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Economic Crises and Policy Change in the Early 1980s: a Four Country Comparison

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This article examines the impact of economic crises on macroeconomic policies in the United States (US), Mexico, Ireland, and Sweden at the start of the 1980s, framed within the context of the policy change literature. These countries are 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.

Each country's response to the crisis affecting it, tempered by historical and political factors, provides an insight into that political economy. These findings enable us compare and contrast the nature of each crisis and the policy responses adopted. The value of such comparison is the perspective it offers, contributing to the goal of building a body of increasingly complete explanatory theory (Mahler 1995).

The Policy Change Literature

Policy change is complex and must be seen in the context of societal and political change (Feldstein, 2002). A crisis implies prevailing policies cannot be sustained without deterioration. An economic crisis can influence the public's policy preferences, leading to policy change (Stevenson, 2001: 621). Due to the complexities in trying to understand policy change, the issue has been approached from a variety of perspectives.

'Advocacy coalition theory' focuses on coalitions sharing core policy beliefs, and on policy-oriented learning, to explain radical policy change (Meijerink, 2005: 1061). The 'epistemic communities' explanation has a rather different emphasis, focusing 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 (Sabatier and Jenkins-Simth 1999). The epistemic community approach provides insights into the roles of information and learning processes in the development of regimes, and addresses the mechanisms through which new ideas and knowledge relating to problems and policy options may influence policy-making, leading to policy change (Meijerink, 2005: 1063).

Based on the concept of windows of opportunity, the 'policy streams' approach to policy change incorporates a role for policy entrepreneurs in engendering change (Kingdon, 1995). Windows of opportunity arise partly 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. Their 'punctuated equilibrium' framework explains policy stability by the existence of an institutionalized policy monopoly that weakens the pressure for change. However, such a monopoly is not permanent (Meijerink, 2005: 1064). For policy change to occur, opponents of extant policy must create new perceptions of the issues at stake, and search for support for their new policy ideas (Meijerink, 2005: 1064). If they gain support at a high administrative level significant policy change may follow. Once the new policy is widely accepted this initiates another period of policy stability as this policy is institutionalized and a new policy monopoly begins. The 'critical junctures' framework, developed by Hogan and Doyle (2007), formalized this argument. It posits that a critical juncture is made up of sequential events: crisis, ideational change, and policy change.

A growing body of literature is devoted to identifying 'incremental policy change'. This recognises continuity during upheavals, and gradual change in times of peace that eventually become transformative (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, whereas drift refers to 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 policy stability.

Thus, the policy change literature looks primarily at the importance of external shocks in initiating policy change. However, policy change may be triggered by uncertainty as to internal problems in the economy. The key players identified in the policy change literature are policy and political entrepreneurs, and coalitions of actors sharing a common belief. The key concept in the policy change literature is ideas - extant ideas that underlie existing policies, and alternative ideas that undermine current policies. This literature should provide insights into developments in each of the countries examined.

Crisis in the USA 1980/1981: *the State of the Economy*

From the late 1960s, 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 of the workforce, unemployment, growing foreign competition, and the impact of the oil shocks. During the 1970s Presidents Nixon and Ford attempted, and failed, to curb inflation and cure the recession. 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. Oil price increases resulting from the Iranian revolution in January 1979 initiated the decade's second oil crisis. As inflation climbed, Carter's approval rating fell to just 21 percent (Wayne, 1992: 260).

The need to reduce inflation constricted the expansionary agenda and induced friction between Democratic policymakers and their interest group allies. Inflation drove the administration towards introducing 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 in the US rose to 15.2 percent (see Appendix A). Federal Reserve Board (Fed) Chairman Paul Volcker believed the 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 consumer credit, including credits cards (Dark, 1999: 120). However, when consumers promptly responded to the new incentives there was an inadvertently large reduction in consumer borrowing, producing a significant decline in economic growth, which slowed to 0.3 percent during the first months of the year[1] (see Appendix A) (Byron 1980a: 44). By late May the Labor Department announced the purchasing power of the American worker was at its lowest since 1972. In early June 1980 the Fed sought to lower the discount rate from 13 to 12 percent, while the prime lending rate dropped to 14 percent, down from 20 percent only 2 months before.

