The Road to Austerity

Seán Ó Riain

DOI:10.1093/acprof:oso/9780198792376.003.0002

Abstract and Keywords

This chapter explores the reasons behind Ireland’s particularly dramatic crisis of 2008 and subsequent experience of austerity. First, it starts with a discussion of the different meanings of ‘austerity’ (and its ‘Keynesian’ alternatives) and their place within the different varieties or worlds of capitalism, arguing that where ‘fiscal prudence’ has been sustainable it has been combined with extensive social spending and investment. Second, the chapter then examines how Ireland turned away from such a path, identifying three major causes behind Ireland’s road to austerity—financialization, the changing character of the European regional project of economic integration, and the weakening of the public and civic foundations of national political economic strategies. Third, it links each of these causes to a broader aspect of the social organization of ‘liberalization’.

Keywords: austerity, financialization, Ireland, economic integration, liberalization, social spending, fiscal prudence

Ireland’s Austerity: Sudden, Severe, and a Long Time Coming
Why was Ireland so helpless in the face of its crisis in 2008? Why was its austerity adjustment so severe, compared to other countries? Why did austerity appear to be such an inevitability, both economically and politically? As well as the challenges posed by facing a crisis of enormous scale, Ireland proved to be hampered by external and domestic political and institutional conditions that made a strong policy focus on austerity a highly likely outcome. Many of the very forces that brought Ireland to its position in the eye of the world’s economic storm in 2008 made it more difficult for the Irish polity to respond in ways that might creatively work through what was inevitably an exceptionally difficult period.

There were three major causes for Ireland’s particularly dramatic adjustment. First was the sheer scale of the financial crisis. This was not simply a matter of the massive debts in the banking system but also of the degree of entanglement of these bad debts with the real economy—primarily through the economic and employment impact of an immediate collapse in construction-related employment and the massive hole in the public finances left both by guaranteeing banking debt and by the disappearance of tax revenues related to property sales. Ireland was dealing not only with a massive debt overhang but also with a damaged and distorted economy.

Second, membership of the European Union (EU) and the Eurozone contributed to both the crisis in Ireland and the focus on austerity as a policy response. Despite the appearance of uncertainty, the EU in practice followed a remarkably consistent and narrow policy of pro-cyclical austerity at both the European and national levels, only moving to a more activist (and still limited) European policy well after the onset of the crisis.

Third, Ireland faced the crisis with a limited national capacity for adjustment. This may seem strange given the widespread international praise for Ireland’s adjustment and recovery. However, Ireland’s capacities were strong in a narrow realm of action, primarily around reducing expenditure while limiting protest. The capacity of the policy system to generate more diverse and creative solutions was more limited, particularly at the level of national policy, as the financialization of the 2000s had marginalized some of the more creative institutional experiments of the 1990s. It is only
in the uneven recovery since 2012 that echoes of these earlier policy successes were to be found.

Behind these proximate causes of Ireland’s crisis and subsequent austerity lie a number of key questions, each of which are examined in this chapter. First, ‘austerity’ itself may serve as a label for quite different political and economic strategies. Therefore, the chapter starts with a discussion of the different meanings of ‘austerity’ (and its ‘Keynesian’ alternatives) and their place within the different varieties or worlds of capitalism. Second, it outlines the three major causes behind Ireland’s road to austerity in more detail. Furthermore, it links each of these causes to a broader aspect of the social organization of ‘liberalization’—looking in turn at financialization, regional projects of economic integration, and the weakening of the public and civic foundations of national political economic strategies. Third, the chapter turns to the complex question of the link between liberalism and austerity—in Ireland’s boom, its crisis, and its current recovery.

