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A comparison of policy responses: Four crisis economies

Keywords: Crisis, economic, policy, change, ideational, paradigm.

Introduction

This paper examines the economic crises affecting Ireland, Sweden, the United States (US) and Mexico at the start of the 1980s in terms of their impact upon these countries' macroeconomic policies. The four countries were selected for examination as they encompass presidential, parliamentary, republican, constitutional monarchical, federal and unitary systems of governance. Two are European states and two are from the Americas, two are large economies while two are small, finally while three of these countries were democracies, Mexico was not a fully functioning democracy at the time. Thus, they encompass an interesting selection of various types of states. Macroeconomic policies were selected for examination as commentators (academics and journalists) tend to focus primarily upon macroeconomic policy instruments, while dealing with the broader sweep of policies affected at the time would have required more space that is available here.

Each country's response to the crisis afflicting it, tempered as it was by a combination of historical and political factors, provides an insight into that political economy. These findings also enable us compare and contrast the nature of each crisis and the policy responses each country adopted. As Blondel (1995: 3) points out, through studying politics comparatively we can discover trends, and achieve an understanding of broader characteristics (Blondel, 1995: 3). The value of comparison is in the perspective it offers, and its goal of building a body of increasingly complete explanatory theory (Mahler 1995; Mayer et al. 1993).

The Policy Change Literature

Policy change is a complex process, and must be seen in the context of societal and political change (Feldstein, 1994). A crisis implies prevailing policies cannot be sustained without deterioration (Haggard and Kaufman, 1995: 14). An economic crisis can influence policy preferences leading to policy change (Stevenson, 2001: 621). Due to the complexities in trying to understand the nature of policy change, the issue has been approached from a variety of perspectives.

Advocacy collation theory focuses on coalitions sharing core policy beliefs, on policy-oriented learning, to explain radical policy change (Meijerink, 2005: 1061). An advocacy coalition consists of 'elected and agency officials, interest group leaders, researchers who share a particular belief system' (Sabatier, 1988: 139). The epistemic communities explanation focuses on networks of individuals who share policy relevant knowledge as they seek to achieve policy change (Haas, 1992: 3). According to the advocacy coalition approach, for policy change to occur, an external shock is required, such as a macroeconomic crisis (Sabatier and Jenkins-Simth 1999; Nohrstedt, 2005: 1042). For the epistemic community approach, policy change may be triggered by uncertainty over the seriousness of problems in the polity (Meijerink, 2005: 1063).

Based on the concept of windows of opportunity the policy streams approach to policy change incorporates a role for the policy entrepreneur in engendering change (Kingdon, 1995;

Zahariadis, 1999). Windows of opportunity arise due to exogenous shocks (Garrett and Lange, 1995). For policy change to occur, when a window of opportunity forms, policy entrepreneurs attempt to gain political support for the solutions they put forward (Zahariadis, 1999). To do this, policy entrepreneurs link problems, ideas, and politics to draw attention to issues and bring them onto government agendas (Mintrom and Norman, 2009: 655).

For Baumgartner and Jones (1993), the process of policy change is marked by long periods of stability disrupted by instances of radical change. The punctuated equilibrium approach illustrates how policy entrepreneurs opposed to extant policy develop alternative ideas, and seek support for this new idea. For policy change to occur, opponents of extant policy must create new perceptions of the issue at stake, and search for support for their newly created policy ideas (Meijerink, 2005: 1064). If they gain support at a high administrative level significant policy change may follow. The critical junctures framework, developed by Hogan (2005; 2006) and Hogan and Doyle (2007; 2008), and perfected by Hogan and Cavatorta (2013) and Hogan and O'Rourke (2015) formalized this argument. It posits that a critical juncture is made up of three sequential events: crisis, ideational change, and policy change.

A growing body of literature is devoted to identifying aspects of incremental policy change. This recognises continuity during upheavals, and gradual change in times of peace that eventually become transformative (Djelic and Quack, 2003: 309–10; Thelen, 2004: 292). Institutions and policies change in subtle, but often significant ways, by a variety of mechanisms, including layering, conversion, displacement and drift. Layering is the placing of new constituents in established institutional frameworks. Conversion is the integration of new groups into institutions, forcing change in the roles these institutions perform. Displacement occurs when new models emerge, calling into question existing organizations (Streeck and Thelen, 2005: 19), while drift refers the absence of institutional stability (Thelen, 2004). As Sheingate (2003: 186) argues, to provide a nuanced account of policy change, we must move beyond the conception of institutions as bastions of equilibrium.

Thus, the literature looks primarily at the importance of external shocks for initiating policy change. However, policy change may be triggered by uncertainty as to the problems in the economy. The key players in policy change literature are policy and political entrepreneurs, and coalitions of actors sharing a common belief or policy relevant knowledge. The key concept in the policy change literature is ideas, extant ideas that underlie existing policies, and alternative ideas that attack current policies. Thus, the literature sees these components as critical to the policy change process.

The United States of America 1980/1981 – The State of the Economy

From the late 1960s onwards US domination of world commerce began to wane as the country labored under the burden of deficits from the Vietnam War, the Great Society program, an explosive expansion in the workforce, unemployment, and growing foreign competition. The enduring recession brought on by the 1973 oil crisis only exacerbated matters. During the 1970s Presidents Nixon and Ford attempted, and failed, to curb inflation, and cure the recession, resulting from the oil crisis.