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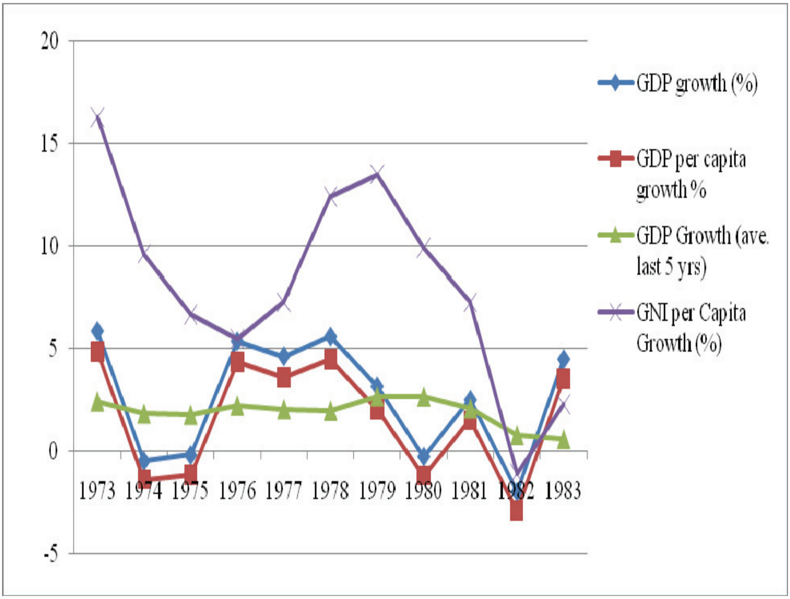
[1] Bureau of Economic Analysis, *National Economic Accounts*, *http://www.bea.gov/national/nipaweb/SelectTable.asp?Popular=Y.*

Figure 1 shows that all measures of GDP growth were stagnant, while GNI per capita growth collapsed between 1979 and 1982.

Figure 1: Indicators of Economic Performance, US (1973-1983)



Source: DataGov (*http://www.iadb.org/DataGob/*), Governance 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 leading economic indicators had suffered their largest declines in a generation.[2] By August the Fed was reporting that the country's factories had operated at 74.2 percent of capacity in July, their lowest level in five years.[3]

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[2] *The Washington Post*, 1 June 1980, p. A1.
[3] *ibid*., 19 August, p. D6.

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.'[4] The proposed tax reductions were seen as admission that incomes policy was incapable of coping with inflation.[5]

The tighter Fed policy, and associated higher interest rates, provoked Carter to condemn 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.[6] The Fed's shifting monetary policies – slowing 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 – propelled the economy into a downward spiral (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.'[7]

Despite declaring the economy to be in recession[8], Volcker wanted high interest rates to keep a rein on the money supply and curb inflation.[9] 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). This situation had consequences for the global economy through the transmission of higher US interest rates abroad, and the reduction in the US consumption of goods and services from the rest of the world. Of the other countries examined here, Mexico was to prove particularly vulnerable to these events in the US.

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

Crisis in the USA 1980/1981: *the Policy Response*

The imposition of controls on consumer credit contributed to the economy's slide and widespread dissatisfaction with 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 to deteriorate, Carter was forced into a crash program of restraint that led to a rise in unemployment (Byron, 1980b: 19). Critiques of extant policy coalesced around alternatives purporting to tackle the economy's ills, in particular monetarism.

The monetarist ideas of Milton Friedman and Robert Lucas, as propounded by 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, 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. Aspiring Republican presidential candidate Ronald Reagan embraced this ideology.

Reagan's message was to reduce taxes, spending on social services, government regulations, and the size of government, to balance the budget – a supply-side approach. Growth would be achieved by removing the barriers perceived to be preventing private enterprise from flourishing. He also favoured increased defense spending and efforts to encourage the collapse of Communism. Where Barry Goldwater failed in 1964, Reagan was convinced he could triumph. He blamed the Democrats' inflationary policies for stifling productivity. The causes of the 1970s inflation were far more complex than simply the growth of the money supply due to increased federal spending (contributory factors including falling productivity, declining value of the dollar and rising oil prices) but Reagan, acting as Friedman's translator, put things in this monetarist 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[10] (*Time*, 1980b: 45). Through this approach Reagan forged an electoral coalition around the idea of monetarism and supply side economics (Blyth 1997).

On 4 November Reagan was elected President in a neo-conservative avalanche that carried 44 percent of the trade union vote[11], traditionally some of the Democrats strongest supporters. 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 Reagan promoted a painless panacea: tax cuts based on the supply-side proposals of Arthur Laffer, and deregulation, wherein the resulting stimulus would boost revenues to balance the budget, reducing inflationary pressure.[12]

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, while cutting $11 billion from public works, job training programs, and unemployment benefits (Jones, 1995: 597). 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.' However, Reagan did not so much reduce the tax burden as shift it, with the fall in income tax being complemented by an increase in payroll taxes for social security (Madrick, 2009: 21). His programmes effectively called for a shift in spending in favour of defense at the expense of welfare.