Austerity in Comparative and Historical Perspective
### Table 2.1. Actual and ‘potential’ budget balances in the ‘varieties of capitalism’ in Europe, 1999-2007

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Nordics/Social Democratic</td>
<td>2.5</td>
<td>0.3</td>
<td>0.1</td>
<td>0.5</td>
</tr>
<tr>
<td>Continentals/Christian Democratic</td>
<td>-1.5</td>
<td>-1.7</td>
<td>-1.7</td>
<td>-1.6</td>
</tr>
<tr>
<td>Mediterranean</td>
<td>-2.9</td>
<td>-4.0</td>
<td>-3.1</td>
<td>-4.7</td>
</tr>
<tr>
<td>Liberal</td>
<td>0.1</td>
<td>-2.5</td>
<td>-0.6</td>
<td>-3.8</td>
</tr>
<tr>
<td>Including: Ireland</td>
<td>1.6</td>
<td>-2.7</td>
<td>-0.7</td>
<td>-3.9</td>
</tr>
</tbody>
</table>

**Source:** Actual Balances—Eurostat; ‘Potential’ Balances—IMF.
Austerity is both a particularly striking aspect of the contemporary era and an idea with a long history (Blyth 2013). A variety of analysts link austerity directly to economic liberalism, primarily through the dominant emphasis within austerity policies on reducing public spending and therefore almost inevitably shrinking the size of the state. However, when we examine the responses to the economic crisis since 2008, the strongest focus on austerity—both in terms of the practical policies advocated and the rhetoric of the moral and economic need to ‘live within the state’s means’—has been in Northern Europe, apparently the least liberal and the most coordinated and ‘social’ of all the capitalisms (Ó Riain 2014).

Table 2.1 illustrates this puzzle, showing the significant differences that persisted across European countries in budget balances in the 2000s—both the actual balance and the ‘potential’ balance (calculated by the International Monetary Fund (IMF) to take into account the effects of the business cycle). These are contested concepts but the pattern is clear enough. The Nordic (p.25) economies do best in terms of ‘fiscal discipline’, running an actual surplus but also balancing their books, even on the basis of the underlying structural deficit (accounting for the effects of the Norwegian oil boom on Nordic surpluses). While running deficits a little larger than the social democracies, Europe’s Christian democracies remained comfortably within the Eurozone criteria. The liberal economies of Ireland and the UK appear to do better, based on their actual balance, but this masked a significant bubble as their large underlying deficits indicate. The Mediterranean economies also had significant difficulties with budget deficits, which were already present in the early 2000s. It is clear, however, that it is the apparently expansionist ‘social market’ economies of Northern Europe who are the most fiscally conservative.

These patterns relate to the creation of the crisis—what of the response once the crisis hit? The alternative to austerity as a strategy for recovery was typically presented as some version of Keynesian stimulus policy that would drive recovery through expansion of the economy rather than direct consolidation of the debt, and that would repudiate the ‘liberal’ policy of austerity. Despite ongoing debates about the self-defeating nature of ‘austerity’ at the European level, EU
elites have resisted what they see as the siren call of Keynesianism.

On the face of it, Europe should be the home of such Keynesian interventions as these should be politically and economically easier in countries with higher levels of social spending. Ironically, however, it is the countries of Continental Europe, with their larger public sectors and ‘social economies’, who have been cheerleaders for austerity policies, while the ‘liberal’, less free-spending states of the UK and USA have been more willing to engage in sustained quantitative easing.

Therefore, the political responses to the crisis in different worlds of capitalism have largely been consistent with their approaches prior to the crisis. This points to a crucial distinction between austerity and fiscal conservatism—with the Northern European countries historically combining their higher levels of social spending (an antipathy to ‘austerity’) with an aversion to budget deficits (a deep commitment to ‘fiscal prudence’). Fiscal discipline had less to do with German cultural memories of the 1930s inflation than with the general logics of these models of political economy (see Ó Riain 2014 for further discussion). In the ‘social market’ economies, fiscal prudence has historically been associated with the protection of the state and the public sector from the cycles of capitalism rather than with shrinking the state to respond to those fluctuations and pressures.

This also suggests that we need to revisit the place of ‘Keynesianism’ in contemporary debates. While Keynes is often read as an advocate of counter-cyclical spending and quantitative easing, this relies purely on a reading of Keynes as macroeconomic manager. Keynes also emphasized a more general role for government, particularly in securing social protection and investment, and generally managing the economy and ensuring appropriate levels of investment and other long-term economic requirements (Block 2012). While most commentators associate the social democratic worlds of capitalism with Keynesianism, in practice it is this more general argument of Keynes for social investments and long-range planning and management that is most characteristic of the social democratic and Christian democratic countries. The Keynes who advocated counter-cyclical spending and
macroeconomic reflation to escape from crisis is, in practice, more widely favoured in liberal political economies—as seen in the persistently higher deficits run in such economies.