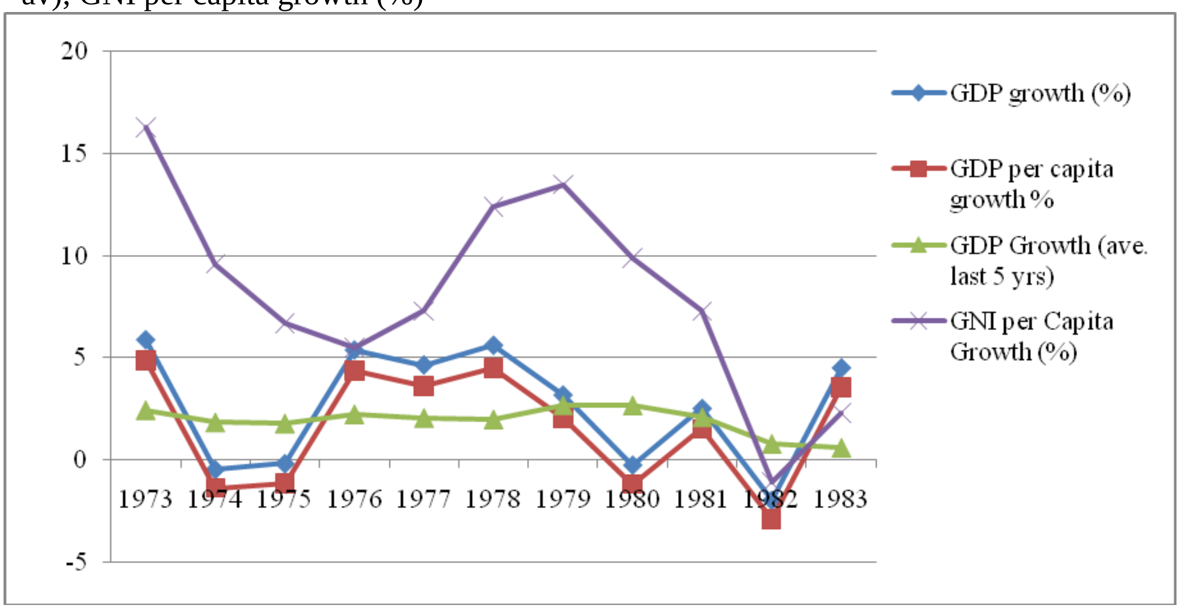
Democratic Party candidate Jimmy Carter was elected President in 1976. At first, Carter pursued expansionary fiscal and monetary policies to reduce unemployment, but a surge in inflation halted this. The oil price increases resulting from the Iranian revolution in January

1979 set off that decade's second oil crisis. As inflation climbed, Carter's approval rating fell to 21 per cent, its lowest level since ratings began (Wayne, 1992: 260). 'Washingtonians joked that he was the first President with poll ratings lower than the prime interest rate' (Boller, 1996: 355).

The need to reduce inflation constricted the liberal agenda, and induced friction between Democratic policymakers and their interest group allies. Inflation drove the administration towards wage and price guidelines, and tighter fiscal and monetary policies, which the trade unions abhorred. As the experience of the Callaghan government in Britain suggests, the exigencies of the international economy at this time produced tensions, and sometimes confrontations, between social democratic governments and their core constituencies (Krieger, 1986: 25).

In 1980 inflation rose to 15.2 percent (Appendix A). Federal Reserve Board (Fed) Chairman Paul Volcker believed the only remedy was tightening the money supply (Krugman, 1990). In March 1980, the President invoked the Credit Control Act, asking the Fed to impose new controls on credit. However, this inadvertently reduced borrowing, producing a decline in economic growth which slowed to 0.3 per cent (Appendix A) (Byron 1980a: 44). Consequently, the Fed sought to lower the discount rate. However, the Carter administration's massive budget deficits deepened the Fed's dilemma. Figure 1 shows that all measures of GDP growth were stagnant, while GNI per capita growth collapsed between 1979 and 1982.

Figure 1: America (1973-1983) GDP Growth(%); GDP per capita growth(%); GDP growth(5 yr. av); GNI per capita growth (%)



Source: Data Gob, Government Indicators Database

The National Bureau of Economic Research (NBER) declared the US in recession in June 1980 (Time, 1980a: 48), while the Commerce Department reported that leading economic indicators had suffered their largest declines in a generation.[1] By August the Fed was reporting

[1] The Washington Post, 1 June 1980, p. A1.

that the country's factories had operated at 74.2 per cent of capacity in July, their lowest level in five years.[2]

By the second half of 1980 the administration's responses to the recession smacked of crisis-management. President Carter's $32.2 billion stimulus package, unveiled in early September, was criticized as 'a weak smorgasbord of morsels instead of a bold strategy.'[3] The proposed tax reductions were seen as an admission that incomes policy was incapable of coping with inflation.[4]

The tighter Fed policy, and higher interest rates, provoked Carter to condemn Fed Chairman Volcker. Although the White House supported Volcker's struggle with inflation, Carter had grown concerned over the impact of interest rates on his re-election bid.[5] The Fed's shifting monetary policies – slowing the growth of the money supply to restrain inflation, then permitting it expand to prevent the recession getting out of hand, before tightening the money supply again – contributed to gyrations in the economy (Church et al., 1981: 44). Prominent economists criticized the Fed's actions, saying they cast doubt on whether it intended to meet its commitment to slow the growth of the money supply to combat inflation.'[6]

Despite declaring the economy to be in recession[7], Volcker intended maintaining high interest rates to keep a rein on the money supply and curb inflation.[8] The Fed ultimately pushed interest rates to their highest levels in a century, slowing borrowing by businesses and individuals alike, and sending the housing and automobile industries into a decline (Time, 1980a: 50). 'Through the joint actions of the Reserve Board and the administration, the economy had been inadvertently plunged into the kind of major recession the White House had been trying to avoid' (Dark, 1999: 120).

The United States of America 1980/1981 – The Policy Response

The imposition of controls on consumer credit contributed to the economy's slide and to widespread dissatisfaction with, and critiques of, government policy (Byron 1980a: 44). The economy was in what Arthur Okun called "the great stagflation swamp" (Byron 1980b: 17). Alan Greenspan observed that, in allowing the economy deteriorate Carter was forced into a crash program of restraint that lead to a rise in unemployment (Byron, 1980b: 19). Critiques of extant policy coalesced around alternative ideas purporting to tackle the economy's ills, namely monetarism.

The monetarist ideas of Milton Friedman, and Robert Lucas, as propounded by organizations such as the American Enterprise Institute, had been present in political circles since the early 1970s (Blyth 1997: 236–37). Such organizations ensured that economic journalism propagated their theories (Blyth, 1997: 237), with the *Wall Street Journal* acting as 'effective synthesizer and chief proselytizer for these ... ideas' (Blyth 2002: 164). Thus, a clear set of alternative ideas, and policy entrepreneurs, were present. Ronald Reagan embraced this ideology.

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[2] ibid., 19 August, p. D6.
[3] The New York Times, 2 September 1980, p. 12.
[4] ibid., 5 October, 1980, p. 8.
[5] The Washington Post, 3 October 1980, p. A1.
[6] The Wall Street Journal, 2 October, 1980.
[7] ibid., 20 November 1980, p. B1.
[8] ibid., 23 September, p. D1.

Reagan's message was to reduce taxes, spending on social services, government regulations, and the size of government itself in order to balance the budget. He favoured increased defense spending, and efforts to encourage the collapse of Communism. Where Barry Goldwater failed in 1964, Reagan was convinced he could triumph in 1980. He blamed the Democrats' inflationary policies for stifling productivity and that they had "created a severe depression" (Kelly 1980: 9). The causes of the 1970s inflation were far more complex than simply the growth of the money supply (rising oil prices, falling productivity, declining value of the dollar) due to increased federal spending, but Reagan, acting as Friedman's translator, placed things in this context (Madrick, 2009: 6).

