affect lower in-

come families' (RTÉ Ireland, 2012). The property tax was—besides the introduction of water charges a year later—one of the few fiscal measures that sparked public protests (O'Malley, 2013: 107). Its predecessor, the household charge, had already been controversial and more than 700,000 people had refused to pay it (Financial Times, 2012g). However, this contestation eludes a coalitional explanation. On the one hand, just as the protests against the water charges, the protests against the property tax were the result of a grassroots campaign rather than driven by an economic actor coalition as employers and trade unions were in favour of a broader property tax (Interviews IE 02, IE 16). Furthermore, due to Ireland's history under British rule, owning property has had an immense cultural significance across classes (Interviews IE 16, IE 17). Despite the protests, the rate of compliance with the tax reached more than 90 per cent shortly before the deadline in July 2013 (EC, 2013c: 18). On the expenditure side, the government continued to implement savings across all ministries and cut items such as child benefit rates and costs in the health sectors (EC, 2013a: 25). A major part of the latter was to be achieved through efficiency gains envisaged in the Croke Park Agreement. Finally, further savings in the public sector were made mainly by additional reductions in public service staff.

The troika had criticised the latter approach and so, in early 2013, the government and the public sector unions initiated talks on a new arrangement that would replace the Croke Park Agreement. In the context of the 2013 budget, the employers had stated that 'further reductions are needed in public sector pay and pensions bill' (IBEC, 2012f). The unions, by contrast, always argued that the Croke Park Agreement had 'delivered both industrial peace and cost reductions' (Sheehan, 2012a). The government, however, wanted to achieve additional cuts amounting to €1 billion until 2015. Talks with the unions dragged on until May 2013. The trade unions rejected a first draft of the then called 'Croke Park 2' agreement by a small margin in April 2013 (Sheehan, 2013b). The government delegated the proposal back to the 'Labour Relations Commission', which was supposed to continue negotiations with the unions. If a compromise was not reached within two weeks, the government threatened to unilaterally implement legislation (Sheehan, 2013b). After the government had made a few concessions on a series of pay-related issues, the so-called 'Haddington Road Agreement' was adopted by the trade unions over the course of May and June 2013 (Sheehan, 2013a).

The main provisions of the new deal were progressive pay cuts for those earning high incomes or pensions, increased working hours, a pay freeze, and a reduction in overtime payments. Reduction in the number of public service workers was also planned to continue through a 'combination of a recruitment embargo, voluntary redundancy and early retirement schemes' (MacCarthaigh and Hardiman, 2018: 120). Although they generally welcomed the new agreement, the troika institutions again warned that 'necessary savings need to be secured while ensuring at the same time that the delivery of essential public services is not compromised' (EC, 2013d: 17).

The new agreement had clear advantages for the government. It would maintain industrial peace while at the same time delivering further fiscal consolidation. It was also a way to 'manage expectations within the trade union movement' (Interview IE 10). The trade unions accepted the deal again because it gave them a

say in future public sector reforms. Furthermore, the outcome was most likely to be preferred to unilateral government action and the questionable prospects of industrial action. However, the adoption by the different trade unions revealed further cleavages within the trade union movement. Several unions representing the 'middle-class' of public service workers—e.g. teachers or nurses—voted against the agreement as they their economic vulnerability increased significantly as a result 'of substantial real cuts in salaries, the imposition of pension levies and in many cases a significant burden in relation to negative equity and substantial mortgages undertaken during the boom' (Whelan and Maître, 2014: 483). Irrespective of their voting behaviour, trade unionists over time became especially critical of the Labour role within government because, in the words of ICTU's outgoing president, they saw 'no difference between it and Fine Gael' (The Irish Times, 2013).

In general, Ireland seemed in good shape to comfortably meet its deficit targets for 2012 to 2015. The first troika reviews of 2013 included much improved forecasts for those years based on improved revenues, 'lower-than-budgeted capital and interest spending', and strong growth especially in services exports (IMF, 2012d: 11). On top of that, Ireland attracted a growing amount of FDI. The government intended to make use of those tailwinds to successfully exit the EAP by the end of 2013. Meeting the SGP's deficit target of below 3 per cent of GDP in 2015 was supposed to be aided by an agreement with the ECB regarding the promissory notes issued by the government in the context of the Irish banking crisis (for more details, see IMF, 2012d: 5; EC, 2013d: 13-14). In 2010, the government had established the 'Irish Bank Resolution Corporation' (IBRC) to deal with financial institutions severely affected by the financial crisis. The government had issued promissory notes amounting to €25 billion, which were used as collateral for the emergency liquidity assistance provided to IBRC. As a result of this transaction, the government would have to pay debt service of €3.1 billion per year until 2023. These payments were a significant strain on the government's fiscal accounts and highly controversial in the public eye. After weeks of speculations and off-stage preparations, on 7 February the Irish parliament adopted the legislation necessary to liquidate IBRC (Courtney and O'Malley, 2014: 166). The new arrangement, of which 'the ECB governing council unanimously took note' (EC, 2013d: 5), implied that the promissory notes would be replaced with long-term government bonds. This change did not have immediate effects on Ireland's fiscal position in 2013 but was forecast to improve the general government balance by about 0.6 per cent of GDP in the following years (IMF, 2012d: 13). More important, however, were the transaction's effects on how Irish government debt was assessed by international financial market actors. Only a few days after the decision, Standard & Poor's, another major rating agency, changed its outlook for Ireland from 'negative' to 'stable'. It argued that the transaction improved the country's debt profile and its chances to exit the EAP as planned (Financial Times, 2013l), that is without additional funding in the form of a so-called 'precautionary credit line'. Debt issuances during the following weeks further confirmed that Ireland's access to private funding was improving.

Before exiting the EAP, the Irish government still had to deliver the 2014 budget. The EC's Winter 2012 Review preordained the roadmap for the budget. In the context of the eurozone's reformed fiscal surveil-

lance, Ireland would have to provide the yearly update of its Stability Programme in April—and the presentation of the budget was preponed from December to October. On this occasion, the troika again endorsed the Irish government's expenditure-based adjustment path (IMF, 2013b: 14). It also applied some pressure on the authorities to continue implementing the €5.1 billion of consolidation measures planned for 2014 and 2015, arguing that 'the margin between projected outturns and budget targets' was narrow (IMF, 2013b: 13). For the 2014 budget, this meant adjustment measures amounting to €3.1 billion. In its Stability Programme update, the government had committed itself to this plan (Government of Ireland, 2013: 6). Yet, given improved economic circumstances in autumn 2013, the government pondered in communication with the troika if a smaller consolidation effort would also be sufficient in order to meet the deficit target of 5.1 per cent of GDP for that year (IMF, 2013b: 14).

Meeting this target and returning to private market funding was facilitated by two factors. First, economic growth had been lacklustre in the first quarter as exports of manufactured goods began to fall in late 2012. This development was attributed to the so-called 'pharma patent cliff', meaning 'a wave of patent expirations for several blockbuster drugs currently manufactured in Ireland' (IMF, 2013c: 7). Its effect extended into 2013 and continued to burden manufacturing exports. In the second quarter, however, growth returned and was driven mainly by services exports. That is, the government could implement the budget amidst improving economic and market sentiments (IMF, 2013d: 9). What is more, Moody's followed Standard & Poor's and in September also changed Ireland's rating outlook from negative to stable. The rating agency praised Ireland's progress 'towards placing its public finances on a sustainable path, restoring competitiveness and illustrating once again the economy's underlying dynamism and attractiveness to foreign direct investment' (Moody's, 2013). The focus of the Irish adjustment strategy to maintain and further develop a well-established growth model resonated well with international financial market actors and convinced them of its sustainability.

The Irish trade unions were less convinced of this approach and demanded a significant change to fiscal policy in the lead-up to the 2014 budget. Its pre-budget submission presented two main propositions. First, it made a case for both reducing the amount of adjustment to be carried out in 2014 given the savings made by the promissory notes agreement, and to introduce an additional stimulus package. ICTU argued for consolidation efforts amounting €2.0 billion, of which more than 75 per cent would result from revenue increases (ICTU, 2013a: 6). In general, the employers shared the sentiment that fiscal adjustment could be somewhat cut back. However, it adamantly opposed any 'tax hikes' (IBEC, 2012c). This stance was certainly shared by its international membership and high-skilled workforce. The ACC would later warn against any increases in income taxes as 'the impact of personal taxation on Ireland's competitiveness, on investment decisions and the ability to retain and attract talent must be recognised' (RTÉ Ireland, 2014). This position, in turn, was refused by the trade unions. ICTU's second main proposal was to introduce revenue increases 'targeted at the highest earning households, along with a contribution from the corporate sector' (ICTU, 2013a: 5). Arguing that the social security contributions as well as effective tax rates in Ireland were low compared to the rest of Europe, the unions stated that income taxes should 'be

increased in a progressive manner' (ICTU, 2013a: 8). Finally, they renewed their demand for a minimum effective corporation tax. In a journal article published in 2010, ICTU's economic advisor Paul Sweeney stated that the benefit of low corporate tax rates had decreased over time and that those rates were mainly kept in place due to the influence of business interests (Sweeney, 2010). Mindful of the growth model's significance as a determinant of fiscal policy-making, the unions argued that a minimum corporation tax rate would be 'unlikely to deter existing or future foreign direct investment' (ICTU, 2013a: 8). Employers and particularly MNCs, by contrast, asked the government to renew its commitment to the corporate tax regime. From their point of view, it was more important for Ireland to improve its 'tax offering to business, to remain attractive to foreign investment' (IBEC, 2012c).

The Irish employers and their multinational counterparts had been relatively content with fiscal policy up until the 2014 budget and therefore issued only moderate demands. None of the budgets so far had called into question the government's business-friendly and low-tax approach. Rather, Ireland's export-led growth model had served as the main yardstick of fiscal policy. The trade unions' propositions were more demanding, yet they also did not call into question the centrality of exports for the Irish economy. The budget was presented to parliament in mid-October. Troika and government eventually agreed that adjustment measures totalling €2.7 billion—two thirds of which were based on expenditure cuts—were sufficient to meet the 5.1 per cent deficit target (IMF, 2013d: 31). This outcome was again much closer to the employers' preferences than the unions'. Revenue increases amounted to €0.9 billion, but only €0.35 billion were based on novel measures. The remainder resulted from carry-overs from previous budgets. The main components of the revenue part were a slight increase of the tax on interest payments, a new levy on financial institutions, and an increase of the levy on pension fund assets (EC, 2013b: 24). Yet, the additional receipts were partially offset by the extension of the reduced VAT rate for the tourism and hospitality sectors, which had been implemented in the context of the 2011 Job Initiative 'to support businesses to create jobs and get people back to work' (Noonan, 2013). Regarding other potential changes to the tax code, two items stand out. First, the finance minister stated that 'there will be no increases in income tax or the Universal Social Charge in 2014' (Noonan, 2013). He thus rejected respective demands by the unions. Second, he, as usual, underscored that the government remained '100% committed to the 12.5% corporation tax rate' (Noonan, 2013). At this, a new tone found its way into the minister's speech as he observed that 'the international rules for taxing multi-national companies have been a focus for much debate across the globe' and that 'Ireland wants to be part of the solution to this global tax challenge, not part of the problem' (Noonan, 2013). Ireland had been under external pressure to change its corporate tax regime on several occasions. However, this time was different. Since mid-2013, the country had been accused by members of a US senate committee that it had been part of Apple's tax avoidance strategy (Financial Times, 2013e). This did not suggest a change to the Irish economic model as such but rather made it necessary to 'examine ways in which Ireland can ensure that our corporate tax regime remains competitive' (Noonan, 2013). Still, it is notable that Ireland became active in this regard only after being pressured by its most important source of FDI—the most significant building block of Ireland's growth model—the United States.

The most important items on the expenditure side were savings on public sector pay, as envisioned in the Haddington Road Agreement, savings in the health sector, and cuts to several social protection programmes (EC, 2013b: 24). The latter aimed mainly at unemployed individuals under 25 and can be considered as another business-friendly measure 'intended to provide greater incentive for the transition to work through a reduction in the reservation wage' (IMF, 2013d: 16). Presenting the cuts to parliament, the Minister for Public Expenditure and Reform dismissed spending-based 'efforts to reflate our economy, regardless of the economic environment' (Howlin, 2013). The minister thus did not only make a case for the government's expenditure-based adjustment strategy. He also stressed the necessity of a small open economy such as Ireland to take the preferences of international financial market actors and other important multinational economic actor groups into account.

The unions criticised that the government 'had taken the wrong options and made the wrong choices in Budget 2014' and that it did not consider the unions' alternative path of fiscal adjustment (ICTU, 2013b). ICTU referred in particular to the proposed wealth tax and the lack of additional investment, which it viewed as implying a loss of jobs instead of creating them. SIPTU's president defended the trade unions' strategy and Labour's role in government. He pointed out that the unions were in no position to insist on policy changes more actively due to the harshness of the troika programme. But even more importantly, he argued, the unions could for the most part only engage in damage containment vis-à-vis a government that was dominated by Fine Gael. Without the influence exerted by the Labour party and the unions, the government would not have reinstated 'the legal mechanisms that protect the pay and conditions of over 200,000 workers and would be selling off all our State Enterprises, Airports, Ports and Harbours which are critical to the resurgence of the economy' (SIPTU, 2013a). Regarding the budget, SIPTU echoed ICTU's arguments in that it criticised the government's insistence 'on protecting the rich' and 'further unnecessary suffering for low income pensioners and struggling families' (SIPTU, 2013b). The employers, in contrast, described the 2014 budget as containing 'significant business wins' as increases of employment costs or income taxes were absent, and welcomed enhancements to the R&D tax credit scheme (IBEC, 2013b). Furthermore, the employers picked up on the statements made by the finance minister regarding the debates on the international harmonisation of tax policy. It stated that 'attracting foreign direct investment remains central to Ireland's strategy to create high-value employment and economic growth' and supported the government's 'continued commitment to the 12.5% rate' (IBEC, 2013a).

5.3.4. Phase four: Ireland's reinforced growth model exits the programme

The 2014 budget was the final one under the programme. The EAP had a time horizon of three years and it was planned that Ireland would exit the programme in December 2013. Throughout the year, the prospects of meeting this objective improved steadily. As the *Financial Times* captioned on October 2013, Ireland was 'back on the market' (Financial Times, 2013b). The spread of Irish over German long-term government bonds had decreased from almost six percentage points to less than two. And in early 2014

almost the same rates applied to short-term debt issued by the two countries (Henning, 2017: 120). The only question was if Ireland would make use of a so-called 'precautionary line'. This would allow the government to draw on troika resources if private funding would dry up again without having to request another programme. Conditionality would still apply to these resources. Although there were some risks connected to being the first country to leave its EAP, the Irish government was not eager to participate in such a precautionary scheme as the Treasury had a significant cash buffer at its command and there was a certain 'fatigue with the troika coming in and laying down the law' (Interview IE 10). Although IMF and ECB were slightly in favour of another safety mechanism, in the end it was a political decision that Ireland would exit the programme without such an arrangement (Henning, 2017: 121). On 14 November 2013, that decision was made official.

In retrospect, the EAP for Ireland was assessed very positively by the troika. The IMF's programme evaluation focussed on potential failures of its pre-crisis surveillance and differences between the Fund and its European counterparts (Donovan, 2016). But it irrespectively found that programme implementation as well as Ireland's record of fulfilling the EAP's policy conditions both were 'very strong' (IMF, 2015a: 13-14). The EC went into more detail while also acknowledging that 'the Irish programme was successful' (EC, 2015: 29) as 'policy decisions before and during the programme helped Ireland regain credibility' (EC, 2015: 30). Finally, it stated that the programme's expenditure-based adjustment strategy had been chosen by the authorities and reflected 'the priorities of the Irish government to continue with a growth model that had delivered much to Ireland' (EC, 2015: 69). This assessment may not only be based on Ireland's actual track record of economic adjustment. At a time when especially the Greek programme had been going off track and the success of Portugal's EAP was still doubted, 'the success of the Irish programme was something the European institutions needed' (Interview IE 10).

Domestically, the EAP was more contested. However, this involved mostly to the collapse of the banking sector, how the government's decision on the blanket guarantee came about, and what role the troika institutions played in imposing large parts of the adjustment costs on the Irish taxpayer. To this end, an investigation committee was appointed, which identified 'four key failures; in banking, regulatory, government and Europe' (Joint Committee, 2016: 4). When it came to fiscal adjustment, public controversy mainly took place in parliament and other more institutionalised settings of political debate. Because the trade unions largely refrained from engaging in industrial action or other forms of protests, political contestation was confined to a few very specific issues that sparked only subdued public outcry. Most prominently this was the case with the, by now infamous, water charges that the Irish government was supposed to introduce on the EC's initiative (Lütz et al., 2019a: 1202). In April 2013, the government delayed the implementation of the measures. The following year saw a series of protests and the issue even became an obstacle to government formation after the 2016 general election. Ultimately, water charges became a lightning rod for a general austerity fatigue at the end of the programme, whereas protests against the adjustment strategy as a whole, or other individual measures, were rather low-key (Interviews IE 10, IMF 08, IE 14).

The small number of protests, however, is not to imply that all relevant actor groups assessed the programme positively. This held especially true for the Irish trade union movement. Although the Labour party as their natural ally was part of the government, the unions were not able to significantly alter the course of fiscal adjustment. Assessing the programme, and thus the government's fiscal adjustment strategy, they 'disagreed totally with the one-sided austerity strategy and we disagreed totally with the absurd notion of expansionary fiscal contraction' (Interview IE 16). That is, the unions dissented from the EAP's economic policy stance in a fundamental way. Regarding their direct contacts with the troika institutions, the union leaders 'found the process of dealing with them very frustrating' (Interview IE 04), and even called the interaction a 'charade' (Interview IE 16). The public trade unions were less openly critical as they were more directly engaged with the government in negotiating the Croke Park and the Haddington Road agreements (Interview IE 09). Their counterparts on the business side were much more appreciative of the programme and 'would have been very supportive of government' (Interview IE 09) as they obviously were in favour of the government's expenditure-based adjustment strategy. The troika's role, however, was a double-edged sword from their perspective. At the beginning of the EAP, the business organisations argued that the economy already was in very good shape as private sector companies already 'had made all the adjustments over the last four years' (Interview IE 02). Those adjustments did not have to be initiated by the troika but were due to 'the productive capacity of the economy's business model' (Interview IE 02). From this point of view, the troika became much more helpful when it started to focus 'on banking and public finances' (Interview IE 02). This positive assessment was shared by the MNCs, namely those from the United States. Looking back at the Irish crisis and the EAP, the ACC attribute the country's 'remarkable economic turnaround' to its 'economic attributes like lower corporate taxes, a flexible and highly skilled workforce, and pro-business policies'(Quinlan, 2015: 43).

Economic key figures developed very favourably after the programme concluded. When the budget for 2015 was due, Irish real GDP had grown by 4.9 per cent on a year-over-year basis and allowed the government to take a slightly expansionary fiscal stance while still meeting its deficit target of below 3 per cent of GDP that year. Two thirds of that growth were accounted for by exports but was also inflated by 'contract manufacturing outside Ireland' (IMF, 2015b: 4). This practice as well as multinational corporations shifting their intellectual property to their Irish branches and other bookkeeping exercises resulted in the Irish economy growing by the almost grotesque number of more than 25 per cent of GDP in 2015.

On paper, the Irish economy emerged again from the EAP with outstanding growth numbers and an economic growth model carried to the extreme. That this was not automatically felt in all areas of the real economy may best be illustrated by the general elections in 2016. Both governing parties lost a considerable number of MPs and the Labour party dropped from 33 to 7 seats. Fianna Fáil scored the biggest gain but still fell short of receiving the most seats. Despite these changes, there was still a considerable majority voting for parties which promised to stay the course of Ireland's export- and FDI-driven growth model.

5.4. Conclusion: Structural power in an extreme growth model

Given the entanglement of the Irish banking sector with international markets, Ireland was the eurozone country hit hardest by the global financial crisis. Furthermore, its pro-cyclical fiscal policy stance proved to be highly problematic when its property bubble collapsed. In conjunction with the financial commitments made to domestic banks, fiscal adjustment was inevitable. Despite considerable efforts to consolidate the national deficit, Ireland came under increasing pressure from international financial market actors and government bond yields skyrocketed. Finally, in late 2010, the Irish government requested financial assistance from the troika and committed itself to implement an EAP over a three-year period.

The EAP comprised of €85 billion in financial assistance provided by the IMF and the EU. In the run-up to the programme, that is between mid-2008 and late 2009, the Irish authorities had already established fiscal consolidation measures totalling €14.6 billion, that is almost 10 per cent of GDP. During the negotiations with the troika, Ireland's government developed a National Recovery Plan which became the foundation of the fiscal adjustment path provided for by the EAP. In the context of the programme, consecutive Irish governments implemented another €12.8 billion (around 7.5 per cent of GDP) of fiscal measures. At this, they pursued an expenditure-based adjustment as only around one third of total consolidation came from revenue increases.

The analysis conducted here has shown that this strategy was the outcome of two explanatory factors that correspond to the distributional and sectoral conflicts and coalitions presented in the previous two chapters. On the one hand, the expenditure-based fiscal adjustment strategy was the continuation of the low-tax and pro-business environment that had been the centrepiece of Ireland's long-established growth model. This growth model had been thriving on exports and the attraction of FDI since the 1990s; in fact, none of the relevant economic actor groups called it into question over the course of the crisis. The groups benefiting most from this model had strong preferences for fiscal policies that kept public spending in check and taxes low. Cutting government expenditures was therefore their preferred approach to fiscal consolidation. On the other hand, potential coalitions advocating for a more redistributive adjustment strategy that would keep spending intact and prioritise increased state revenues were too weak and disunited to have a decisive influence on fiscal policy-making.