Streeck (2014) links austerity to a structural shift in capitalism as a whole, as governments used looser private and public credit since the 1970s as a mechanism to meet increased expectations in an era of declining growth. Schafer and Streeck (2013) argue that escape from this failure is ever more difficult as declining growth made it more difficult to keep up with debt obligations (or to use inflation to erode debt). This made governments more responsive to the financial institutions that lent to them than to the citizens who elected them. However, instead of simply expressing an irresistible structural shift in capitalism, the turn to austerity can be seen as a combination of established patterns of economic policymaking combined with significant shifts in European economies, in particular. The fiscal prudence and conservatism of Northern European economies had historically been counterbalanced by a number of central planks in their political economies. A banking system oriented towards long-term productive investments had helped to smooth out the cycles in the private economy. In the public sector, a strong emphasis on long-term social and economic investments, and on universalist collective systems of social protection, protected citizens while enabling them to adjust to challenges of external trading regime changes. These were key private and public aspects that (p.27) both enabled and were reinforced by fiscal conservatism in the European model. However, many of these elements have been eroded, particularly since the 1980s, weakening the foundations of fiscal prudence even as the rhetoric of balanced budgets grew ever more intense and was formalized in EU rules.

We can see therefore that ‘austerity’ and ‘Keynesianism’ can, in practice, serve as labels for quite different approaches to fiscal prudence and macroeconomic policy in different contexts; that these approaches are associated with different worlds of capitalism and different approaches to private investment and social protection; and that the foundations of fiscal conservatism have, in practice, been eroding in recent decades as public sectors are increasingly weakened. It is in
this context that we can now turn to examining the three key pressures that led Ireland on the road to austerity.

Ireland’s Road to Austerity
Three of the grand themes of contemporary capitalism—financialization, a particular form of international economic integration and ‘liberal’ economic policies—intertwined to make Ireland’s crisis particularly dramatic.

Financializing the Irish Economy
An attenuated version of the European model of development was at the heart of the genuine development of the Irish economy in the 1990s—productive investment, enabled by enterprise policy; European investment in social and regional cohesion within a trading zone; and a set of ‘creative corporatist’ institutions that mobilized capital and labour as well as managing relations between them. However, the 1990s project of productive investment in new industries, supported by lively developmental state agencies, was overwhelmed in the 2000s by the rise of property speculation, with cheap credit and speculative ‘flipping’ of residential and commercial buildings driving a property bubble. Ultimately this led to a banking crash, and massive bank debts were loaded onto the public purse.

On one reading, Ireland’s financial crisis was a very local crisis. The sub-prime mortgages and securitized mortgage products that were central to the triggering of the US crisis were much less important in the Irish case, where lending to developers and inflated property prices were much more significant (Connor, Flavin, and Kelly 2012). While mortgage lending practices loosened in the 2000s, the crisis was not caused by mortgage defaults (although these became significant elements of the evolving crisis) but by developers failing to repay loans to banks when liquidity suddenly dried up in 2008.
However, other features of the Irish crisis were shared more broadly. As Connor, Flavin, and Kelly (2012) point out, Ireland shared with the USA features such as ‘irrational exuberance’ among market actors, a ‘capital bonanza’ (easy access to cheap capital for banks—in the Irish case through international borrowing), and failures of regulation and ‘moral hazard’. To this list, we might add the absence of a significant public housing system. In addition, the various crises of the current period are linked through increasingly close financial integration, with the US crisis in 2008 the tipping point for Irish banks’ collapse as interbank liquidity dried up very rapidly. This financial integration itself has been closely linked to a broader project of economic liberalization, most clearly since the 1990s.

Ireland proved a world leader in the financialization of the economy: ‘the increasing role of financial motives, markets, actors and institutions in the operation of the domestic and international economies’ (Epstein 2005: 3; Kus 2012). While there are many potential indicators of this process, Krippner (2011) takes the share of profits within the economy going to financial activities as her central measure of financialization, arguing that this measure reflects both the sectoral growth of finance and the accumulation of power within the economy. Figure 2.1 outlines trends in the profits of the ‘financial intermediation’ sector (banks and other financial institutions,

![Figure 2.1. Proportion of all corporate profits (gross operating surplus) going to the ‘financial intermediation’ (banking) sector, 1988–2007](image)

*Note:* EU14 and the France and Germany measures are an average of national rates, not a total of all profits across those countries.