Reagan, acting as political entrepreneur, capitalized on anti-government sentiment, emphasizing individualism and a smaller Federal role. Tax

[10] The misery index, a crude measure of the intensity of the 'stagflation' problem, is the sum of the unemployment rate at any point in time and the annual rate of inflation in that year.
[11] *The Washington Post*, 16 February, 1981, p. A1.
[12] For a discussion of Laffer's economics, see White (1983).

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 interpreted as a clear mandate for neo-conservative policies (OECD 1982a: 10).

The strains building on the US economy during the 1960s came to a head in the 1970s in the wake of a series of exogenous shocks. The Carter's administrations weak and indecisive response to the economic crisis provided a window of opportunity for Reagan, acting as political entrepreneur, to link his ideas on lower taxes, deregulation, and reduced government spending to the problems in the economy. A strong advocacy coalition developed around Reagan's ideas. His election, and the alternative policies he implemented, punctuated the policy equilibrium that had existed under his predecessors.

Crisis in Mexico 1981/1982: *the State of the Economy*

After the Second World War, Mexico implemented an import substitution policy, protecting the agrarian and consumer goods sectors behind import quotas (González, 2005). The model succeeded as there was significant external demand for Mexican raw materials despite its trade barriers. However, it created a private sector dependent upon state protection (Hernandez, 2008)[13]. Import substitution in the 1960s was superseded by a policy referred to as stabilizing development. This approach focused on enhancing productivity and competitiveness (McCaughan, 1993).

In an effort to grow the economy in the wake of the first oil shock, the government increased expenditure and its level of intervention (Lustig, 1992). However, this, combined with negative agricultural supply shocks (decreases in supply in the US) that turned the terms of trade in favour of Mexican agriculture, led to inflation reaching 20 percent in 1974 (Moreno-Bird and Ros, 2009: 129). When President López Portillo

[13] Interview (July 2008) with Luis Miguel Beristain Hernandez, PhD in Administrative Sciences; Business and Politics professor, Director of Professional Development, Enterprise Development and Social Development at ITESM.

came to power in 1976, he inherited a balance of payments deficit, sectorial instability and socioeconomic inequalities threatening political stability (Alarcon and McKinley 1992). This legacy was due to the combined effects of rapid population growth, the 1973 oil crisis (Mexico was a net oil importer at the time), the global recession, and falling agricultural exports. The middle class had become disillusioned with its inability to express itself in a political culture dominated by one party – the Institutional Revolutionary Party (PRI). These influence signalled the end of the stabilising development phase (Rubio, 2008).[14]

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 (McCaughan 1993). The hope was oil revenues would stabilize the economy (Calderón-Madrid, 1997). While the danger of immediate crisis was circumvented, the economy's structural problems remained unresolved (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). 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, while a sharp reduction in the US money supply increased interest rates, 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,

[14] Interview (July 2008) with Luis Rubio, PhD in Political Science; Mexican writer on politics, and economics.

in response to a weakening international economy, PEMEX declared oil production would be insufficient to reactivate the economy.[15] '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 regard 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).

By 1982, as confidence in the economy waned, Mexicans began converting pesos to dollars at a rate of 25 billion pesos 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 percent in 1982 and 4.2 percent in 1983 (see Appendix A). As Figure 2 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. Output fell in all industries,[16] unemployment jumped towards 15 percent,[17] 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.[18] The budget deficit stood at 16.5 percent of GDP.[19]

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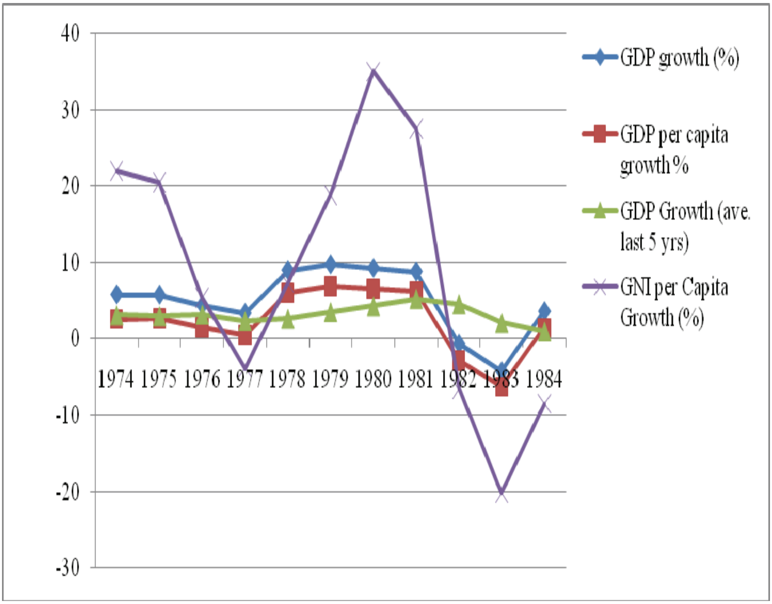
[15] *Magazine Nexos, Sociedad, Ciencia y Literatura,*. January, 1982. "De Díaz Mirón a Díaz Serrano".
[16] *ibid*.
[17] *ibid*, 20 December, 1982.
[18] *ibid*, 1 January, 1983.
[19] *ibid*., 20 December, 1982.