The coalition in favour of expenditure cuts consisted of two major actor groups. Most importantly, Irish employers did not only have a general preference for low taxes and a small state. Their political stance was solidified further in that they profited from and were the drivers of Ireland's export-led growth model and had therefore no interest in the state increasing its revenues. This position was shared by the large number of MNCs engaged in Ireland, which politically and economically had become increasingly influential over the years. This influence was most distinct regarding Ireland's corporate tax regime but also extended to other policy issues, which together provided the basis of the country's system of attracting FDI. Over time, products and services of the companies located in Ireland's exporting sectors became more and more sophisticated. The same goes for the skill-level of workers in these sectors. This had two implica-

tions. Employers had strong preferences for comparatively low-income tax rates in order to remain internationally competitive when recruiting high-skilled workers from all over the EU. In addition, these high-skilled workers had become an increasingly influential actor group that favoured expenditure-based adjustment. This is because they did not profit from state spending on social policy but found themselves rather at the upper end of the income spectrum. As shown by the rationale given by successive government, fiscal policy in Ireland indeed had become 'a valence issue not a partisan one' (Iversen and Soskice, 2015b: 76) and was strongly influenced by export-led growth model and its most prominent actor groups.

At the same time, coalitions in favour of more redistribution and a revenue-based adjustment strategy were not strong enough to challenge the political clout of these groups. First of all, it was not feasible or in the interest of any group of economic actors to promote policies that would fundamentally call into question Ireland's growth model. Here it was clear that trade would have to serve as the main driver of post-crisis growth. Second, the trade union movement—arguably the most obvious actor group to demand more redistributive fiscal policies—was politically weakened by the collapse of social partnership that had been blamed for contributing to the fiscal crisis. The public sector unions later struck an agreement with the government regarding their contribution to fiscal adjustment. This, however, also implied that an essential and well-organised subgroup of the trade union movement was not available for any considerable form of social protest or industrial action. It also meant that organised low-skilled workers lost an important potential ally for revenue-based adjustment strategy, namely high-skilled workers in the public sector. What is more, workers in the exposed sectors faced much lower economic risks—or even received pay rises—during the crisis than their counterparts in the sheltered sectors. It was therefore particularly difficult to get the former to engage in defending the interests of the latter. Although the Irish Labour party became part of the new coalition government, it was not able to push through policies that would significantly reduce the economic risk faced by low-skilled workers at the expense of high-skilled workers or business interests. Rather it was confined to damage containment and, in any case, was equally committed to Ireland's export-led growth model as most other parties in parliament.

Economic actor groups located in the exposed sector influenced fiscal policy-making during the eurozone crisis to a much larger extent than their counterparts located in sheltered sectors. This is because exports were considered to be a much more important driver of economic growth than domestic consumption. High-skilled workers, and other actor groups thriving on international trade, faced lower economic risks and were much more influential than low-skilled workers and actor groups facing higher economic risks due to their dependency on domestic consumption. Fiscal policy-making in Ireland did not result from different coalitions competing for political influence on a level playing field. Instead, it was the result of several marginalised economic actor groups struggling against a well-established coalition of domestic and international actors who thrived on an export-driven growth strategy by both government and the private sector.

Chapter six: Portugal

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Revenue-based adjustment in a non-dynamic economy

This chapter provides an in-depth case study of the Portuguese EAP and is structured as follows. Part one gives an overview of fiscal policy-making in Portugal before the crisis and the budgetary imbalances it produced. It then turns to the global financial crisis and its impact on the Portuguese economy. The following subchapter two assesses how the Portuguese government adjusted to the crisis before it turned to the troika for financial assistance. The main case study in subchapter three then shows in detail how domestic actor coalitions with strong preferences for a revenue-based adjustment strategy influenced fiscal policy-making. A final subchapter concludes.

Since the late 1990s, Portugal's state budget had not only been in constant deficit, but government debt increased, and the country was subject to the EU's Excessive Deficit Procedure (EDP) almost permanently after 2002 (EC, 2016: 32). Amidst sluggish economic growth and mounting external imbalances since the early 2000s, neither conservative nor socialist governments could successfully contain the deficit. This combination proved to be problematic when the global financial crisis hit the eurozone and resulted in deteriorating market sentiments. The national deficit soared up to more than 10 per cent of GDP in 2009 and barely decreased a year later. In the course of the year 2010, the Portuguese government adopted a total of three austerity packages that were implemented only partially (IMF, 2011f: 6). After the rejection of a fourth package of austerity measures and the resignation of the prime minister, the government turned to the troika and requested financial assistance in April of 2011.

The EAP for Portugal rested on two main pillars. It envisaged overall fiscal consolidation amounting to 10.6 per cent of GDP to reduce the deficit below the SGP's threshold by 2013. It was planned that two thirds of the adjustment would result from expenditure cuts. Second, a broad set of structural reforms would supposedly to raise the economy's growth potential and improve its competitiveness to boost exports at the expense of domestic consumption. Because there was no property boom, Portuguese banks were affected by the crisis to a lesser extent. Financial sector reforms therefore played only a secondary role in the EAP.

6.1. The crisis hits Portugal: A growth crisis turns into a fiscal crisis

Before the global financial crisis, the story of the 'Portuguese slump' (Reis, 2013) did not feature very prominently in the CPE literature. This section therefore provides two brief accounts of the global financial crisis and its impact on Portugal. Section 3.1.1. shows how domestic politics influenced fiscal policy-

making and illustrates the resulting economic imbalances. Section 3.1.2. then describes the effects of the global financial crisis on the Portuguese economy in view of those imbalances.

6.1.1. Fiscal policy-making in Portugal before the global financial crisis

In contrast to Ireland, Portugal's economic performance prior to the global financial crisis was lacklustre at best. In the late 1990s, the economy boomed as growth averaged almost four per cent of GDP annually. At the same time, the current account deficit grew steadily. After Portugal entered the eurozone, annual growth fell to around one per cent of GDP amidst persisting current account balances. The general government balance, which had been in deficit before already, reached more than 4 per cent of GDP in 2001, further increased thereafter and one year later Portugal entered an EDP.

Government debt breached the SGP's threshold of 60 per cent of GDP in 2004. Nevertheless, interest rates on long-term government bonds fell from almost 6 per cent in January 2000 to 3.2 per cent in mid-2005 (ECB, 2021). Although sovereign debt was high, the national budget still profited from lower interest costs (Kopits, 2016: 4). Private indebtedness, especially in the corporate sector, also increased from less than 100 per cent of GDP to almost 200 per cent only ten years later (EC, 2011e: 8). In both cases, a large share of this debt had been borrowed abroad and net foreign assets increased by 78.5 per cent between 2000 and 2007 (Reis, 2013: 151).

Government spending and revenues as a per cent of GDP grew much faster in Portugal than in the rest of the eurozone. Primary expenditure, which stood at around 40 per cent of GDP in 2000, reached 45 per cent of GDP in 2005 (Macedo, 2007: 10). Compared to the rest of the EU, current spending and transfers rose exceptionally fast in the late 1990s (OECD, 2003: 64-65). Portuguese governments used the savings resulting from lower interest rates mainly to finance additional expenditures (Kopits, 2016: 5). Starting from a lower level than most other European countries, Southern European welfare states expanded significantly since the 1980s, standing out against the trend of retrenchment that occurred during that time in other European countries (Petmesidou and Guillén, 2014). In the 1990s, the remarkable generosity of the pensions systems further expanded in order to cope with the high economic risk of poverty faced by the mostly low-skilled elder workers (Reis, 2013: 159). In conjunction with the expansion of the public sector, pensions drove public expenditure in the early 2000s (Torres, 2009: 57). When economic growth collapsed, the government resorted mostly to revenue increases, temporary spending freezes, and other contingency measures to the address the growing deficit (Royo, 2013: 202). Due to the frequent use of one-off measures to increase revenues, however, official deficit statistics did 'understate the structural imbalances in public finances' (Eichenbaum et al., 2016: 10).

Government expenditures on social protection increased by 6.6 per cent between 2000 and 2008. Together with Japan, this marked the highest increase of all OECD countries (OECD, 2011a: 67). Old age pensions were by far the most impactful driver of this development (Reis, 2013: 159). The EAP furthermore

identified health costs and an oversized public sector as key sources of budget overruns (EC, 2011e: 12; IMF, 2011f: 4). Public sector expansion was problematic for two reasons. First, government expenditures on public servants rose as wages grew way faster than in the private sectors (OECD, 2003: 74). Portugal's public wage bill was one of the highest in the OECD, although the share of public sector employment in total employment was below the OECD median (OECD, 2008b: 47). Second, fiscal risks stemmed from the proliferation of state-owned enterprises (SOEs) and public-private partnerships (PPP). SOEs were prevalent in several areas of the economy and in 2006 accounted for 2.5 per cent of total employment and their value added for 3.7 per cent of GDP (OECD, 2008b: 57-58). Most of these SOEs were in deficit and thus added to public debt as they regularly had to be recapitalised (EC, 2016: 30). PPPs gained in importance in the late 1990s and early 2000s and were most prevalent in the health sector and in infrastructure spending. Although they were supposed to yield revenues at a later point in time, they implied debt of around 14 per cent of GDP (EC, 2011e: 11). On the revenue side, Portugal's fiscal system, which was fragmented by the widespread use of tax expenditures (Branco and Costa, 2019) and 'affected by inefficiencies' (EC, 2016: 48), could not keep up with state spending. Structural deficiencies in budget management processes further contributed to this development (OECD, 2003: 70; 2006: 49).

Fiscal policy-making in the run-up to the global financial crisis was characterised by piecemeal reform efforts. These efforts were usually induced externally and based on a 'reactive rather than proactive budgetary policy stance' (Torres, 2009: 57) but also showed that external pressure had only limited effects (Royo, 2013: 208). The economy had been slowing down before, but the collapse of economic growth in the early 2000s made a fiscal policy reaction inevitable. Growth fell from 3.7 per cent of GDP in 2000 to 1.6 per cent of GDP in 2001 as the increase of domestic consumption dropped from 5.1 to 1.2 per cent (OECD, 2003: 26). Backed by the opposition, in June the government adopted a first set of emergency measures. But towards the end of the year, it became clear that the measures would not suffice and further amendments to the 2001 budget were presented to parliament parallel to the budget for 2002. Eventually, the socialist minority government needed the support of a single renegade MP from the right-wing opposition party *Centro Democrático e Social – Partido Popular* (CDS-PP) to pass the legislation (Magone, 2002: 1071-1072). These endeavours still did not stop the growth of government expenditures and the deficit widened considerably. This was due to the weak state of the economy and lower than expected tax receipts (OECD, 2003: 46-47).

This trend continued in the following year as early elections resulted in a new coalition government formed by the conservative Social Democratic Party (PSD) and the CDS-PP. Growth slowed down even more and, in 2003, the economy dipped into recession. The general government deficit, which in January was expected at 2.2 per cent of GDP, was calculated in June to reach more than 4 per cent of GDP. A few months later, the EC opened an EDP for Portugal. Without consulting the opposition, the government reacted by adopting another series of emergency cuts such as temporary spending and wage freezes (OECD, 2004: 104). The government's equally confrontational approach to public sector reform was met with strong resistance by the trade union movement (Magone, 2003: 1064-1065). Current expenditures

continued to grow in 2003 and planned tax reductions had to be postponed (OECD, 2003: 53-54). The government met the EDP's deficit targets in 2002 and 2003 only by resorting to one-off revenue increases amounting to 1.6 and 2.3 per cent of GDP respectively (OECD, 2004: 105).

A negative side-effect of persistent austerity was that economic growth remained low and unemployment increased steadily. In June 2004, Prime Minister Barroso resigned. His successor, Pedro Santana Lopes, publicly committed to stay the austerity course (Magone, 2005: 1164). His government, however, was short-lived. Early elections in February of 2005 resulted in an absolute majority for the Socialist Party (PS). Later that year, the EC opened a second EDP for Portugal and agreed with the new government on a more long-term approach to fiscal consolidation. Yet, the national deficit was expected to reach around 6 per cent of GDP since the government abandoned the usage of one-off measures, the economy was still stagnant, and spending pressures persisted (EC, 2005: 5). Between 2006 and 2008, the socialist government continued its attempts to close the national deficit and, at the same time, had to cope with a stubbornly sluggish economy. During that time, it initiated a comprehensive public sector reform and agreed with the trade unions and the employers on reforms of unemployment benefits and the labour law. Neither of the two pacts was endorsed by CGTP. Whereas most employers' federations supported the reforms, they were met with increased industrial action by parts of a divided trade union movement (Campos Lima and Naumann, 2007b, 2007e).

In contrast to the Irish case, fiscal policy in the lead-up to the global financial crisis in Portugal focused on how to deal with a growing national deficit amidst economic stagnation. Successive governments were not able to cope with increasing expenditure growth, which was driven mainly by social policy and the public sector. Although external pressure was high, most attempts to implement fiscal consolidation focused on short-term and one-off measures. The economic downturn increased economic risks for a broad range of social actor groups, which in turn saw their stakes in fiscal policy-making increase. The confrontational approach by most governments, as well as by the efficient CGTP and the dire state of the economy, made fiscal policy-making extremely challenging. This was exacerbated by the absence of a clear and functioning growth model. Indeed, there was no consensus between political parties or economic actor groups on how to organise the economy.

6.1.2. The global financial crisis and its impact on Portugal

In contrast to Ireland, Portugal did not face a property bubble prior to the global financial crisis. This reduced the exposure of the banking sector to the collapse in international housing and interbank markets. What turned out to be much more problematic was the weak state of the Portuguese economy and public finances. Stubbornly high current account deficits resulted in high external debt, with low productivity and high unemployment. The crisis impacted Portugal mainly through the aggravation of the economic downturn and its direct effects on government finances, a sudden stop of capital inflows, and ultimately the worsening of international financial market sentiments.

IMF data show that growth was subdued after 2001 and even went into negative territory in 2003. Unemployment doubled between 2000 and 2008. At the same time, the current account deficit averaged almost 10 per cent of GDP. The latter had been fuelled in the 1990s by capital inflows, which financed domestic consumption and investment, as well as rising imports to meet domestic demand. When the boom came to an end in the early 2000s, the current account deficit receded for a few years as investment decreased and household savings increased. The latter, however, 'was partly offset by increasing public dissaving' (Blanchard, 2007: 6)—that is, growing public deficits. The allocation of capital inflows between various sectors and how it related to changes in productivity was also problematic. In the early 2000s, productivity fell across the economy, most markedly in sheltered sectors such as wholesale and retail trade. Yet, employment was still growing in these sectors despite the slowdown in economic activity, which suggested 'a misallocation of the resources coming into the country' (Reis, 2013: 157). The development in the sheltered sector was matched by a decline in exports and export competitiveness. Portugal's mostly low-tech exports met increasing competition from Asia as well as Eastern Europe and a shift towards high-tech trade was thwarted by the country's skill-structure (EC, 2011e: 6).

In the run-up to the global financial crisis, the Portuguese economy was facing a series of problems. The economic slowdown and the concurrent increase in unemployment burdened public finances as automatic stabilisers resulted in increased expenditures. Revenues fell short of compensating for the additional spending. What is more, expenditures increased independent of the economy's development as pensions and public sector wages went up due to political decisions made in the late 1990s. Several attempts to work against these developments failed and public debt increased from 55 per cent of GDP in 2000 to 65 per cent of GDP in 2007. This was problematic (but not fatal) so long as the interest rates on government bonds remained low and international financial market actors were willing to lend money to the Portuguese state, corporations, and households.

In 2007, when the Irish housing market already collapsed, it seemed as if Portugal was turning the corner. Compared to 2005, the 2007 deficit more than halved and fell below the SGP threshold. This was the lowest deficit in almost 30 years and Portugal could exit the EDP one year early (IMF, 2008: 16). Growth also returned, amounting to 2.5 per cent of GDP that year. However, Portugal's fragile recovery disintegrated when the global financial crisis devolved into a full-blown economic crisis. The public deficit skyrocketed due to the effect of automatic stabilisers and an attempt to counter the crisis with an expansionary budget in 2009. Although they were not immediately affected in the early phase of the crisis, several Portuguese banks now needed public support, which implied additional costs for the government. As market sentiments deteriorated and the eurozone was increasingly pressurised by international financial market actors, Portugal's borrowing costs approached prohibitive levels and an EAP became likely.

6.2. General assessment

6.2.1. Fiscal adjustment in the global financial crisis

Portugal initially attempted to weather the impact of the global financial crisis on the economy by implementing fiscal stimuli in 2008 and 2009. At the same time, the government continued its attempts to reform the public sector and establish other structural reforms. However, it became clear in late 2009 that the deficit was about to reach almost 10 per cent of GDP. Facing additional pressure by international financial market actors, the just recently re-elected government unveiled its consolidation plans. Over the course of the year, it adopted a series of austerity packages and introduced further cuts in the 2011 budget. When a fourth austerity package was rejected in parliament in March 2011, the government announced early elections and turned to the troika for financial assistance.

The government could provide the economy with a fiscal stimulus because the banking sector had weathered the initial phase of the crisis relatively well. In contrast to Ireland, it was not necessary to immediately commit enormous amounts of support to domestic banks. Between 2007 and 2010, it had guaranteed funding amounting to 22.8 per cent of GDP but ultimately had only 3 per cent of GDP in actual expenses, which was one of the lowest figures in the EU (Woll, 2014: 32). After the euro summit had agreed on a coordinated approach to support financial stability in October 2008, Portugal adopted the so-called 'Initiative to Strengthen Financial Stability'. The initiative included transparency measures, a guarantee on bank deposits, and state guarantees on bank assets (Torres, 2009: 60). Also in late 2008, the government nationalised two small banks, which were liquidated in 2010 and sold in 2012 respectively (Véron, 2016: 22). The fiscal effects of this exercise were accounted for only in April 2010 (EC, 2011e: 14).

The fiscal stimuli in 2008, and especially 2009, amounted to around 1.2 per cent of GDP and relied on tax cuts and additional expenditures (IMF, 2010b: 8). Fiscal policy in 2008 was initially based on a continuation of the government's effort to reduce the deficit and to leave the EDP as soon as possible—which it successfully did in mid-2008. This had already been foreseeable in March, when the budget's deficit target for 2008 was revised downwards to 2.2. per cent of GDP as budget execution proved better than estimated. In reaction, the government reduced the VAT standard rate from 21 to 20 per cent, thus partly rolling back increases implemented in the years before (EC, 2008b: 257). In late 2008, however, the global financial crisis severely impacted the Portuguese economy. The government announced a range of measures with the objective of moderating the effects of the crisis on households and corporations. The measures for households aimed mainly at the lower end of the income spectrum in that they extended several allowances for the elderly and families (Government of Portugal, 2009b: 24). Corporations, and especially SMEs, were planned to profit from reductions in the corporate income tax and additional credit lines (Caldas, 2013: 4).

At the same time, the government was preparing the 2009 budget that planned to provide another fiscal stimulus in accordance with the EU's 'European Economic Recovery Plan', which had been adopted in 2008. It allowed for an 'co-ordinated budgetary impulse […] in order to produce a substantive positive

and rapid impact on the European economy and on employment' (EC, 2008a: 7). The government announced that it would stop consolidating the budget in an attempt 'to respond to the challenges of the global crisis while maintaining the government's commitment to disciplining public finances' (Financial Times, 2008). The 2009 budget included a 2.9 per cent pay rise for public sector workers. Negotiations with the trade unions on this issue did not come to an agreement. The unions had demanded increases of 5.9 per cent (CGTP) and 3.5 per cent (UGT) respectively, arguing that higher pay rises were necessary to compensate for recent losses in purchasing power (Campos Lima, 2009). Quoting the severity of the global economic crisis, the government rejected these demands and carried out the changes unilaterally. The budget also introduced the so-called 'Investment and Employment Initiative' which was based on the Recovery Plan. The latter had simplified the procedures for financial support within the framework of the EU's cohesion policy which would contribute additional funding. This initiative was designed 'especially for the benefit of the most vulnerable groups in the population' (Government of Portugal, 2009b: 25). On the revenue side, the 2009 budget reduced the employers' contributions for older workers in small and micro enterprises, maintained the reduced VAT rate, and changed some tax procedures to improve the liquidity of firms. On the expenditure side, funding was provided for the renovation of schools, infrastructure investments, and to exporting SMEs. Social protection and support to household income were expanded as well (EC, 2009a: 246).

Amidst the escalating global crisis, the government entered negotiations with the social partners regarding a series of labour market reforms. The negotiations had begun in 2007, were concluded in mid-2008 and touched upon a series of issues (Campos Lima and Naumann, 2011: 161-163). Two of those issues are of importance here. Most of the social partners—CGTP being the notable exception—had agreed upon a new code of labour law. The new code introduced greater wage flexibility, as well as working time and redundancy regulations. The employers pushed for more flexibility as it was supposed to increase the country's competitiveness vis-à-vis regions such as Eastern Europe. From their perspective this was necessary because labour intensity and the reliance on low-skilled labour still defined most Portuguese companies (Campos Lima and Naumann, 2007a). The trade unions took a more critical stance and argued that 'only flexibility is discussed and security is not considered' and that the new law would not protect 'against precarious employment situations' (Campos Lima and Naumann, 2007c). Both employers and unions quoted increased economic risks even before the crisis affected the Portuguese economy more deeply. Another agreement was reached between the government and UGT. CGTP again did not sign the agreement, which aimed at aligning private and public employment provisions (Campos Lima, 2008a).

CGTP rejected both pacts and organised several protests. Most prominently, around 200,000 private and public sector workers took to the streets in June 2008 following a call by CGTP, which claimed that the new laws would 'serve the economic interests of employers' and exacerbate 'the problems of low wages and work precariousness' (Campos Lima, 2008b). UGT's approach was much more cautious. This approach allowed its representatives to present themselves to the government as the more reasonable alternative to CGTP and to eventually push through some of their demands (Campos Lima, 2008f). In the

end, UGT assessed the reforms more positively than their counterparts on the employers' side. The latter appreciated that some changes took place at all and that they were the result of negotiations with the trade union movement but also made clear that the changes were 'not sufficient to meet the needs of employers' (Campos Lima, 2008d). The public sector reforms were more controversial. Although some of those measures were based on a compromise between UGT and the government, the state took a more confrontational stance towards the public sector, especially in education. After a series of protests and strikes supported by CGTP and UGT, the government postponed planned changes to the pay system and the evaluation of teachers (Campos Lima, 2008e; Magone, 2009). Furthermore, the new labour law was submitted by the president to the Constitutional Court, which in December 2008, found that some provisions were unconstitutional as they violated 'the right to secure employment and the principle of proportionality' (Campos Lima, 2008c).