*Source:* OECD STAN Database.
but not including insurance, real estate, and other business services) for the years for which Organisation for Economic Co-operation and Development (OECD) statistics are available.

(p.29) The statistics reveal some interesting variation in Irish banking profits. Despite their lack of contribution to economic development (Honohan 2006), Irish banks were comparatively profitable in the mid-1990s. Their share of corporate profits declined during the mid-1990s only to recover somewhat alongside the export boom of the late 1990s, and surge dramatically from 2003 to 2007. Ireland’s financial expansion was only one leg of a ‘triple financialization’, also including Anglo-American financial systems and the financialization associated with European integration and the euro in the 2000s. While the USA was always more financialized than the European core, that gap widened significantly over the 1990s, and financialization is most closely associated with ‘liberal market economies’ (Hall and Soskice 2001) such as the USA, UK, and Ireland. Nonetheless, the EU economies closed the gap somewhat from 2001 onwards—with France and Germany showing a surge in the 2002–4 period. Since the proportion of Irish banks’ liabilities derived from foreign sources grew dramatically in the 2000s (Lane 2011), these were very significant trends.

This financialization was both a driving force in economic liberalization and also enabled by ‘liberal’ policies. The key ‘liberal’ element in Ireland’s policy regime during these years was the faith in the ability of private capital to allocate investment resources effectively in the economy. Crucially, the new government’s budget of 1998 reduced capital gains tax from 40 per cent to 20 per cent, with a view to releasing pent-up capital into the economy. This goal was rapidly achieved—in the decade after the reduction of capital gains tax to 20 per cent in 1998, bank lending in the economy grew by 466 per cent. However, that capital flowed primarily and rapidly into property investment. Together, domestic banks and a small group of residential and commercial property developers misallocated capital in Ireland on a grand scale. A lending and investment coalition focused on domestic property was able to secure the lion’s share of available capital, to the cost of competing sectors (most notably the medium- and high-tech sectors). Construction and real estate lending increased from
7 per cent to 28 per cent of total lending over the period. In contrast, the high-profile high-tech sectors attracted less than 2.5 per cent of credit (Ó Riain 2014).

With an institutionally and personally weak Financial Regulator, finance in Ireland was to be a liberal experiment based on governance by a set of market mechanisms. Unfortunately, these mechanisms failed to provide the necessary controls. Most basically, competition between the banks appears to have been a factor in ‘crowding in’ the two leading banks, Allied Irish Banks (AIB) and Bank of Ireland (BOI), into ‘irrational’ property lending. Anglo Irish Bank, the bank infamously most closely associated with property lending, saw a surge in profits to the point where it had significantly closed the gap with BOI by 2007. Executive compensation followed suit—including, as became apparent in 2008, secret loans to executives and directors of as much as €70 million. (p.30) AIB, Ireland’s most profitable bank, responded to the Anglo surge with a shift into real estate and development lending, with a corresponding boost in profits—and subsequent disastrous collapse.

If market competition did not provide the discipline required, perhaps managerial authority could. In practice, however, the centralization of executive authority in the banks reinforced the convergence of optimistic assessments of asset quality, capital position, and economic growth (Ó Riain 2014). Bank executives faced few challenges to their perspectives. Authority within the banks was highly centralized, as an Anglo Irish Bank Annual Report noted:

The Bank’s centralized business model enables quick decision-making, ensuring consistent delivery of service to our customers and effective management of risk. It also allows us to operate in an efficient and streamlined manner, as reflected by our cost to income ratio of 27 per cent. (Anglo Irish Bank 2006: 4)

Senior bank executive salaries rose rapidly in all banks through the 2000s, with bonuses that were, in practice, increased by corporate strategies that inflated the bubble (TASC 2010).
Shareholders were the other candidates for providing sufficient external oversight from within the private sector as a ‘market for governance’ (Davis 2009). However, the stock market itself reinforced the tendencies towards financialization. Ó Riain (2014) examines trends in a variety of Irish Stock Market Indices from 1995 to 2005. The General Index showed strong growth in the late 1990s but dipped from 2001 to 2003 and only recovered by 2005. However, the financial stocks surged from 2000 onwards, after strong growth in the 1990s. The stock market was also a weak mechanism for distributing investment to the productive and innovative, rather than speculative, sectors. The technology-based Irish Technology Exchange Index never recovered subsequent to the dot.com bubble bursting in 2001, while the financial stocks increased rapidly in value. The stock market rewarded the lending patterns that were ultimately to crash the economy.