Figure 2: Indicators of Economic Performance, Mexico (1974-1984)



Source: DataGov (*http://www.iadb.org/DataGob/*), Governance Indicators Database.

Despite GDP growing at 8 percent annually between 1978 and 1981, this was to prove the worst crisis to hit Mexico since the Great Depression (Edwards, 1995: 17). Opinion polls found great scepticism concerning the economy (Basañez, 1985). Whereas the 1970s had seen an influx of foreign direct investment (FDI), the early 1980s witnessed its flight (Edwards, 1995).

Crisis in 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, opposition parties were not sufficiently strong to challenge the PRI's previously hegemonic position. Miguel De La Madrid, a fiscal conservative, was the PRI's candidate.[20] 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 revolutionary ideology (Cárdenas, 2008)[21]. With society in turmoil free market advocates wanted a President who would support the rights of private property (Luna *et al*., 1987).

In his inaugural address President De La Madrid declared a new economic approach was needed.[22] 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. 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 promote exports (Looney, 1985: 112). 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, 1992: 29), along with a draconian budget for a 50 percent deficit reduction[23].

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.[24] The administration signaled its desire for foreign direct investment (FDI) by relaxing investment restriction (Cornelius, 1985: 115), permitting Mexican businesses to

[20] *ibid*. 5 October, 1981.
[21] Interview (July 2008) with 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]).
[22] First Annual Presidential Report of President Miguel De La Madrid, 1September, 1983.
[23] *ibid*.
[24] *Latin America Regional Reports*, 4 June, 1982, pp. 1-2.

form international partnerships (Tournaud, 2008). These policies had a significant impact upon economic and social development.
During 1982, the peso was devalued twice as a means of increasing exports (Katz, 1994). However, the exchange rate with the US dollar collapsed from 23 peso to the dollar in 1980 to 143 in 1983. De La Madrid also sought a less confrontational approach with the IMF (Nelson, 1990: 63). 'Acceptance of the IMF embrace [was] a major break-through' (IGS, 1982: 1720), as it permitted Mexico avoid a debt moratorium (Looney, 1985: 121). The reduction in government spending enabled Mexico to reach its IMF targets for reducing the public sector deficit. However, this had a recessionary impact 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 recognized that his administration could not rely on oil exports.[25] The solution to financing development was sought through privatizing public enterprises, with almost 900 of the 1,155 state-owned enterprises in 1982 being sold off over the following decade (Hernandez, 2008). This was one of the largest privatization programs ever undertaken (Chong and López-de-Silanes, 2004). Thus, De La Madrid sought to combine macroeconomic stabilization and structural change with a focus on export orientated manufacturing (Cornelius, 1985: 110).

Although these austerity measures resulted in labour unrest, the relationship between the private sector and the state was transformed over the 1980s. Neoliberal reforms made the private sector a key player in reviving the economy (Beristain, 2008). Business organisations became actively 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. These events allowed for the creation of new societal organisations, and interest groups that sought an input into policy making. Thus, Mexican economic history can be divided into before, and after, 1982 (Cárdenas, 2008).