During the final stages of the election Reagan declared Carter's record on inflation and unemployment "a failure on a scale so vast, in dimensions so broad, with effects so devastating, that it is virtually without parallel" (Church 1980: 17). Reagan attacked Carter for permitting a doubling in the so-called misery index (Okun's discomfort index) that Carter had badgered Gerald Ford with during the 1976 campaign (Time, 1980b: 45). Through this approach Reagan forged an electoral coalition around the notion of monetarism (Blyth 1997).

On 4 November Reagan was elected President in a neo-conservative avalanche that carried 44 per cent of the trade union vote[9], traditionally some of the Democrats strongest supporters. Carter had inherited a bad situation, but left it worse. The new administration's economic policies were different from those of its predecessor in their political roots and theoretical foundations (OECD, 1982a: 9). To combat stagflation he promoted a painless panacea: tax cuts based on the proposals of Arthur Laffer, and deregulation, wherein the resulting stimulus would boost revenues to balance the budget, reducing inflationary pressure.

The new president's program, dubbed Reaganomics, constituted the belief that American capitalism, freed from the burden of taxes and regulation, would surge ahead. Reagan's first budget proposed $750 billion in tax cuts over three years (Jones, 1995: 597). The administration also cut $11 billion from public works, job training programs, and unemployment benefits (Brown, 1981: A1). According to the OECD (1982a: 24) 'a trend towards reduced economic regulation was carried further by the immediate application of the remaining stages of crude oil price decontrol and the abolition of the Council on Wage and Price Stability.' That said, Reagan did not so much reduce the tax burden as shift it, with the fall in income tax being complimented by an increase in payroll taxes for social security (Madrick, 2009: 21). At the same time spending was redirected into a huge peacetime military build up.

Reagan, acting as political entrepreneur, capitalized on anti-government sentiment, emphasizing individualism and a smaller Federal role. Tax relief was allied to a restructuring of federal expenditure, bringing sharp changes in the fiscal influence on the economy. Reagan won the election by having a discernible set of alternative ideas which could replace extant arrangements. The result was a clear mandate for neo-conservative policies (OECD 1982a: 10). D'Souza (1997: 85) saw Reagan's program as the most ambitious since the New Deal.

Mexico 1981/1982 – The State of the Economy

After the Second World War Mexico implemented an import substitution policy (Narula, 2002). This encompassed protecting the agrarian and consumer goods sectors behind import quotas

[9] The Washington Post, 16 February, 1981, p. A1.

(González, 2005). The model succeeded as there was demand for Mexican raw materials. However, it created a private sector dependent upon state protection (Hernandez, 2008)[10]. Import substitution was superseded by a policy referred to as stabilizing development in the 1960s (Salinas, 1999). This focused on enhancing productivity and competitiveness (McCaughan 1993; Salinas 1999).

When President López Portillo came to power in 1976 he inherited a balance of payments deficit, sectorial disequilibrium; and socioeconomic inequalities threatening political stability (Alarcon and McKinley 1992). This was partly due to the effect of the 1973 oil crisis (Mexico was a net oil importer at the time), the resultant worldwide recession, falling agricultural exports, rapid population growth, and middle class disillusionment with its inability to express itself in a one party (Institutional Revolutionary Party (PRI)) dominated culture signalled the end of stabilising development (Rubio[11], 2008). Following the oil crisis the government expanded expenditure and increased its intervention in the economy (Lustig, 1998). This, combined with a negative agricultural supply shocks, led to inflation reaching 20 per cent in 1974 (Moreno-Bird and Ros, 2009: 129).

However, in 1978 Petróleos Mexicanos (PEMEX), the state oil company, discovered huge oil reserves, and with the second oil crisis in 1979, an oil boom followed (Székely, 1983; McCaughan 1993). The hope was that oil revenues would stabilize the economy (Calderón-Madrid, 1997). However, this only circumvented the danger of immediate crisis, without resolving the economy's structural problems (Nelson, 1990: 95).

Once Mexico became a net petroleum exporter pressure grew to expand public spending (Bailey, 1980). 'Rather than pay the political price that sweeping redistributive policies – especially tax reform – would have entailed, the Portillo administration (1976-1982) sought to expand the economic pie and increase the role of the state in the economy' (Cornelius, 1985: 88). As the number of state owned enterprises quadrupled, expenditure outstripped petroleum revenues and an anaemic taxation system (Calderón-Madrid, 1997; Solís, 1981). To finance these projects Mexico borrowed $78bn. by 1981 (Alarcon and McKinley, 1992). The economy began to overheat, and as inflation surpassed 25 percent in 1981 the peso became overvalued, and the competiveness of exports, apart from oil, diminished (McCaughan, 1993).

Recession in the US reduced demand for Mexican goods, and weakened the international oil market, while a sharp increase in interest rates there reduced the money supply, and put pressure on Mexico's debt servicing, as US banks had lent the country $25 billion. Servicing Mexico's total debt reached $16 billion in 1982, more than its revenues from oil (Cornelius, 1985: 89). As oil prices fell, in response to a weakening international economy, PEMEX declared oil production would be insufficient to reactivate the economy.[12] 'Collapsing oil prices and rising international interest rates erased Mexico's prosperity' (Starr, 2006: 53). The critical error by the Mexican government had been to see high and increasing oil prices as a permanent feature of the international economy, while increasing interest rates were regarded as a temporary phenomenon (Moreno-Bird and Ros, 2009: 135).