Nor did an increasing engagement with international financial institutions have the required effect. A crucial role here was played by the credit-rating agencies, private regulatory organizations that provide ratings of the quality of a wide variety of financial instruments, linked both to private and sovereign issuers. These agencies provided increasingly positive ratings of Ireland’s banks, including for Anglo Irish Bank—which in turn was given a series of international accolades by consulting firms. The market institutions which were to provide a regulatory function to market actors and actions failed disastrously to limit the financialization of Ireland’s economy, and actually facilitated and rewarded the dangerous expansion of the financial sector to a scale that would ultimately produce Ireland’s dramatic austerity. (p.31)

From Development to Financialization in the European Project

Ireland’s financialization might have had domestic roots but was driven to dangerous heights by the changing dynamics of European integration. The entry of Ireland in 1973 was a major challenge for the EU as it was the first country admitted to the EU with significantly worse structural development and lower national income per capita than elsewhere in the EU (although there were regions within other countries, such as the Mezzogiorno in Italy and the ‘Celtic peripheries’ of the UK
which were significantly poorer regions hidden within wealthier national nation states).

However, in the 1990s, European public funds were part of an effort to promote convergence across European regions and ultimately funded a high proportion of Ireland’s investment during this decade of development. Much of this funding was related to agriculture but there were significant increases also in the total non-agricultural funds and in the European social funds that supported training and other measures for labour market inclusion. This increase persisted through the 1990s and only returned to the nominal levels of 1989 in 2007. Even in the booming late 1990s, EU funds accounted for over 15 per cent of Irish public capital expenditure—a very important contribution considering that the vast bulk of productive capital spending in the Irish economy during this period and later came from the public sector (White 2010).

However, Ireland’s relationship with Europe changed significantly in the 2000s as the character of the European economic project itself shifted. A policy that incorporated strong elements of public developmentalism within a trading union was supplanted by private financialization in a monetary union. A growth model was available in the Eurozone and was behind Ireland’s celebrated growth of the 1990s—and even more clearly contributed to the growth in Denmark and the Netherlands at the time (Behling and Ó Riain 2015; Hemerijck and Visser 1999). However, the project of financialization overwhelmed this growth model—both in the private sector, where financial activity drove an increasing share of profits, and in the political world, where the power of the idea of austerity, and the shrinking of the state, was deeply tied to the legitimation of the guiding role of financial markets (Blyth 2013).

The European form of financialization retained the historical emphasis on banks but the European banking system itself became increasingly marketized. European banks increasingly abandoned long-term relations with industrial clients, raised their funds through financial markets, and diversified their operations to place additional emphasis on speculative activities. They competed aggressively with US and UK banks in the 2000s to take advantage of ‘innovation’ in financial instruments and activities, creating a European banking bubble of their own. The bubble in German banking, for
example, may (p.32) have been shorter and less dramatic than in the liberal economies but nonetheless had some disastrous effects.

German commercial banks saw a rapid increase in their holdings of securitized assets and a disimprovement in their capital adequacy ratios between 2003 and 2007 (IMF 2009: Appendix Table 4). While significant elements of the banking system—including the savings and state banks—remained largely outside the bubble and continued to lend to small businesses before and through the crisis (Federation of Small Businesses 2012: 12), the large commercial banks expanded their international lending and became significant drivers of financialization in Europe. The triangle of Irish banks, international funders, and credit-ratings agencies connected the Irish financial world, based on personalized property development lending, to the international trade in securitized financial instruments through the standardizing effects of credit ratings. In the process, it further weakened the ties between financial and industrial capital in both the European periphery and the core.