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

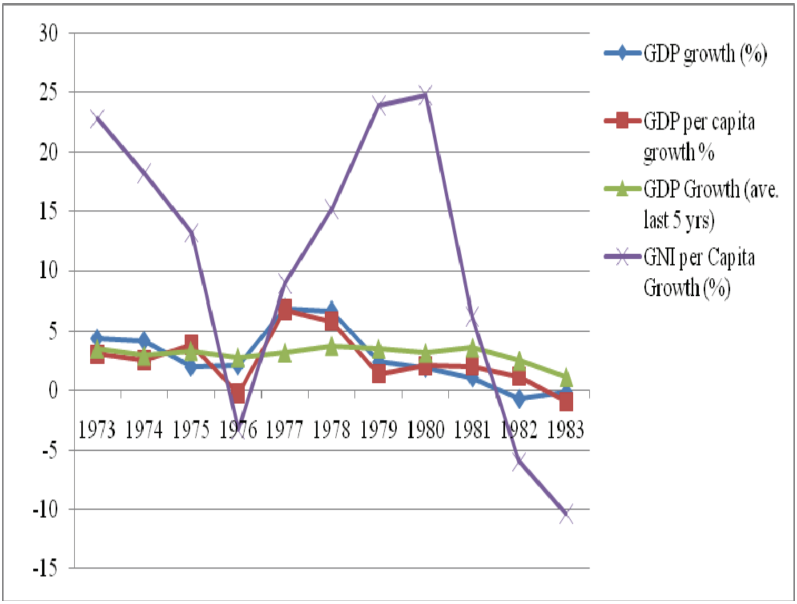
By the mid 1970s, the Mexican economy was experiencing severe challenges. President Portillo's administration used the discovery of oil as a means of expanding state enterprises while avoiding structural reforms. However, state expenditure outpaced oil revenues and drove up debt. When oil prices collapsed in the early 1980s Mexico was unable to service these debts. Recession in the US reduced demand for Mexican exports while pushing up interest rates. President De La Madrid imposed the austerity measures his predecessor had avoided and opened the economy to foreign competition. The collapse of oil prices constituted an exogenous shock contributing to economic crisis, ideational change and radical policy change - a critical juncture in Mexican economic policy.

Crisis in Ireland 1981/1982: *the State of the Economy*

The latter years of the 1970s saw the Irish economy performing relatively strongly. The previously high levels of inflation and unemployment had begun to fall, while growth returned (Leddin and Walsh, 1998: 26). Real GDP increased by 5.3 percent per annum between 1976 and 1979 (OECD, 1982b: 8). However, this recovery proved fleeting due to a combination of factors. The Fianna Fáil government that came to power in 1977 employed an expansionary 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 percent in 1981. This exacerbated inflationary pressures, and resulted in record deficits in the current external balance and the public sector accounts (OECD, 1983: 7). The structural problems highlighted during the first oil crisis had remained unresolved. The government implemented more expansionary measures in 1980 due to the worsening international economic climate and stagnating domestic demand. However, instead of stimulating the economy, these expansionary measures contributed to inflation rising to 18.2 percent (see Appendix A). As the economy shrank unemployment and emigration increased.

Reducing inflation, eliminating government borrowing and providing increased incentives for industry were seen as essential to righting the economy. However, adjustment to the European Monetary System (EMS), which Ireland entered in 1979, initially failed to reduce inflation. In 1981 domestic demand remained weak, while all measures of GDP were stagnant (Figure 3). Additionally, GNI *per capita* growth declined between 1980 and 1982. Unemployment reached 9.3 percent, with manufacturing industry experiencing a fall in output of 2 percent and the loss of 10,000 jobs, while the building industry was also in recession (NESC, 1981: 1-3). The rates of unemployment and inflation rose towards historically high figures (see Appendix A), despite government commitments to full employment.

Figure 3: Indicators of Economic Performance, Ireland (1973-1983)



Source: DataGov (*http://www.iadb.org/DataGob/*), Governance Indicators Database

The fiscal deficit, intended to be temporary, became impossible to eliminate in an economic climate of decline. By 1981 the Irish national debt reached £10.2 billion, of which £3.7 billion was external (Leddin and Walsh, 1998: 155-156). The public sector borrowing requirement peaked at 20.1 percent of GNP, the national debt stood at 80 percent of GNP, while the budget deficit stood at an arguably equally unsustainable 7.3 percent of GNP (Leddin and O'Leary, 1995: 167). The balance of payments deficit was 13 percent of GNP.[26] Almost half of Exchequer borrowing in 1981 went to financing the current budget deficit (Bacon *et al*., 1982: 6). Fianna Fáil's policies contributed to reducing growth from over 5 percent in 1977 to effectively zero by 1981, and in the same period doubled the national debt. The government's spending was so high that the total amount budgeted for 1981 had been consumed by June of that year.

The need to control public expenditure, reduce the deficit and prevent excessive reliance on foreign borrowing dictated the adoption of tighter fiscal policies. However, the catch-all nature of Irish political parties induced 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 like those found in Continental neo-corporatism.

Crisis in 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 a period of weak and unstable government. The new administration sought to bring order to the public finances, constraining rising public service pay more tightly than its predecessor. 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.