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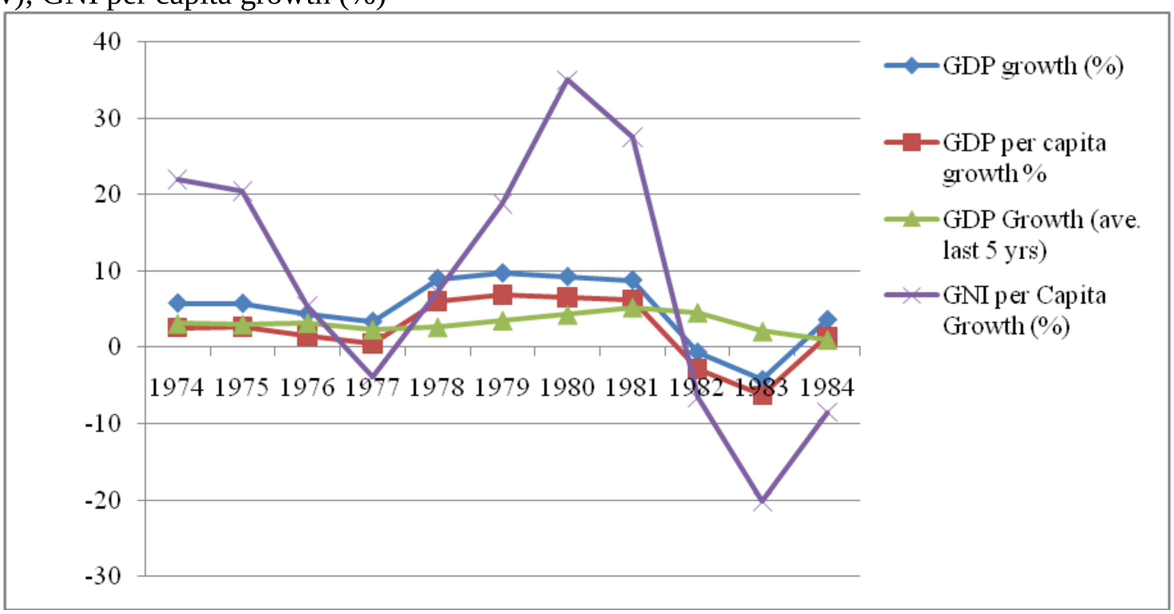
[10] **Luis Miguel Beristain Hernandez**, PhD in Administrative Sciences. Business and Politics professor, Director of Professional Development, Enterprise Development and Social Development at ITESM (Interviewed July 2008).
[11] **Luis Rubio**, PhD in Political Science. Mexican writer on politics, and economics. (Interviewed July 2008).
[12] *Magazine Nexos, Sociedad, Ciencia y Literatura,*. January, 1982. "De Díaz Mirón a Díaz Serrano".

By 1982, as confidence in the economy waned, Mexicans began converting pesos to dollars at 25 billion a day (Sancton et al., 1982: 40). The gravity of the situation came to international attention on August 13, 1982, when:

> The government fired the shot heard around the world, announcing that it could not meet interest payments coming due within the next few days and initiating negotiations for bridge loans and rescheduling agreements with the US Treasury, the IMF, and the private commercial banks. (Nelson, 1990: 97)

GDP contracted by 0.6 per cent in 1982 and 4.2 per cent in 1983 (Appendix A). As Figure 4 shows, all measures of GDP were in decline by the early 1980s, while GNI per capita growth underwent the largest collapse of the countries examined. Inflation reached 58.92 percent in 1982 (Katz, 1994). Output fell in all industries,[13] unemployment jumped towards 15 percent,[14] while more than 20 million people, half the workforce, were underemployed (Cornelius, 1985: 92). Compounding matters, US banks stopped lending to Mexican companies as they owed US$600 million in unpaid interest.[15] The budget deficit stood at 16.5 percent of GDP.[16]

Figure 4: Mexico (1974-1984) GDP Growth(%); GDP per capita growth(%); GDP growth(5 yr. av); GNI per capita growth (%)



Source: Data Gob, Government Indicators Database

This was the worst crisis to hit Mexico since the Great Depression (Edwards, 1995: 17). Minimum wages were insufficient to meet the needs of most Mexicans (Lustig, 1986). Opinion polls found great scepticism concerning the economy (Basañez, 1985). Whereas the 1970s had seen an influx of FDI, the early 1980s witnessed its flight (Edwards, 1995). Despite growing by

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[13] ibid.
[14] ibid, 20 December, 1982.
[15] ibid, 1 January, 1983.
[16] ibid., 20 December, 1982.

8 per cent annually between 1978 and 1981, by the end of 1982, Mexico faced one of the severest crises in its history (Barker and Brailovsky, 1983).

Mexico 1981/1982 – The Policy Response

By mid March 1982, President Portillo's administration was scrambling to save the economy (Taylor and Lopez, 1982: 38). During the 1982 presidential election all contenders focused on the crisis. However, as Mexico was an evolving democracy, opposition parties were not sufficiently strong to challenge PRI's position. Miguel De La Madrid, a fiscal conservative, was the PRI's candidate.[17] He was 'among the leaders of the conservative faction based in the treasury' (Nelson, 1990: 98). His selection constituted a rupture with the PRI's rhetoric of harking back to a revolutionary ideology (Cárdenas, 2008)[18]. However, Mexican society was in turmoil, and free market supporters wanted a president who would support the rights of private property (Luna et al., 1987).

In his inaugural address De La Madrid declared a new economic approach was needed.[19] However, 'policy options and instruments appeared limited [for Mexico], which as a debtor was subject to the conditionality imposed by the International Monetary Fund (IMF)' (Golob, 2003: 375). The fact that the IMF was dictating policy indicates that political entrepreneurship for Mexico had moved from the domestic to the international context. Sources of external finance had dried up in the aftermath of the crisis (Hernandez, 2008). Even when oil prices rose, the industry did not have the capacity take advantage. De La Madrid wanted to take policy to the right, stabilizing and opening the economy (Lustig, 1992: 28). The new government sought to keep domestic interest rates competitive (Looney, 1985: 112), while incentivising exports. For decades free trade had been 'the policy option that dare not speak its name' (Golob, 2003: 370). An austerity program – *Programa Inmediato de Reordenacion Economica* – was introduced (Lustig, 1998: 29), along with a draconian budget for a 50 percent deficit reduction[20].

The government 'embraced an approach toward liberalisation, privatisation and deregulation' (Pastor and Wise, 1997: 421). However, a major concern was Mexico's inability to compete in foreign markets, and its inadequate level of saving.[21] The administration signalled its desire for FDI by relaxing investment restriction (Cornelius, 1985: 115), permitting Mexican businesses form international partnerships (Tournaud, 2008). These policies had a significant impact upon economic, and social, development (Cornelius, 1985: 84).

During 1982 the peso was devaluated twice to increase exports (Katz, 1994). However, the exchange rate with the dollar collapsed from 23 peso to the dollar in 1980 to 143 in 1983. De La Madrid also sought a less confrontational approach to the IMF (Nelson, 1990: 63). 'Acceptance of the IMF embrace [was] a major break-through' (ISG, 1982: 1720), as it permitted Mexico avoid a debt moratorium (Looney, 1985: 121). The reduction in government spending enabled Mexico reach its IMF targets for reducing the public sector deficit. However, this had a

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[17] ibid. 5 October, 1981.

[18] **Cuauhtémoc Cárdenas**. Mexican politician, active in Mexican politics in the 1980s and important political representative of Mexico's opposition parties (Partido de la Revolución Democrática [PRD]).