The economy's steady deterioration in 2009 affected public finances and domestic politics. In January, Standard & Poor's downgraded Portugal's credit rating, after the government had announced that it expected a slight decrease in GDP for 2009 and unemployment to rise further (Financial Times, 2009c). In its Stability and Growth Programme update, the government had calculated with a deficit of 3.9 per cent (Government of Portugal, 2009b: 35). It became clear over the course of the year that this was not realistic and by October the EC expected the deficit to climb to 6.5 per cent of GDP (EC, 2009b: 3). Ultimately, the deficit surged to 9.3 per cent (OECD, 2010: 31).

This did not bode well for the government that faced general elections in September. The PS lost votes but was able to retain its relative majority in parliament. The PSD could not profit from this development and gained only a handful of votes. During its campaign, the PSD distanced itself from the Socialist's focus on public investment as a driver of economic recovery without clearly stating how it would approach public finances (Financial Times, 2009b). The extreme left, and especially the newly found Left Bloc, was the election winner. This prompted the employers, namely CIP, to urge the PS to not even consider a coalition with the radical left as this 'would be fatal to growth, investment and employment' (Financial Times, 2009d). Lacking a feasible coalition partner, the Socialists ended up forming a minority government. It was clear that the new government would have to implement budget cuts irrespective of domestic demands for an expansionary fiscal policy stance (IMF, 2009: 9).

The new minority government could not go ahead with the fiscal policies it deemed necessary and faced a strong left-wing group of parties that refused austerity but demanded additional spending. In other words, the Socialist government depended on (passive) support by the PSD to adopt budgetary measures (Campos Lima, 2010e; Magone, 2014c). During its election campaign, the PS had made the case for a strategy to overcome the economic crisis based on public investment and expansionary social policy to fight poverty and economic inequality (Government of Portugal, 2009a: 4). The government presented its budget plans in late January. The budget consisted of both consolidation efforts as well as stimulus measures. In total, it aimed at cutting the deficit by 1 per cent of GDP in 2010 and to meet the SGP

threshold by 2013 (Financial Times, 2010d). Besides a series of investment measures, the budget plan also contained some more controversial fiscal adjustment propositions.

First, the new government increased the statutory minimum wage in December 2009 based on provisions included in a social pact struck in 2006. The extent of the increase was rejected by most employers. The minimum wage did not have any direct fiscal implications, but the employers were to be compensated for around 15 per cent of the increase by a cut to the so-called 'single social tax'. Whereas the employers demanded additional compensation, CGTP heavily criticised the tax cut's effect on the revenues of the social security system (Campos Lima, 2010c). The government's plan to resume the reform strategy it had initiated after coming to power in 2005 was even more contested. In addition to the structural reforms included in the strategy, the government now wanted to further contain expenditures on public sector wages given the large deficit. Most importantly, it planned a freeze of real public sector wages to a maximum increase of 0.8 per cent in 2010. Furthermore, it intended to prepone the alignment of public and private sector pensions (Campos Lima, 2010e). Again, the two trade union confederations reacted differently. CGTP called for a demonstration in February, which rallied together around 50,000 civil service workers. UGT, by contrast, did not join the demonstration but entered negotiations with the government that were scheduled to last until March when the budget was supposed to be adopted in parliament (Campos Lima, 2010e). A few days before that, a general strike in the public sector took place, this time support by unions affiliated to CGTP as well as UGT (Campos Lima, 2010d).

Irrespective of the protests and the strike, the government stuck to its agenda as it became increasingly pressurised by international financial markets. Between September 2009—when the government came into office—and February 2010, long-term government bond spreads had increased from slightly below 4 per cent to almost 4.6 per cent (ECB, 2021). The budget was adopted in March, helped by the conservative opposition's abstentions. In addition to the public sector wage freeze, the budget included a temporary tax on higher wages, privatisations, and cuts to military spending (Financial Times, 2010g). In an attempt to counteract pressures by international financial markets, the government made two additional announcements in March. First, it published a new Stability and Growth Programme for the years 2010 to 2013 where it spelled out its plans to reduce the general government deficit to 2.8 per cent by 2013. This implied consolidation efforts totalling 3.5 per cent of GDP. More than two thirds of this consolidation were planned 'to be based on the reduction and control of the most significant expenditure components' (Government of Portugal, 2010c: 13), namely the compensation of public sector employees and social transfers. Second, it presented the first of a series of Stability and Growth Pacts *(Pacto de Estabilidade e Crescimento, PEC)*. The first *PEC* implemented several prominent budget provisions such as the tax increase on higher incomes and the already announced changes to public sector remuneration (Magone, 2011: 1103).

Already by April, it turned out that this was not enough. Two major rating agencies—Fitch Ratings and Standard & Poor's—downgraded Portuguese bonds and the EC demanded additional efforts to meet the EDP targets (Financial Times, 2010h; Magone, 2011: 1103). In reaction to the EC and similar statement

by the ECOFIN council, the government announced that it would reduce its deficit in 2010 another percentage point by bringing forward a series of measures initially planned for 2011. The government now unveiled mostly revenue increases, expenditure cuts were scheduled mainly for 2012 and 2013 (OECD, 2010: 31). For 2010 and 2011, consolidation was based on VAT increases as well as an increase of personal and corporate income taxes for higher earners. Cutbacks predominately affected transfer to state-owned enterprises, regional and local governments, as well as capital expenditure (EC, 2010a: 51). The PSD under its new leader, Pedro Passos Coelho, supported this second *PEC* as it was adopted in parliament in June 2010. But at the same time, the PSD called for a bigger say in the government's approach to fiscal adjustment in order to ensure that it 'shares the burden' (Financial Times, 2010i; Magone, 2011: 1103). The trade union movement strongly objected to the abolishment of the social policies that had been part of the Investment and Employment Initiative. On 29 May 2010, CGTP and UGT unions together took to the streets in one of the largest demonstrations in recent history. Even though they did not partake in the protest, the employers, in the person of CCP's President João Vieira Lopes, also acknowledged 'the social impact' the withdrawal would have on those facing exceptionally high economic risks (Campos Lima, 2010a). Taken together, the two *PECs* were estimated to have a total effect of 1.2 per cent of GDP in 2010, 4.1 per cent in 2011 and around 5 per cent in 2012 and 2013 (OECD, 2010: 31).

In autumn 2010, three developments exerted additional pressure on the government. Bond spreads jumped by another 0.7 percentage points within a few weeks (ECB, 2021). Instead of being cut, the deficit increased by almost €400 million withing the first seven months of the year (Financial Times, 2010j). Finally, conflicts between government and opposition deepened when the PSD declared it was not willing to support further tax hikes (Magone, 2011: 1104). The conflict dragged along during September and October when the budget for 2011 had to be adopted and the government planned a third *PEC*. The conflict between PS and PSD ended up revolving around a relatively minor tax item of around €230 million (Financial Times, 2010l). For the PSD to abstain from the parliamentary vote on the budget and thus allow it to pass, the government had to give up some tax increases amounting to €500 million. Instead, they were to come from budget cuts in the line ministries and the sale of state-owned assets (Financial Times, 2010k). On the revenue side, the 2011 budget included another VAT hike by two percentage points, the revision of tax benefits for corporations, as well as an increase in the social security contributions for civil servants. On the expenditure side, it mainly focused on the public sector where it reduced higher salaries and introduced a freeze of promotions and automatic tenures. Cuts to the increases of social benefits introduced in 2009 were also part of the package (Caldas, 2013: 7; Government of Portugal, 2010a). Finally, the government transferred Portugal Telecom's pension fund to the public sector and gained one-off revenues of around 1.6 per cent of GDP (EC, 2011e: 10).

The government made it clear that further fiscal adjustment had become inevitable as it was willing to meet its EDP obligations and to defend its international credibility (Government of Portugal, 2010a: 1). This only further worsened the already fraught relationship between the government and trade unions. Whereas CGTP had already been outspokenly critical of the government's fiscal policy, UGT still had

been available as a negotiating partner. One cornerstone of the government's programme for 2009 to 2013 had been the so-called 'Pact on Employment'. Referring to the Global Jobs Pact adopted by the International Labour Organisation in June 2009, the pact was a negotiated policy initiative meant to create jobs and sustain domestic demand while preserving decent work conditions and a socially fair distribution of the negative effects of the crisis (Government of Portugal, 2009a: 9). UGT had made a series of demands, especially regarding social policy and inequality, but also acknowledged the severity of the global crisis. However, the conclusion of the pact was uncertain given that it was supported only by CIP and UGT. When the government presented its fiscal adjustment measures for 2011, UGT dropped out of the negotiations due to what it described as the government's 'brutal attack on workers' rights and conditions' (Campos Lima, 2011b). More importantly, however, UGT also joined CGTP's call for a general strike on 24 November 2010. This was especially remarkable as it was the first joint strike of the two federations since 1988 (Moury and Standring, 2017: 667) and the first strike ever a socialist had to face that was supported by UGT (Campos Lima and Artiles, 2011: 397). The unions argued that the budget represented 'a generous concession to those in favour of liberal policies without a social dimension' and a 'capitulation to pressure from international financial speculation' (Campos Lima, 2010b). Despite the unions' opposition, the government proceeded with its consolidation strategy. On 15 December, it adopted its 'Competitiveness and Employment Initiative' (*Iniciativa para a Competitividade e o Emprego*), which contained 50 different measures aiming at improving the economy's competitiveness but also the go-ahead to proceed with fiscal consolidation (Government of Portugal, 2010b).

Nevertheless, the government's efforts suffered another setback at the end of the year when Fitch Ratings again downgraded Portuguese government bonds after two other rating agencies—Moody's and Standard & Poor's—warned that a downgrade was be imminent (Financial Times, 2010b). At a time when Ireland had concluded its negotiations with the troika and bond spreads reached a record level of almost 7 per cent, Portugal was pending to be the next programme country.

In January, the lingering conflicts between PS and the conservative opposition intensified. The CDS-PP had already broken its shaky consensus when it voted against the 2011 budget. The PSD also cast further doubt on the government's consolidation strategy and demanded that Prime Minister Sócrates resign if he requested financial assistance (Financial Times, 2011l). Portugal's political and economic problems culminated in March. Bond spreads shot up and the government announced additional austerity measures. It published an update to its Stability and Growth Programme one month earlier than planned and a fourth *PEC*. The main objective of the former was to convince international financial market actors and European partners that Portugal was determined to honour its international commitments and to pursue an ambitious reform agenda (Government of Portugal, 2011a: v). It planned to reduce the deficit to 4.6 per cent of GDP (Government of Portugal, 2011a: 11).

The government now was mainly concerned with implementing its short-term policies to tackle the fiscal crisis. *PEC* number four provided for expenditure cuts to the tune of 2.4 per cent of GDP and revenue increases amounting to 1.3 per cent of GDP (Financial Times, 2011h). In the run-up to the parliamentary

vote, however, all opposition parties declared that they would not support the *PEC*. On 23 March, the austerity package was rejected in parliament, José Sócrates resigned as prime minister and snap elections were called for 5 June. Less than two weeks after the resignation, Portugal officially requested financial assistance from the troika.

In conclusion, save for a short period of fiscal stimuli in immediate reaction to the global financial crisis, various Portuguese governments had been trying to consolidate public finances. Economic growth was sluggish due to a lack of international competitiveness and growing unemployment. Just as the fiscal adjustment measures implemented in the early and mid-2000s achieved initial successes, the global financial crisis hit the fragile economy. External pressure mounted when the eurozone became increasingly affected by the financial crisis and further fiscal consolidation became inevitable. Over the course of a series of budgets and several emergency packages, Portugal's Socialist government pursued a mixed strategy based on both expenditure cuts and revenue increases. In doing so, it faced growing opposition by trade unions as well as by the opposition in parliament.

The adjustment strategy pursued by the Socialist government meets most expectations formulated in chapter four. Adjustment was based on both expenditure cuts and revenue increases, but overall expenditures remained comparatively high. A large part of the adjustment measures targeted the public sector and social policy, which were by far the most important spending items. This strategy was much less growth-driven as it was in the Irish case. It was rather problem-driven since growth was absent in the run-up to the global financial crisis and fiscal consolidation had been dragging on. Traditional economic actor coalitions were partly involved in social concertation and partly relied on industrial action to avoid adjustment costs.

Fiscal policy-making was not based on a specific growth model logic. Although the share of consumption in the economy was much bigger than the share of trade, the former was not able to function as a dynamic driver of economic growth. Still, when the global financial crisis hit, a significant part of the fiscal stimulus implemented by the government focused on domestic demand. When fiscal expansion was rendered unfeasible, and external pressures by international financial market actors and the EC forced the Portuguese government to fiscally adjust, the absence of a functioning growth model expoised the lack of a clear yardstick for fiscal policy-making. The lack of international competitiveness of large parts of Portugal's exposed sectors contributed to the economic and fiscal problems of the economy. In contrast to Ireland, there was no advanced sector expected to drive economic growth after the crisis. If anything, fiscal policy aimed at establishing a new growth model as opposed to restoring an existing one. Sustaining domestic consumption was a major objective of the stimulus measures, nevertheless, VAT increases were implemented. The improvement of the economy's international competitiveness loomed in the background as a more general purpose of economic policy-making.

As a result, fiscal and economic policy-making was much more contested by the different political parties than in Ireland. The Socialist government as well as the conservative opposition were able to strike a shaky

compromise given the severity of the economy crisis. The opposition accepted a series of adjustments and obtained a few concessions but in the end broke with the pact when the prospects for a change in government were best. PS and PSD both intended to live up to the traditional and class-based preferences of their core constituencies (Afonso and Bulfone, 2019). On several occasions, the PS referred to issues of inequality, to initiatives by the International Labour Organisation and other labour-related issues and its initial response to the fiscal crisis taxed especially higher earners. This may be one reason why Portugal was the only Southern European crisis country where inequality fell significantly in the early phase of the crisis (Perez and Matsaganis, 2018). The PSD, by contrast, demanded to confine the role of the state in the economy and made a case against further tax hikes.

Domestic economic actor groups and coalitions were also split over individual policies and could not agree on any policy strategy. The disunity of the trade union movement continued in the context of social concertation. It ended only when they joined forces to protest against the government after a series of austerity packages aimed at the core constituencies of both federations. Both trade federations pursued class-based preferences in that they demanded more redistribution, better protection for those facing high economic risks while rejecting several measures that intended to reduce the tax burden for corporations. This stands in stark contrast to Ireland where the trade union movement was deeply invested in the export-driven growth model. Moreover, Portuguese trade unions did not suffer the same delegitimization process as their Irish counterparts but were able to organise a series of broad-based demonstrations.

6.2.2. Fiscal adjustment in the eurozone crisis

Irrespective of the government's reassurances that it would come to grips with the national deficit, market pressure did not cease during the first quarter of 2011. Over the first three months of the year, bond yields breached the 7 per cent threshold several times (ECB, 2021). Yields above this level viewed by many market participants as unsustainable (Financial Times, 2011p). Shortly after the election, the finance minister had stated that it would not be possible for the government to pay more than 7 per cent interest on its bonds and that a request for financial assistance would become unavoidable (Interviews PT 05; PT 11). Ireland's request and the derailment of the Greek EAP in early 2011 further thwarted the government's attempts to avoid a programme (Henning, 2017: 122-123). The EC shared this assessment as it feared 'contagion' from Greece to Portugal (Interview EC 04) and the resulting 'systemic risk' for the rest of the eurozone (Interview EC 05). Yet, the Portuguese government was steadfast to avoid an EAP as long as possible—and it defended this position domestically and internationally. Most members of government were convinced that the adoption and implementation of the fourth *PEC* would be sufficient to calm investors and to persuade the ECB to intervene in the bond markets on Portugal's behalf (Moury and Standring, 2017: 668). At the European level, it was discussed how and if the ECB was supposed to serve as a lender of last resort for ailing eurozone members. But the ECB belied any expectations and even increased its official interest rates in late April (Henning, 2017: 123). In an attempt to appease its European

partners and show its commitment to consolidation, the PS struck a preliminary agreement with the EC and the ECB to prevent a full-blown programme (Interviews EC 08; PT 07). It wanted to avoid an EAP for two reasons. On the one hand, the party felt that the conservative opposition was pushing for a bail-out to have a unique opportunity to implement a liberal policy agenda (Interview PT 07). On the other, Portugal was sceptical of the IMF in light of collective memories of the country's two Fund programmes in the 1970s and 1980s (Interview PT 11; Djankov, 2014: 90; Henning, 2017: 123).

To further demonstrate the credibility of its commitment and to increase pressure on the opposition, the government put the fourth *PEC* to vote, although there was no formal requirement to get the parliament's consent (Moury and Standring, 2017: 668). What is more, José Sócrates announced that he would stand down as prime minister if the *PEC* failed in parliament. The conservative opposition voted against the proposal and Sócrates handed in his resignation. The PSD, whose consent would have been crucial for the *PEC* to pass, argued that the *PEC* had been put together by the government without really consulting the opposition and did not sufficiently focus on expenditure cuts. Furthermore, the PSD stated that the government lacked any credibility to fiscally adjust given its failure to implement the previous three *PECs* (Magalhães, 2012: 313). The reaction by international financial market actors was negative and swift. Within less than a week, Standard & Poor's downgraded Portuguese government debt two times to slightly above junk level (Financial Times, 2011k, 2011r). The government formally requested financial assistance on 7 and 8 April. Negotiations between the government and the troika had started before already and, after the insistence of Germany's Chancellor Angela Merkel, the IMF also became involved (Henning, 2017: 123).

The programme was negotiated within six weeks. Preliminary work had been conducted in all three policy areas: that is, structural adjustment, fiscal adjustment, and financial stability (Interview PT 06). Of those three issues areas, the latter was the least prominent since Portugal did not suffer a financial and banking crisis to the extent that Ireland did (Interviews EC 01; EC 08). The EAP thus focused on the structural reform part and especially on fiscal consolidation. The March 2011 update of Portugal's Stability and Growth Programme served as the basis for the fiscal component (Interview EC 08). It was very likely that the elections would result in a change of government. The troika therefore negotiated with the cocialist government but also asked the conservative opposition parties for their commitment to the programme and kept them informed about the negotiations (Interviews EC 08; PT 01; PT 11).

In the end, the coalition between PSD and CDS-PP won an absolute majority. The Portuguese programme was considered a 'qualified success' (IMF, 2016: 2) by the IMF, although 'to a lesser extent' than Ireland (IEO, 2016: 35). In the eyes of the EC, the programme 'was effective in achieving its primary objective of restoring confidence in the Portuguese economy' (EC, 2016: 10). In terms of fiscal policy, it identified 'tangible progress in putting the public finances on a more sustainable footing' (EC, 2016: 10). The positive evaluations by the troika institutions, however, were also informed by the troika's and the creditors states' wish for another success story as the Greek programmes failed (Interviews EC 08; EC

11). This also contributed to some of the good will shown especially by European institutions (Interview EC 08; EC 11).

In general, the government assessed the EAP positively as well. Yet, government officials acknowledged that the composition of fiscal adjustment changed over the course of the EAP. Revenue increases played a more important role than expected. Initially, it was planned that expenditure cuts would contribute two thirds of total consolidation. But ultimately that figure turned out to be around 50 per cent (Interview PT 01) although tax increases were 'not the first option of the government' (Interview PT 02). Furthermore, some observers argued that the programme's 'across the board cuts were very destructive' (Interview PT 06). The troika institutions were also not fully convinced. The IMF argued that 'the composition of consolidation was less supportive of growth than planned' (IMF, 2016: 17). The EC also criticised that permanent expenditure cuts did not progress as planned. It acknowledged that 'fiscal performance was broadly in line with the targets in the second half of the programme' (EC, 2016: 53) but also found that 'Portugal shied away from pursuing some of the most difficult measures' (EC, 2016: 11).

In the context of the fifth as well as the seventh review, the EAP's deficit targets were revised upwards considerably. The exact levels of these revisions were the subject of prolonged discussions between troika and government and even resulted in a government crisis in mid-2013 (Interviews EC 14; IMF 06; PT 01; PT 11). Domestic opposition to the programme was much more pronounced in Portugal than in Ireland. Most prominently, the country's Constitutional Court vetoed a series of measures, most of which targeted the public sector. Although they were much less violent than in Greece, several protests and strikes took place over the course of the programme (Accornero and Ramos Pinto, 2015).

The fiscal part of the EAP strove for front-loaded fiscal adjustment as means to safeguard Portugal's return to private funding, while at the same time 'mitigating the impact on growth' (IMF, 2011f: 10; Eichenbaum et al., 2016: 26). Regarding its effects on the Portuguese economy, fiscal policy had two major objectives. It was supposed to cut expenditures in order to 'reduce the public sector's large claim on resources' (EC, 2011e: 16), and to achieve 'fiscal devaluation' that would reduce domestic consumption and support export-led recovery (Eichenbaum et al., 2016: 27; IMF, 2016: 16). In contrast to the Irish programme, there was a larger misalignment between programme and the domestic economy. The EAP's purpose of rearranging the economy and establishing a new growth model arguably made implementation more difficult. As I will describe below, despite the conservative government's intentions, it soon had to abandon its preferred expenditure-based adjustment strategy due to domestic opposition. The government found it difficult to find support for a 'complete change of [economic] model' (Interview PT 02). Instead, it had to give in to strong traditional actor coalitions in favour of a more redistributive and revenue-based fiscal consolidation strategy.

6.3. The EAP for Portugal

This subchapter presents the main part of the case study and examines how the Portuguese government implemented the fiscal part of its EAP in depth. It shows how the preferences of domestic coalitions influenced the government's policy reactions to the economic crisis. First, I describe negotiations of the EAP that took place in April and May 2011. Second, I then turn to the early programme phase and the policy measures taken by the Portuguese government over the course of almost two years—between June 2011 and April 2013. More than 50 per cent of total fiscal consolidation was supposed to be implemented in 2011 amidst rising pressure by international financial market actors and public creditors. That is, 2011 was not only decisive for the eventual outcome in terms of economic growth but also regarding the potential of further conditionality and additional measures. As opposed to Ireland, implementation was fragmentary and economic conditions worsened so that 2012 was characterised by constant renegotiations of the EAP's conditionality. Next, the third section shows how domestic opposition, court vetoes, and a government crisis chipped away at the government's willingness to further push for fiscal adjustment. Finally, Portugal exited its programme in June 2014, slightly ahead of schedule, when another court veto struck down a programme measure.