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

Economic and political instability peaked in 1981-1982. Between June 1981 and November 1982 three general elections each 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. By 1982, as balancing the budget became critical, all political parties agreed on the need to stabilize the debt/GNP ratio (Mjoset, 1992: 381). Apart from crisis-induced cutbacks, no coherent ideas/policies emerged, however, 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 then, with national debt exceeding GNP and the current budget deficit spiralling out of control, a coherent corrective policy was essential. 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. 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. As a result, government spending on social services jumped from 28.9 percent of GNP in 1980 to 35.6 percent by 1985 (Leddin and Walsh, 1998: 302). Control over current spending proved difficult, with high unemployment and rapid population growth. By the mid 1980s the economy was in a downward spiral, with high taxes and interest rates depressing investment and productive capacity. The state of the economy over 1980-1985 marked a major discontinuity with the experience of the 1970s. By the mid-1980s unemployment was being offset by emigration.

In 1987 the national debt reached 130 percent of GNP. Nevertheless, over its lifetime the Fine Gael-Labour coalition succeeded in cutting inflation from 17 percent to less than 4 percent, while the public sector borrowing requirement was almost halved to 13 percent of GNP. The macroeconomic policies introduced in the late 1970s - and political recklessness - led to unsustainable macroeconomic imbalances. Additionally, the Fine Gael wing of the coalition government decided that the social partners had no right to influence economic policy. Thus, the centralized agreements (between the trade unions, employers, and government) that, by the late 1970s had acquired a macroeconomic significance as wide-ranging wage and policy accords were ended, as the government considered them incompatible with reduced spending (Cox, 1983). As a result, many interest groups, especially the trade unions, found themselves removed from the corridors of power. The period 1980 to 1987 was one of prolonged recession, falling living standards, high unemployment and emigration.

By the late 1970s the Irish economy was in deep difficulty due to a combination of adverse circumstances and political misjudgments. Pro-cyclical policies contributed to inflation, while the economy stagnated and unemployment rose. However, instead of confronting the problems head on, the Fianna Fáil government sought to neutralize opposition by means of *ad hoc* policy concessions to various interest groups. The period 1981-82 was dominated by three changes of government, each incapable of implementing coherent policies. The coalition government that came to power in late 1982 struggled to right the economy, with cutbacks dominating its economic policies.

Crisis in Sweden 1981/1982: *the State of the Economy*

By the mid 1970s Sweden was experiencing stagflation. This situation contributed to the Swedish Social Democratic Party (*Socialdemokratiska Arbetarepartiet* (SAP)) losing of power in 1976, for the first time in 44 years. The SAP had been the most successful political party in any Western European democracy over the preceding four decades. Thereafter, the SAP shifted towards the centre of the political spectrum. The non-Socialist coalition-government that came to power in 1976, made up of the Centre Party, Liberals, and Moderate Party, commissioned reports on the economy that were 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).

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 unstable (OECD, 1984: 7).
Growth in public expenditure outstripped economic growth (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 development contributed to the number of public sector jobs increasing by 43 percent between 1972 and 1982, and coming to outnumber those in private industry after 1978 (Gress, 1988). Labour productivity growth slowed substantially from about 1970. Lindbeck (1997: 1312) argues that sluggish aggregate productivity growth in Sweden after 1970 was, to some extent, the result of the large size of the public sector and the slow labour productivity growth.

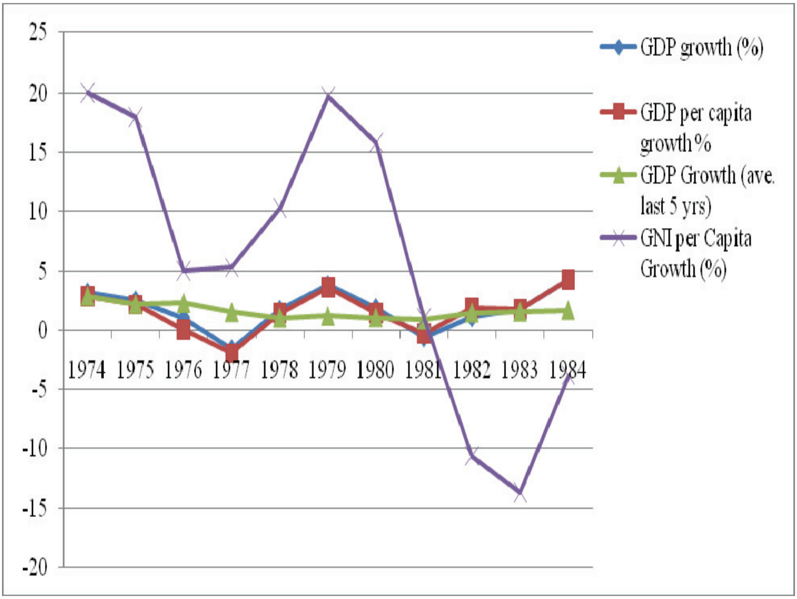
This had a knock-on effect on the level of exports, which stagnated over the decade (Ryden and Bergstrom, 1982). Worryingly, Sweden's share of the world economy dropped 40 percent during that decade (Peterson, 1987). Foreign competition made substantial inroads on the Swedish domestic market, as suggested by the steady rise in the share of imported manufactured goods (OECD, 1984: 12).