[19] First Annual Presidential Report of President Miguel De La Madrid, 1September, 1983.

[20] ibid.

[21] Latin America Regional Reports, 4 June, 1982, pp. 1-2.

recessionary impact (Pastor and Wise, 1997: 421) as fiscal and monetary solutions proposed by the IMF and OECD (changing from import substitution to export promotion) failed to take account of the global contraction (Allen et al., 1992).

De La Madrid recognised that his administration could not rely on oil exports.[22] The solution to financing development was sought through privatising public enterprises, of which 1,155 were sold off (Hernandez, 2008). De La Madrid sought to combine macroeconomic stabilisation and structural change, with a focus on export orientated manufacturing (Cornelius, 1985: 110).

The Economic Solidarity Pact was introduced in 1987. Signed by business, labour, and peasant leaders, its objectives were to further reduce the fiscal deficit, tighter monetary policy, the liberalisation of trade, and a comprehensive agreement on incomes' control (Lustig, 1992: 51). This increased flexibility in collective bargaining contracts by reducing fringe benefits, union influence, and privileges (Serrano, 1997).

Although these austerity measures resulted in labour unrest, the relationship between the private sector and the state transformed over the 1980s (Middlebrook, 2004). Neoliberal reforms made the private sector a key player in reviving the economy (Beristain, 2008; Tournaud, 2008). Business organisations became engaged in debates over economic policy, where previously the private sector had been kept at a remove (Golob, 2003: 371). As a result, business confidence improved (Warnock, 1995). These events opened the way for increased democratization. Thus, Mexican economic history can be divided into before, and after, 1982 (Cárdenas, 2008; Serra-Puche, 2008). Mexico started down a different path under De La Madrid.

Ireland 1981/1982 – The State of the Economy

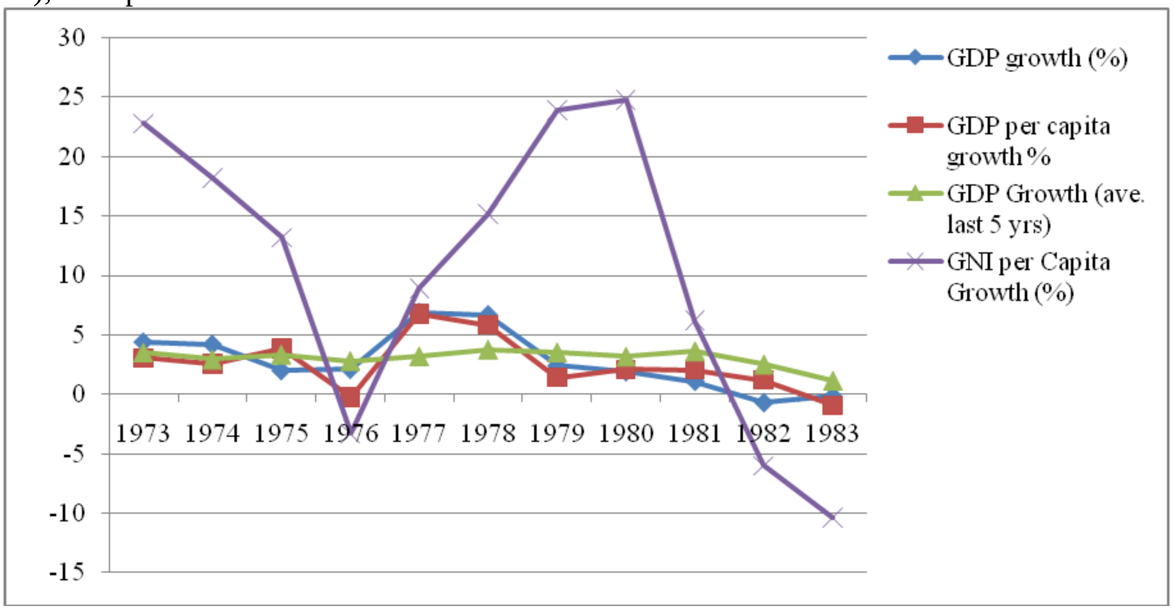
The latter years of the 1970s saw the Irish economy recover from the downturn following the 1973 oil crisis. Inflation and unemployment began to fall, while growth returned (Leddin and Walsh, 1998: 26). Real GDP increased by about 5.3 per cent from 1976 to 1979 (OECD, 1982b: 8). However, the Fianna Fáil government that came to power in 1977 employed an expansionist fiscal policy when the economy was growing at an unsustainable rate (OECD, 1982b: 10). Strong pro-cyclical fiscal policies led to deterioration in fiscal balances, with the public sector-borrowing requirement increasing from 13 percent of GNP in 1976 to 20.1 percent in 1981. The structural problems highlighted during the first oil crisis remained unresolved by the time the second crisis struck in the wake of the Iranian revolution. This exacerbated inflationary pressures, and resulted in record deficits in both the current external balance and the public sector accounts (OECD, 1983: 7). The government implemented expansionary policies in 1980 on account of the worsening international economic climate, increasing unemployment and emigration (OECD 1982b: 50). However, this increased inflation to 18.2 per cent in 1980 (Appendix A).

Adjustment to the European Monetary System (EMS), entered in 1979 after severing the link with Sterling, initially failed to bring inflation down. Following its rapid growth in the second half of the 1970s domestic demand fell in 1980 and remained weak in 1981. Reducing inflation, the elimination of government borrowing, and the provision of increased incentives for industry were all seen as essential to righting the economy. By 1981 GDP growth had fallen to

[22] The Third World Magazine, December, 1983, p. 72.

1.1 per cent, while Figure 3 shows that all measures of GDP were stagnant. Additionally, GNI per capita growth declined between 1980 and 1982. Unemployment reached 9.3, with the manufacturing industry experiencing a fall in output of 2 per cent and the loss of 10,000 jobs, while the building industry was also in recession (NESC, 1981: 1-3). Coinciding with the slowdown in GDP growth the rate of unemployment and inflation rose towards historically high figures (Appendix D), despite government commitments to full employment (OECD, 1982b: 10).

Figure 3: Ireland (1973-1983) GDP Growth(%); GDP per capita growth(%); GDP growth (5 yr. av); GNI per



Source: Data Gob, Government Indicators Database

The fiscal deficit, intended to be temporary, became impossible to eliminate in an economic climate of decline. By 1981 Irish national debt reached £10.195 billion, of which £3.7 billion was external (Leddin and Walsh, 1998: 155-156). Leddin and O'Leary (1995: 167) state that at this time the public sector borrowing requirement peaked at 20.1 per cent of GNP, the national debt stood at 80 percent of GNP, while the current budget deficit stood at an equally unsustainable 7.3 per cent of GNP. The balance of payments deficit was 13 per cent of GNP.[23] Almost half Exchequer borrowing in 1981 went to financing the current budget deficit (Bacon et al., 1982: 6). Fianna Fáil's policies reduced growth from over five per cent in 1977 to effectively zero by 1981, and in the same period doubled the national debt. The government's spending was so high the total amount budgeted for 1981 had been consumed by June.