6.3.1. Phase one: Negotiating the EAP – a fragile political consensus

Following his resignation as prime minister in late March 2011, José Sócrates met with President Anibal Cavaco Silva to discuss the way forward. The two met amidst considerable external pressure to apply for financial assistance. Standard & Poor's double downgrade had made it obvious that the door to private market funding was closing. EC and ECB had been in the country to assess Portugal's public finances since February in the context of the government's Stability and Growth Programme update (Henning, 2017: 123). Sócrates' administration would remain in office as a caretaker government until the early elections, which were set to take place on 5 June.

The preliminary agreement between the government and the European institutions served as the starting point for the EAP negotiations, which were officially initialised in early April. On 17 May, less than four weeks after the IMF's then managing director had announced that the Portuguese authorities had approached the Fund, staff-level agreements on programme technicalities were reached and finalised. Total funding amounted to €78 billion. The contributed IMF one third and European funds two thirds. Analogous to the Irish programme, the interest rates which applied to borrowing from the two EU's funds was set at a similar levels as the IMF's lending rates (EC, 2011e: 30). As already discussed in the Irish case study, this would become a controversial subject because the interest rates were considered to be overly punitive. For now, however, the approach to fiscal adjustment was clear. The March update of the government's Stability and Growth Programme and the fourth *PEC* served as the foundations for the EAP (Interviews EC 08; IMF 06). It was therefore planned that the first programme year would focus 'mainly on budgetary execution rather than devising new measures' (EC, 2011e: 19). The government deficit was

envisaged to hit 3 per cent of GDP in 2013 and sink below that threshold starting in 2014 (IMF, 2011f: 47; EC, 2011e: 18).

The negotiations were conducted solely by the troika and the government and did not involve the parliament (Interview PT 07). The EC would later praise the 'cooperative environment' of the negotiations and the 'consultation with the main opposition parties and other civil society partners' (EC, 2016: 13). The conservative opposition parties willingly consented to the broad lines of the EAP as they 'did not see the bail-out as a hostile act but as an unfortunate necessity' (Interview PT 01). This stands in stark contrast to the position of the parties left of the PS, which rejected any interaction with the troika or support for the programme (Magone, 2012: 263). Both trade union confederations met with the troika prior to the negotiations, but they also were sceptical towards the EAP. Whereas UGT stressed the importance of national unity in battling the economic crisis, CGTP emphasised that it opposed 'clearly and unambiguously new austerity packages similar to those that have been applied in other countries' (Campos Lima, 2011a). The employers' positions were strongly influenced by the sectoral orientation of their core constituencies. CIP, which expressed its demand for the continuation of the social partnership process, joined CCP and stated that improving financing conditions for corporations 'was more important than cutting wages or increasing taxes' (Campos Lima, 2011a). For the farmers, by contrast, the most important issue was that financial support by the state would be maintained (Interview PT 02; Campos Lima, 2011a).

The government had spelled out its planned adjustment path in its Stability and Growth Programme Update. However, as the programme was negotiated, economic indicators had worsened further so that the EAP applied more comprehensive adjustment measures while at the same time allowing for the 3 per cent deficit target to be met one year later. Table 6.1. gives an overview of the deficit targets and the planned fiscal adjustment schedule of the two programmes. The government stated its efforts were 'probably the biggest fiscal consolidation effort ever made in Portugal and also the biggest deficit reduction underway in Europe this year' (Government of Portugal, 2011a: 11). Its initial adjustment plan was rather ambitious in that it intended to reduce the deficit target from almost 10 per cent of GDP in 2010 to 3 per cent of GDP only two years later. The adjustment path and the corresponding targets were an issue that stirred controversies between the government and the troika—but especially between the troika institutions themselves. The IMF advocated a much slower adjustment path that would lead to a deficit below 3 per cent of GDP only in 2015. As opposed to this, the Commission and the ECB wanted this target to be met earlier (Henning, 2017: 124). Ultimately, the Portuguese plan was postponed by one year to 2013. There was also some slight disagreement between the IMF and its European partners regarding the calculation of the programme's deficit targets. Whereas the IMF would have preferred nominal budget targets, the EC insisted on targets that were measured against GDP, meaning, equivalent to the provisions of the SGP (Eichenbaum et al., 2016: 53; see also Lütz et al., 2019a). Eventually, the EC's approach was chosen. This would later make meeting the targets exceptionally difficult when GDP contracted more than anticipated (Interviews PT 01; 02; Eichenbaum et al., 2016: 53).

The second controversial issue was the financial envelope of the EAP: the total sum provided to Portugal by the troika. The IMF would have liked the ECB to supply more liquidity directly to the Portuguese banking sector to allow for a smaller programme. This clearly contradicted the ECB's preferences, which did not want to expose its balance sheets (Henning, 2017: 125). In the end, the programme contained a cash buffer for the banking sector amounting to €12 billion. The remainder was supposed to allow the government to re-finance its debt (Interview PT 03). The amount of financing that would be provided to the banking sector was heavily influenced by the approach taken towards measuring the banks' needs of recapitalisation. Ultimately, the Bank of Portugal's method was chosen, which did not recognise the losses of banks upfront but only when they actually occurred (Interview PT 08). On the one hand, the decision was left to the Bank of Portugal because the troika institutions did not want to call into question the Bank's quality as a market supervisor. Moreover, the IMF's staff feared, 'antagonizing it on this issue would diminish the authorities' ownership of the program' (Véron, 2016: 24). On the other hand, recognising potential bank losses upfront would have meant additional funding needs of around €50 to €60 billion (Interview PT 08). As a result, the EAP for Portugal 'stopped short of a full-fledged approach to the financial sector' (Véron, 2016: 23). The same held true for the SOE sector. The ECB favoured additional funding, but the EC decided against this approach to provide stronger incentives for the SOEs to be restructured (Interview EC 01). The financial envelope for restructuring the banking sector as well as the SOEs thus fell short, and 'a combination of some misperception and lack of money did not allow for the financial system to be resolved from the very beginning' (Interview PT 02).

Table 6.1.: Portugal's fiscal targets and consolidation by year

	2011	2012	2013	2014
Fiscal targets				
Government (March 2011 Update)	*-4.6*	*-3.0*	*-2.0*	*-1.0*
Economic Adjustment Programme	-5.9	-4.5	-3.0	-2.3
Fiscal consolidation				
Government (March 2011 Update)	*5.3*	*2.5*	*1.2*	*N/A*
Economic Adjustment Programme	5.7	3.0	1.9	0.0

Notes: Per cent of GDP.
Source: EC (2011e: 18); Government of Portugal (2011a: 11, 14, 15, 36).

As opposed to the Irish case, fiscal policy hardly proceeded during the negotiations of the EAP. The fourth PEC had been rejected in parliament and there was no potential for cooperation beyond the opposition's general commitment regarding the need for adjustment and the provisions of the programme. The

differences between PS and PSD also affected the electoral campaign. The campaign soon escalated as PS and PSD presented contradicting interpretations of the responsibility for the economic crisis and especially on the right approach to tackle it. The PSD was about to form the 'most liberal government' in the country's history (Interview EC 07) and Passos Coelho was an exceptionally liberal figure even for the PSD (Interview PT 07; for a more comprehensive analysis see Magalhães, 2014). The party's approach to present itself as explicitly pro-austerity and in favour of reducing the state's role in the economy was a risky bet given the left-leaning tendency of the electorate when it came to economic policy (Magalhães, 2012: 321). Still, Passos Coelho promised to go beyond the programme and to 'change the country' (Interview PT 02) and the party's manifesto envisaged a 'change of the current statist paradigm' (Diário de Notícias, 2011).

One important element of PSD's plan to change the Portuguese growth model was a so-called 'fiscal devaluation' based on a reduction of the social security contributions paid by employers in exchange for an increase of the VAT. This measure was part of the EAP and had been praised by the IMF as 'a potentially game-changing' boost for Portugal's international competitiveness (IMF, 2011h). The measure became one of the most controversial issues of the campaign. The PSD intended to reduce social security contributions by four percentage points and to refinance this reduction by slightly changing VAT rates. The Socialists, by contrast, argued that the PSD's plans would require much larger VAT increases and warned against the plan's 'negative social and economic impact' (Financial Times, 2011q). This echoed the general sentiment of the Socialists' campaign, namely that the election was 'a fight for the survival of the fundamental traits of Portuguese social welfare policies' (Magalhães, 2012: 315). Shortly after the EAP was agreed upon, Prime Minister Sócrates claimed that cuts to the minimum wage or to public sector employment would not be part of the EAP (Financial Times, 2011o). Forming a coalition with parties from the extreme left still was not an option for the socialists given the strong differences regarding European integration and other important policy areas. In the context of the 2011 election, the far left parties were highly outspoken regarding their rejection of the EAP and refused to even meet the troika institutions (Interviews PT 01; EC 14; Campos Lima, 2011a). CDS-PP, finally, sided with the PSD's endeavour to transform the Portuguese economy. At the same, the party tried not to deter parts of its electorate that were dependent of state transfer—especially pensioners (Magalhães, 2012: 315).

Portuguese voters had three clear alternatives on election day. The parties of the extreme left lacked a realistic chance to enter government; voting for them was a clear rejection of the EAP. The PS, which had formed the outgoing government and had negotiated the EAP, presented itself as the defender of Portugal's state-oriented and spending-driven growth model. The PSD, finally, promised a transformation of the economy and a reduction of the role of the state. In contrast to the Irish case, there was no well-established growth model that the major parties were able to agree upon. This intensified their differences during the campaign and opened up the potential for a more confrontational opposition in parliament after the election. Whereas the exceptional liberal PSD—together with CDS-PP—promised an expendi-

ture-based adjustment strategy, the PS made its intentions clear to maintain as much of the state's spending structure as possible.

6.3.2. Phase two: A unifying trade union movement and an attempt to alter a lacklustre growth model

The elections brought about a clear result. It was, however, less clear than some observers expected. The PSD, which lead polls throughout the campaign, fell short of gaining an absolute majority. Still, the Socialists were punished severely by the voters, receiving its worst election result since 1987. José Sócrates' thus resigned as the party's leader. The CDS-PP's result, by contrast, was the party's best since 1983 (Fernandes, 2011: 1300). Here, the low voter turnout of less than 60 per cent accounts for the result. Whereas the PSD's campaign pledge to restructure the economy mobilised voters, large segments of the PS's core constituencies abstained from the election. This resulted in an exceptionally low result for the Socialist party although voters' preferences on economy policies did not significantly move to the right (Magalhães, 2012). In contrast to Ireland, the results of the elections stayed within the usual volatility limits of the party system (Magalhães, 2012: 310). As expected, the Socialist party was punished for how it had managed the economic crisis. Furthermore, its promise to defend the welfare state was only partially credible given its attempts of fiscal adjustment in the run-up to the global financial crisis (Magalhães, 2014: 192). But it did not lose exceptional amounts of votes. At the same time, the PSD needed the CDS-PP as a coalition partner to achieve an absolute majority in parliament.

The negotiations of the coalition agreement between PSD and CDS-PP proceeded swiftly. Between 2002 and 2005 the two parties already had formed a coalition government. Given the enormous external pressure, it took them less than three weeks to come to an agreement and to take office. During the negotiations, there were only two minor issues that had the potential to stir controversy. CDS-PP opposed PSD's candidate for the speaker of parliament and objected to PSD's plan to form a government of at most 10 ministers as a signal of economic efficiency. Both issues were easily resolved, however, and eventually a small government of only 12 ministers was inaugurated (Fernandes, 2011: 1301). Of those ministers, the arguably most important was the finance minister. As a signal to the troika and international financial market actors, Passos Coelho chose Vítor Gaspar. Before entering politics, Gaspar had worked for the ECB and the EC and was 'well-known' to the troika's mission chiefs (Interview EC 01).

The new government was eager to display its commitment to the EAP and its intention to use it 'as a window of opportunity to pursue reforms that would have met tremendous opposition otherwise' (Moury and Freire, 2013: 36). This is exactly what the new government was criticised for by the PS—now in opposition—which argued that 'the opposition parties from the right internalised the discourse of the creditors' (Interview PT 07). Several ministers confirmed this, stating that they intended to make use of the programme to follow through with difficult reforms, and that they 'saw no important differences between the MoC and their own policy preferences' (Moury and Freire, 2013: 47; Interview EC 07). The troika's

mission teams were also aware of this and suggested that the government needed the programme to push through policy measures against the trade unions' opposition (Interview EC 01). On several occasions, the new prime minister stated that he did not view the EAP as being imposed on him but that it was his programme and that he would be decisive in implementing it (Interviews EC 01, PT 07). In the eyes of the IMF, Passos Coelho was 'the most committed reformer' that Portugal had seen in a long time (Interview IMF 06). Finally, the employers—in this case CIP—were convinced that PSD at that time 'was really the right [party] to be there' (Interview PT 09).

Gaspar's nomination as finance minister was not the only signal the new government was anxious to send to external actors. Throughout the early phase of the programme, the mantra 'Portugal is not Greece' was repeated publicly and in internal discussions (Magone, 2014c). The derailment of the first Greek programme had contributed to Portugal's economic woes and the deterioration of market sentiments. The government was therefore eager not to be lumped together with Greece as it dealt with its own programme and 'spent a lot of time trying to place Portugal close to Ireland and far from Greece' (Interview PT 02). Vis-à-vis the troika, the government's 'first mission was to present the Portuguese case as a very specific one' and as a Southern European country that, as opposed to Greece, was able to stick to its commitments (Interview PT 11) and able to implement the EAP's and meet its targets (Interview PT 05).

A major reproach made by PDS's election campaign was that even if the former government adopted a series of austerity packages in parliament, it failed to properly implement them. One of the first organisational measures of the new government was therefore to centralise the decision-making process at the Prime Minister's Office, to streamline the interaction with the troika, and to keep the line ministries in check (Interviews EC 08; EC 14; PT 01). This was to be safeguarded by a new monitoring unit called *Estrutura de Acompanhamento dos Memorandos* (ESAME). Just as the new finance minister, the head of this newly installed unit, Carlos Moedas, was not an established politician but rather a technocrat from outside of politics. Moedas sat at the cabinet's table and reported directly to Prime Minister Coelho about the implementation process of the EAP and was supposed to serve as a 'bad cop' vis-à-vis the line ministries (Interview PT 01). ESAME was staffed with civil servants but also with experts from the private sector, in other words, 'people that normally would not serve in the government' (Interview PT 01). Furthermore, by organising and closely monitoring the troika's review missions, the government strived to regain 'a little bit of control in the process' (Interview PT 01). Compared to Greece, the troika found that the government's approach brought with it 'significantly better ownership and implementation' (Interview EC 08; EC 14).

The swift conclusion of the negotiations between PSD and CDS-PP and of ESAME's installation was encouraged by mounting external pressure. Two weeks after the new government had taken office, it faced another downgrade by a major rating agency. On 5 July, Moody's downgraded Portugal's government bonds to 'junk level', arguing that the country could need a second bailout. The rating agency cited 'formidable challenges' and potential repercussions from the Greek programme, which could thwart the government's attempt to reduce the public deficit to three percent by 2013 (Moody's, 2011b). Internation-

al markets reacted immediately, and Portuguese government bonds skyrocketed by another 1.5 percentage points. In its reply, the government argued that the rating decision ignored the 'broad political consensus' in favour of resolute fiscal adjustment. It also noted that the agency disregarded a special income tax on Christmas allowances, which the Minister of Finance had announced in order to close emerging budget gaps (Financial Times, 2011m). The tax was introduced in the very first bill passed by the new government in parliament and was heavily criticised by both UGT and CGTP as violating the principle of social solidarity (Campos Lima, 2011c).

The introduction of this one-off tax increase was the first measure the government adopted in reaction to the deficit turning out to be higher than expected (EC, 2011f: 16). Initially, the fiscal part of the EAP consisted of two parts. The major part was based on implementing the 2011 budget, which was envisaged to cut the deficit by 5.3 percentage points. On top of that, the programme provided for additional measures amounting to 0.3 percentage points (EC, 2011e: 35). The fiscal adjustment strategy was planned to be mainly expenditure-based as spending cuts were supposed to contribute 3.7 per cent and revenue increases 2.0 per cent of GDP (IMF, 2011f: 11). The bulk of the latter was to be based on the increase of the standard VAT rate, which had already been implemented in January, and was calculated to generate additional revenues amounting to 0.8 per cent of GDP. Further revenue increases affected tax expenditures for corporations and households as well as the taxation of pensions and social transfers. The expenditure cuts predominately targeted the public sector. Here, cuts to the public sector wage bill accounted for a large part of consolidation, namely 0.9 per cent of GDP. The remainder would then come from reductions in immediate consumption and social transfers. SOEs were another important item on the troika's list as they entailed 'large fiscal risks' (EC, 2011e: 10).

PDS and CDS-PP highlighted the broad political consensus about the necessity of facing those fiscal risks, highlighting that 85 per cent of the elected MPs—including those of the Socialists—supported the programme (Government of Portugal, 2011b: 8). This impression was shared by the troika, at least in the early stages of the programme (Interview EC 10). During the negotiations, it prioritised safeguarding a ';broad consensus' (Interview EC; IMF, 2011f: 17). Later, it praised the 'cooperative attitude' shown by the Socialist opposition (EC, 2011f: 7). The government also was eager to signal its commitment to the programme by stating that it would put the EAP first before considering any measures 'whose implementation will prove impossible until fiscal sustainability is assured' (Government of Portugal, 2011b: 21). At the same time, it reiterated its pledge to go beyond the programme and promised to 'be more ambitious in carrying out the process of adjustment of the Portuguese economy' (Government of Portugal, 2011b: 21) as it argued that the Portuguese economy was at 'one of the most decisive crossroads in […] recent history' (Government of Portugal, 2011b: 11).

The government presented two important mainstays to base the Portuguese growth model on after the programme. It echoed the troika's demand to make important parts of the economy 'more market-oriented and less dependent on state intervention' (EC, 2011e: 27). The central argument was that it was necessary to 'overcome the culture of paternalism and dependency' (Government of Portugal, 2011b: 8-9)

and that cuts to state expenditures were going to be ‘a lever to improve productivity, increase growth potential and create jobs’ (Government of Portugal, 2011b: 12). The government did not only refer to PPPs and SOEs, about which troika argued that, in many of them, ‘the involvement of the state is economically not justified’ (EC, 2011e: 22). But it also intended to redirect the states resources ‘towards tradable goods and services and support for exports and the internationalisation of Portuguese companies’ (Government of Portugal, 2011b: 26). In contrast to the Irish case, however, this suggested ‘reversing the deindustrialisation of the country that has occurred in recent years’ (Government of Portugal, 2011b: 41), rather than improving services exports. Finally, it picked up on one of the troika’s main measures, namely fiscal devaluation, with a special focus on ‘the effect it can have on those producing tradable goods and services’ (Government of Portugal, 2011b: 28).

That is to say, the conservative government took office with a clearly liberal economic policy agenda and a strong emphasis on converting the country into an export-driven economy by reducing the role of the state. In doing so, it was constrained by a series of factors. On the one hand, it was clear that a growth strategy similar to Ireland’s was not feasible given the structure of the economy as well as the distribution of skills required for such an approach. Consequently, the government programme targeted rebuilding the existing industrial basis. Foreign direct investment was much less prominent than in Ireland and related mostly to the EU’s structural funds (Government of Portugal, 2011b: 43). Furthermore, the government was acutely aware of its dependence on its social partners if it wanted to implement far-reaching reforms. It therefore committed itself ‘to make every effort to reach a comprehensive social agreement with the social partners’ (Government of Portugal, 2011b: 31). Finally, the EAP and the government programme accounted for the fact that a much larger group of people were facing comparatively high economic risks. In fact, both documents stressed the necessity to protect ‘the most vulnerable segments of the population’ (EC, 2011e: 20; Government of Portugal, 2011b: 31).

The preparation of the 2012 budget was the new government’s first major measure. Before that, however, two important events took place. First, Portugal was able to get rid of the additional levy attached to the loans it received from the EU and maturities of the loans were extended. Here, Portugal profited from the groundwork laid by the Irish authorities and debt management agency as the Portuguese government had agreed with its Irish partners ‘that they should bring the topic up in the discussion’ (Interviews PT 02; 03). Second, in August the troika’s first review mission was due. The mission was crucial for the new government because it was keenly aware of the deterioration of its fiscal position. Shortly after taking office, it learned that the EAP’s assumptions were too optimistic, and that actual expenditures and deficits were much higher (Interview PT 01).

The review identified budgetary shortfalls amounting to 1.1 per cent of GDP. Tax revenues performed slightly lower than projected but the additional expenditure of around 0.9 per cent GDP completely threw the budget out of balance (IMF, 2011e: 8). Intermediate consumptions and public sector wages were the main drivers of the expenditure overruns as several measures included in the 2011 budget were not implemented yet. Moreover, spending on the compensation of public servants was higher than expected due

to a series of last-minute promotions in late 2010 (EC, 2011f: 16). This presented the government with what would be a constant challenge over the course of the programme as it had to identify additional measures to fill emerging fiscal gaps. This time, the government relied on a series of one-off measures that were exclusively revenue-increasing. It preponed the VAT rate increase on energy prices, introduced a one-off surcharge on the personal income tax, mapped out additional sales of concessions in the telecommunications sector, and transferred assets from the banking sector's pensions funds into the state's social security system (IMF, 2011e: 8). As a result, the troika 'concluded that fiscal consolidation remains on track' (EC, 2011f: 17) although both government and troika considered one-off measures to be 'unsatisfactory' (IMF, 2011e: 8). From the government's point of view, this was the beginning of 'a catch-up process because the initial starting point was incorrectly defined', which resulted in the necessity to implement even more measures than initially planned (Interview PT 01). The troika did not fully share this view and emphasised that it was necessary 'to base future consolidation on structural consolidation measures' (EC, 2011f: 17).