This financialization was linked to the long-term twin project of monetary union and increased financial integration. Capital liberalization could support Germany’s industrial competitiveness through laying the foundations for a single currency, ultimately the euro. The euro has been a significant subsidy for German exports, relative to the deutschmark which, had it continued, would have been a much stronger currency and have made German exports much more expensive. In addition, the banking sector itself became an important export sector in Germany, as in more liberal economies such as the UK and Ireland. While capital liberalization meant a significant shift away from the bank-centred hausbank system that had underpinned much of German industrial growth, it could still be seen as a strategy to boost the competitiveness of German exports.

In addition, at the macroeconomic level, the liberalization of finance was seen by key German policymakers as providing the external market discipline on public finances that was to be crucial to the European project (Ó Riain 2014). The financialization of European economies was linked to a broader project of apparently managed economic integration and, in particular, the monetary union of the 2000s. The
financial integration that the euro facilitated was politically significant in shifting the balance of the different ‘models of capitalism’ within the EU, as the greatest threat to social democratic strategies came less from trade integration than from the danger posed by financialization to governments’ ability to mobilize capital for productive investment (Scharpf 1991). In the process, the European economy became badly unbalanced, as, where this financialization took off most dramatically, (i.e. in the European periphery) it was funded through external financial systems. Where once Europe had invested heavily in the future, it now speculated on it.

Fiscal rules were to provide the protective shell around this financial system and the inevitable bubbles that would emerge. Much attention has focused on (p.33) the failure to keep to these rules, particularly in France and Germany in the early 2000s, and the demonstration effect of the leniency towards these major countries. While legitimate, this focus obscures the more fundamental point noted earlier that the foundations of fiscal prudence were firmly in Europe’s productive and welfare institutions which were themselves being undermined—notably by the very financialization that was supposed to discipline public finances. European policymakers may well have seen the Economic and Monetary Union (EMU) of the 2000s as the transplanting of the historically established European political economy and ‘social model’ from the national to the transnational stage. Indeed, Jacques Delors (the architect of the strategy of the 1990s and EMU) himself expected a crisis of sorts to materialize but believed it would force countries into the necessary adjustments (Begg 2016). In practice, however, the missing ‘social Europe’ materialized to a minimal degree, as ‘negative’ market integration dominated the European project (Scharpf 1999). Ultimately, this proved disastrous as it meant that some crucial elements of the European model were never transplanted to the transnational level.

Overall then, the EMU played a key role in making the crisis—even if the proximate causes are to be found in how various economic and political actors reacted to the new macroeconomic context. The euro’s major flaw was one of its most touted successes—a particularly deep financial integration, which policymakers initially expected to provide an external discipline to businesses and states but which in fact it brought the exact opposite. This combined disastrously...
with the decline in flexibility available to governments to develop their own responses to such external pressures, and the tight coupling of their various national economies meant that weaknesses in one set of institutions (and especially financial systems) had strong transnational knock-on effects.

In addition, EMU was not as neutral as regards national models as was often portrayed. As we saw earlier in this chapter, the kinds of macroeconomic policy combinations that went with hard currency and low inflation were well suited to Nordics and Continentals and those countries were always better placed to manage the new context of the euro (including those Nordic economies, such as Denmark, that tracked the euro despite not joining it). More seriously still, the kinds of compensating investments and protections that were used in those countries to compensate for the disciplines of ‘hard’ monetary and currency regimes were absent at the European level (and were actually weakened after EMU was introduced). Most fundamentally, the euro covered a fault line within the EU itself. The major advantage of the euro for Germany was that it provided it with a far weaker currency than it would otherwise have had, strengthening its export competitiveness. However, this weakness of the euro depended upon the developmental weakness of peripheral economies. A significant upgrading of the peripheral economies would have challenged the German attraction to the euro project.

(p.34) This hard edge to the euro project was institutionalized in the European Central Bank (ECB) and shown most clearly in the role played by Jean-Claude Trichet in a series of communications with the Irish Government. These are claimed to include an infamous phone message left before the bank guarantee of 2008 for the Minister for Finance to ‘save your banks’, before the Troika bailout, and when he warned the next unfortunate Minister of a ‘bomb’ that would go off if Ireland did not back away from a proposal to make lenders pay a portion of the costs of the crisis. Although full details have never emerged, Trichet’s brand of ‘destructive ambiguity’ about the European reaction to Irish policy decisions clearly was designed to protect the European financial system above the EU’s member states—whether out of desire to save the banks from the costs of their mistakes, or
out of uncertainty as to the effects on the European banking system as a whole. The European project, as experienced by Ireland at least, had been transformed dramatically from Delors to Trichet.