The need to control public expenditure, reduce the deficit, and prevent excessive reliance on foreign borrowing, dictated the adoption tighter fiscal policies. However, the catch-all nature of Irish political parties imposed an inducement on governments to buy off short-term pressure from interest groups through ad hoc policy concessions. This worked against consistency in imposing severe economic policies, and formulating enduring agreements between the state and economic interest groups found in Continental neo-corporatism. When the Irish government

[23] Central Bank of Ireland, Annual Report, 1982, p. 16.

made an economic policy decision they were usually loath to stick with it for fear of alienating some group of supporters.

Ireland 1981/1982 – The Policy Response

The 1981 general election saw a minority coalition government of Fine Gael and Labour replace Fianna Fáil. At a most inopportune time, the country found itself condemned to, what proved to be, a period of weak and unstable government (Walsh, 1981: 1). The new government sought to bring order to the public finances, constraining rising public service pay more tightly the previous Administration (FitzGerald, 1991: 385). The supplementary budget introduced in July 1981 was designed to reduce the central government borrowing requirement and the balance of payments deficit. However, being a minority Administration made it difficult for the government to maintain it policies, and its time in office proved a matter of daily crisis management (O'Byrnes, 1986).

Not only economically, but politically, instability peaked in 1981-1982 (Mjoset, 1992: 381). Between June 1981 to November 1982 three general elections brought a change of government. The minority Fine Gael-Labour Coalition fell on budget day 1982. It was succeeded by a minority Fianna Fáil administration in March. In autumn 1982 the Fianna Fáil's government's cutbacks alienated the independent deputies supporting it and the government collapsed (Collins, 1992: 62).

By 1982, although all Parties agreed on the need to stabilize the debt/GNP ratio (Mjoset, 1992: 381). The ideas underpinning economic growth of the 1970s, Keynesian and neo-corporatism (Bew et al. 1989), were abandoned, as balancing the budget became critical. But, apart from crisis-induced cutbacks, no coherent ideas/policy options emerged, as the governments of this period were of such short duration and unstable character.

The general election of November 1982 was won by a majority Fine Gael-Labour Coalition which remained in power until 1987. By November 1982, with national debt exceeding GNP, and the current budget deficit spiralling out of control, a coherent corrective policy was essential. Thus, the state of the public finances permitted the government little scope for action other than austerity measures. All political parties became committed to curbing public expenditure as an essential precondition for economic recovery (Munck, 1993: 38). However, the Coalition government experienced difficulty in devising an effective strategy (O'Byrnes, 1986: 219).

The deflationary medicine was first applied in early 1983 with cutbacks in health spending and the public capital programme (O'Gráda, 1997). However, with the economy stagnating unemployment more than doubled between 1980 and 1985, and as a result government spending on social services jumped from 28.9 per cent of GNP in 1980 to 35.6 per cent by 1985 (Leddin and Walsh, 1998: 302). By the mid 1980s the economy was in a downward spiral, with high taxes and interest rates depressing investment and productive capacity. Control over current spending proved difficult with high unemployment and rapid population growth. The economy over 1980-1985 marked a major discontinuity with the experience of the 1970s (NESC, 1986: 2). By the mid-1980s unemployment was being offset by emigration (OECD, 1986: 12).

By 1987 the national debt had tripled to 130 per cent of GNP (McCarthy, 1999). Nevertheless, over its four and a half years in power the Fine Gael-Labour coalition succeeded in cutting inflation from 17 per cent to less than 4 percent, and the borrowing requirement was almost halved to 13 percent of GNP. Nevertheless, the macroeconomic policies introduced to shelter Ireland from the consequences of the oil shocks of the 1970s, and political recklessness, had led to unsustainable macroeconomic imbalances. The period 1980 to 1987 was one of prolonged recession, falling living standards, huge unemployment, and emigration (O'Donnell 1998, 6).

Additionally, the Fine Gael wing of the coalition decided that the social partners had no right to influence economic policy (Jacobsen, 1994). Thus, the centralised agreements (between the trade unions, employers, and government) that, by the late 1970s had acquired a macroeconomic significance, as they became wide-ranging wage and policy accords, were ended as the government considered the terms that characterised them incompatible with curbing spending (Cox, 1983). Thus, many interest groups, especially the trade unions, found themselves removed from the corridors of power (Roche, 1994: 172).

Sweden 1981/1982 – The State of the Economy

After the 1973 oil crisis Sweden experienced recession and stagflation. This contributed to the Social Democratic Party's (*Socialdemokratiska Arbetarepartiet* (SAP)) loss of power for the first time in 44 years in 1976. The SAP had been the most dominant political party in Western European politics (Bergstrom, 1991: 6). Thereafter, the SAP shifted more to the right of the political spectrum. The non-socialist government commissioned reports on the economy that were all infused with 'the rising currents of monetarism, public choice theory, and neo-liberalism that were to come to the fore in the coming decade' (Andersson, 2006: 101). The second oil crisis reinforced the impact of the first. Economic performance during the first two years of the 1980s was particularly poor. Furthermore, in spite of the adjustment policies pursued by the authorities, correction of the imbalances that had built up since the 1970s was slow, and the economy remained in disequilibrium (OECD, 1984: 7).