The budget kept the deficit target for 2012 at 4.5 per cent of GDP despite the adverse effects of the recent spending overruns. For 2012, they produced an additional gap of 0.6 per cent of GDP, which the government had to close in addition to the measures already provided for in the initial EAP. Furthermore, the troika demanded a 'much stronger and more balanced approach to adjustment' (IMF, 2011e: 9). The 2012 budget was scheduled to be adopted in parliament in November. In late August, the finance minister had unveiled the government's plans to implement the biggest spending cuts in recent history (Financial Times, 2011n). A first draft budget was presented to parliament in early October. It met strong opposition from the trade union movement. The two most controversial measures were the temporary abolishment of the Christmas allowances for public sector workers and pensioners earning more than €1,000 per month and the increase of the weekly working time by half an hour. Both trade union federations rejected the measures because they were 'not fair, nor balanced and they do not promote growth and employment' (Campos Lima, 2010f). CGTP and UGT demanded that the adjustment period for meeting the 3 per cent deficit target should be prolonged until 2016 or 2017 to avoid even harsher cuts. Furthermore, they announced a strike for 24 November when the budget was to be decided upon in parliament. UGT, which so far had taken a much more careful and pro-European approach than CGTP, now joined ranks with its competitor (Campos Lima, 2010f).

Ultimately, the 2012 budget introduced consolidation measures amounting to more than 6 per cent of GDP (IMF, 2011g: 48). Two-thirds of the adjustment effort were based on expenditure cuts, most prominently cuts to public sector wages and pensions as well as cost control operations in the health sector. On the revenue side, the VAT was increased for a large number of goods and services (EC, 2011g: 86-90). Under the shadow of the trade unions' 24-hour strike, the parliamentary debate took place. At the same time, Fitch also downgraded Portuguese sovereign debt. The Socialist Party publicly supported the strike, although it was expected not to vote against the budget. The budget was discussed controversially within the PS. António José Seguro, the Party's new secretary-general, was part of a faction that did not want to

vote against the budget given that the party had signed the initial EAP (Interview PT 07). He faced a strong group within the party that opposed the budget, arguing that the PSD was using 'the programme as an opportunity to impose a radical agenda and they are going to go way beyond what the troika said' (Interview PT 07). Ultimately, the PS abstained from the vote.

The parliamentary debate resulted in one important change. Initially, the government had planned to suspend Christmas allowances, that is the 13th and 14th monthly salary, for those earning more than €1,000 per month and to suspend one of those salaries for earners between €485 (the minimum wage) and €1,000. The government had been criticised before by the trade unions when it introduced a tax on Christmas allowances for all workers. The unions had argued against the measure because it taxed only labour and not corporations or capital income and demanded a more progressive and redistributive approach to fiscal policy (Campos Lima, 2011c). When it came to the 2012 budget, the government considered both points given the strong opposition in parliament and on the streets. The threshold for the suspension of both additional salaries increased to €1,100 and those earning between the minimum wage and €600 per month were exempt. This modification was compensated for by an increased tax rate on capital gains and investment income (EC, 2011g: 20).

When the 2012 budget was adopted, public finances had further worsened. Budgetary shortfalls had almost doubled in comparison to the first review and now were calculated to stand at 2.25 per cent of GDP (EC, 2011g: 18). Again, current as well as capital spending were the main drivers while the sales of concessions and real estate fell short of expectations (IMF, 2011g: 4). In order to still meet the deficit target for 2011, the government substantially increased the amount of assets transferred from the banking sector's pension funds to around 1.8 per cent of GDP (EC, 2011g: 85). It was clear, however, that this would not be a practicable approach for 2012 because large parts of the 2011 shortfalls would carry over into the next year. Initially, the EAP for 2012 anticipated adjustment measures amounting to 3 per cent of GDP. This amount now had doubled to around 6 per cent due to the extension of the financing gap identified at the outset of the programme (to 3.8 per cent of GDP), carry-overs from 2011 (1.3 percent), and the deterioration of macro-economic conditions (IMF, 2011g).

Irrespective of its efforts in late 2011, the Portuguese authorities had to deal with another rating downgrade, this time by Standard & Poor's in January 2012. This marked a motivational 'low point' for the prime minister and his team (Interview PT 01). Standard & Poor's now was the third major rating agencies that rated Portuguese government debt at 'junk' level. As a result of the downgrade, long-term Portuguese government bond spreads reached their peak and now stood at more than 12 per cent (ECB, 2021). The government publicly disagreed with the decision, arguing that the downgrade considered only the situation in the wider eurozone and not the effort of individual countries. It emphasised its consolidation efforts and pointed out that it was projected to achieve a deficit of around 4 per cent of GDP, that is, much lower than the EAP's target of 5.9 per cent (Financial Times, 2011j). It had achieved this exceptionally low deficit by further increasing the contribution made by the banks' pensions funds. This one-off measure now totalled 3.5 per cent of GDP (IMF, 2012h: 7).

However, the new year also brought good news for Portugal. First, it appeared that last year's expenditure overruns affected the fiscal position in 2012 to a lesser extent than initially feared. The government's emergency measures, which it had introduced in the second half of 2011, had significantly reduced primary expenditure overruns and corresponding tax hikes carried over to the next year (EC, 2011h: 18). Second, and more importantly, on 18 January the government agreed with the social partners on a new social pact. For the government, 'that was a surprise' (Interview PT 01) given the strong and united resistance by CGTP and UGT against the 2012 budget only a few weeks before. The previous November, trade unions had taken issue with the government's plans to increasing the weakly working time. Nonetheless, the government continued working on the respective bill and presented it to parliament in December. Except for CIP, the employers' associations were indifferent towards the measures. For the unions, however, working time was an issue they were not ready to compromise on. Whereas CGTP called for a nationwide demonstration, UGT stayed open to negotiations but argued that the draft bill rendered it impossible to agree on any form of social pact (Campos Lima, 2012b).

The conflict with the trade unions and social pact had important implications for the EAP. On the one hand, the government's proposal to the trade unions did not only contain structural reforms, but also provisions on unemployment benefits that were part of the EAP's fiscal adjustment strategy. On the other hand, the government was eager to find an agreement with UGT, at the very least, as this would also set the tone for future fiscal reforms. The government knew that it would be challenging to push through reforms against a united trade union movement and therefore it 'wanted to have the social partners on board' (Interview EC 07) even if 'that meant that we did not go as far as we wanted for example in the labour law reform' (Interview PT 01). After protracted negotiations, the pact was agreed upon by all social partners except for CGTP, which had left final meeting stating that 'the social partners' compromise was unacceptable and would damage Portugal' (Campos Lima, 2012c). UGT, by contrast, wanted to clearly signal that the unions were willing to engage in social dialogue and contribute to necessary reforms (Interview PT 10). Its main objective was to contain some of the measures included in the EAP, to represent those facing high economic risks, and to 'counterbalance the negative impact' of the programme (Interview PT 10). Not all trade unions agreed with this course. Subsequently, some of them joined CGTP and its more antagonistic strategy (Magone, 2013: 193). Again, the employers did not express enthusiasm about the agreement although the troika on several occasions urged them to be more outspoken about their policy preferences (Interview EC 01). From the government's perspective some influential businesses in the non-tradable sectors that profited from the status quo did not want 'to shake up the situation too much' (Interview PT 02).

Regarding a future growth model, the social pact consequently included only careful declarations. While it laid out a state-led strategy to promote the export capacities of Portuguese businesses and to attract FDI, it also adopted measures meant to raise 'awareness among consumers, companies and public authorities regarding the quality of domestic products' and protect the economy from 'unfair trade competition' (CES, 2012: 13). Finally, 'key' to the agreement was to include measures 'that mitigate the social impact of

the crisis' (CES, 2012: 4). That is, irrespective of its liberal reform agenda and enormous external pressure, the government already faced strong domestic constraints at an early stage of the programme. The amount of fiscal adjustment it had carried out was enormous and focused mainly on the expenditure side thus far. What is more, several measures targeted the public sector, which the troika viewed as being overly privileged. Still, the government was aware of the limits of its ambitions to reconstruct the Portuguese economy. In contrast to the Irish case, these limits were not set by a well-functioning growth model that implied an adjustment strategy supporting the economy's advanced sectors. Rather, they resulted from strong domestic interest groups and coalitions. The trade union movement was strong enough to 'force [the] government back to the table' (Campos Lima, 2012b) to negotiate the next policy steps' terms. The protest against the EAP's initial provisions had shown the potentially strong opposition the government would have to overcome. Since it could not count on the employers to provide significant support for its undertakings, it had to consider the unions' preferences.

An immediate consequence of UGT signature to the pact was that it would refrain from further industrial action. On 22 March, another general strike took place, the second since the new government had taken office. In contrast to November, however, only CGTP officially issued a call for participation (Campos Lima, 2013d). UGT abstained from supporting the protests, arguing that 'another strike was not the best way to fight rising unemployment' (Financial Times, 2012m). The result was a much lower participation rate than a few months earlier. Also, the strike almost exclusively affected the public sector. The government could feel endorsed in its approach to economic and fiscal policy-making by UGT's reluctant but continued willingness to sit at the negotiating table. International pressure also seemed to slowly wane as Portugal successfully sold a batch of short-term government bonds in February. Long-term bond spreads started to recover and fell by more than one percentage point within one month after having reached their peak in January (ECB, 2021). The bond sale was another opportunity to distance Portugal from Greece. The minister for economic affairs stated that the country was pressing ahead with its reforms faster than any other crisis country (Financial Times, 2012k). At the same time, the governments faced demands to extend the programme. PS, as the main opposition party, pushed for a longer programme duration to allow for a smoother fiscal adjustment process (Interview EC 14). For the same reason, it argued for an increase in the EAP's size (Interview EC 14). The latter demand was echoed by CGTP as well as CIP. Both intended to cushion the effect of the adjustment process on the economy. Here CIP's main interest was to improve financing conditions for Portuguese companies, making a case for €30billion 'in rescue funds' (Financial Times, 2012i). However, the government did not consider an extension. The troika also rejected any programme extension as it needed a working programme given the weak performance of the Greek EAP (Interview EC 14).

In the context of the troika's third review mission in February, the government had announced the adoption of a supplementary budget 'to regularize a number of offsetting revenue and expenditure items' (IMF, 2012h: 17). It mainly dealt with the transfer of the banks' pension fund and a series of PPPs. Additionally, it accounted for the deterioration of macro-economic conditions and the labour market and the potential

effects on economic risks. Consequently, the supplementary budget introduced 'some increase in social transfers on account of adverse labour market developments' (EC, 2012e: 14). The troika accepted this but warned against potential interferences with budget execution since expenditures increased due to a spending surge on unemployment benefits in the first quarter of 2012 (EC, 2012e: 14). Still, the troika's fourth review mission, which took place in late May and early June, was the first one without additional measures. It found that meeting the deficit target for 2012 was feasible and that the budget execution was on track. As a result, no new measure were discussed (IMF, 2012g: 12). The government's endeavour to rebuild the Portuguese growth model also seemed to progress as export growth gathered pace. This had two important consequences for both the economy and fiscal policy. On the one hand, the economy's non-tradable sectors that had suffered from a decrease in domestic demand were more labour-intensive than their exposed counterparts. This resulted in large employment losses especially in construction, wholesale, and retail trade (EC, 2012e: 8). On the other hand, domestic demand was (intentionally) taxed higher than exporting activities. The economy's rebalancing towards the latter therefore negatively affected state revenues (IMF, 2012g: 6).

Despite these positive developments, the government suffered a substantial setback mid-year. The highly controversial cuts of the 13th and 14th monthly of public sector workers had been referred to the Constitutional Court to review if the measure was in accordance with the constitutions. On July 5, the Court vetoed the measure as unconstitutional on the ground that it violated the fundamental principal of equality. This was due to the fact that it only affected public sector workers (Fabbrini, 2014: 101). The measure had been a cornerstone of the 2012 budget because cuts to the public sector wage bill were supposed to contribute almost half of all expenditure cuts (EC, 2011h: 83-86). In its ruling, however, the Constitutional Court acknowledged the country's exceptional circumstances, notably the EAP's conditionality (Fabbrini, 2014: 100). Since the Court also acknowledged that fiscal adjustment was in the public's interest, as well as the state's dependency on financial assistance, it suspended the effect of its ruling for the current year (Fabbrini, 2014: 101). That meant the government did not have to find an immediate substation for the cuts before 2013.

The negotiations of the 2013 budget would therefore take place under even closer public and international scrutiny than before. Portuguese bond spreads remained much higher than Irish although both countries were profiting from Mario Draghi's statement that the ECB was 'to do whatever it takes' (Draghi, 2012). Following the Court ruling, the government tried to win the Socialists' parliamentary support for the upcoming budget since it was obvious that the far-left opposition would vote against it (Magone, 2013: 191). But this time the PS was not willing to back the government's fiscal adjustment strategy. It argued that PSD and CDS-PP contradicted the Socialist's approach to 'minimise the impact on our country' and were 'not executing the programme that we negotiated' (Interview PT 07).

Two months after the court decision, the EAP underwent another important turning point. In early September, the government had unveiled its final 'fiscal devaluation' plans. The troika considered the measures ;a key element of a strategy to boost competitiveness' (EC, 2011g: 19). The EAP therefore fore-

saw an internal devaluation that would reduce the social security contributions paid by employers. In order to keep the reduction budget-neutral, it was planned to be compensated for by permanent expenditure cuts or other fiscal policy measures aimed to reduce domestic consumption (EC, 2011e: 20). The troika had pushed for the fiscal devaluation strategy to be implemented promptly. It argued that the EAP's depended on a more open economy and improved international competitiveness (IMF, 2011e: 17). However, it also made a case for the measure to be carefully designed since the cuts risked 'being absorbed in profit margins' due to the lack of competition in some domestic sectors of the economy (IMF, 2011e: 17). The government's initial idea, to target companies that generated employment, was cautioned against by the troika as it argued that it was 'not obvious that employment promotion is a good proxy for increased efficiency' (IMF, 2011e: 14). Initially, the 2012 budget was supposed to make the first step towards fiscal devaluation. However, the government shied away from it, although this implied further efforts 'to remove constraints to export-driven growth' (IMF, 2011g: 12). Given the enormous amount of fiscal consolidation already planned for 2012, it viewed additional changes to the social security system as too risky politically and with regard to budget execution (EC, 2011h: 22; IMF, 2011g: 9).

These risks materialised when the government eventually decided to act. Without consulting its social partners, in September the state announced plans to reduce the social security contributions paid by employers and companies by 5 percentage points, while at the same time increasing them for workers by 7 percentage points (Campos Lima, 2012a). In the end, both would contribute the same share of the wage bills, that is 18 per cent (Financial Times, 2012h). This proposition was met with harsh criticism by the opposition but also by the social partners (Interview EC 07). In the wider public, the approach left the impression that 'the government intends to cut our wages and give our money to the capitalists' (Interview PT 05). This point of criticism was taken up by CGTP, which again called for a general strike. This time, UGT did not object to CGTP's proposal, but argued that a strike was worth considering because the government's proposition would undermine the recent social pact (Campos Lima, 2012a). UGT's strategy was twofold in that it was ready to join CGTP but also lobbied the government and highlighted that it was important to continue social partnership (Interview PT 10). Then, on 15 September, Portugal witnessed one of the biggest demonstrations in its democratic history. More than 500,000 people took the streets in Lisbon alone (Interview PT 02; Campos Lima, 2012a). It was surprising for both government and troika that most employers' associations participated in the protest. This was especially disappointing for the government, which had banked on the employers' support (Interviews PT 02; EC 08). CIP was the only employer group openly in favour of the measure, although it demanded that the changes should apply solely to companies located in the traded sectors (Interview PT 09). On the one hand, the employers were afraid of the potential repercussions for industrial peace (Interview EC 08). On the other hand, they brought forward the argument that the reduction in the workers' disposable income would have negative effects on domestic demand and thus on economic recovery (Campos Lima, 2012a). The latter point was expressed most emphatically by CCP and its clientele located in retail and other sheltered sectors (Interview PT 07). Even PSD's coalition partner used the opportunity to sharpen its political profile and came out against the fiscal devaluation proposal (Moury and Freire, 2013: 44). Lastly, the PS grabbed the chance

to revoke its implicit agreement with the government and to irretrievably distance itself from the EAP. What is more, the PS publicly announced that it would vote against the 2013 budget in November (Campos Lima, 2012a).

The government quickly gave in and withdrew the measure without presenting an alternative. In addition to that, it scheduled a meeting with the social partners for the following week (Financial Times, 2012l). As it approached the adoption of the 2013 budget, the government faced a series of challenges. The controversy revolving around fiscal devaluation had shattered the already shaky political consensus regarding the EAP. Furthermore, the government was forced to find replacements not only for the planned changes to the social security contributions. but also for the cuts vetoed by the Constitutional Court. Finally, the fiscal context further worsened as domestic demand contracted faster than expected. This again resulted in significant revenue shortfalls (EC, 2012d: 4).

The fifth troika review was due in October and was supposed to lay the groundwork for the 2013 budget. The review mission's central finding was linked to the execution of the 2012 budget. On the expenditure side, the government had performed well. Despite increased payments on unemployment benefits, overall expenditures developed as planned (EC, 2012d: 4). The revenue side, however, had developed much worse than expected. In the context of the fourth review, the troika had already pointed out potential risks to fiscal revenue, which now had 'fully materialized' (IMF, 2012f: 7). The shortfalls emerged because intakes from direct taxes (that is, both corporate and personal income taxes), indirect taxes, and social security contributions all fell short of expectations. In total, the deficit was projected to be 1.8 per centage points higher than the target of 4.5 per cent of GDP (EC, 2012d: 8). One-off proceeds from the sale of airport concessions, some changes to EU structural funds, and lower interest payments chipped away 1 percentage point from this amount (IMF, 2012f: 59). Finally, the government committed to cut the 2012 deficit by another 0.3 per cent by additional revenue-increasing measures. It planned to increase taxes on investment income and high value properties as well as to prepone a set of minor changes to social benefits (IMF, 2012f: 59; EC, 2012d: 54).

What is more, the government convinced the troika institutions that it needed more time to meet the programme targets. Therefore, deficit targets for 2012 to 2014 were revised upwards (see Table 6.2.). The government's main argument for the revision was that 'the initial projections on many of the macro variables proved to be completely wrong' (Interview PT 02). Furthermore, 'the economy did not react as was expected' to the amount of fiscal consolidation and the measures implemented (Interviews PT 02; PT 01). The troika agreed that the economy rebalanced 'at a faster-than-expected pace' (EC, 2012d: 4). Unemployment rose faster in sectors that depended on domestic demand and public revenues fell accordingly (Interviews PT 05; PT 06; EC, 2012d: 4). This point was echoed by the employers. Even CIP, which generally supported the programme and the reform process associated with it, argued that 'budget consolidation went too far in terms of austerity and that compromised economic growth' (Interview PT 09). The Portuguese authorities also identified external factors that had worsened the macro-economic context,

namely the negative outlook for the rest of the eurozone. From this point of view, the economic weakness of Portugal's main trading parties weighted heavily on the economy's growth prospects (Interview PT 06).

Table 6.2.: Revised fiscal targets and consolidation by year (fifth review)

	2011	2012	2013	2014
Fiscal targets				
Economic Adjustment Programme	*-5.9*	*-4.5*	*-3.0*	*-2.3*
Fifth review	(-4.3)	-5.0	-4.5	-2.5
Fiscal consolidation				
Economic Adjustment Programme	*5.7*	*3.0*	*1.9*	*0.0*
Fifth review	4.3	5.7	2.9	1.8

Notes: Per cent of GDP.
Source: (EC, 2012d: 21).

In any case, the troika at least partly agreed with the Portuguese government. It did not only revise the EAP's deficit targets but also announced that its forecasts would use 'more conservative macroeconomic assumptions' (IMF, 2012f: 5). On the other hand, the troika was aware of the collapsing consensus between government and the Socialist opposition and feared that the 'window of opportunity for reforms' was closing (Interview IMF 06). This fear seemed to be justified, especially considering the fate of the planned fiscal devaluation. The retraction of this measure was mainly a success for domestically-oriented interest groups, which were profiting from a lack of competition in sheltered sectors (Interviews EC 01; EC 11). On the side of capital, these were mostly the larger and well-established companies that 'represented the existing dominant sectors' (Interviews PT 01; EC 08). The holds true for the trade union confederations which, aside from the public sector, had their strongholds in the same sectors. This opened up the possibility of a strong cross-class coalition between those dominant organisations. It was not necessary for the coalition partners to find a broad agreement. But on several occasions—such as the planned changes to the social security contributions—their preferences were sufficiently similar enough for them to form a temporary coalition. Moreover, the trade unions were in a politically much more powerful position than in Ireland, which made industrial peace a much more valuable good in Portugal (Interviews PT 07; PT 10; EC 14). The alliances between employers and workers were formed not only when it came to fiscal issues. The alliances extended also to the realm of structural reforms, for instance the liberalisation of collective bargaining, which was opposed not only by the trade unions but also by several important employers' associations (Interview PT 01; for a comprehensive analysis, see Bulfone and Afonso, 2020). Furthermore, companies located in the exporting, which arguably would have profited most from the reform, did not have the political clout to substantially influence the government's decision-making process as 'they did not have a voice' (Interview PT 01). Although the preferences of those actor groups were relatively clear and they also expressed them vis-à-vis the troika, they would not do so publicly, and their

preferences were not able to find their way into the political discourse (Interviews PT 02; EC 01; EC 08; EC 14; IMF 06).

These power relations would also have implications for the design and especially the implementation of the 2013 budget. Although the deficit target for 2013 had been revised upwards, the amount of fiscal consolidation measures to be implemented was still higher than initially planned. Going forward, the government needed to find adjustment measures that the Constitutional Court and economic actor groups, which had proven their ability to influence the course of the EAP, would accept. Even after the fiscal devaluation plan was scrapped, the latter continued to influence economic policy-making. When the government unveiled that it would replace the measure with a series of revenue increases, the trade union movement concretised the announcement it had made earlier and called for a general strike on 14 November. Again, the call was led by CGTP, but this time it was joined by a number of UGT's affiliates (Campos Lima, 2013d). Officially, however, UGT as an overall confederation did not participate in the strike (Magone, 2013: 193).