Central government's expenditure grew at a faster pace towards the end of the 1970s than it had at the beginning of the decade, while revenues stagnated. Budget deficits were financed through borrowing. However, there was no political mandate for radical budget cuts or revenue enhancements. To avoid internal disputes, the non-Socialist 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 percent in 1982, its highest level since 1945 (see Appendix A). Although this would have been a low figure elsewhere, it was regarded as a scandal in a country accustomed to full employment (Apple Jr., 1982: 3). However, many economists believed that the real level of unemployment, including the jobless in training programs, workers forced into early retirement and those who had given up seeking employment, was closer to 16 percent (Branegan, 1982: 32).

For Swedes this was an unprecedented situation. Economic growth, which had averaged 2.5 percent annually throughout the 1970s, contracted in 1981 and expanded by only 1 percent 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, the budget deficit prevented the government pursuing a counter-cyclical fiscal policy.

Figure 4: Indicators of Economic Performance, Sweden (1974-1984)



Source: DataGov (*http://www.iadb.org/DataGob/*), Governance Indicators Database

With a sluggish economy, stagnant revenues and rising expenditures, the government's budget deficits accelerated during the 1970s, reaching 13 percent 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). The Swedish debt/GNP ratio increased by over 250 percent in the six years between 1976 and 1982.

Crisis in Sweden 1981/1982: *the Policy Response*

In autumn 1981 the krona was devalued by 10 percent and, in the spring of 1982, the non-Socialist coalition government introduced an austerity program. The 1982 election was dominated by talk of economic crisis (Osnos, 1982: A15). During the campaign, the SAP, under Olof Palme, attacked the viability of the country having another non-Socialist government. The SAP presented a 'Crisis Programme' on how Sweden could save and work its way out of crisis. The economic problems and internal cabinet crises within the ruling coalition deprived the government of credibility (Mjoset, 1992) while the opposition SAP gained in popularity (Hadenius, 1997: 129-30).. SAP won the election with its set of proposals to improve the 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 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, 1993). The subsequent cuts in the public sector resulted in deep divisions between the SAP and LO (Andersson, 2006: 116).

The Third Way, as an attempt to maintain a level of social democracy, 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, aiming to create 30,000 jobs (Apple Jr., 1982: 3). The centerpiece of Finance Minister Kjell-Olof Feldt's strategy was a devaluation of the krona by 16 percent in early October 1982.[27] This was implemented in conjunction with a price freeze and increases in sales and corporate taxes, comprising a sweeping 'crisis plan' (Dullforce 1982: 1). The SAP identified labour costs as key to international competiveness.

The LO, the largest union association, accommodated devaluation by demanding average wage increases of 2.5 percent in ensuing bargaining, so as not to undermine the government's strategy. The devaluation, together with 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 initiatives, growth and profits. Under pressure for more individual freedom and the internationalisation of the economy, these reforms saw the SAP move in a neo-liberal policy direction (Taylor, 1991: 17).

Meanwhile, 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 former non-Socialist coalition governments (OECD, 1984: 23).

To placate the LO, the SAP introduced wage-earner funds in 1983, despite opposition from the Swedish Employers' Federation (*Svenska Arbetsgivarforening* (SAF)) opposition. In 1976 the LO had proposed a levy on corporate profits to transfer control of enterprises with more than 50 employees to the unions. However, the implemented version had been heavily modified from the original proposal, transforming 'from an overtly socialist union proposal to a number of toothless share holding funds' (Meidner, 1993: 223). This modified version dissatisfied the LO

[27] *Financial Times*, 12 October, 1976, p. 1.

(Lewin, 1985: 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 emphasis on investment in growth to an emphasis on cost reduction (Andersson, 2006: 124).