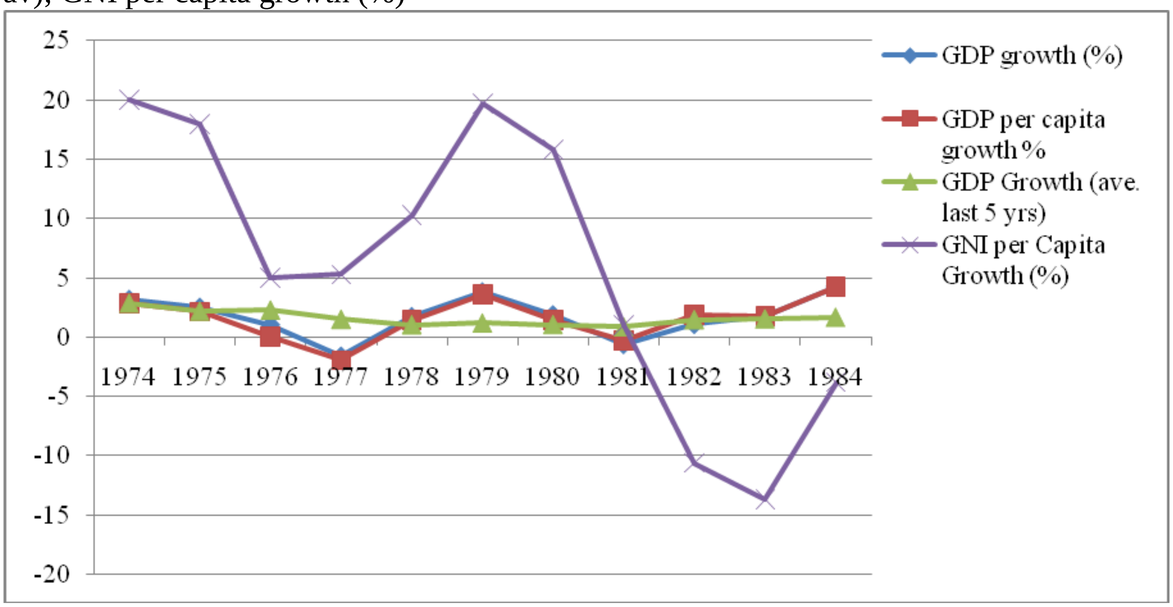
Growth in public expenditure outstripped growth of the economy (OECD, 1984: 9). The public sector's share of GNP rose under the non-socialists (1976-1982), so that by 1982 public sector expenditure constituted 67 percent of GNP (OECD, 1990: 59). This explains how the number of public sector jobs increased by 43 percent between 1972 and 1982, coming to outnumber those in private industry after 1978 (Gress, 1988). Productivity growth declined significantly from 1970 onwards due to the size of the public-sector (Lindbeck, 1997). This had a knock on effect on the level of exports, which stagnated over the decade (Ryden and Bergstrom, 1982). Worryingly, Sweden's share of the world economy dropped 40 percent during that decade (Peterson, 1987). Foreign competition made substantial inroads on the Swedish domestic market, as suggested by the steady rise in the share of imported manufactured goods (OECD, 1984: 12).

Central government's expenditure grew at a faster pace by the end of the 1970s than at the beginning of the decade, while revenues stagnated. The budget deficits were financed through borrowing. However, there was no political mandate for either radical budget cuts or revenue enhancements. To avoid internal disputes, the non-socialists parties in government wanted neither to raise taxes nor be accused of trying to dismantle the welfare state (Branegan, 1982: 32).

In 1981 inflation hit 12.1 percent and unemployment reached 3.1 per cent in 1982, its highest level since 1945 (Appendix A). Although this would have been a low figure elsewhere, it was a scandal in a country accustomed to full employment (Apple Jr. 1982: 3). However, many economists believed unemployment was closer to 16 per cent if it included the jobless in training programs, workers forced into early retirement and those who had given up looking for work (Branegan, 1982: 32).

For Swedes this was an unprecedented situation. Economic growth, which had averaged 2.5 per cent throughout the 1970s, contracted in 1981 and expanded by only 1 per cent in 1982. Figure 4 shows that all indicators of GDP growth were low in the early 1980s, while GNI per capita growth collapsed. In the context of the international recession of the early 1980s, the budget deficit prevented the government pursuing a counter-cyclical fiscal policy.

Figure 8: Sweden (1974-1984) GDP Growth(%); GDP per capita growth(%); GDP growth(5 yr. av); GNI per capita growth (%)



Source: Data Gob, Government Indicators Database

With a sluggish economy, stagnant revenues, and rising expenditures, the government's budget deficits accelerated during the 1970s, reaching 13 per cent of GNP in 1982 (Siven, 1984). The Riksbank predicted that 'the deficit on the national budget would grow from around SKr78 billion under the 1982-83 budget to some SKr90 billion in 1983-1984' (Dullforce, 1982: 1). 'In an international context, both the level of the budget deficit, and the swing in the budget balance since the mid-1970s has been more pronounced than in most other OECD countries' (OECD, 1982c: 16). By 1982 Sweden's debt/GNP ratio stood at 59.3 per cent, whereas 12 month before it had been 50.8 per cent, its growth an indication of the size of the budget deficit. The Swedish debt/GNP ratio increased by 250 percent in 6 years.

The *New York Times* argued that the Swedish economy, once the envy of Europe, had been hobbled by foreign debt, an adverse balance of payments, slow growth, and unemployment.

Compounding matters, Swedes were reluctant to see the welfare state cut back and to accept the remedies proposed to deal with their problems (*Financial Times*, 18 September 1982: 15).

Sweden 1981/1982 – The Policy Response

In autumn 1981 a 10 percent devaluation of the krona was conducted, and in the spring of 1982 the non-socialist coalition government introduced an austerity program. However, the opposition SAP gained in popularity (Hadenius, 1997: 129-30). The non-socialists wanted to neither raise taxes, nor be accused of dismantling the welfare state (Branegan**,** 1982: 32).

The 1982 election was dominated by talk of economic crisis (Osnos 1982: A15). During the campaign the SAP, under Olof Plame, attacked the viability of another non-socialist government. The party presented a Crisis Programme on how Sweden could save and work its way out of crisis. The economic problems, and Cabinet crises, deprived the non-socialist government of credibility (Mjoset, 1992). SAP won the election with a set of proposals to correct extant policies and right an economy.

The new SAP government implemented a recovery program: the Third Way (Apple Jr. 1982: 3). It argued that renewed growth required redistribution of income from labour to capital. This also marked a major change in SAP economic planning, behind which lay the influence of its research department which, since 1976, had achieved ascendancy over the Trade Union Confederation's (*Landsorganisationen i Sverige* (LO)) research department within the labour movement (Meidner, 1989). The subsequent cuts in the public sector and restraint in wage negotiations resulted in deep divisions between the SAP and the LO (Andersson, 2006: 116).

The Third Way, an attempt to maintain a level of social democracy (Martin, 2000: 234), was a wide-ranging stabilization program encompassing demand management measures, as well as initiatives to promote structural change and ensure an equitable distribution of the burden of adjustment (OECD, 1984: 21). The SAP was determined to pour funds into job-creating industries, and to increase taxes for that purpose. The party planned to spend $100 million, and hoped to attract an addition $350 million in private investment, to create 30,000 jobs (Apple, 1982: 3). The centerpiece of Finance Minister Kjell-Olof Feldt's strategy was the devaluation of the krona by 16 per cent. The SAP had identified labour costs as the key to international competiveness. This was implemented in conjunction with a price freeze and increases in sales and corporate taxes, in a sweeping "crisis plan" to stimulate the economy and eliminate its imbalances (Dullforce 1982: 1).