It was foreseeable that the trade unions would not only protest the specific revenue increases introduced earlier but the 2013 budget and the continuation of the government's adjustment strategy more generally. Budgetary discussions between the government and the troika had taken place already during the fifth review mission in late August and early September. In the context of the mission, the Portuguese government presented an initial list of the adjustment measures it intended to include in the 2013 budget. In contrast to the year before and the initial plans, the list exhibited a change in the government's adjustment strategy. Revenue measures now accounted for more than 70 per cent of total consolidation (EC, 2012d: 18). The key reason for this shift in fiscal composition was the government's reaction to the constitutional veto a few months earlier. To accommodate the Court, the government had decided to reinstate one of the two monthly salaries it had cut. The additional expenditures resulting from the reinstatement and the abolished change to the social security contributions were to be compensated for by revising the personal income tax system. The revision was projected to raise revenues of around 1.25 per cent of GDP (EC, 2012d: 20). The reform reduced the number of tax brackets and introduced a surcharge of 3.5 per cent on taxable income above the minimum age and a so-called 'solidarity surcharge', which would progressively apply to taxable income above €80,000 (EC, 2012f: 17).

In their reviews, both troika organisations warned against the government overly relying on revenue increases. The IMF, for example, advocated curtailing spending on social transfers instead. However, given strong domestic opposition, the Portuguese authorities 'found it challenging to identify more expenditure cuts at this state' (IMF, 2012f: 18). The EC was equally critical of the government's changing adjustment strategy. It pointed out the risk that the expected revenues could not materialise due to the impact of the reform on growth and the potential contraction of the tax base. The EC, therefore, called on the Portuguese government to prepare 'a set of contingency measures, predominantly on the expenditure side' (EC, 2012d: 20) in case those risks were to come to pass and to 'ensure a medium-term growth-friendly fiscal adjustment tilted towards the expenditure side' (EC, 2012d: 55).

Contrary to the troika's demands, the budget law eventually adopted by parliament in November was tilted to the revenue side even more. Expenditure cuts were now expected to contribute only 20 per cent to total consolidation (IMF, 2013a: 7; EC, 2012f: 18). Still, the troika institutions stated that the budget was consistent with the EAP's provisions because it continued to consolidate the budget 'with a structural primary adjustment close to 2 percentage points of potential GDP' (IMF, 2013a: 7). One condition for the troika's approval was the government's pledge to proceed with the comprehensive expenditure review it had initiated in summer to identify further spending cuts (EC, 2012d: 20-21). The review's results were scheduled for discussion during the seventh review mission. The Portuguese government again highlighted its intention to transform the state's role in the economy but also the enormous political pressure it faced. Irrespective of its agenda, it emphasised the necessity to consult social partners and the opposition in parliament 'to ensure that this review has the broad-based support to reform the role and functions of the Portuguese state' (IMF, 2013a: 26).

The budget affected three major expenditure items. Social spending, as well as the health sector, SOEs, and PPPs, were to be rationalised. Moreover, the budget aimed at limiting spending on public sector wages by reducing the number of public servants. This would mainly be achieved by not replacing retired workers and by reducing the number of civil servants with fixed term contracts (Magone, 2013: 192). The core group of public sector workers, that is CGTP's main constituency, 'had some cuts on income, but they were never dismissed' (Interview PT 02). On the revenue side, the budget did not only provide for the changes to the personal income tax system mentioned above. It also lowered the number of corporate tax exemptions and increased some excise taxes. Finally, it broadened the tax base for social security contributions (EC, 2012f: 18).

Although the government had abolished its fiscal devaluation plan and the 2013 budget introduced mostly progressive measures (EC, 2016: 13), it faced continuing domestic opposition. Again, the trade unions were most vocal. Reacting to the draft budget for 2013, both trade union confederations heavily criticised government and troika. Both argued for an extension of the adjustment period, whereby CGTP also demanded a renegotiation of Portuguese public debt at the international level (UGT, 2012: 5; CGTP, 2012: 2). In the eyes of CGTP, the troika—and the EC in particular—were responsible for the dire state of the Portuguese economy (CGTP, 2012: 1), whereas UGT viewed the government as being even more neoliberal than the troika itself (UGT, 2012: 3). With regard to the budget's revenue side, both organisations found it 'completely unacceptable' that personal income tax increases would be much higher than corporate tax increase (UGT, 2012: 2; CGTP, 2012: 6). Furthermore, both insisted on the government to fully reinstate the public sector salaries and argued that several provisions of the budget were unconstitutional. Consequently, UGT did not only call upon the opposition to challenge the government in parliament but it also announced that it would request the President of the Republic to refer the budget law to the Constitutional Court in order to review its constitutionality (UGT, 2012: 3).

Finally, UGT announced that it generally supported any form of industrial action or protest that would take place on 24 November, but that it would not join CGTP's call for a general strike (UGT, 2012: 6).

Both unions criticised that the government's constant austerity affected mostly poorer and middle-class workers in that it significantly curtailed their disposable income. But beyond that, CGTP showed a slightly stronger emphasis on the domestic economy than UGT as it also called into question the EAP's focus on export-led growth. On the one hand, CGTP rejected the government's and the EAP's assumption that the state weighted excessively on the economy (CGTP, 2012: 2). On the other hand, it made clear that it mostly represented sheltered sectors when it argued that the government's attempts to stimulate the economy overly benefitted (exporting) companies. In its words, they were 'supporting the cash flow of businesses but […] insufficient in the face of falling domestic demand' (CGTP, 2012: 4-5). At this juncture, the orientation of the trade unions towards the domestic economy, the political weakness of the exporting industries, and the lack of a functioning trade-led growth model shows that the development of any form of sectoral, cross-class coalition in Portugal was very unlikely. This stands in contrast to the Irish case, where the dominance of the exposed sectors was a vital impulse for such a coalition.

Despite the trade union protests, the government ignored most of their points of criticism. Indeed, it was under significant external pressure by the troika as well as international financial market actors. The parliamentary vote on the budget was due in late November. In the weeks before, government bond spreads slowly increased again after they had been in decline for almost one year. Markets obviously drove the government to take a decisive step towards fiscal consolidation. Although it had revised the deficit targets for Portugal, the troika also increased pressure during its meeting with the authorities only a few days before the vote. In its review, it demanded further contingency measures to counteract carry-over effects (IMF, 2013a: 7). In the eyes of the troika, this had become more urgent because the additional measures that were agreed upon during the fifth review mission had not been fully implemented yet (EC, 2012f: 17). Ultimately, the 2012 deficit target was likely to be missed by about 0.25 per cent of GDP even though the Portuguese government was 'adamant this would be offset through tighter spending execution' (IMF, 2013a: 7).

The budget law for 2013 was adopted in parliament on 27 November. The bill was supported solely by the two governing parties. All other parties, including the Socialists, voted against it. The president signed the law one month later but immediately referred it to the Court for constitutional review. The president's main concern related to the wage cuts in the public sector as well as the effect of the 'solidarity tax' on pensions (Financial Times, 2013d). His initiative was supported by the Socialist Party. The opposition parties of the far-left also asked the Court to review the budget law but challenged a broader range of measures, most prominently the reform of the personal income tax system (Campos Lima, 2013b). International financial market actors, however, deemed the budget to be sufficient and slowly released their pressure. Bond spreads fell by more than two percentage in the two months after the bill was passed. The sentiments of the rating agencies also improved as 'they moved towards upgrades at the time [and] the reports they were publishing on Portugal were gradually getting better' (Interview PT 03). As a result, the country was able to tap the long-term debt market for the first time since it had requested financial assis-

tance in 2011. Demand for the bonds was stronger than anticipated and the government considered this a turning point with regard a full return to private funding (Financial Times, 2013j).

The festive mood did not last long. In late February, the troika arrived in Lisbon to conduct its seventh quarterly review mission. The three institutions eventually returned to Portugal in April and again in May. A series of events had delayed the publication of the seventh review until June. During the troika's first visit, it became apparent that the macroeconomic outlook had worsened significantly because the labour market as well as economic activity contracted much sharper than expected (EC, 2013e: 11). Together with a set of one-off factors resulting accounting changes, this resulted in a deficit of 6.4 per cent of GDP, that is 1.4 above target (EC, 2013e: 11). Still, the troika institutions argued that fiscal consolidation was 'broadly on track' since the underlying deficit for 2012 stood at 4.9 per cent of GD without the one-off factors (EC, 2013g). However, it became clear that the ailing Portuguese economy would be too much of a drag on fiscal adjustment. The troika therefore again allowed the EAP's deficit targets to be revised upwards. For 2013, the target was increased by one percentage point to -5.5 per cent of GDP and the deadline for meeting the SGP's threshold was postponed by one year to 2015.

Meeting those targets was hampered by the Constitutional Court's veto on several expenditure measures of the 2013 budget on 5 April. Although it accepted most measures it revised, its decision still resulted in a fiscal gap amounting to €1.3 billion or 0.8 per cent of GDP (IMF, 2013f: 69). Most importantly, it confirmed its veto against the cuts to the Christmas allowances of public sector workers because it did not consider the reinstatement of one of the two extra salaries to be sufficient. This time, however, its decision had an immediate effect, despite the programme. The Court's main argument was that the cuts 'failed to comply with the principle of equality as demanding a proportional sharing of the burden of the public charges' (Fabbrini, 2014: 102). Furthermore, it dismissed the government's plan to reduce illness and unemployment benefits as 'violating the minimal protection of social rights enshrined in the Constitution' (Fabbrini, 2014: 102).

The Court assigned the government two difficult tasks. First, it had to find replacements for the rejected measures. Second, it became clear that the government would need a strategy to avoid—or at least deal with—further Court decisions (Interviews PT 12; EC 14). First of all, the government had to fend off calls by the opposition and the trade unions for the prime minister's resignation, early elections and a renegotiation of the EAP. The government was helped by the president who argued that the governing coalition had the backing that was necessary to 'fulfil its democratic mandate' (Financial Times, 2010f). After a few days of deliberation, Prime Minister Coelho appointed Miguel Maduro to serve as 'Joint Minister of Government and Regional Development' (Magone, 2014b: 257). Besides being responsible for the EU's structural funds, he was also in charge of understanding the Court's decision and reviewing the constitutionality of new adjustment measures. Maduro's work as Advocate General at the EU's Court of Justice qualified him for the job. He would work with the troika's mission teams as 'it was very hard for anybody including in Portugal to know how the court would rule' (Interview IMF 06). The Court's praxis not to hold any hearings before taking its decision made it even more complicated. That is, the government

did not have any possibility to directly communicate the rationale of its measures to the Court but in writing (Interview PT 01). The troika obviously faced the same constraint, however, its mission teams also 'never felt it was right for the technical people like us to be addressing the supreme body of the member state' (Interview EC 14). The troika's interaction with the court was therefore mediated by the government (Interview EC 14).

For the government, the vetoes suggested a difficult political dynamic. Now, it would have to find a series of new measures, which was politically costly 'in terms of opinion polls and because we were doing something which was harsh. […] but in the minds of the people, that new measure was on top of the other measure' (Interview PT 01). In the eyes of the troika, this resulted in two conflicting reactions by the Portuguese government. On the one hand, the government was anxious to avoid further vetoes by the court as it knew that this would negatively affect its international reputation and, thus, its return to private funding (Interview EC 08). On the other hand, it would frequently cite the danger of a constitutional veto when negotiating politically controversial measures with the troika (Interview EC 08).

Soon after the verdict in April, Portugal's prime minister began to publicly contemplate a constitutional revision to enable the cuts and to 'slim down the state' (The Economist, 2013). As a result of the revolutionary struggle during Portugal's democratisation, the constitution defined the country 'as a state engaged in constructing socialism' (Fishman, 2011: 247). The court then based its decisions on very general principles within this left-leaning constitution (Interview EC 08). However, this also meant that the Court's verdicts were highly politicised in the wider public and connected directly to the country's democratisation process (Interview IMF 06). Even if the troika may have supported such an attempt to change the constitution, it was reluctant 'to challenge the constitution' (Interview EC 14) and it rather focused on working 'within what was the current state of play' (Interview IMF 06). Ultimately, the government decided against a constitutional change. To obtain the necessary majority in parliament, it would have needed the support of the Socialist opposition. However, it was clear the PS was not willing to grant its consent. Furthermore, it considered bringing regulations at the European level into play. This mainly concerned the recently adopted fiscal compact. The IMF's argument was that 'in Portuguese law it says the European commitments trump domestic ones in the legal hierarchy' (Interviews IMF 06; PT 01). This would then imply that European regulations constitute a budgetary constraint and that the Court would have to be 'mindful of our European commitment' (Interviews PT 12; EC 14). Legally, this was a 'grey area' because it previously had not been thought through to the end. Thus, the government was ultimately unwilling to test the waters (Interview PT 01). This also was the result of the political situation on the domestic level. Facing increasing opposition in parliament, as well as by Portugal's strong trade union movement, it would have been politically very costly to challenge the Constitutional Court.

6.3.3. Phase three: A government in crisis faces mounting opposition

A worsened macroeconomic outlook the court veto derailed the seventh programme review. The mission teams sent by the troika and the government concluded their final discussions in May and the official review documents were published in early June. Over the course of the negotiations, the Portuguese government had to solve a series of problems and faced mounting domestic opposition.

Only a few days after the Court's veto, the troika increased its pressure on the government to substitute the cuts with alternative measures. On 12 April, the Eurogroup and the ECOFIN Council convened in Dublin for informal meetings to discuss the progress of the EAPs for Ireland and Portugal. The most important decision taken that day concerned extending EU loan maturities by seven years. At the same time, the chiefs of government also made clear that it was 'crucial that both Ireland and Portugal continue along the path of determined programme implementation' (Rehn, 2013). Portuguese bond spreads slightly increased in the aftermath of the Court's verdict, and the government was still dependent on the troika's funding as it was only slowly regaining access to private bond markets. Two days later, the troika's mission team met with the Portuguese authorities for further negotiations. The troika internally voiced doubts about Portugal's debt profile, especially its financing needs in the immediate aftermath of the planned programme exit. In a leaked paper, the troika institutions pointed out 'that, unlike Ireland, Portugal has yet to re-establish a proven track record with the financial markets' (Financial Times, 2013c).

Parallel to these negotiations, the trade union movement announced another round of protests for May 1. On the eve of that day, the government announced how it planned to proceed with fiscal consolidation in the final programme year. The finance minister made a strong case for an expenditure-based adjustment strategy, especially in view of replacing the measures vetoed by the Constitutional Court. Referring to the 'enormous' tax hikes adopted in the 2013 budget, he explicitly excluded further revenue increases and argued that 'the state cannot be any bigger than citizens are prepared to pay for' (Financial Times, 2013g). What is more, the government announced that it wanted to continue with its contractionary fiscal policy until 2016 to accommodate international markets and to counteract the troika's concerns.

The announcement was met with country-wide protests on Labour Day. Although they did not protest jointly, both UGT and CGTP voiced their opposition to the government's plans. With regard to fiscal policy, the even more moderate UGT stated that it 'would reject any cuts that affected wages, pensions or public sector jobs' (Financial Times, 2013f). Thus, the protests illustrated the clear contradiction between the government's intention to reduce the role of the state in the economy and the trade unions class-based demands for higher public expenditures. Furthermore, the demands made by the unions were an expression of the preferences of their public sector constituency.

Later that month, the government further specified the expenditure cuts it planned for the coming year. They notably targeted civil servants. The convergence between private and public sector was one of the cornerstones of the programme. Working hours in the latter were therefore planned to be increased from 35 to 40 hours. The same applied to the calculation of public sector pensions, which were also harmonised

with their private sector counterparts (Campos Lima, 2013c). Additional measures included the reduction of civil service employment and remuneration, as well as the introduction of a requalification scheme that would involve incremental wage cuts (EC, 2013e: 18). Finally, it was unveiled that the statutory retirement age would be increased by one year (Campos Lima, 2013c). Since the new measures involved large-scale changes to working conditions in the private and the public sector, the government attempted to enter conversations with the trade unions. However, given that the prime minister made a case for the unavoidability of permanent reductions of public sector wages, pensions, and employment numbers, an agreement was very unlikely. Indeed, the CGTP stated point-blank that 'this brutal austerity package is totally unacceptable' (Financial Times, 2013h).

Independent of the discussions with the social partners, in late May the government adopted a supplementary budget for 2013 and 2014 to close the fiscal gap that resulted from the Court's veto. The budget included across-the-board cuts in line ministries, revised changes to illness and unemployment benefits, and 'reprogrammed' European structural funds (IMF, 2013f). Further reforms would be implemented only after the consultation process with the social partners showed results and would mainly apply to the year 2014. That is, adjustment in 2013 was mainly revenue-based, whereas the ratio between tax hikes and expenditure cuts was envisaged to be more balanced in 2014 (EC, 2013f: 17). Given the incompatibility between the preferences of the social partners and the government, however, the troika highlighted the 'potential political and legal risks of the process' (EC, 2013e: 20).

Soon, these risks materialised. On 27 June the fourth general strike during the programme took place. CGTP and UGT joined forces this time and organised the strike together (Campos Lima, 2013a). The strike again was mainly sustained mainly by the two trade union confederations' public sector membership (Reuters, 2013). This time, however, the employers to some extent endorsed the unions' demands. While they did not partake in any industrial action, a leading figure in CIP stated that 'workers have cause to be indignant' (Financial Times, 2013m). What is more, a few days before the strike, the four leading employers' associations had published a joint report that criticised the government 'for high unemployment and sharp falls in investment and production' (Financial Times, 2013m).

The court decisions did not only directly affect public finances but also had some ramifications for government stability. Cracks emerged between CDS-PP's leader Paolo Portas and the then Minister of Finance Gaspar. Eventually, the latter resigned, the government was reshuffled, and the eighth review delayed until November. Over the course of the programme, the finance minister had been a prominent spokesperson of the government in terms of its fiscal adjustment strategy and the necessity for harsh austerity measures in general. Despite the government's difficulties to push through those measures, the minister's resignation on 1 July still came as a surprise. Officially resigning for private reasons, Gaspar cited the dire state of the economy and the sluggishness of the adjustment process as causing his decision in a letter to the prime minister (Magone, 2014c: 354-355). The government was in danger of breaking apart when Foreign Minister Paolo Portas announced his resignation on the following day. Portas stated that he resigned because he disagreed with the prime minister's promotion of Maria Luís Albuquerque as the next

finance minister (Interview PT 01). Albuquerque had worked as state secretary in the finance ministry before and was expected share the fiscal policy stance of her predecessor and the troika therefore welcomed her promotion (Interviews PT 01; EC 06; EC 14). Passos Coelho's promise to stay in office and to continue implementing the EAP, and his refusal to accept Portas' resignation were not enough to calm financial markets. Within 24 hours, long-term government bond yields shot up by almost 2 percentage points (Financial Times, 2013k). In the end, the prime minister was able to manage the crisis and keep the coalition together. Maria Luís Albuquerque would still be promoted, and Paolo Portas would remain foreign minister. More importantly, he also become responsible for the negotiations with the troika. Although his preferences were less well aligned with the troika's, the prime minister's plan was that this would make it 'more difficult for our coalition partner to distance itself from the things that were being decided' (Interview PT 12).

In the eyes of several government members, these changes implied a newly found drive to follow through with the final year of programme implementation (Interviews PT 01; PT 02). This conviction, however, was shared neither by international financial market actors nor by the troika (Interviews EC 08; EC 14). After the sentiments of the former had slightly improved at the beginning of the year, their outlook on Portugal's debt position worsened again amidst the government crisis and its aftermath (Interview PT 03). On the domestic level, President Cavaco Silva tried to moderate between government and opposition. External observers had expected him to back the government and to endorse the cabinet reshuffle (Financial Times, 2013i). Instead, the president asked the coalition government to find some kind of mid-term agreement with the Socialist opposition. But given that the Socialists had called for early elections in the context of the government crisis and asked for a re-negotiation of the EAP, such an agreement was highly unlikely. Citing the incompatibility of their economic policy stance with the government's, the Socialists pulled out of the negotiations after less than two weeks (Magone, 2014b: 262). Cavaco Silva ultimately sided with the government and the opposition's calls for early elections remained unanswered.

The government received tailwinds when economic data showed that the economy's performance exceeded expectations in the second quarter of 2013. Domestic consumption gathered pace and exports continued to grow as well. This resulted in a quarterly expansion of 1.1 per cent of GDP, which compared favourably with an initially projected contraction of 0.1 per cent (IMF, 2013e: 5). The good news ended when the Constitutional Court delivered another verdict in late August. This time, the Court objected to the just recently introduced requalification scheme, thus 'effectively limiting the government's scope to dismiss public sector employees' (IMF, 2013e: 4). It argued that the labour mobility provisions of the scheme and the associated wage cuts would violate the fundamental 'principle of proportionality and legitimate expectations' (Fabbrini, 2014: 102).

Although the government reshuffle was intended to lock the PSD's coalition partner into the continuation of the fiscal adjustment path, it also brought the voices in CDS-PP to the fore, which were critical of the programme. Discussions between troika and the government's junior coalition partner commenced in September. In this context, CDS-PP's leader, Paolo Portas, raised objections to the path of fiscal adjust-

ment as well as to the amount of the fiscal burden to be put on pensioners (Interview PT 02). Regarding the fiscal adjustment path, CDS-PP's leader reverted to the government's earlier argument that both the EAP's initial assumptions had been too optimistic, and its fiscal targets were unrealistic (Interview PT 01). The troika had agreed with this reasoning and revised the programme targets on two occasions. However, the smaller of the two coalition partners argued that the Court's verdict had resulted in another fiscal crisis and that the troika should revise the targets again (Interview EC 14). This resulted in a 'basic disagreement on fiscal targets' between troika and government (Interview IMF 06). The discussions focused on the target for 2014, which had been revised from -2.5 to -4.0 per cent of GDP as part of the seventh review. The main demand made by Portugal's new chief negotiator vis-à-vis the troika was to revise the target again to -4.5 per cent. The wider public had willingly taken up this demand and the troika saw itself confronted with strong political support for further revisions. From the troika's perspective, this was 'pure politics' as the 4 per cent target 'did not matter and in economic terms it could have been 4.5 anyway' (Interview EC 14). It still insisted firmly on maintaining the target. For the troika, it was a 'question of being credible and being committed' (Interview EC 14). On the one hand, it argued that it would be more difficult for Portugal to regain market access if the targets were changed again (Interviews IMF 06; EC 14). On the other hand, the EC especially wanted to retain its credibility vis-à-vis the creditor states and avoid the impression that it was being easy on Portugal (Interview EC 14). Ultimately, the troika came out on top 'in this trial of strength' (Interview EC 14). Its credibility argument was shared by most PSD members of the government. But in the eyes of the troika, the discussion had negatively affected the government's programme ownership (Interview EC 14).

The second point of contention between the troika and the reshuffled government concerned the reform of the pension system. One of the main themes of the programme still was the reduction of government expenditures on pensions, especially in the public sector. Although some cuts had already been made, the pension system was still a drag on public finances. The aforementioned 'solidarity tax' on higher pensions was one of the revenue measures to respond to this. It had been referred to the Court for constitutional review but ultimately did not get vetoed. The CDS-PP still objected to this measure, arguing that it implied 'a triple taxation on pensioners' because pensions had already been cut and subjected to personal income tax increases (Interview PT 11). Another explanation, however, was that they intended to protect one of their core constituencies, namely private pension holders (Interview PT 12). Eventually, two changes were adopted. First, the solidarity tax was maintained but 'adapted to take into account the cumulative impact of other pension reforms' (EC, 2013e: 19). Second, the troika insisted that the government raised additional revenues. Since the Constitutional Court had vetoed cuts to public pensions before, the idea now was to introduce a so-called 'sustainability contribution' levied on public pensions (Interview PT 12).

Autumn 2013 can be seen as the end of the EAP's implementation phase. Programme ownership dwindled, and the government was unwilling to substantially work against domestic opposition. Even if the troika warned in its November review that Portugal's access to private market funding was contingent on

programme implementation (EC, 2013e: 43), the country's financing conditions improved steadily. After a short hike in the aftermath of the government crisis, bond spreads declined again as market sentiments in the entire eurozone changed for the better. Portugal's dependence on troika financing diminished so that the troika lost its most important means of exerting pressure on the government (Interview EC 08). The domestic economy also bounced back. Employment numbers improved as domestic demand and exports grew (IMF, 2014a: 6). Why the economy was finally improving was interpreted differently. In the eyes of the opposition, 'the economy started growing when they stopped cutting salaries and pensions' (Interview PT 07). The Socialist Party focused on internal demand as the main driver of growth and argued that the reforms implemented by the government did not contribute much to the economic rebound (Interview PT 07). The government partially echoed this argument. Clearly, it emphasised the positive effects of its adjustment strategy. Vis-à-vis the troika, however, it also argued that 'the problem was not enough consumption' (Interview EC 14). The troika, by contrast, warned against the notion that Portugal 'had to get back to a consumer-led model' (Interview EC 14). It reiterated its focus on export-led growth and stressed that 'a return to the pre-crisis growth model is not an option' (IMF, 2014a: 4).

The 2014 budget was the last budget under the EAP. In October, a draft law was submitted to parliament that was the government's attempt to re-establish 'the balance between revenue and expenditure-based consolidation' (EC, 2013f: 17). It had to account for budget execution issues that accumulated over the year. The shortfall amounted to 0.8 per cent of GDP of which 0.6 per cent were permanent. Although some of the shortfalls resulted from changes in EU funds and Portugal's contribution to the EU budget, additional expenditures on wages and intermediate consumption also materialised again (IMF, 2013e: 8). Just as in 2013, the government mainly adopted temporary one-off measures to compensate for the overruns. Therefore, the troika cautioned the government that meeting the 2013 deficit target depended on 'the successful implementation of the corrective measures as well as continued tight expenditure control during the rest of the year' (EC, 2013e: 17).

The same held true for the 2014 budget also due to some carry-overs from 2013. The measures to counterbalance these carry-overs were mainly revenue-based and, again, the government turned to one-off measures. However, troika staff 'emphasized the need to strictly limit recourse to temporary measures' (IMF, 2013e: 13). Most of the measures for the 2014 budget were based on a comprehensive public expenditure review (PER) initiated in the context of the sixth review mission in autumn 2012. The PER had been delayed by the Court's intervention and by 'the difficulty of building political consensus around some measures' (IMF, 2013e: 9). Even though the 2014 budget was tilted much more towards the expenditure-side than its predecessor, horizontal measures such as public sector wage and pensions cuts did contribute only half as much to fiscal consolidation as initially envisaged. The troika criticised these changes 'as implementation of horizontal measures is easier to enforce, monitor, and maintain' (IMF, 2013e: 13). The horizontal measures were to be replaced with across-the-board cuts to intermediate consumption and to the budgets of line ministries.

My analytical framework provides an explanation especially for the changes made to the measures provided for by the PER. The PER had been adopted only after all stakeholders had been consulted (IMF, 2013e: 13). That is, the government saw the necessity of building at least a minimal political consensus within the coalition government but also with domestic interest groups and especially the trade union movement. As a result, the total amount of cuts, as well as their impact on public sector workers, was reduced significantly. Furthermore, the government took into account that a large group of pensioners faced high economic risks, and 'there were discussions how to mitigate the effect on lower pensions' (Interview EC 07). Lower pension represented almost 90 per cent of all pensions in this calculation and, in the end, 'were not touched' (Interview PT 02). This meant that higher pensions received 'cuts of almost 40 per cent in some cases' (Interview PT 12).

The alignment of public and private sector pensions was an important reform objective. This had raised political controversy, and ultimately the aforementioned 'sustainability contribution' was supposed to meet this objective at least partially. However, in December, the Constitutional Court intervened again and vetoed the contribution as it infringed on 'the principle of legitimate expectations' (Fabbrini, 2014: 102). Again, the government had to find replacement measures worth around 0.2 per cent of GDP. It agreed with the troika to substitute the planned *sustainability* contribution by broadening the base of the already existing *solidarity* contribution in addition to changes to the public sector's special health scheme (EC, 2014b: 21-22). In the eyes of the troika, these measures merely were to bridge the time until the government would come up with a comprehensive reform of the pensions system, which it viewed as 'critical to addressing the still large gap between social transfers and social contributions and improve intergenerational equity' (IMF, 2014a: 11). Eventually, however, such a comprehensive reform of the pension system was postponed and never came into being (EC, 2016: 61).

Several factors contributed to why the government's eagerness to follow through with programme implementation waned significantly after the Court's decision in December. First of all, the budget law had been adopted by parliament already, and the following review missions 'focused on budget implementation' (IMF, 2014a: 11). Second, external pressure decreased significantly, especially since the beginning of 2014. Over the course of January 2014, Portuguese bond yields fell below 5 per cent for the first time in four years (ECB, 2021). Portugal profited from Ireland's successful programme exit and Moody's rating upgrade for Irish government debt (Financial Times, 2014c). Given the underperformance of the Greek programme and the troika's willingness to present the Portuguese EAP as another success story, the government's efforts to place Portugal closer to Ireland than to Greece bore fruit. Since a return to private funding was now within the government's grasp, its dependence on troika funding disappeared. This also affected the government's willingness to overcome domestic opposition and fulfil the EAP's final provisions. Rather, it was willing to give in to political demands made by the parliamentary opposition. For example, after discussions in parliament, 'key wage bill and pension measures have been amended to better protect lower income earners and ensure more equitable savings' (IMF, 2014a: 64). However, this was not an expression of a newly found consensus between the former political opponents.

One of the few agreements the coalition government and the socialist opposition found in the final phase of the programme was on a reform of the corporate income tax system, which was adopted by a parliamentary majority of 85 per cent (EC, 2014b: 24). Its main objective was to make Portugal's corporate tax system more competitive and bring it into line with the European average. The final reform was far from producing an extremely low tax rate—such as Ireland's 12.5 per cent—as it merely reduced the rate from 25 to 23 per cent and abolished a series of tax expenditures (EC, 2016: 54). It was easy to accept for both parties as it was fiscally neutral, aimed mainly at simplifying the system and did not explicitly favour or disadvantage any of their core constituencies.

In mid-January, political differences between government and opposition and the incompatibility of their economic policy stances came to the fore again. During the first weeks of the year, the government reached out to the Socialists to agree on constraining expenditures beyond the duration of the programme. The Socialist Party rejected the proposition. It stated that it would not partake in 'the government's strategy for impoverishing the country' and that it was committed to reducing the public deficit but would do so through 'a strategy for job and wealth creation' (Financial Times, 2014d). The PSD junior coalition partner partly echoed this stance. CDS-PP's party leader and the government's chief negotiator responded to the troika's eleventh review that the government did not 'believe in development based on low wages' (Financial Times, 2014a). He argued that private wages had already adjusted but did not remark on potential public sector wage cuts. That statement and the absence of fiscal consensus upset international financial markets only briefly, and bond yields continued to fall during the first quarter of 2014. In April, Portugal conducted its 'first regular debt auction since applying for international help in 2011' (Financial Times, 2014b). In May, finally, the government announced that it would pursue a 'clean' programme exit and would not rely on a precautionary credit line. The Portuguese authorities benefitted from the ECB's measures to strengthen investors' trust in eurozone government debt. They decided it was 'a better message for the market' to finish the programme without a precautionary credit line (Interview PT 03).

6.3.4. Phase four: An early exit

Portugal's 'clean programme exit' occurred sooner than anticipated. On 1 June, the Constitutional Court again vetoed a series of budgetary provisions. This time, its decisions affected cuts to public sector wages as well as several social policy provisions introduced in the 2014 budget law. To receive that final outstanding tranche of its troika loan, the government again would have to find alternative measures. Since the Court made its decision only two weeks before the twelfth and final review mission, there was a high probability that the review and the programme exit would be delayed (Interview IMF 09). The government was sure that it would need more than these two weeks to find substitutions for the vetoed measures. It had, therefore two alternatives. It could either let the programme expire without using the last tranche or postpone its exit from the programme. It abstained from the latter also because there was an-

other court decision pending, which had the potential to delay the final review even further (Interview IMF 08). What is more, similar to the discussions regarding the precautionary credit line, 'the same reasoning and arguments [were now] presented to the markets' (Interview PT 03). Given that the Portuguese treasury had built up a comfortable cash reserve, it was decided to conclude the programme without the final review. Irrespective of its intrinsic preferences for an economic overhaul, the government had lost one of its main leverages to assert these preferences against domestic opposition. Despite the harsh reforms it imposed on the country as part of the EAP, the conservative coalition viewed its chances in the 2015 general election as slowly improving in late 2013 and early 2014. This was another reason for its growing reluctance to implement further reforms and an important motivation for its early programme exit (Interview EC 08).

In the context of its final review mission, the troika had already pointed out 'important downside risks to the budget, related to continuing legal challenges' (EC, 2014d). When these risks materialised, the troika merely 'took note' of Portugal's early exit and, at the same time, urged the government to continue with its reform process (IMF, 2014b). It was clear that the troika still saw an extensive need to reform. It also was sceptical towards continued domestic opposition to the reform process and the government's increasing willingness to give in to this opposition. For example, in its first post-programme surveillance report—published in December 2014—the troika assessed that 'in 2014, the fiscal adjustment has been progressively reduced and is now deemed to be of lower quality than the initial plans for several reasons' (EC, 2014c: 17). That is, as soon as the programme was over, the explanatory factors analysed here were even more impactful. As external pressure now was largely absent, the government fully turned to a more revenue-based adjustment strategy and used revenue surpluses to finance new public expenditures.

6.4. Conclusion: Contesting fiscal policy-making

Portugal could avoid being hit directly by the global financial crisis since its banking sector was less entangled with international markets than, for example, Ireland's. However, in the run-up to the crisis, economic growth had been below the European average, and the country even moved into recession in 2003. Accordingly, its national finances were in almost constant deficit, despite several attempts to consolidate the budget. When the financial crisis turned into the eurozone, and the sentiments of international financial market actors soured, Portugal lost access to private funding as government bond yields soared up. On 7 April 2011, the Portuguese government turned to the troika and requested financial assistance linked to implementing a three-year adjustment programme.

The EAP for Portugal amounted to €78 billion. Before the programme, the Portuguese government initially had adopted an expansionary fiscal policy stance to counteract the impact of the global financial crisis in 2008 and 2009. Irrespective of multiple austerity packages, the budget deficit in 2010 reached almost 10 per cent of GDP. In the context of the EAP, the newly elected conservative government implemented fiscal consolidation efforts amounting to around 12.5 per cent of GDP (EC, 2014a: 19). The

previous government—which had negotiated the programme with the troika just before being voted out of office—had agreed upon a fiscal adjustment strategy that mainly was based on expenditure cuts. Although the conservative government was committed to the programme, the adjustment path was altered. Over the course of the programme, fiscal consolidation relied increasingly on revenue increases.

The analysis conducted in this chapter has shown that this strategy resulted from two explanatory factors that correspond to the distributional and sectoral conflicts and coalitions presented in the analytical framework. Portugal lacked a consistent growth model in the lead-up to the eurozone crisis. Even if the economy was mainly based on private and public consumption, growth was sluggish. In contrast to the Irish case, the Portuguese EAP did not aim to re-establish a functioning growth model but attempted to establish a new one. The new model was supposed to thrive on exports and reduce the country's current account deficit. However, this approach challenged several important domestic actor groups, namely those located in the sheltered sectors that depended on domestic consumption and on the state as an employer or consumer. Especially on labour's side, these actors were in a majority in the traditional, class-based organisations. By contrast, workers and corporations in the exporting sectors, which would have favoured an adjustment strategy that aimed for a new growth mode, were not represented by the traditional and well-established organisations. Finally, Portugal lacked any advanced sectors on which bipartisan growth consensus could have been based. Instead, Portuguese trade unions, that is, traditional coalitions favouring a more redistributive adjustment strategy, were politically highly influential and could prevent expenditure-based measures on several occasions.

Employers formed the only significant actor groups in favour of expenditure groups. This, however, was more a general, class-based preference than an agenda the employers would forcefully push forward. Two factors counteracted such an approach. First, Portugal's employers' associations primarily represented corporations located in the sheltered sectors that viewed domestic consumption as the most critical driver of economic growth. Furthermore, they did not necessarily profit from policies such as 'fiscal devaluation', which targeted exporting companies. This actor group, in turn, did not play a significant role in Portugal's business associations and therefore was deprived of political influence on fiscal policy-making. Second, due to the trade union's political strength and their readiness to resort to industrial action, the employers were willing to strike cross-class compromises with their counterpart on labour's side. Just as the constituencies of the leading employers' organisations, the trade unions' membership also is mainly located in the sheltered sectors and especially the public sector. It follows then that cross-class coalitions in Portugal were likely only between domestically oriented actor groups, if at all. Moreover, given their mainly low-skilled membership, the trade unions' main concern was an adjustment strategy that would maintain state spending to protect actors exposed to high economic risks.

In contrast to the Irish case, fiscal policy-making in Portugal was not 'a valence issue' (Iversen and Soskice, 2015b: 76) but depended on partisanship. As a result, the conservative government faced resistance in the streets and in parliament. The politico-economic consensus between government and parliamentary opposition, which had been established at the beginning of the programme, was only short-

lived. The conservative coalition between PSD and CDS-PP, whose most important electorate was formed by small business owners and shopkeepers (Afonso and Bulfone, 2019: 246), took office based on a reform- and business-oriented agenda. However, it soon gave in to domestic opposition by strong trade unions and made concessions to the Socialist opposition in parliament.

Traditional, class-based actor groups located in the sheltered sectors influenced fiscal policy-making during the eurozone crisis to a much larger extent than their counterparts in the exposed sectors. The former flourished mainly on private and public consumption, although this was not based on a functional and consistent growth model. Low-skilled workers and other actor groups dependent on higher state spending were much more influential than high-skilled workers and other actor groups that thrived on international trade. Fiscal policy-making in Portugal was less the outcome of a cross-party and cross-class consensus on the continuation of a specific growth model. Rather it was influenced by well-established, traditional actor groups against which did not face assertive challengers.

Chapter seven: Conclusion

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Towards a comparative political economy of fiscal adjustment

As a result of the eurozone crisis, Ireland and Portugal were excluded from private market funding and were forced to request financial assistance from public lenders. The two countries had to commit themselves to the implementation of closely monitored EAPs to receive financial assistance from the so-called 'troika'. The creditor's preferred strategy was to close the national deficit, mainly based on expenditure cuts, as opposed to revenue increases. Yet, the two borrower governments did not merely translate external pressure into domestic policies. Already before the programme, the Irish government had carried out an expenditure-based adjustment strategy without meeting considerable political resistance and continued to do so. By contrast, Portugal's consolidation efforts became increasingly reliant on revenue increases as the government faced substantial domestic opposition.

To explain this outcome, I have developed the *constrained coalitions approach* as a midrange theory of the politics of fiscal adjustment and applied it to the cases of Ireland and Portugal. My analysis showed how economic actor coalitions and national growth models influenced fiscal policy-choice and how international financial market actors can constrain domestic politics. Ireland's expenditure-based adjustment strategy reinforced the country's well-established export-led growth model. Domestic actor groups favouring a different strategy lacked the common preferences and the political power to challenge the government's approach. The Portuguese government planned to convert the country's consumption-based but lacklustre economy into an export-led growth model. However, neither the government nor domestic coalitions that could have supported such an approach were politically strong enough to prevail against traditional actor groups advocating for a revenue-based adjustment strategy. Notwithstanding the constraints posed by the institutional framework of eurozone membership and the adjustment programmes, fiscal policy is still determined to a large extent by domestic politics

7.1. Findings

International pressure made Ireland and Portugal request financial assistance and was used by the troika and the governments to push through controversial programme measures. The effectiveness of external pressure subsided when the eurozone's crisis resilience improved, and both countries came closer to returning to private market funding. Even if developments at the international level played a role, domestic politics decisively influenced all aspects of programme implementation.

From the outset of the eurozone crisis, it was clear that the eurozone's small deficit states would have to bear the brunt of the adjustment costs as they faced pressure to adjust from two sides. International financial market actors assessed their fiscal position much more critically than larger eurozone states, most notably Germany. Starting in early 2010, Irish and Portuguese sovereign bond yields soared almost in parallel. Within less than half a year, they reached a level that excluded both countries from private debt markets as borrowing costs became prohibitive. As a result, they had to turn to the troika for financial assistance if they wanted to avoid sovereign default. Even if this paradigm has been challenged recently (Roos, 2019), the assumption was that such a default would have unforeseeable consequences. Avoiding it was therefore imperative. Both governments waited until the last moment before they requested assistance and were in dire need of external support. Consequently, the negotiations of the fiscal aspects of the EAPs for Ireland and Portugal proceeded rather swiftly. The programmes included detailed policy conditions the borrower government had to fulfil to receive credit tranches.

The troika used the crisis countries' need for funding as leverage to advance its reform agenda. The borrower governments sometimes also referred to the necessity to accommodate markets and international creditors when justifying austerity vis-à-vis domestic opposition. However, the effectiveness of the troika's leverage depended to a great measure on the borrowers' alternatives, that is, their access to private debt markets. In both cases, government bond yields continued to increase due to a series of rating downgrades and deteriorating macroeconomic outlooks. External pressure was highest in the early programme phase. Therefore, both EAPs 'frontloaded' around two-thirds of fiscal consolidation into the first programme year. The programmes initially involved adjustment strategies with a strong focus on expenditure cuts instead of revenue increases. This approach was justified with reference to macroeconomic research, which found expenditure-based fiscal consolidation to be more effective and growth-friendly. When the troika's initial reviews positively assessed the adjustment efforts of both governments, market sentiments improved as well. This development accelerated in 2012 when the European Stability Mechanism was finally established. It was then that Mario Draghi delivered his famous 'whatever it takes' speech. Shortly after that, the programme countries could plan their return to private market funding.

Despite external pressure, the fiscal policy preferences of the Irish government and the troika were much closer aligned than was the case in Portugal. The disagreements between the Irish government and the troika were negligible. The IMF's defence of Ireland's corporate tax regime against some creditor states that demanded an increase of the low rate is a case in point. Already before the EAP, Irish fiscal policy had depended on the expenditure-based adjustment strategy favoured by the troika. The troika then adopted the government's NRP as the basis for the programme's fiscal part and left it virtually unchanged. External pressure, by contrast, featured more prominently in the Portuguese case. Although the newly-elected conservative government had been part of the negotiations with the troika and announced its commitment to the programme, it faced substantial domestic opposition. Indeed, its fiscal policy preferences were less aligned the troika's. The same holds for the EAPs' objective to improve international competitiveness and how it resonated with domestic actor groups. Whereas in Ireland, powerful actor

groups in the exposed sectors supported this objective and had compatible preferences, in Portugal, this objective was only to be met against the opposition of influential interest groups, most prominently the Portuguese trade unions.

The imperative to reinduce economic growth—at least in the long run—was central to any fiscal policy discussion. The Irish government could rely on a well-established growth model, whereas Portugal's government sought to establish a new one. Despite this difference, growth models were a major rationale for the justification of different adjustment strategies. Ireland fended off demands by some of its creditors to increase its corporate tax rate as it would undermine its FDI-driven growth strategy. The Irish authorities reiterated this argument in almost every public statement on its fiscal policy approach. In the Portuguese case, the government referred to the country's growth model in two different ways. When it dealt with domestic opposition, it emphasised the necessity to reduce the state's role in the economy and shift growth from consumption towards exports. Vis-à-vis the troika, however, it made a case for retaining domestic consumption as a main driver of economic growth to avoid policies that clashed with the preferences of important economic actor groups.

Before the crisis, the Irish growth model was clearly driven by exports and FDI, whereas Portugal's economy depended on private and public consumption. What is more, Ireland's model was much more pronounced and economically successful than Portugal's. Both factors ultimately affected fiscal policymaking. If anything, the Irish growth model became even more distinct over the course of the crisis, and FDI and MNCs gained importance and economic influence. This did not only result in an exceptional economic rebound after the programme. It also artificially inflated growth numbers, which arguably increased political disaffection. In any case, Ireland's 'advanced sectors' were highly influential, and their preferences for expenditure cuts strategy were not contested. Rather, they served as the starting point for essentially any fiscal and economic policy decision. For example, the Irish Labour had promised its voters to re-negotiate the programme to be more employee-friendly. Ultimately, however, these concessions were limited to a series of activation measures and other social policies and neither questioned the outstanding status of the exposed sectors nor the expenditure-based adjustment strategy.