A Flaw in the Social Contract

Given these twin pressures of financialization at home and a changing European region abroad, did Ireland have the domestic institutions and strategies that could navigate through these complex waters?

Ireland’s apparent exit from the vicious circle of underdevelopment in the 1990s involved not only economic and social progress but also significant institutional innovations within the political economy. In particular, industrial development was driven forward both by multinational capital and by an emerging ‘developmental network state’ (Ó Riain 2004). Macroeconomic stability was provided through neo-corporatist social partnership agreements from 1987 onwards. Taken together, these provided a form of what Darius Ornston has called ‘creative corporatism’ (Ornston 2012). While many authors, including Ornston, have described Ireland as a case of competitive corporatism, in fact this label poorly described the Irish experience. In the 1990s, Ireland delivered support for active labour market policy (ALMP), risk capital, and (to a lesser extent) research and development (R&D) that approached the levels provided in the European social market economies (Ó Riain 2014). Irish corporatism in the 1990s, therefore, was more creative than the competitive corporatism description allows.

Ireland faced twin challenges at the end of the 1990s—to upgrade the economy to cope with rising costs and to tackle the significant inequalities that dogged Irish society, particularly the linked problems of income inequality and jobless households. The political challenge was substantial for Ireland in the early 2000s therefore, despite the significant successes of the late 1990s. Nonetheless, the degree to which the policy system and the society failed to manage these challenges was dramatic.

(p.35) A number of the institutions that might have addressed these challenges were thus in place—although only weakly established in many cases. However, in the 2000s, the
The pendulum of governance swung away from these institutions and back towards a highly centralized government system that gave enormous power to a small group of key ministers, highly responsive to electoral cycles and partisan politics. The 2000s saw the erosion of developmental capacities and coalitions that had been developed in the 1990s but were now sidelined by property- and credit-growth machines—effectively sidestepping the challenge of economic upgrading.

This period saw the rise of strategies of growth in the UK and USA based on the expansion of private debt to inflate demand and drive consumption-based growth—a strategy that came to be called ‘privatized Keynesianism’ (Crouch 2009). This private-sector bubble proved to be central to ‘the failure of Anglo-liberal capitalism’ (Hay 2013). Given the developmental successes and massive employment expansion of the 1990s, the expansion of demand in Ireland was partly based on genuine and sustainable improvements in living standards. Furthermore, the critical effects of loose credit in the domestic economy were seen first and foremost in the business lending sector. However, as the 2000s went on, household debt expanded rapidly, including both housing and consumer debt—moving Ireland closer to the ‘privatized Keynesian’ model.

Disastrously, this financialization of business and households also found its way into the public finances through the structure of taxation and levels of public spending. As the bargains struck through social partnership and through partisan politics expanded in their scale through the 2000s, they relied most heavily on the return of after-tax income to citizens across the income distribution. With social security taxes and corporate taxes already low entering the Celtic Tiger years, the period from 1998 to 2002 saw major cuts in income tax, with the top rate dropping from 48 per cent to 41 per cent.

This focus on income tax reductions was reinforced by the structure of the Irish welfare regime, which placed a particularly strong emphasis on providing households with more after-tax income rather than significantly expanding the social services available to citizens. The structure of the Irish welfare state itself, in common with other liberal and Mediterranean welfare states, relied more heavily on transfer payments than on services. Indeed, the major policy report on the welfare state in the 2000s—the National Economic and
Social Council (NESC) Report on the ‘developmental welfare state’—argued for both a rebalancing of income transfers, social services, and active measures, as well as for a more flexible system of supports across the life course (NESC 2005). This notion found little support in the government, and welfare improvements in the 2000s emphasized increases in payments and eligibility. A welfare state that focused on cash payments rather than universal public services did little to build public support for protecting social services.