The LO, the largest union association, accommodated devaluation by demanding average wage increases of 2.5 per cent in ensuing bargaining. The devaluation, and international economic recovery, resulted in high earnings and export expansion (Ahlén 1989: 333). The thrust of SAP policies pointed in a different direction than previously, with Feldt determined to give priority to private sector growth, profits, and market forces. A series of structural reforms were introduced overturning the traditional priorities of the SAP. Under pressure for more individual freedom, and the internationalisation of the economy, these reforms saw the SAP move in a neo-liberal direction (Taylor, 1991: 17).

Fiscal policy was held tight, and the slimming of the public sector would, it was argued, create crowding in effects (Mjoset, 1992: 349). The public sector austerity strategy, with a profit explosion and wage restraint, created tension between the SAP and LO. Nevertheless, the government restored welfare entitlements cut by the non-socialists (OECD, 1984: 23).

To placate the LO, the SAP, in the face of Swedish Employers' Federation (*Svenska Arbetsgivarforening* (SAF)) opposition, introduced wage-earner funds in 1983. In 1976 the LO proposed that a levy on corporate profits be used to transfer control of enterprises with more than 50 employees to the unions. At the time the SAP had been sceptical about the idea (Whyman and Burkitt, 1993: 612). 'Industrialists regarded the funds as a device to achieve bureaucratic control of industry' (Gress, 1988: 130). However, the version implemented in 1983 been heavily modified from Rudolf Meidner's proposal in 1976 (Gould, 1993). It had transformed 'from an overtly socialist union proposal to a number of toothless share holding funds' (Meidner, 1993: 223). However, the modified version of the funds also dissatisfied the LO (Lewin, 1985a: 296).

To maintain the welfare state the SAP had prioritized private sector growth. The third way marked a reversal in the SAP's perspective on social policy, moving from an investment in growth, to costs that needed to be reduced (Andersson, 2006: 124).

Conclusion

This paper has provided an insight into how four countries sought to deal with the economic crises afflicting them at the start of the 1980s. Their responses to these crises, which, to some extent, could trace their origins to the oil shocks of the 1970s, were dictated by country specific combinations of political, policy and economic concerns. In this respect, the responses of each of the countries were different, and it is these differences that led to the unique policies the countries pursued.

In the case of the US, the long term decline in its dominant economic position, combined with various administrations' inability to damp down the inflationary pressures building in the wake of the 1973 oil shock, led to a crisis in the economy. In response to this crisis President Ronald Reagan sought to take economic policy in a different, if not altogether coherent, direction, reorientating taxes, deregulating, and redirecting government spending away from social welfare programs and towards the military. Reagan saw himself as an advocate of classic liberal economic thinking, though his military expenditure could be seen as Keynesian. During his time in office the economy recovered and grew robustly, with unemployment and inflation falling. However, the national debt increased greatly over this period. This was to prove a debt legacy which future administrations and generations would have to grapple with.

For Mexico, the 1973 oil crisis, uncompetitive industries, and a growing population, placed strains upon its economy. However, the discovery of vast oil reserves in the late 1970s seemed a panacea. Oil was used to finance the expansion of the public sector. However, much additional finance came in loans from the US, which, by the early 1980s, was in recession and experiencing high interest rates. This reduced demand for Mexican exports, and simultaneously added to the cost of servicing the US borrowing. Relying upon oil as a permanent source of increasing income, while paying insufficient heed to rising interest rates, damaged the economy. In response to the crisis the PRI moved to the right under De La Madrid. The increased importance of the private sector to the management of the economy led to its increasing involvement in policy making, opening the way for greater democratization of Mexican society in later years.

In Ireland, a combination of the oil shocks, and the unnecessary implementation of a pro-cyclical fiscal policy in the late 1970s, brought the economy to its knees in the early 1980s. By 1981, as the international economy was going into recession, the Irish national debt, budget deficit and inflation rate were all approaching record levels. Measures to stem the budget deficit and national debt proved futile as economy went into a vicious downward spiral. Irish political parties being catchall in nature worked against their imposing harsh economic policies. Throughout 1981/82 three changes of government impeded the implementation of a consistent approach to righting the economy. By the mid 1980s emigration was reducing the level of unemployment and the population. It would be 1987 before the economy began to very slowly recover.

In Sweden, the impact of the oil shocks, combined with the slowdown in economic growth, began pushing the economic policies to the right. The growth in public sector expenditure, and public sector employment, became unsustainably expensive, and at the same time reduced productivity. Economic growth slowed, unemployment and inflation rose, and the budget deficit and national debt expanded rapidly. In response, the SAP government in 1982 shifted economic policy to the right, moving itself away from the position of its LO ally. The Third Way programme placed the priority on private sector growth and market forces, while shrinking the public sector was seen a necessary to make the economy more dynamic, and growth orientated. Even the introduction of the wage-earner funds was conducted in a half hearted manner, with the form they took being very different from originally envisaged. The emphasis of economic policy had shifted from the public to the private sector, and away from traditional socialism.

Appendix A

Country/Year	Unemployment	Inflation	Debt/GNP ratio	GDP Growth Rates	Interest Rates
America					
1979	5.7	11.3	33.1	2.4	13
1980	7.0	13.5	33.3	-0.3	15
1981	7.5	10.4	32.5	2.3	19
1982	9.7	3.8	35.2	-2.1	15
Mexico					
1980	4.2	26.36	30.53	9.22	22
1981	4.2	27.93	32.59	8.77	28
1982	6.8	58.92	53.3	-0.63	41
1983	6.9	101.7	66.53	-4.2	60
Ireland					
1980	7.3	18.2	71.91	1.9	16
1981	9.9	20.4	77.45	1.1	16
1982	11.4	17.1	86.53	-0.7	17
1983	13.6	10.5	97.60	-1.6	14
Sweden					
1980	2.0	13.7	43.2	1.9	15
1981	2.5	12.1	50.8	-0.6	17
1982	3.1	8.6	59.3	1.1	17
1983	3.5	9.0	64.6	1.8	15

Sources: Leddin and Walsh (1998); Mitchell (1993); Eurostat Yearbook 1997. Luxembourg: Office for Official Publications of the European Communities; Alan Heston, Robert Summers and Bettina Aten, Penn World Table Version 6.1, Center for International Comparisons at the University of Pennsylvania (CICUP); World Bank Group, World Development Indicators WDI Online, http://publications.worldbank.org/WDI/

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