Portugal lacked a well-established growth model or advanced sectors, which could have served as the cornerstones of a political consensus about fiscal adjustment. The attempt to completely overhaul and readjust the economy made fiscal adjustment more challenging than in the Irish case. The socialist government, which negotiated the programme, and its conservative successor could merely agree on the necessity of reducing the national deficit and reinducing growth. This consensus, however, soon collapsed due to the incompatibility of the two party's economic policy stances. The conservative coalition government voiced its intention to reduce the state's role in the economy and rely on an expenditure-based adjustment strategy. It faced strong opposition in parliament not only by the far left but also by the socialists. These parties relied on state spending and domestic demand as the main drivers of economic growth and thus dismissed the consolidation measures preferred by the troika and government. The short-term cross-class alliance between employers and workers when protesting the 'fiscal devaluation' is a case in point for the

absence of a Portuguese 'growth consensus'. Fiscal devaluation was a measure that specifically targeted the exporting sectors' international competitiveness. The latter, however, was neither a sector that was a keystone of economic growth nor was it represented by any influential organisation and the government cancelled the policy as it faced strong domestic resistance.

The further activity and influence of traditional class-based actor groups—namely trade unions and employers' associations—differed between Ireland and Portugal. In both cases, trade unions demanded less harsh and more progressive cuts to spare lower income brackets. The troika institutions also observed the effects of the programmes on economic inequality, but the unions made them politically salient. They expressed preferences for a more revenue-based adjustment strategy that would burden higher capital and corporate incomes. Conversely, employers strongly preferred an expenditure-based adjustment strategy—although these preferences were less pronounced in Portugal than in Ireland. In the latter case, considerations for the long-established growth model, a growing number of high-skilled workers in exposed services sectors, and foreign direct investors trumped the demands of domestically-oriented trade unions. In Portugal, by contrast, export-oriented actors neither had access to other coalitions nor the political power to cope with highly influential traditional actor groups. Secondly, cross-class coalitions formed in both cases based on the alignment of preferences of various groups, albeit for different reasons. The importance of the Irish exporting sector for economic growth facilitated unions and employers to find common ground regarding Ireland's 'small state and low tax' approach towards fiscal policy. Portuguese employers and trade unions also formed ad hoc coalitions, most prominently in the issue of fiscal devaluation. In contrast to the Irish case, this was not driven by a mutual commitment to a specific growth model. Rather, it was based on the employers' endeavour to safeguard industrial peace and on domestically-oriented actors defending their vested interests.

One reason for the larger influence of Portuguese trade unions was that social partnership was upheld during the programme, whereas it collapsed in Ireland. Although it was a long-established decision-making process in both countries, it suffered massive delegitimisation in Ireland for several reasons. On the one hand, social partnership was argued to have benefited public sector trade unions most and, thus, to have contributed to the country's fiscal crisis. On the other hand, the pre-crisis practise of wage restraint in exchange for tax cuts was no longer feasible given the massive collapse of state revenues. This later contributed to the split within the trade union movement between public sector unions and their counterparts in the private sector. The two groups could not find common ground on fiscal policy also because the public sector unions entered into an agreement with the government and were not willing to engage in any form of industrial action. Finally, the public sector did not contribute substantially to the Irish growth model and could therefore not find any coalition partners with similar preferences.

This stands in stark contrast with the Portuguese case. Before the crisis, the two major trade union confederations did not cooperate in any form. When the Portuguese government began to implement fiscal consolidation measures, the two federations overcame their antagonism and cooperated for the first time in two decades. Their political influence was based on two factors. On the one hand, the large number of

low-skilled workers exposed to high economic risks formed their most important constituencies. Furthermore, the trade unions' preference for a revenue-based adjustment strategy was at least partially shared by influential, domestically-oriented employer groups.

7.2. The explanatory power of the constrained coalitions approach

The empirical findings of my analysis support the expectations formulated in the analytical framework. Traditional actor groups formulated class-based preferences in both cases. They were highly influential in Portugal's non-dynamic economy where many low-skilled workers were exposed to high economic risks. Traditional coalitions were less influential in Ireland, where many high-skilled workers facing low economic risks contributed to a highly dynamic economy. As opposed to domestically-oriented actor groups, sectoral coalitions that are exposed to global markets favour an expenditure-based adjustment strategy that takes issues of international competitiveness into account. The political power of sectoral groups, however, depends on the distinctiveness of the national growth model.

Ireland and Portugal are representative cases for the large group of small European states often are neglected by CPE research. They show that different economic growth models are feasible even within the tight framework of the eurozone. It follows from these findings that the analysis of the interaction between economic and political changes is, and will continue to be, an essential question for further research. In any case, fiscal policy will remain the most important means for governments to influence the economy and thus to have a lasting effect on economic success or failure.

7.2.1. What did we learn?

Based on the assumptions made in the analytical framework, I expected Portugal to pursue a revenue-based adjustment strategy and Ireland to rely on a consolidation strategy based on expenditure cuts. Portugal embodied an economy driven by domestic consumption rather than exports and where a large share of the population faces high economic risks, mainly due to their low skill levels. Ireland, by contrast, represented an economy where FDI and exports play a much more significant role than domestic consumption. Here economic risks are comparatively lower given the high skill level of the population.

The two case studies met these expectations not only given the ultimate outcome but also regarding how the explanatory factors of my analytical framework played out in the two cases. Trade unions and employers' associations usually issued policy demands that reflected the preferences of their class-based constituencies. Trade unions were the most critical actors when it came to voicing the effects of fiscal adjustment on economic inequality as well as on disposable income and domestic demand. In doing so, they demanded an adjustment strategy based on higher personal and corporate taxes, which would at the same time preserve social spending for those facing high economic risks. Employers, by contrast, were supportive of

the programmes and their potential to induce economic reforms and reduce the role of the state in the economy.

Growth models can affect the relevance of class-based preferences and coalitions. Ireland's distinct growth model made sectoral coalitions more likely than in the Portuguese case. In contrast to the Irish case, class-based preferences in Portugal were not affected by considerations for a national growth model. If at all, cross-class coalitions were based on the endowment of different actor groups with power resources and were facilitated by companies' lack of influence in the exposed sectors. This is in stark contrast to Ireland, where virtually all relevant economic actor groups had internalised the export-led growth model. The significance of the Irish growth model did not automatically translate into stable cross-class coalitions. But both employers and employees considered the potential effect of their policy demands on export-led growth. Most prominently, the trade unions never questioned Ireland's low corporate tax regime and suggested only very cautious policy changes, if any.

Coalition formation depended on two factors. On the one hand, potential coalitions were not formed because the policy preferences of the respective actor groups were misaligned or dwarfed by other considerations. On the other hand, they formed only when they could expect a realistic chance to influence policy-making. This is exemplified by the absence of a cross-class coalition in Portugal's exposed sectors, as well as the absence of a class-based alliance between Irish private and public sector trade unions. Portugal's antagonist industrial relations make cross-class coalitions less likely. Trade unions and employers put their antagonism behind them only when fiscal policy threatened their privileged position within the domestic economy. Irrespective of their preferences, actor groups in the exposed sectors could not expect to overcome this political stronghold. Given their political weakness, Irish public sector unions were unable to find allies also because their demands for higher state spending contradicted the preferences of their counterparts in the exporting sectors.

Finally, political parties based their policy decisions on domestic coalitions but varying degrees. In Ireland, different governments *a priori* precluded fiscal policies, which had the potential to undermine the country's growth model. Due to their structural power, economic actor groups, such as multinational corporations or international investors, did not even have to directly exert influence. Their general importance for economic growth was large enough for their preferences to be considered regardless (see also Woll, 2016). Direct and open political influence played a much more important role in Portugal. Although the conservative government was eager to implement far-reaching (fiscal) reforms, it often failed to overcome domestic resistance against those measures. Given that there was no clearly identifiable and working growth model, differences between political parties and their core constituencies mattered more significantly that in the Irish case.

What can we learn from these findings beyond the two cases and the programme countries in general? To start with, the eurozone crisis and the EAPs constitute a very specific context of fiscal policy-making. Distributional conflicts were arguably more intense than during 'normal' times (Häusermann, 2010: 81),

international market actors mispriced sovereign risk (De Grauwe and Ji, 2012), and the EU was in a state of emergency and shock. Still, these circumstances are not a necessary precondition for my theoretical framework to be accurate. Fiscal policy always implies distributional conflicts between different economic actor groups and 'permanent austerity' as a policy-making context predates the eurozone crisis (Pierson, 1998). However, a point can be made that international financial market actors constrain small states more than their larger and more powerful counterparts. This was also especially pronounced during the eurozone crisis, when government bond rates for peripheral states skyrocketed as international financial market actors 'fled to safety' by purchasing government bonds of Germany and other larger states. What is more, states such as Italy and France were considered 'too big to bail' (Blyth, 2013a: 51) and thus the bulk of the adjustment costs fell upon the programme countries (Frieden, 2015).

Nevertheless, domestic politics were more important than external pressure when it comes to explaining fiscal policy-making during the crisis. In this regard, Ireland and Portugal represent two different configurations of institutions, coalitions, and growth models that can also be found elsewhere. Portugal is not the only European state with a slightly underdeveloped economy and a politically influential trade union movement. Its configuration resembles Greece, whose fiscal adjustment strategy was even more tilted towards revenue increases (Kopits, 2016: 26). In these countries, low-skilled workers and businesses facing aggravated international competition are exposed to high economic risks. Furthermore, non-existent or underperforming growth models do not counterbalance intense political demands for redistributive politics. The opposite holds true for Ireland, where traditional trade union constituencies are in decline. What is more, a highly distinct growth model, export- and FDI-led growth, trumps any deviating preferences. Although Ireland may represent an extreme case in that regard, it is not the only small European state that pursues a growth strategy based on FDI and high-tech industries (Ornston, 2012). Moreover, the politics of fiscal adjustment in Ireland are illustrative of those in other post-industrial societies. Traded services and high-skilled actor groups in exposed sectors gain importance in other economies as well and substantially affect the dynamics of preference- and coalition formation (Wren and Rehm, 2013, 2014).

So far, I have only explored two of the four potential configurations of economic risk and national growth models. Despite its exit from the EU, the United Kingdom is a potential case that represents a dynamic economy based on consumption-led growth. High-skilled workers are also concentrated in the dynamic services sectors in the UK, but domestic consumption plays a more important role than exports. The UK is also a compelling case because Brexit could serve as another test case for the effects of economic risks on fiscal policy preferences. On the other side, Hungary is an exciting example of a relatively non-dynamic economy and a growth model being almost entirely dependent on external investment and merchandise trade (Bohle and Greskovits, 2019; Bohle and Regan, 2021). However, Hungary partially eludes my theoretical approach. Trade unions—like in other CEE countries—are much weaker here, and social concertation has been absent (Bohle and Greskovits, 2010). Therefore, it would be interesting to see how the fiscal policy preferences of economic actor groups translate into policy-choice and which role coalitions play at this.

An open question remains how the politics of growth models may develop over time. As I have shown, it is generally feasible to pursue different adjustment strategies within the eurozone. Two different trajectories of change are conceivable. On the one hand, the Irish example shows what happens when a growth model becomes partially disconnected from major economic actor groups. The result is political change based on economic dynamics due to a growth model overly relying on external investment and growth that appears in the national account but does not reach the real economy. By contrast, the Portuguese example shows how some elements of the underlying growth model may change independently of economic policy-making. In the early 2000s, trade contributed negatively to GDP growth as imports were much higher than exports. Over the crisis, this changed, and exports were the only driver of economic growth since austerity weighed heavily on domestic consumption. In other words, the apparent politics of fiscal adjustment were accompanied by less obvious changes in the structure of the economy. It would therefore be another important research object to investigate when economic changes may tilt the domestic balance of power and in which direction.

Having incorporated interests and institutions in my analytical framework, one logical step would be to reflect on the role of ideas. On the one hand, ideas and norms relate to individual preferences and their formation. Especially when it comes to distributional aspects, notions of economic equality and fairness have a bearing on preference formation and may even trump material interests (Alesina and Giuliano, 2009; Plümper et al., 2009). On the other hand, ideas influence (collective) perceptions of material interests. Ireland and Germany are cases in point when it comes to demonstrating the political power of economic ideas. Their respective growth models have both brought about paradigmatic economic policy ideas that trump every attempt to challenge them. As I have shown for the Irish case, accommodating international investors over time became the central paradigm for fiscal policy-making. The same holds true for Germany, where the export-led growth model became so entrenched that it continues to dominate most economic policy discussions.

To sum up, a few generalisations can be made based on the analysis conducted here. Traditional actor groups formulating class-based policy preferences still significantly influence policy-making in small European states. However, their political clout depends on mainly two factors. Class-based preferences for or against more redistribution can be trumped by considerations for a well-established growth model. Furthermore, the dynamic of preference- and coalition formation changes significantly in post-industrial societies. These findings open three lanes for future research. The comparison between Portugal and Ireland suggest that higher skill levels and the increasingly traded services are associated with stronger political support for an expenditure-based adjustment strategy. This begs whether there is a linear relationship between economic sophistication and the balance of power between actor groups with different fiscal policy preferences. I would tentatively argue that this is the case, but it depends on the context if and how more egalitarian policy preferences counterbalance this development. Alternatively, my dissertation has pointed out that international financial market actors have constrained domestic policy-making. Therefore, the shifting influence of external investors, and how it changes over time, is another important object of

investigation. Here, the comparison between Ireland and Portugal implied that investors in government debt only indirectly constrain domestic politics, whereas providers of FDI have more direct channels to influence policy-making. Finally, the role of ideas in the formation of fiscal policy preferences could also be investigated further. For example, how do economic changes affect the relationship between material interests and ideational considerations?

7.2.2. Looking ahead

Since the onset of the global financial crisis, a series of political developments have taken place at the domestic and European level that have important implications for fiscal policy-making. On the one hand, domestic growth models emerged from fiscal austerity with varying success. On the other hand, the eurozone's tight economic framework still allows for different fiscal strategies to prosper. Finally, the recent COVID-19 pandemic resulted in a rapid surge of government expenditures all over Europe.

After an almost fatal crisis protracted by a series of political mistakes (Sandbu, 2015), most eurozone economies eventually started to grow again in 2015. This 'success', however, was not evenly distributed and took different shapes in the context of different growth models. Ireland is one of the most extreme cases. The EAP and the government's fiscal adjustment strategy contributed to the Irish growth model being more pronounced than ever. Domestically-oriented actor groups, such as public sector trade unions, lost political influence and fiscal policy became even more aligned with the preferences of international investors. On paper, this strategy was successful. The economy had been in recession for only two years. Growth accelerated after Ireland exited its programme and climbed to more than 8.5 per cent of GDP in 2014. This number, however, was dwarfed in 2015 as the GDP expanded by more than 25 per cent. The downside of this development is illustrative of the challenges future Irish governments will confront. Such exorbitant growth numbers swiftly deflate sovereign debt when measured against GDP. But to a large extent, they do so only virtually. A large share of 2015's growth resulted from MNCs shifting their assets to Irish subsidiaries in order to ready themselves for a potential reform of the international tax system (Financial Times, 2017). When the size of Ireland's 'real economy' is calculated, the result is about 25 per cent smaller than what GDP numbers suggest (Government of Ireland, 2018: 3). This resonates with analyses that argue that the unequal distribution of economic benefits within and without the Irish societies 'is unlikely to be politically, or electorally, sustainable' (Regan and Brazys, 2018: 223). After the programme exit, public opinion considered housing and healthcare to be the main issues in Irish politics (Little, 2021). Both policy areas had suffered from insufficient funding due to expenditure cuts made during the programme. The dissatisfaction with this development and the disparity between calculated and perceived economic growth was taken up by Sinn Féin during its campaign for the 2020 general election. In doing so, it won the majority of votes cast. For the first time in the Celtic Tiger era, a party that was not fully committed to Ireland's growth model became the strongest party in parliament.

In Portugal, domestic politics followed a slightly different route after the eurozone crisis. General elections took place in 2015. The conservative coalition government that had implemented the EAP was able to win more votes than expected and became the strongest party in parliament. But it fell short of a majority and was not likely to find parliamentary allies for its policy agenda. During their campaign, the Socialists promised to 'turn the page on austerity' (Financial Times, 2019) and reignite expansionary fiscal policy. For the first time in Portugal's democratic history, it turned to the extreme left parties for parliamentary support. The Socialist Party formally formed a minority government, but the cooperation with its partners on the far left was highly institutionalised (Fernandes, 2016). The extreme left had dropped some of its most radical demands and committed to Portugal's membership in the eurozone and the ensuing obligations. However, what united those parties was their approach towards fiscal policy and their eagerness to take back a series of contractionary programme measures. The new government faced a series of challenges, but ultimately it was successful in its endeavours. Although, the extent of its success is still contested. On the one hand, it served a complete term in office and reversed some of 'the most visible and controversial austerity measures' (Fernandes et al., 2018: 513). On the other hand, it achieved this at the cost of less visible but direly needed public investment expenditures.

After their programmes, the fiscal policies of both countries clashed with the EC. Portugal's revision of programme measures and expansionary fiscal policy was assessed negatively in the context of the European Semester. Lengthy discussions between the EC and the government resulted in slight budgetary changes, which both parties could sell as a political success. As opposed to this, the EC did not threaten to reject Ireland's budget but opened an illegal state aid case against the country. It argued that Ireland's corporate tax system provided sweetheart deals to multinational corporations in the country. The Irish government outrightly repudiated the EC's demands, insisting on its sovereignty to conduct tax policy and referred the case to the EU's general court.

In other words, the analytical framework developed here cannot only explain approaches to fiscal adjustment but also enlightens our general understanding of fiscal and economic policy of small European states. This allows me to provide a preliminary answer to one of the questions raised in the introduction, namely 'about the viability of different development models within one economic zone' (Hancké et al., 2007: 3-4; Johnston and Regan, 2018). Fiscal policy is still largely determined by domestic politics, that is, by national growth models and domestic actor coalitions. This confirms what Peter Katzenstein argued some decades ago (Katzenstein, 1984, 1985). Small states need to find niches in the world economy where they can prosper, and this has important implications for domestic policy-making.

In this light, the recent COVID-19 pandemic poses an enormous challenge to policy-makers. The governments of most advanced economies relied on fiscal policy to dampen the effects of the pandemic on the economy. In contrast to the sovereign debt crisis, however, the European institutions this time sanctioned the surge in public spending. Clearly these were emergency measures in the context of an unprecedented global crisis. However, it is also clear that one day deficits and debt will have to be reduced.

Analysing these countries' return to fiscal consolidation and how and when they will conduct will be critical for future investigation. When those governments fiscally adjust, what will be the decisive fault lines? There is no reason to believe that the explanatory factors analysed here will lose explanatory power in the future. Domestic growth models will continue to play an essential role in the calculus of governments. Domestic actor groups will continue to form coalitions for or against a specific fiscal adjustment strategy. However, new or altered actor groups will join the race for political influence. Differences in skill levels are likely to become more rather than less important. If government expenditures on welfare are cut, the question of who deserves what and why becomes ever more pressing (Attewell, 2021).

Fiscal policy has the potential to stir generational conflicts between young and old (Frieden, 2015), it affects populist reactions to migration (Manow, 2018), and it can provoke or dampen feelings of social marginalisation (Gidron and Hall, 2020). For better or worse, it substantially affects our everyday life. This implies a heavy responsibility for policy-makers. How governments fulfil this responsibility and by whom they are influenced will continue to be an urgent question.

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List of interviews

Code	Affiliation	Place	Date
EC 01	Mission Team	Berlin	10 July 2012
EC 02	Mission team	Brussels	14 January 2016
EC 04	DG ECFIN	Brussels	18 January 2016
EC 05	DG ECFIN	Brussels	18 January 2016
EC 06	Eurogroup	Brussels	19 January 2016
EC 07	DG EMPL	Brussels	19 January 2016
EC 08	Mission team	Brussels	19 January 2016
EC 10	Mission team	Brussels	20 January 2016
EC 11	Eurogroup Working Group	Brussels	21 January 2016
EC 14	European Commission	Brussels	22 January 2016
GER 02	Member of Parliament (SPD)	Berlin	24 November 2016
GER 03	Ministry of Finance	Berlin	6 December 2016
IE 01	Department of Finance	Dublin	19 April 2016
IE 02	IBEC	Dublin	20 April 2016
IE 03	Department of Public Expenditure and Reform	Dublin	20 April 2016
IE 04	ICTU	Dublin	21 April 2016
IE 06	Government Advisor	Dublin	22 April 2016
IE 07	Department of Finance	Dublin	25 April 2016
IE 09	IMPACT	Dublin	26 April 2016
IE 10	Department of Finance	Dublin	27 April 2016
IE 11	National Treasury Management Agency	Dublin	28 April 2016
IE 13	Department of Finance	Dublin	28 April 2016
IE 14	Social Justice Ireland	Dublin	28 April 2016
IE 15	Member of the Government	Dublin	29 April 2016
IE 16	SIPTU & ICTU	Dublin	29 April 2016
IE 17	Department of Finance	Washington, D.C.	22 October 2015
IMF 06	Mission team	Washington, D.C.	20 October 2015
IMF 08	Mission team	Washington, D.C.	21 October 2015
IMF 09	Executive Board	Washington, D.C.	21 October 2015

IMF 14	Mission team	Washington, D.C.	23 October 2015
PT 01	Government official	Brussels	29 February 2016
PT 02	Member of the Government	Lisbon	18 October 2016
PT 03	Portuguese Debt Management Agency	Lisbon	20 October 2016
PT 05	Ministry of Finance	Lisbon	24 October 2016
PT 06	Bank of Portugal	Lisbon	24 October 2016
PT 07	Member of Parliament (PS)	Lisbon	25 October 2016
PT 08	Portuguese Banking Association	Lisbon	25 October 2016
PT 09	CIP	Lisbon	25 October 2016
PT 10	UGT	Lisbon	26 October 2016
PT 11	Member of the Government	Lisbon	27 October 2016
PT 12	Member of the Government	Phone interview	30 November 2016