In response to the problems in the economy, the SAP presented its Third Way proposals for public expenditure cuts and prioritizing the private sector. This strategy, while damaging the SAP's relationship with its trade union allies, contributed to Swedish economic expansion in conjunction with an international economy recovery. The economic crisis provided a window of opportunity for the SAP to implement new economic policies that altered the established policy approach that had existed over the preceding decades. For Kjellberg (1992: 88) this marked the demise of the Swedish Model.

Conclusion

In examining the four countries' policy responses to economic crises, tracing their origins to the ending of the long post-war boom in the 1970's, this article highlights the interdependence of politics and economics. Conducting this examination within the context of the policy change literature assists our understanding of the process of policy change.

The long-term decline of the US economy, combined with the inability of successive administrations to damp inflationary pressures building since the late 1960s, led to an economic crisis. In response, Ronald Reagan, playing the role of political entrepreneur and at the head of an advocacy coalition consisting of a range of policy entrepreneurs, used the window of opportunity that the crisis created to take economic policy in a different, if not altogether coherent, direction. Extant economic policy was punctuated by reorientating taxes, deregulating the private sector of the economy and redirecting public spending away from social welfare and towards the military. During Reagan's presidency the economy recovered and grew robustly. However, the increased national debt

proved to be a legacy with which future administrations would have to grapple.
By the 1970s uncompetitive industries and a growing population placed severe strains on the Mexican economy. The discovery of oil in the late 1970s seemed a panacea, generating revenue that was used to finance public sector expansion. Additional finance came in loans from the US, which, by the early 1980s, was in recession with high interest rates. This scenario led to the reduction in demand for Mexican exports while dramatically adding to the cost of servicing its US borrowings. In response, the PRI government moved to the Right under President De La Madrid. This transformation in Mexican economic policy constituted a critical juncture.

In Ireland, a combination of the global downturn, and pro-cyclical fiscal policies in the late 1970s brought the economy to its knees. By 1981 the national debt, budget deficit and inflation rate were approaching record levels. Being catch-all in nature, the Irish political parties had difficulty imposing harsh economic policies, in spite of the window of opportunity the crisis presented. Neither a political entrepreneur, nor an advocacy coalition, emerged to champion radical policy change. Throughout 1981/82, governmental instability impeded the implementation of a coherent approach to righting the economy. It was 1987 before the economy began to recover, albeit even then slowly.

In Sweden, the impact of the global downturn on domestic economic growth provided the SAP government with the opportunity to break out of the policy model that had developed over the preceding generation. The SAP shifted economic policy to the centre with The Third Way programme. This programme, placing priority on private sector growth and initiative while shrinking the public sector, was seen as necessary to make the economy more dynamic, and growth oriented. The emphasis of economic policy shifted away from Swedish-style socialism.

For each county the problems with its economy came to a head in the late 1970s. In the US and Mexico, Presidents Reagan and De La Madrid, presenting themselves as political entrepreneurs, took economic policy to the right. In Sweden the SAP moved toward the center with its Third Way programme. In these countries the economic crises provided windows of opportunity for policy changes to occur. However, in Ireland political instability and fear of alienating sections of the community meant that, when finally confronted in the late 1980s, the scale of the economy's problems had become enormous. It was remarkable then that a dramatic economic turnaround occurred in Ireland after 1987 and ushered in two decades of unprecedented progress and prosperity. The Irish governments of the late 1980s and early 1990s displayed an exceptional determination to reduce the size of the national debt and budget deficits, while also ensuring low inflation, and industrial relations tranquillity. National pay agreements contributed significantly to the improved industrial relations climate and the transformation in the public finances. This was a blast of fiscal rectitude impelled by the necessity of putting the public finances in order, so as to preserve Ireland's economic sovereignty (Burda, 1997).

The cases examined here are not purely of historical interest. They serve to illustrate the cross national diversity of crisis experiences and responses that always has to be recognised in political economy analysis. In the wake of the current global financial crisis we have been presented with the spectacle a range of countries, as well as sub national jurisdictions, struggling to prevent economic collapse. Iceland has seen its financial system fail spectacularly; Greece is in the midst of political and economic turmoil that has raised serious questions about the future of both the Euro and the wider European Project. There are growing concerns about the sovereign debt situations in Portugal, Spain, and Ireland. California, ground zero for the US subprime mortgage debacle, is being referred to as a failed economy and state (Harris, 2009: 32). Thus, the historical issues considered in this paper have a significant contemporary echo.

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Appendix A: Economic Date for the Four Countries

Country/ Year	Unemp.	Infl.	Debt/ GNP ratio	GDP Growth Rates	Interest Rates
USA					
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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