The combination of low tax and spending always rendered Ireland’s fiscal model vulnerable (Ó Riain 2004, 2009). While many economists worried aloud about increased public spending through the 2000s and, in particular, increases in public sector wages, the factor that turned these structural weaknesses into an acute crisis was the increased dependency of the state on the ‘bubble taxes’ from capital gains and real estate sales. The financial and fiscal crises were tightly linked together through the property bubble, the core of the banks’ business model and the source of the state’s surging but vulnerable tax revenue. The flaw at the heart of Ireland’s social contract was expressed in the reliance on bubble taxes—the increased spending of the 2000s was financed to an unsustainable degree by the bubble. When the financial crisis hit, those tax revenues disappeared and the weakness of the social contract was disastrously exposed.

Overall, even as creative corporatism was eroded in the 2000s, so too was the prudent fiscal management of the late 1990s. Fiscal policies that drove the speculative bubble ever higher while weakening the national tax base followed the path of privatized Keynesianism and laid the foundations for later austerity.
Recovery Without Transformation
Ireland’s story offers some important lessons about actually existing economic liberalism. Ireland is often classified with the Anglo-American ‘liberal’ family of capitalisms, and some features of its experience are similar. Cutting capital gains tax and providing tax breaks to boost investment, relying on the stock market to provide oversight, insisting on ‘light-touch’ banking regulation, and limiting state capacity to even gather information about bank activities—all these crucial and familiar ‘market mechanisms’ contributed directly to Ireland’s disastrous crash. These combined with other features common to liberal political economies—centralized governmental power and weak civic institutions, welfare states focused on transfers rather than services, structural budget deficits, and a macroeconomic strategy based on domestic consumption rather than export production—to produce economic crisis.

More than six years after its crash, Ireland’s economy is now showing signs of a significant recovery. In particular, employment is growing and tax revenues are increasing, while budget deficits are narrowing. This employment growth is, however, only loosely related to ‘internal devaluation’ and the improvement of wage competitiveness. Even foreign firms have only been a part of this recovery. Improved investment and innovation underpin the growing importance of Irish-owned manufacturing, information technology (IT), and business services firms to employment, and the state has played a key role in creating new markets and investors in commercial property development, also a key driver of employment growth (Byrne forthcoming; Ó Riain forthcoming). In both these sectors, wages have not declined but in fact have grown modestly.

However, Ireland’s ability to move forward is threatened by the same three trends that contributed to its crash. While banks are not lending as recklessly as they once did, they have provided little credit to productive businesses, and the government has only just created a long-promised state investment bank (which now seems to be stimulating new levels of activity in private bank business lending). Both finance and property are once again being boosted as growth sectors, and rising rents and prices are putting pressure on households and small businesses.
Alongside this emerging refinancialization, the Eurozone’s policy response has been famously inadequate. Perhaps it is not surprising that European leaders have pursued austerity as even Europe’s social democracies have historically been reluctant to run budget deficits and expose themselves to international financial markets. But it does seem surprising that these same social democracies have consistently rejected serious attempts to balance current spending cuts with significant investment plans to boost growth or social well-being. A current investment plan, channelled through public agencies, is dwarfed by a new round of ‘quantitative easing,’ which shovels funds into private finance. While ‘cheap money’ is helping Ireland’s business gain some credit, the overall effect has been to refloat the financial sector with relatively little impact on investment, given the volume of funds transferred into the European economy. Much of Ireland’s export recovery has been driven by stimulus elsewhere, given the crucial importance of US foreign investment and tourism.

Finally, tax cuts have re-emerged on the political agenda as growth has resumed, not surprisingly a popular move with a beleaguered population. This brings into focus a challenge for the forces opposing current European and Irish austerity policies. Contrary to common perceptions, balancing budgets has not been a tactic of Europe’s economic liberals, but of the EU’s social democrats. They have sought social solidarity in a social contract based on high employment, strong social services, and egalitarian wages—all wrapped in a protective shell of prudent finances. The Irish and European approaches today emphasize only the shell, including precious little of the social protection. The rediscovery of an older social democratic project involving prudence, protection, and economically and socially productive activity—an approach too long marginalized within EU policy debates—is long overdue.

References

Bibliography references:


Block, F. 2012. ‘End this Depression But How?’ Dissent, summer. Available at: <https://www.dissentmagazine.org/online_articles/end-this-depression-but-how> (accessed 3 July 2016).


Access brought to you by: