WHAT CAN EXPLAIN THE VARIATION IN MACROECONOMIC POLICY TOOLS USED IN SPAIN, PORTUGAL AND ITALY WHEN COMPARING ECONOMIC CRISIS?

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1 ABSTRACT

The recent financial and sovereign debt crisis and the difficult recovery by southern European states facilitated the debate concerning the imposed restraints of the European Union on macroeconomic decision making. Several politicians and interest groups suggested a dissolution of the European Union to regain macroeconomic freedom. This research aimed to investigate the factors accountable for the variation in used macroeconomic policy tools during two economic crises in cabinets in Portugal, Spain and Italy. During the debt crisis of the 1980’s and the financial and sovereign debt crisis of 2007 until 2012 the influence of the international economic regime, political constraints and partisan ideology were investigated. Through this it was determined what factors account for the variation in macroeconomic policy tools and whether variation exists among the two economic crises. Moreover, the thesis aimed at identifying whether southern European economies were less restrained during the debt crisis of the 1980’s. Currently many political parties throughout Europe promote leaving the European Union due to the restrictions so this thesis investigated whether less restrictions were present in an earlier crisis.

The research demonstrated a clear presence of the international economic regime during both economic crises in which the regime severely influenced the macroeconomic policy decision making of the cabinets. During the debt crisis of the 1980’s the IMF and the European Community posed restrictions on the macroeconomic and trade policy whereas during the financial crisis the European Commission and European Central Bank severely influenced the direction of the policies. The constraints appear to be similar during both economic crises as the IMF and the EC have imposed conditions on the southern European economies in both time periods.

Additionally, a weak correlation was found between having fewer political constraints and the usage of expansionary policy during the debt crisis whereas the absence of pressure from the international economic regime seemed to facilitate expansionary policy during the financial crisis. However, the influence of partisan ideology on macroeconomic decision making during economic crises was not encountered since no clear relation could be established between these two variables.
Hence, it was concluded that the influence of the international economic regime severely accounted for the variation in macroeconomic policy tools used during both economic crises. Moreover, it can also be stated that political constraints would not weaken significantly with a dissolution of the European Union as other institutions will perform a similar role instead as seen in the debt crisis. Additionally, the factor of political constraints seemed to have a mildly facilitating role in the decision making process whereas partisan ideology seemed to partake no role of importance in the macroeconomic decision making process in economic crises.
# Table of Content

<table>
<thead>
<tr>
<th>Section</th>
<th>Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Abstract</td>
<td>1</td>
</tr>
<tr>
<td>2. Introduction</td>
<td>5</td>
</tr>
<tr>
<td>2.1. Societal and Theoretical Relevance</td>
<td>7</td>
</tr>
<tr>
<td>2.2. Limitations</td>
<td>8</td>
</tr>
<tr>
<td>2.3. Thesis Structure</td>
<td>9</td>
</tr>
<tr>
<td>3. Theoretical Framework and Background</td>
<td>10</td>
</tr>
<tr>
<td>3.1. Economic Crises</td>
<td>10</td>
</tr>
<tr>
<td>3.2. Macroeconomic Policy Tools</td>
<td>11</td>
</tr>
<tr>
<td>3.3. Policy Styles in Economic Crises</td>
<td>13</td>
</tr>
<tr>
<td>4. Literature Review</td>
<td>16</td>
</tr>
<tr>
<td>4.1. Influence of International Economic Regime</td>
<td>16</td>
</tr>
<tr>
<td>4.2. Influence Political System Structure</td>
<td>18</td>
</tr>
<tr>
<td>4.3. Influence of Partisan Ideology in Government</td>
<td>19</td>
</tr>
<tr>
<td>4.4. Hypotheses and Causal Mechanisms</td>
<td>20</td>
</tr>
<tr>
<td>4.4.1. Cabinet and Crisis Specific Hypotheses</td>
<td>21</td>
</tr>
<tr>
<td>5. Research Design</td>
<td>27</td>
</tr>
<tr>
<td>5.1. Concept Definitions and Operationalization</td>
<td>28</td>
</tr>
<tr>
<td>5.2. Cases and Sources and its Justification</td>
<td>29</td>
</tr>
<tr>
<td>6. Narrative Process Tracing</td>
<td>31</td>
</tr>
<tr>
<td>6.1. Debt Crisis of 1980</td>
<td>31</td>
</tr>
<tr>
<td>6.1.1. Portugal</td>
<td>32</td>
</tr>
<tr>
<td>6.1.2. Spain</td>
<td>39</td>
</tr>
<tr>
<td>6.1.3. Italy</td>
<td>45</td>
</tr>
<tr>
<td>6.2. Summary of the Debt Crisis</td>
<td>53</td>
</tr>
<tr>
<td>6.3. Cross-Case Comparison</td>
<td>55</td>
</tr>
<tr>
<td>6.4. European Monetary Union, Financial Crisis and Sovereign Debt Crisis</td>
<td>56</td>
</tr>
<tr>
<td>6.4.1. Portugal</td>
<td>57</td>
</tr>
<tr>
<td>6.4.2. Spain</td>
<td>63</td>
</tr>
</tbody>
</table>
6.4.3. Italy.........................................................................................................................68
6.5. Summary of the Financial Crisis...........................................................................74
6.6. Cross-Case Comparison.....................................................................................76
6.7. Overview of the variation among cases...............................................................77
7. Analysis & Discussion..............................................................................................80
8. Conclusion...............................................................................................................82
9. References...............................................................................................................84
2 INTRODUCTION

In the recent financial crisis of 2008 the weaknesses of various European states and its economies were exposed resulting in the sovereign debt crisis of 2010 in Mediterranean economies. Through the global economic downturn after the bursting of the housing bubble it was demonstrated that multiple global industries were financially unstable thus resulting in an economic crisis affecting almost all states (Kahler & Lake, 2013) (Wallace, Pollack, & Young, 2015). Economic crises belong to the proposed business cycle in which recession and recovery play an important role in the continuous development of the economy (O'Sullivan & Sheffrin, 2003). However, the recent economic crisis has shown increasing difficulties with the recovery part of the business cycle for countries in southern Europe. Almost a decade later the economies of Spain, Portugal and Italy have still not entirely recovered from the economic crisis. Consequently, they also do not have an optimistic forecast on the future of the economy. The average business cycle of an economy is estimated to be around a decade resulting in the label The Great Recession for the current crisis.

Nevertheless, within economics the proposed theory for recessions and recovery is framed in a cycle, which means that these situations have occurred multiple times in history. Hence, these states have resolved economic crises before, however, it has been proven that throughout time countries do not continuously use the same macroeconomic policy tools as a response to economic crises (Gourevitch, 1986).

There are various factors determining the macroeconomic policy tools chosen by the government to recover from economic crises such as government party ideology, political systems and strength of business and labour (Gourevitch, 1986). However, in recent years another important factor has arisen that led to much controversy within the European member states. The recent financial crisis of 2008 has been the first economic crisis since the implementation of the third stage of the European Economic and Monetary Union. Within this agreement all European Monetary Union member states form a single monetary union thus eliminating the autonomy over a macroeconomic policy tool. During the recovery of the financial crisis it has been opted by a myriad of politicians and members to withdraw from the European Monetary Union as it restricts the recovery from economic crises on its own terms. Within the Southern European countries concerns have been expressed from
politicians and civilians regarding the power of the European Monetary Union on the domestic economic policy. At the same time similar voices are heard from its northern neighbours who are concerned about the economic growth of their country or the European Union in general.

In copious instances references are being made to previous economic crises from which these economies recovered with fewer difficulties leading to the debate whether the European Monetary Union restricts certain countries from recovering adequately. In the debt crisis of 1980 the aforementioned countries were not restricted by a common monetary policy and were thus considered to be free in its choice for macroeconomic policy tools. However, during the debt crisis of 1980 Spain and Portugal recently became democracies after years of an authoritarian ruler and thus the political system as well as the partisan ideology has altered in the period between these two crises. In Italy the cabinets in power have also fluctuated highly within that time period and in all countries the used policies have been changing due to increasing convergence with the rest of Europe. Through a comparison between the two economic crises in Spain, Italy and Portugal this thesis will identify which factors can account for the variation in policy tools used. This reveals whether the European Monetary Union is the sole influencer of the macroeconomic policy tools or whether the other changes in variables in these countries played an equally important role. Additionally, it should provide information on whether the southern European economies would be better off with a dissolution of the European Monetary Union or whether similar restraints existed in previous economic crises.

The research demonstrated the presence of a high influence of the international economic regime on the macroeconomic policy decision making process during both economic crises in all cabinets. Hence, it can be stated that the macroeconomic policy tools are highly restrained by the international economic regime in both crises. This supports the statement that southern economies would not necessarily be better off with a dissolution of the European Monetary Union as similar constraints existed earlier. Additionally, the political constraints of a cabinet seem weakly correlated with expansionary policies when political constraints are low during the debt crisis whereas during the financial crisis no such evidence can be found. Furthermore, the thesis identifies the lack of evidence on the influence of partisan ideology on the direction of the macroeconomic policy decision making in economic crises resulting in
the rejection of the academically derived hypothesis regarding the expectations on influence of partisan ideology.

2.1 Societal and Theoretical Relevance
Due to the severity of the recent financial crisis the relevance of accurate explanations has surged. The great recession of 2008 was an economic crisis that affected almost all governments, businesses and societies. The deep impact on society calls for adequate macroeconomic policy responses from the government that lead to an effective and efficient recovery from the economic crisis. The need of society for accurate depictions of the macroeconomic functioning ensures the relevance of this investigation since it researches the influencing factors on macroeconomic policy making decisions. A deeper understanding of this process should lead to a precise problem identification of the previous economic crises thus leading to an easier recovery from future economic crises.

Additionally, the influence of the international economic regime, such as the European Union, has been much debated in the media and political debates in the previous years. This is reflected in the United Kingdom referendum in 2016 about the departure from the European Union (BBC, 2016) and the surge of anti-Europe parties such as the Party for Freedom in the Netherlands, National Front in France and the United Kingdom Independence Party in the United Kingdom (Stratfor, 2015). This leads to an increased interest in the possible policy restrictions set by the international economic regime of which the importance will be investigated in this thesis. Therefore, the possible limitations posed by the international economic regime on the recovery from economic crises is of an increasing interest within society.

The theoretical and academic relevance of this research originates in the scientific interest of the somewhat unforeseeable phenomena such as an economic crisis and the predictability of its effects. Through this research it is expected that a contribution can be made to the academic literature regarding the comprehension of policy decisions in crisis situations. The formulation of policy has been of high importance since the establishment of democracy. Hence, the tracing of the process leading up to the decision making should add more evidence to support academic hypotheses (Stone, 2011).
Moreover, since the impact on society of this economic crisis was severe this leads to an increased interest in the phenomenon. The great recession leads to an increased demand of society from researchers for knowledge on the subject. Through this thesis I hope to contribute slightly to an increased understanding of the choice for a macroeconomic policy tool during a crisis.

2.2 LIMITATIONS
The structure of the research project unfortunately also poses its limitations. Due to the restricted time period in which the research had to occur it was necessary to leave out certain aspects of the research that had otherwise been included. Especially the archival research requires determined dedication and effort that simply proved unachievable in the set amount of time. Therefore, a selection of sources had to be made of which not all could thoroughly be studied meaning that the selected news articles and government documents may be biased. Through the usage of triangulation, the amount of bias should be reduced to an absolute minimum, but complete exclusion of bias cannot be guaranteed.

Since the units of analysis are not randomly selected and only represent a small N the expected generalizability of the research is low (Bryman, 2012). The intention is to provide evidence on the suggested hypotheses and to explain what factors influence the decision making process when choosing a macroeconomic policy tool in economic crises. Because of the extensive case analysis, which takes into account a multiplicity of variables, needed for providing the aforementioned research goals the investigation lacks generalizability to a larger population.

Due to the historical aspect of the comparative analysis of two time periods in various countries an unequal availability in information can be noted. The period between 1977 and 1982 is defined by a lesser availability of relevant material. Due to the complete dependence on printed media and books in that time period only a small amount is digitalized and accessible. Additionally, the media in Spain and Portugal, following the recent transition to a democracy might not be considered unbiased. Hence a particular caution has to be taken in assessing and analysing the written media. Through triangulation it is once again intended to minimize the biases although a complete exclusion of bias is uncertain.
2.3 Thesis Structure

The thesis will follow a deductive structure in which firstly the theoretical framework will be addressed in chapter 2. In this chapter the framework will be provided in which the classification of macroeconomic policy styles will be framed based on the book ‘Politics in Hard Times’ by Gourevitch (1986). In the succeeding chapter the state of the art academic literature will be reviewed to provide a solid basis for the generation of the hypotheses for this thesis. It will synthesize the academic literature on the influence of the international economic regime, political systems and partisan ideology. Subsequently, chapter 4 will deliver insights into the research design to ensure that replicability of the study is possible. Additionally, the concepts will be defined and operationalized and a justification of the used sources provided.

In chapter 5 the actual analysis will take place in which a description will be provided of the Debt Crisis of 1980 and its general causes after which the narrative process tracing will focus specifically on Portugal, Italy and Spain. Subsequently the financial crisis of 2008 will be described followed by specific process tracing in Portugal, Italy and Spain. In the third part of the chapter a comparison between the economic crises will be made to provide an interpretation of the results. In the following chapter the results will be discussed and the hypotheses will be tested as reject or confirm them. The final chapter will consist of a conclusion in which the research question will be answered followed by a reflection on the process and recommendations for further research.
3 THEORETICAL FRAMEWORK AND BACKGROUND

To research the used macroeconomic policy tools and its variation among time and countries it is required to first define the theoretical framework. Through the usage of this framework the research will be structured and results can be categorized. First the various macroeconomic policy tools and the concept of economic crises will be explained to gain a deeper comprehension of the much used terms in this research. After the provided background on important terms, the macroeconomic policy tools will be grouped according to the theoretical framework of Gourevitch (1986).

3.1 ECONOMIC CRISSES

Since the main scope of the thesis is concerned with the economic crises and the used macroeconomic policy tools a brief background to economic crises will be provided. An economic crisis is part of the business cycle, which entails four parts. Firstly, the economy is in an expansionary phase which is followed by the peak after which the recession sets in. At the bottom point of the recession the economy will pass the trough after which the cycle repeats (Parkin, Powell, & Matthews, 2008). An economic crisis occurs when faced with a decreasing GDP brought upon the economy by one of the various types of causes (Parkin, Powell, & Matthews, 2008). The causes can be labelled and grouped into the following main categories:

- Financial Crisis
- Fiscal or Debt Crisis
- Currency Crisis
- Supply Shock

A financial crisis can be defined as a cause of an economic crisis due to difficulties in the banking sector concerning the availability of credits to the banks. The lack in available funds leads to an increased interest rate on loans for consumers as well as causing difficulties for repaying short-term liabilities of the balance sheet. A fiscal crisis arises when governments experience difficulties repaying their debts leading to concerns in the market about the government’s trustworthiness causing investors to sell government bonds. This leads to increased interest rates and a low credit rating for the government bonds. Thirdly, a currency crisis can also occur due to a decreased confidence in a country’s important industry leading
to rapid selling of the country’s currency by investors hence lowering the value and its competitive position on the global market. Lastly, a vast increase in the prices of important imported products such as oil can decelerate economic growth leading to increased inflation and reduced production. (Parkin, Powell, & Matthews, 2008).

Additionally, it is important to establish the difference between a recession and depression. A recession is defined by a consecutive decline of at least two quarters in the GDP whereas a depression occurs after a 10% decline in GDP in a consecutive period. Moreover, stagnation may be considered an economic crisis when the economy is faced with a lack of growth while not experiencing a decline in the GDP (Rothermund, 2012). Stagnation does not affect the economy as much as a recession or depression might.

3.2 **Macroeconomic Policy Tools**

Macroeconomic policy tools can be defined as ‘The branch of economics concerning with large-scale or general economic factors, such as interest rates and national productivity’ (Oxford Dictionary, 2016). The used macroeconomic policy tools thus affect the economy, which separates it from the field of microeconomics that focuses on the individual. Within macroeconomics we define three types of policy that can be used to influence the economy. These are monetary policy, fiscal policy and trade policy.

Firstly, monetary policy is concerned with the supply of money and the determination of interest rates and exchange rates (Bird, Mandilaras, & Popper, 2012) (Dolamore, 2016). Through these instruments the policymakers intend to influence the spending and saving behaviour of consumers and hence stimulate economic growth or contraction when desired (Mathai, 2016). Through a countercyclical policy it stimulates spending in economic downturn whereas saving is promoted in economic growth (Mathai, 2016). Because of the time-consistency problem in politics it is nowadays considered preferable to delegate monetary policy to central banks due to its long-term effects on inflation (Moe, 1990) (Mathai, 2016). Through the supply of money in the market and the reduction of the interest rates for banks, the interest rates for consumers and business will be lowered leading to an increased consumption thus stimulating economic growth in an economic downturn. Additionally, the inflation rate and output stabilization has to be managed to prevent drastic price and wage increases. Therefore, the money supply and interest rates has to be managed carefully.
Fiscal policy is concerned with the government spending or taxation policy as to influence the economy. Through increasing or lowering taxes the government might stimulate economic growth or contraction to reach macroeconomic stability (Horton & El-Ganainy, 2016). Additionally, it might also increase or decrease its expenditure to stimulate the GDP. Fiscal policy has been a topic of debate in the field of public policy for centuries already, starting with the proposed laissez faire method of Adam Smith (1776), in which government involvement in the economy was discouraged, (Smith, 1776) and the Keynesian economics, in which government involvement through increased spending and lowered taxes, was encouraged (Keynes, 1936).

Whilst monetary and fiscal policy are considered to be the main components of macroeconomics, this research will also include trade policy as a part of this. The inclusion of trade policy is determined because of its influence on the economy and its usage by policy makers to influence the economy. Trade policy is the usage of restrictions and limitations on products and services to protect domestic markets and it is usually applied through quotas, tariffs, subsidies or embargos. Quotas are meant to limit the amount of imported goods and thus protect domestic producers. Tariffs are taxes set on imported goods to prevent competition from abroad to offer cheaper products and outcompete domestic producers. The usage of embargoes restricts any import at all from a specific foreign market or country whereas subsidies to domestic producers ensure that they can compete with the price levels from foreign producers.

Now that the various macroeconomic policy tools have been defined they will now be associated with the theoretical framework of Gourevitch (1986).
3.3 Policy Styles in Economic Crises

In his book on responses to international economic crises Peter Gourevitch (1986) defines five policy styles that are used by governments in times of economic crises. These five policy styles are based on the exploited policies in the economic crises of 1873-1896, the Great Depression of the 1920’s and the Oil Crisis of 1973. The five policy alternatives are as follows:

1. Classical Liberalism
2. Socialization of Ownership and Planning
3. Protectionism
4. Demand Stimulus
5. Mercantilism

The classical liberalism is based on the idea of the laissez faire method in which government is expected not to be involved in the economy (Smith, 1776). The classical liberalism style supports a pro-cyclical policy for economies in which the business cycle is followed from the expansion through the peak to contraction followed by the through point with as little as possible interference from the government. The government is expected to solely provide the necessary services such as defence, education, infrastructure and security and is only expected to be involved in the economy when deflation is required to ensure competitiveness in the market. From the perspective of classical liberalism, the market will eventually destroy the weak businesses and because of comparative advantage the unemployed will be retrained and specialized in a service or product that can be provided competitively in the market.

On the opposing side Gourevitch (1986) describes the Socialization and Planning policy style, which entails public control over investment and replace market operations with planning. To ensure the prevalence of values such as stability, social relationships and family it is presumed that nationalization of key industries is essential. The laissez faire method is criticized because of its sole focus on profit generation and maximization of self-interest. Thus it is proposed to involve the government in the planning of the market and the public control over key industries to preserve the aforementioned values.
The third policy option is labelled *Protectionism* and is mostly concerned with the protection of domestic markets through quotas, tariffs and subsidies. After the international economic downturn, labelled the Great Depression, most countries returned to a focus on the domestic economy and thus embraced protectionism to protect its markets from the unstable international economy. In general, two arguments are presented to justify the protectionist policy style. Firstly, it is deemed necessary to protect new industries or emerging markets as they might be too vulnerable to the instability of the international economy. Secondly, it is argued that certain sectors such as agriculture need to be protected to ensure independency in times of war and conflict. Additionally, there are two important characteristics of protectionism. It involves state involvement in the economy, but only on the trade policy aspect of the macroeconomic policy. Protectionism further supports a limited state with a restriction in powers and accommodates market functioning. Additionally, it unites domestic producers against international threats instead of against each other thus creating a sense of national sentiment.

As a fourth policy style the *Demand Stimulus* alternative is proposed by Gourevitch (1986). This approach is highly related to the Keynesian approach to macroeconomic policy, which suggests that demand has to be stimulated by the government through an increase in government spending or a reduction in taxes. Through a multiplier effect it is expected that the increase in money would stimulate demand continuously in an economic downturn. The government expenditure could vary from spending on military, infrastructure of the construction sector. Because of the unused capacity in the economy it was expected that the demand stimulus approach would only lead to uncontrollable inflation when the nearly impossible full employment was reached.

The last policy alternative is labelled *Mercantilism*, which focuses on state aid to specific industries or companies. This policy is the only policy concerned with issues such as the protection of specific companies or the structure of the industry. The state action can be expressed through regulation, subsidies for specific firms, establishment of regulatory agencies and manufacturing standards. The reasoning behind mercantilism is that the market function is not sufficient in itself, which can be due to highly technological products or weak industries due to relative newness. Hence, the markets are protected due to the importance
of effective and efficient production to the state and society or the necessity for quick production such as in war products.

These five policy alternatives are theoretically speaking available to all countries in crisis periods, however, not all are considered in the policy formulation period. Through this research it is expected to discover the main determinant of macroeconomic policy tools in economic crises. Through the theoretical framework of Gourevitch (1986) all countries will be categorized in both economic crises to facilitate a comparison.

The strength of the theoretical framework resorts in its foundation in evidence from previous major economic crises such as the Great Depression of the 1920’s. This provides the framework with a solid basis from which comparisons can be drawn. Subsequently, it also provides a categorization of policy alternatives in which countries can relatively easily be grouped together according to certain characteristics. The weakness mostly resorts in the continuously innovating economies and thus governments, which means that certain policy styles become outdated and new ones are implemented. Hence, carefulness is advised when applying the theoretical framework since its creation occurred decades ago.
4 LITERATURE REVIEW

The literature review will provide a synthesis of the academic literature published on the three main explanatory independent variables. In the theoretical framework of Gourevitch (1986) there are five factors identified that possibly influence the policy choice of governments in economic crises. These are the production profile, the intermediate associations, state structure, economic ideology and international system (Gourevitch, 1986).

The production profile can be explained as the economic preferences of important actors in society. This could for example be the dominance of the agricultural industry in a country, which thus possibly prefers a protectionist or mercantilist policy from its government.

Intermediate associations are concerned with the role of political parties in transferring the policy preferences of society to government. The variable of state structure involves the role of institutional structure and bureaucracies in the policy process. Subsequently, the economic ideology relates to the perception of economic models and theories as adequate policy responses and lastly the international system deals with the influence of war and security issues on shaping economic policy.

For this research a combination of these explanatory variables will be used. The chosen independent variables are based on the ones proposed by Gourevitch (1986), but updated and amalgamated with the explanations of current academic literature. As a result, three explanatory independent variables have been identified from the literature and will below be synthesized to provide insights into the current discussions in academic literature. The three variables are the influence of International Economic Regime, Political System Structure and Partisan Ideology in Government.

4.1 INFLUENCE OF INTERNATIONAL ECONOMIC REGIME

The international economic regime has recently attracted much attention due to the rising importance of the European Union in the financial crisis of 2008. In 1995 it was already argued by Strange that globalization led to a decreased role of importance for national governments in the creation of domestic policies. She suggests that the prominence gained of multinational corporations severely limits the policy making capabilities on a national level as she demonstrates through the telecommunications market that dominate the regulation setting (Strange, 1995). Subsequently, it was investigated by Yesilkagit et al. (2010) that the influence
of an international economic regime such as the European Union was only marginal in the case of the Netherlands. Through an analysis of the European influence on Dutch policy and regulation setting they discovered that solely 12.6% of the policy decisions were influenced by the European Union (Yesilkagit, 2010). Potrafke (2015) adds that through the analysis of the KOF index of Globalization no strong correlation was found between globalization and market regulation. In the example of credit market regulation there was no strong relation found between globalization and market deregulation as was also the case in ownership of banks regulation (Potrafke, 2015). Additionally, it is argued by Helleiner (1995) that much of the influence of supranational institutions on domestic policies is allowed and supported by national governments that appreciated the economic benefits of globalization and the associated transfer of policy making to supranational institutions (Helleiner, 1995).

The truth will lie somewhere in the middle as was identified by Knill & Lehmkuhl (2002), Kohler-Koch (2004) and Simmons, Dobbin and Garrett (2007) who distinguished the various policy diffusion strategies applied by dominant states or supranational institutions such as the European Union or the IMF (Kohler-Koch, 2004). Within the globalized market it is expected that diffusion occurs through four strategies, namely Social Construction, Coercion, Competition or Learning (Simmons, Dobbin, & Garrett, 2007). More specifically, Knill & Lehmkuhl (2002) identifies three particular policy diffusion strategies that occur within the European Union, which are the options of forcing member states to adopt the policy through legislation, through strengthening the domestic actors in favour of the proposed policy and lastly through altering the beliefs of domestic actors regarding the proposed policy (Knill & Lehmkuhl, 2002). Additionally, the conditionality attached to the standby agreements, which are technically loans, provided by the IMF severely limit the policy decision making process of receiving countries. This is considered an example of the Coercion strategy described by Simmons, Dobbin and Garrett (2007).

Subsequently, it is argued that the influence of an international economic regime such as the European Monetary Union favours certain countries in its policy making instead of being neutral. Hall (2014) and Armingeon & Baccaro (2012) argue that the structure of the European Monetary Union and the affiliated common monetary policy favours Northern European economies whereas it damages Southern European economies. Through the establishment of a common inflation rate and a stable exchange rate it is believed that Southern European
economies can no longer use their previous macroeconomic responses to crises while it enlarges the competitive advantage of northern European economies (Armingeon & Baccaro, 2012) (Hall P., 2014).

4.2 Influence of Political System Structure

Another important explanatory variable is the political system structure, which compares to the proposed state structure variable of Gourevitch (1986). However, the variable introduced in this research is mostly concerned with the structure of government and the policy creating capacity. Within academic literature it is debated whether the structure of government influences the decision making capabilities. It is argued that within a democracy a distinction can be made based on the type of democracy (Schmidt, 1996). In a consensus democracy, meaning a multi-party system, policy decision making is considered more difficult since the demands and wishes of a variety of actors has to be taken into consideration. However, in a majoritarian democracy it is considered easier to formulate and implement certain policies since less resistance is faced in the process. Additionally, it is of importance whether the government structure is considered to be open to non-state actors or whether it has a closed attitude towards external influences. In an openly managed government the pressure of external actors increases resulting in a more complicated policy creation process whereas in a closed government it is expected that decisions can be made without facing this external pressure thus simplifying the policy process (Kitschelt, 1986).

For this research the focus will lay on the amount of veto points and political constraints in a government structure. In a consensus democracy a higher number of veto points is expected due to the involvement of multiple political parties and non-state actors whereas in authoritarian regimes the veto points are expected to be fewer. Thus, the amount of veto points is expected to greatly influence the policy making process (Tsebelis, 1995) (Hammond, 1996). Veto points are persons or institutions that can block a policy in the policy process. Thus it is proposed that the fewer veto points in a governmental structure the simpler the policy process and thus the higher the policy instability. In a government with a myriad of veto points it is suspected that policies are more stable and tend to stick due to the difficulty of altering public policies in a multiple veto point system.
4.3 Influence of Partisan Ideology in Government

The third explanatory variable is the partisan influence in government, which is concerned with the partisan ideology of the political party or parties in government. Schmidt (1996) argues that partisan ideology plays a more important role in majoritarian democracies than in consensus democracies due to the fewer veto points that can complicate the policy process. Therefore, the simpler policy process enables the political party to include more of its partisan ideology in the policies. However, due to the time-inconsistency problem it is argued that political parties in a majoritarian government limit themselves and future political parties in government to prevent retaliatory action when the other major parties are in government (Moe, 1990).

Additionally, it is argued that the electoral cycle influences the expression of partisan ideology by government parties (Buchanan, 1977). When nearing the elections, it is expected that political parties behave opportunistically and thus implement policies according to their partisan ideology whereas in the middle of their term it is expected that a more neutral stance is taken (Buchanan, 1977). However, it is also found that all partisan ideologies tend to increase public spending when nearing the elections thus not necessarily following the partisan ideology of contraction or expansion (Alesina A., 1995), (Wagner, 2014).

Moreover, the issue of the influence of partisan ideology is highly debated and the evidence is contradicting. It is argued by a variety of authors that a left-wing oriented government uses an expansionary policy thus increasing public spending and lowering taxes whereas right-wing government apply contractionary policies that entail decreasing budgets and austerity policies (Allers, 2001) (Garcia-Sanchez Isabel-Maria I.M, 2011) (Rudolph, 2005). Simultaneously evidence is encountered in cases in which the proposed policy directions are not found, hence rejecting the aforementioned hypothesis regarding partisan ideology (Bosch, 1995) (Pommerehne, 1978). Additionally, there are authors acquiring evidence that partisan ideology does not influence the public policy in the long term and can thus solely make alterations in the short term they are in government without directly influencing the long term effects (Panagiotis Liargovas, 2007) (Alesina & Roubini, 1992).
4.4 HYPOTHESES AND CAUSAL MECHANISMS

From the literature review various causal mechanisms are exposed that lead to the testable hypothesis for this thesis. These causal mechanisms are grounded in theory and will facilitate the process of determining which explanatory variable is accountable for the variation in used macroeconomic policy tools in economic crises. Firstly, four general hypotheses and causal mechanisms will be stated that were derived directly from the literature. Secondly, cabinet specific hypotheses will be generated for each case resulting in a total of eighteen specific hypotheses that will be tested in the analysis.

The first causal mechanism is concerned with the influence of the international economic regime that can affect the sovereignty and authority of national governments. From the literature it was demonstrated that the European Union uses a variety of diffusion strategies to influence the policy making at a national level. The causal mechanism in this instance is that joining the European Monetary Union severely limits the possibilities of national governments when analysing policy alternatives. Hence, it is expected that joining the European Monetary Union has a negative effect on the macroeconomic policy choices for Portugal, Italy and Spain, which leads to the following hypothesis:

*Hypothesis 1:*

**Joining the European Monetary Union leads to a decreased autonomy over the choice in macroeconomic policy instruments**

Regarding the explanatory variable of political system structure, the literature suggests a clear causal mechanism. From the literature we can draw that an authoritarian government is expected to most easily influence the policy creation process due to its reticence and low amount of veto points. However, on the other side of the spectrum it is expected that a consensus democracy is incapable of altering policies too often due to the high amount of veto points. Thus in the interest of the research it is expected that the transition from an authoritarian regime towards a democracy highly influences the policy process. Hence, the following hypothesis will be tested:
Hypothesis 2:

The amount of veto points in a political system restrains macroeconomic policy instruments choices in economic crises

Concerning the influence of partisan ideology in government on the macroeconomic policy tools, there are two possible causal mechanisms that will be tested. Firstly, the literature partially suggests the effect of partisan ideology on the short term policies. The expected causal mechanism is that left-wing oriented governments will favour a more expansionary macroeconomic policy whereas right-wing cabinets will implement contractionary policies. Centrist governments will generally apply a balanced and mixed set of macroeconomic policies avoiding extreme positions. Additionally, it is suggested that partisan ideology has a lower influence in consensus democracies in contrast to majoritarian democracies. Hence, the second causal mechanism is that partisan ideology has a smaller effect on the macroeconomic policy tools in consensus democracies whereas the effect is more visible in majoritarian democracies. These two causal mechanisms lead to the following two hypotheses:

Hypothesis 3:

A left-wing government will use expansionary macroeconomic policies in economic crises whereas right-wing governments will support contractionary macroeconomic policies

Hypothesis 4:

Partisan ideology has a smaller influence on macroeconomic policy instruments in consensus democracies whereas it has a bigger influence in majoritarian democracies

Through the testing of these four hypotheses it is expected that the main determinant of macroeconomic policy choice in economic crises can be established. These hypotheses provided the basis for the following country specific hypotheses that can be applied more narrowly to the cases of interest. Additionally, these specific hypotheses are accompanied by the expectations for the analysis and the outcome of the hypotheses.

4.4.1 Crisis and Cabinet specific hypotheses

After having generated four general hypotheses from the academic literature it is now of importance to apply these hypotheses to the specific cases to bring forth the expectations. A
total of twenty-four crisis and cabinet specific hypotheses have been generated through which the expectations for the analysis are described.

Firstly, the media and politicians of anti-Europe political parties suggest the macroeconomic policy tools choices are restrained since the establishment of the European Monetary Union. Hence, the expectation could be derived that the non-existence of the European Monetary Union as known today during the debt crisis of 1980 should lead to a macroeconomic policy decision making process without international pressure and constraints. However, according to the IMF the Portuguese cabinets applied for standby agreements in 1978 and 1983 that have conditions attached, which highly influence and restrain the decision making process in Portugal (the International Monetary Fund, 2016). The Italian cabinets solely applied for a standby agreement in 1977, which was also accompanied with economic reforms and macroeconomic policy prescriptions (the International Monetary Fund, 2016) and was part of the European Economic Community, which affected the trade related macroeconomic policies available. Additionally, Spain also applied for the standby agreement, but never withdrew loans from the fund (the International Monetary Fund, 2016). In the case of Spain, however, reforms had to be implemented to agree on a standby agreement thus some form of restraints on the macroeconomic policy decision making process is expected. Therefore, the following three hypotheses following the expectations have been formulated:

*Crisis Specific Hypothesis 1:*

*Portuguese cabinets were similarly restrained by the International Economic Regime in its macroeconomic policy making during the debt crisis of 1980 when comparing with the financial crisis of 2008*

*Crisis Specific Hypothesis 2:*

*Spanish cabinets were less restrained by the International Economic Regime in its macroeconomic policy making during the debt crisis of 1980 when comparing with the financial crisis of 2008*
Crisis Specific Hypothesis 3:

Italian cabinets were similarly restrained by the International Economic Regime in its macroeconomic policy making during the debt crisis of 1980 when comparing with the financial crisis of 2008

Secondly, the literature suggested that fewer veto points in the domestic political system would simplify implementing policy changes and widens the availability of macroeconomic policy tools. According to the Political Constraints Dataset (Henisz, 2002) and Veto Points Dataset (Jahn, Behm, Düpont, & Oberst, 2014) the Portuguese, Italian and Spanish cabinets faced on average fewer veto points and hence fewer political constraints during the debt crisis of 1980. Therefore, we expect more policy change during the debt crisis of 1980 in comparison with the financial crisis of 2008 leading to the following hypotheses:

Crisis Specific Hypothesis 4:

Portuguese cabinets had fewer veto points and political constraints in macroeconomic policy making during the debt crisis of 1980 facilitating easier macroeconomic policy change in the recent economic crisis

Crisis Specific Hypothesis 5:

Spanish cabinets had fewer veto points and political constraints in macroeconomic policy making during the debt crisis of 1980 facilitating easier macroeconomic policy change in the recent economic crisis

Crisis Specific Hypothesis 6:

Italian cabinets had fewer veto points and political constraints in macroeconomic policy making during the debt crisis of 1980 facilitating easier macroeconomic policy change in the recent economic crisis

For the variable regarding the partisan ideology and the influence it imposes on the used macroeconomic policy tools two tables have been created in which the expectations regarding the effects of partisan ideology will be presented. Derived from the literature is the expectation that left-wing oriented cabinets will apply an expansionary fiscal policy due to
the socialist ideology whereas right-wing oriented cabinets will use contractionary fiscal policy due to the liberal background. Additionally, it is expected that centrist parties will approach economic crises via a mixed and balanced policy programme that applies a variety of expansionary and contractionary macroeconomic policies. The formation of a centrist cabinet with smaller left or right wing parties will lead to a slight tendency towards the political orientation with which the coalition cabinet has been formed.

The expectations derived from the academic literature combined with the data concerning the political ideology in power leads to the following expectations.

Table 1

Expectations regarding influence of partisan ideology on macroeconomic policies in 1977-1982

<table>
<thead>
<tr>
<th>Cabinets</th>
<th>Period in Power</th>
<th>Partisan Ideology</th>
<th>Expectation Used Macroeconomic Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Portugal</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>Soares</em></td>
<td>1976-1978</td>
<td>Left-wing</td>
<td>Expansionary</td>
</tr>
<tr>
<td><em>Sá Carneiro</em></td>
<td>1980</td>
<td>Right-wing</td>
<td>Contractionary</td>
</tr>
<tr>
<td><em>Pinto</em></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>Balsemão</em></td>
<td>1981-1983</td>
<td>Right-wing</td>
<td>Contractionary</td>
</tr>
<tr>
<td><strong>Spain</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>Suárez</em></td>
<td>1977-1981</td>
<td>Centre-Conservative</td>
<td>Mixed and Balanced</td>
</tr>
<tr>
<td><em>Calvo-Sotelo</em></td>
<td>1981-1982</td>
<td>Centre-Conservative</td>
<td>Mixed and Balanced</td>
</tr>
<tr>
<td><em>González</em></td>
<td>1982-1996</td>
<td>Left-wing</td>
<td>Expansionary</td>
</tr>
<tr>
<td><strong>Italy</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>Andreotti</em></td>
<td>1976-1979</td>
<td>Centre</td>
<td>Mixed and Balanced</td>
</tr>
<tr>
<td><em>Cossiga</em></td>
<td>1979-1980</td>
<td>Centre</td>
<td>Mixed and Balanced</td>
</tr>
</tbody>
</table>
Table 2

Expectations regarding influence of partisan ideology on macroeconomic policies in 2007-2012

<table>
<thead>
<tr>
<th>Cabinets</th>
<th>Period in Power</th>
<th>Partisan Ideology</th>
<th>Expectation Used Macroeconomic Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portugal</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Socrates</td>
<td>2005-2011</td>
<td>Left-wing</td>
<td>Expansionary</td>
</tr>
<tr>
<td>Passos Coelho</td>
<td>2011-2015</td>
<td>Right-wing</td>
<td>Contractionary</td>
</tr>
<tr>
<td>Spain</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Zapatero</td>
<td>2004-2011</td>
<td>Left-wing</td>
<td>Expansionary</td>
</tr>
<tr>
<td>Rajoy</td>
<td>2011- now</td>
<td>Centre-Conservative</td>
<td>Mixed and Balanced</td>
</tr>
<tr>
<td>Italy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prodi</td>
<td>2006-2008</td>
<td>Left-wing</td>
<td>Expansionary</td>
</tr>
<tr>
<td>Berlusconi</td>
<td>2008-2011</td>
<td>Right-wing</td>
<td>Contractionary</td>
</tr>
<tr>
<td>Monti</td>
<td>2011-2013</td>
<td>Technocratic</td>
<td>Mixed and Balanced</td>
</tr>
</tbody>
</table>

Lastly, a general expectation can be formulated regarding the answer to the research question. By studying the literature regarding the influential factors on macroeconomic policy decision making and the preconceived information regarding the policy process during both economic crises in Portugal, Italy and Spain an expectation regarding the research question can be formulated. Based on this information the expectation arises that the influence of the international economic regime is most likely to explain the variation in possible
macroeconomic policy tools as a response to economic crises. Therefore, the following general hypothesis for the thesis can be generated:

General Thesis Hypothesis 24:

The influence of the International Economic Regime is bigger than the amount of veto points, political constraints or political ideology on the variety of possible macroeconomic policy tools as a response to economic crises.
5 Research Design

The design of the research is based on qualitative research in the form of Small-N research. Through the extensive studying of documented sources such as media publications, official statistics, academic literature and government publications the factors influencing the macroeconomic policy decision making as a response to economic crises will be analyzed.

The research will employ two types of goals, of which the explanatory goal is considered to be the main aim. By analysing the aforementioned documents, it is expected that an explanation arises regarding the determinants of macroeconomic policy making. However, since a process tracing sequence will be applied a form of descriptive research is also used. Through the process tracing and causal narrative the various factors influencing the policy process in Spain, Portugal and Italy during the two economic crises will be highlighted leading to the explanations regarding the policy decisions.

As part of the explanatory type of research, two types will be used to answer the research question. Firstly, theory testing will be used to test the hypothesis proposed by the academic literature. Secondly, the theoretical framework provided by Gourevitch (1986) will be applied to cabinets in both economic crises.

The approach of the research is a comparative case study, which combines both a longitudinal aspect as well as a cross-sectional aspect. By comparing the two economic crises the longitudinal aspect is presented whereas the comparison being drawn to multiple cases reflects the cross-sectional aspect. The approach of causal narrative and process tracing is borrowed from the within-case research approach to combine the strengths of multiple qualitative research approaches. For both economic crises a causal narrative will be constructed for the three countries to identify the determining factor of the macroeconomic policy tools.

For the analysis a triangulation approach will be used through the usage of three perspectives. Firstly, media publications during and after both economic crises will be analysed to gain insights into the explanations for macroeconomic policy decisions and the influences attributed to the independent variables. Secondly, official government documents and statistics will be analysed to determine the policy proposals and the actual output. Thirdly, the academic literature, statistics, datasets and working papers provided by international
organizations and research institutes will be used to create another perspective on the macroeconomic policy decisions. Through the combination of these various perspectives it is expected to realize an objective comprehension of the macro-environment influencing the macroeconomic policy decision making.

5.1 CONCEPT DEFINITIONS AND OPERATIONALIZATION
Initially, there are two main concepts to this research that are used in a broad sense. The first concept is regarding the macroeconomic policy as a response to economic crises, which is defined by the measures government can take to influence the national economy. The policy makers can use either monetary, fiscal or trade policies to affect the economic situation of a country. Following the model of Gourevitch (1986) the combinations of these measures can be divided into five different policy alternatives. For this thesis this will be considered the dependent variable as we expect the macro-environment to influence the macroeconomic policy decision making process.

The second concept is regarding the influence of the macro-environment. This broad concept will be subdivided into the independent variables of influence of the international economic regime, influence of domestic political system structure and the influence of partisan ideology in government. The independent variable regarding the influence of the international economic regime concerns the limitations or help offered by institutions such as the European Commission or the IMF. This variable will be measured through the regulations that affect the member states of the international economic regime and how this limits the possibilities in policy making for these states. The second independent variable involves the structure of the political or electoral system in the researched states and how this affects the policy decision making process. From the literature it was derived that the structure of the political system can restrain the decision making process leading to compromises or rejection of policies. This variable will be measured through studying government documents about the electoral system and the official policy process, and datasets from research institutes measuring veto points and political constraints. For the measurement of political constraints and veto points, the datasets of Henisz and Jahn, Behm, Dupont and Oberst were used (Henisz, 2002) (Jahn, Behm, Düpont, & Oberst, 2014). The third variable is concerned with the partisan ideology in government and its effects on the macroeconomic policy process. The ideology and policy preferences of the political parties in government are expected to favour a particular set of
Variation in Macroeconomic Policy Tools Explained

macroeconomic policies. To measure the influence of partisan ideology it will be analysed whether the proposed policies were implemented according to the partisan ideology or whether compromises had to be made. The dominance of political parties and their ideology will also be measured to determine the possible amount of influence on the policy making process. For the data on cabinet composition and partisan ideology the dataset of Armingeon, Isler, Knopfel and Weisstanner has been used (Armingeon, Isler, Knöpfel, & Weisstanner, 2015)

5.2 Cases and Sources and its Justification
The selected cases of Spain, Portugal and Italy are based on the comparable difficulties in recovering from the recent financial crisis. The variety of used macroeconomic policy tools differs per state in the economic crisis, however, they all suffered greatly from the consequences of the crisis. Due to this slight variation on the dependent variable these three cases were selected. Additionally, the comparison with the Debt Crisis of 1980 is made since a great deal of variation has occurred in the independent variables in comparison with the recent Financial Crisis. The rise of the European Union and its affiliated European Monetary Union leads to an increasing influence of the international economic regime. Simultaneously, the domestic political system structure has altered due to the transition from authoritarian regimes to democracies in Portugal and Spain whereas the rise of communism in the 1970’s in Italy lead to continuous struggles in the political system (Ginsborg, 1990) (Cortes Generales, 1978) (Presidency of the Italian Republic, 1947) (Costa Lobo, Costa Pinto, & Magalhaes, 2012). Additionally, the partisan ideology in cabinet has also fluctuated in all countries. The choice of cases is also justified due to the societal relevance that is attached to the analysis of influential factors of macroeconomic policy decisions and its consequences on the economy. Besides all these specific similarities these countries also share a similar geographic location, comparable culture and share a common language family. Subsequently, the two economic crises are comparable since the debt crisis of 1980 was caused by an oil shock in the 1970’s that exposed the weak debt structure of Italy, Spain and Portugal and the same occurred during the financial crisis of 2008 and the resulting sovereign debt crisis of 2008.

The unit of analysis for this thesis will be the cabinets of Italy, Spain and Portugal in the five-year period surrounding both economic crises. For the debt crisis of the 1980’s it has been determined to investigate the cabinets in the period between 1977 and 1982 whereas in the
financial crisis of 2008 and the resulting sovereign debt crisis it has been decided to analyse the cabinets between 2007-2012. During the five-year period surrounding the debt crisis of 1980 there have been three cabinets of importance in Portugal, three in Spain and four in Italy. During the five-year period surrounding the financial crisis of 2008 Portugal had two cabinets, Spain had two and Italy had three resulting in a total amount of cases of eighteen. For the purpose of adequate research short-term cabinets from the same political parties that succeeded each other have been grouped together due to the lesser impact each had individually. Within these two time frames the economic crises reached the peak meaning that the most important macroeconomic policy tools as a response were adopted and implemented. The choice for cabinets is justified because the decision for macroeconomic policy tools is decided by these cabinets and all influencing variables can be directly linked to these cabinets.

For this thesis the sources used will be documented sources. A variety of documented sources will be applied to reach a triangulation effect that improves the validity of the research and reduce the bias. Through the usage of three different perspectives it is expected that the narratives and facts from one source can be confirmed from another perspective thus minimizing bias. The first perspective is obtained from media publications in all states during and after both economic crises. Subsequently, the second perspective is obtained from government documents, whereas the third perspective is obtained through the analysis of academic literature, statistics, datasets and documents from international organizations and research institutes.

The usage of these sources can be justified due to the complex nature of the issue and the longitudinal aspect of the research. Unfortunately, it has proven to be difficult to conduct interviews with politicians in these particular countries especially due to the limited time and resources available. Thus, to ensure the highest quality of data the triangulation approach is used to guarantee confirmation from various perspectives.

In the following chapter the Debt Crisis of the 1980s will firstly be analysed followed by a country specific causal narrative highlighting the important influential factors of the macroeconomic policy decision making process. Subsequently a general analysis of the Financial Crisis of 2008 will be provided, which is followed by a country specific analysis.
6 NARRATIVE PROCESS TRACING

This chapter will be dedicated to the narrative process tracing of the decision making process regarding the chosen macroeconomic policies as a response to the two economic crises. Both economic crises will be described in detail to provide an accurate background of the global economic events preceding the domestic economic crises in Portugal, Spain and Italy. Additionally, important historical economic events will be described for every country to gain insights into the economic and political situation that was created for the cabinets to be dealt. Lastly, the narrative process tracing will be presented in which the process will be described leading to the applied macroeconomic policies and the motivations and restrictions in this process.

6.1 DEBT CRISIS OF 1980

The sovereign debt crisis of the 1980’s in the Mediterranean countries commenced with the oil shock of 1973 followed by the oil shock of 1979. Due to the rising costs of oil the dependent southern European economies faced a declining growth and hence increasing difficulties towards the repayment of government debts. The ensuing sovereign debt crisis, the recent transition to democracy in Portugal and Spain and political struggle in Italy resulted in complex economic reforms that had to be implemented in the late 1970’s and early 1980’s (Ginsborg, 1990).

The first minor shock was caused by the ending of the Bretton Woods System in 1971 via the Nixon Shock in which the fixed exchange rate system was abandoned and a floating exchange rate adopted (Krugman P., 2016). The introduction of the floating exchange rate caused uncertainty and instability in the international economy thus presenting a challenge for the Portuguese, Spanish and Italian cabinets (Krugman P., 2016).

The oil shock of 1973 was induced due to the oil embargo of the Organization of Petroleum Exporting Countries (OPEC) on the United States and its partners after their involvement in the Yom Kippur War (US Department of State, 2016). The oil embargo entailed a complete ban on oil exports to the targeted nations and a reduced oil production severely pushing the price of oil upwards. The prices of oil quadrupled from three dollars per barrel to twelve dollars during the oil embargo that lasted until march 1974 and greatly increased the inflation and unemployment rates in copious domestic economies (Macalister, 2011) (US Department
The first oil shock led to a public demand in oil importing countries towards a lesser dependence on the oil exporting countries leading to adopting measures such as car free Sundays and gas rationing (University of California, 2016).

The second oil shock commenced in 1978 when the tensions between the liberal Shah and the Islamic Fundamentalist Ayatollah Khomeni intensified in Iran (Penn State University, 2016). Due to the intensification of this conflict the two groups eventually violently confronted leading to the cease in oil production in Iran. Even though solely 5% in oil production was lost, due to the increased oil production of Saudi Arabia, the prices of oil increased by 150% from thirteen dollars to thirty-four dollars (Graefe, 2013) (Penn State University, 2016). Hence, the increase in oil prices was not caused by the decreasing oil supply, but due to the panic and fear of a repetition of the oil crisis of 1973 (Graefe, 2013). Therefore, states started to buy and store oil as a form of insurance against a possible oil crisis even though this strategy only pushed prices further up. Due to the increasing oil prices the debt pressure rose once again because of the economic decline causing inflation and rising unemployment.

Therefore, the combination of these two oil shocks and the debt levels of southern European countries led to a sovereign debt crisis between 1977 and 1982. As a result, the Portuguese, Spanish and Italian cabinets had to formulate macroeconomic policies to stimulate economic growth once again. In the following sections the macroeconomic policies implemented by these cabinets and the policy process will be described.

6.1.1 Portugal
Until 1974 Portugal was governed via the political regime of the ‘Estado Novo’, which was considered a dictatorship under the rule of primarily the inventor, Antonio de Oliveira Salazar, until 1968 followed by Marcelo Caetano until the Carnation Revolution in 1974. Combined with this revolution was the withdrawal of Portugal from its colonies as the first act of the newly installed government and the declaration of independence by East Timor, Angola, Mozambique, Cape Verde, Macau and Guinea Bissau. These decolonization efforts and the revolution had a huge impact on the Portuguese economy, especially since the economy also coped with the shock of the Oil Crisis of 1973. The decolonization lead to a return of Portuguese citizens from the former colonies meaning that the population of Portugal expanded by 6% in one year leading to increases in unemployment and balance of payment...
difficulties (Silva Lopes, 1982). Additionally, the decolonization lead to a 10% decrease in exports to its former African colonies and a significant decrease in workers’ remittances due to their return. Simultaneously, the trade unions became highly militant after years of repression and negotiated a real wage increase of 25%, which combined with the oil shock, decreasing exports and influx of Portuguese citizens from abroad worsened the balance of payment difficulties (Silva Lopes, 1982) (Schmitt, 1981).

During the reign of Salazar, the macroeconomic policy was based on two decisive principles. Firstly, extensive state regulation was implemented combined with private ownership of the means of production. The entrepreneurs agreed to the strict regulation in exchange for monopolies in certain industries and the promise of the government to not nationalize companies (Solsten E., 1993)(P.118). The extensive regulation entailed the control over wages and private investment decisions. During the reign of Salazar Portugal joined the General Agreement on Trade and Tariffs in 1962, the IMF in 1961 and became a founding member of the European Free Trade Association (EFTA) in 1959. These memberships forced Portugal to implement various trade liberalizations and to remove the protectionist measures such as the industrial license that had to be bought from the government. Additionally, Portugal signed a free-trade agreement with the European Community in 1972 in which it was decided that Portugal had to remove restrictions on community goods before 1980 and on specialized products before 1985. At the initiation of the free-trade agreements Portugal’s economy was already relatively open at trade being 46.2% of GDP, however, with the removal of the restrictions an upward trend was continued reaching 52.9% in 1974 (World Bank, 2016). After the Carnation Revolution the Communist Party together with the Movement of the Armed Forces (MFA) governed the country in which the foundation was laid for a constitution that promoted fair elections but also entailed nationalisation and increasing wages for workers.
These developments led to a sharp decline in the real GDP of Portugal in 1974 and 1975. Due to the increased wages consumer expenditure increased after 1975 resulting in another increase in the real GDP. In the mid 1970’s various industries were nationalized to distribute the income fairly among the Portuguese citizens. This development lead to higher wages for employees. However, attributable to these high wages Portuguese industries were forced to augment the prices to remain profitable resulting in a loss of competitiveness in the international market. Since no systematic adjustments were made to the value of Portuguese Escudo this meant that international competitiveness continued decreasing. Additionally, the nationalization of a myriad of core industries and banks meant that the Portuguese government gained an interest in various small and medium sized enterprises in which the government interfered to prevent bankruptcy. During the nationalization efforts between 1974 and 1976 a total of 244 private enterprises were nationalized, which was followed by a brain drain via an exodus of managers and entrepreneurs to Brazil.

After the Carnation Revolution, the first elections were held 1976 in which the left-wing single party minority cabinet of Soares was elected. Since only 40.7% of the parliament was controlled by the Socialist Party of Soares, and cooperation with the communist party was not possible after the earlier tensions between both, a single-party minority government was installed. The single-party minority government faced a relatively high level of political constraints due to the veto points active in the political system. Because of the earlier nationalization efforts and loss of competitiveness a current account deficit was created that had to be addressed by the cabinet of Soares. At first the Soares cabinet intended to decrease the structural deficit through austerity measures. However, after proven unsuccessful the cabinet of Soares approached the IMF.
The Portuguese government did experiment with devaluing the Escudo. However, due to it being unannounced and not accompanied by other measures such as adjustments of interest rates and real wages it led to speculation and thus decreasing interest in the Portuguese commodities and capital outflow. It was argued that to regain international competitiveness the currency will have be to devalued as well as decreasing the real wages and matching the interest rates with the depreciation of the Escudo (Krugman & Macedo, 1979).

As part of the Revolution a more social stance was adopted in the public sector meaning that public expenditure increased severely in the form of social security, the creation of unemployment insurance, improved pensions and subsidies to industries, which combined with the influx of Portuguese returners lead to increasing public expenditure. Since public revenue did not increase at the same rate the government deficit worsened (Schmitt, 1981).

Due to the increasing current account deficit and the incapacity of the newly formed cabinet of Soares to accurately deal with the balance of payment difficulties the IMF and other institutions were approached in 1977 (Amaral, 2010)(P. 32) (the International Monetary Fund, 1977). The European Free Trade Association, European Investment Bank and the World Bank provided loans to finance the debt and relieve the short term debt pressure. However, the salvation of Portugal was found in the Paris Credit supply, which were 14 countries willing to provide funds for Portugal as long as an upper credit tranche stand-by agreement was also made with the IMF. The loan amounted to 800 million dollars of which 500 million dollars was distributed within a year after which the IMF also committed to providing 50 million dollars in the first year. Afterwards, the remaining 250 million dollars would be provided in line with the developments (Schmitt, 1981) (Silva Lopes, 1982).
Hence, the creation of a Stabilization Program in cooperation with the IMF was demanded by the 14 countries forming the Paris Credit providers. In 1977 the negotiations commenced and in May 1978 the letter of intent was drawn and sent stating the content of the policy package that would be implemented in the upcoming year. The main points of the stabilization program were as follows (Portuguese Government, 1978) (Silva Lopes, 1982) (the International Monetary Fund, 1977) (the International Monetary Fund, 1978):

- Faster depreciation of the exchange rate
- Restraints on wage increases
- Relaxation of quantitative restrictions on imports
- Increases in the interest rates
- Sub ceilings on public sector borrowing from the banking system

These unpopular austerity measures forced Soares to resign in 1978 after which three non-partisan caretaker governments were installed that were designed to maintain the status quo until the elections and further implement the measures of the IMF.

The most important introduced measure was the introduction of the crawling peg system for the Portuguese Escudo advised by the IMF and a group of MIT advisers (Amaral, 2010)(P. 32) (Silva Lopes, 1982) (Bodganowicz-Bindert, 1983). It was announced that the Escudo would depreciate monthly with 1%, which was in line with the average expected inflation of the OECD countries. Additionally, the domestic interest rates were increased albeit not entirely equal to the depreciation rate to prevent capital outflow due to the difference in world market interest rates and domestic market interest rates. The IMF soon demanded a monthly depreciation of 1.25% and an initial devaluation of 7% to boost the international competitiveness. Additionally, an increase in the interest rates by 4% was demanded to prevent the Bank of Portugal from suffering of losses due to an unforeseen acceleration of depreciation. The real wages were decreased by 17% in the period of 1976-1979, which combined with the earlier policies meant a 22% depreciation of the real exchange rate and a 45% decrease in relative labour costs thus regaining part of its international competitiveness (Trading Economics, 2014) (OECD, 2016) (Silva Lopes, 1982). The main goal of eliminating the balance of payment difficulties was also accomplished as in 1979 the deficit was reduced to almost non-existent as can be seen in table 3. Moreover, the regained competitiveness in the
global economy and the relaxation of quantitative restrictions on import increased the openness of the economy. After the oil shock of 1973 and the ensuing debt crisis, trade as a percentage of GDP fell to 37.7% in 1976 but quickly recovered to pre-crisis levels and surpassed these in 1980 at 54.2%.

Figure 3

Openness of the Economy: Trade as a percentage of GDP in Portugal 1960-1983 (World Bank, 2016)

However, no measures were taken to prevent the public sector and public industries from accumulating foreign debt to finance its operations. Thus, the already increasing public debt expanded even further due to poorly operating public companies that were financed via foreign lending. It was expected that increase in external earnings would compensate for the accumulating foreign debt (Schmitt, 1981), however, with the second oil shock this turned out not to be viable.
Thus after 1979 the current account balance started turning into a deficit once again, partially caused by the second oil shock, but also due to the accumulation of debt to finance losses. Because of the non-partisan caretaker governments in power no rigid macroeconomic measures could be introduced until the newly elected government came into power. In the elections of 1979 the first majority government was elected and the right-wing Social Democratic Party led by Sá Carneiro came into power with a parliamentary majority of 52.6%. As a result, the political constraints and veto points diminished providing the opportunity for the Sá Carneiro cabinet to implement macroeconomic measures in line with the partisan ideology. However, Sá Carneiro died in an air crash in 1980 meaning that he had to be replaced after having been in power solely 372 days. As a result, he was replaced by Pinto Balsemão at the beginning of 1981 to lead the right-wing cabinet until the next election. Due to the second oil shock, the resulting increase in inflation and declining GDP the current account deficit rose again forcing the cabinet of Pinto Balsemão to take necessary measures to reduce the deficit (United Press International, 1981).

The ideology of the Sá Carneiro cabinet and the Pinto Balsemão cabinet was directed towards the liberalization of industries and the further integration into the European Community (Müller & Strom, 2003) (Gallagher, 1981). Additionally, the market-based approach was promoted as was the promise of tax cuts, increasing welfare spending and creation of jobs (Gallagher, 1981). The promotion of trade liberalization and the application of the market structure was in line with the conditions imposed by the European Community on Portugal for accession (Costa Pinto, 2002). However, due to internal struggles within the Social Democratic Party and the smaller political parties about the amount of liberalization in the market the cabinet proved incapable of applying the promoted expansionary policy. The first

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Table 3

**Balance of Payments (Current Account)** (the International Monetary Fund, 1973-1984)

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<tr>
<th>Portugal: Balance of Payments Analytic Presentation</th>
<th>Millions of U.S. Dollars</th>
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<tbody>
<tr>
<td>Goods, credit (exports)</td>
<td>1.54</td>
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<tr>
<td>Goods, debit (imports)</td>
<td>3.54</td>
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cabinet of Pinto Balsemão was dissolved after one year followed by another cabinet led by Pinto Balsemão due to a majority in party support for continuation (Müller & Strom, 2003). However, no agreement could once again be reached on the economic liberalization strategies hence the cabinet was once again dissolved. As GDP started to decrease during the cabinets of Pinto Balsemão, the debt pressure became more intense every following year resulting into approaching the IMF for another stand-by agreement in 1982.

6.1.2 Spain

Until 1975 Spain was ruled by a military dictator after the civil war that ended in 1939. Franco was the military general that assumed leadership of the authoritarian regime and he was both chief of state and the head of the government providing him with no restrictions regarding the creation of policy. The dictatorship of Franco was based on seven fundamental laws of which one was concerned with the labour policy. Strikes were labelled treason and employers and employees were required to work together for the good of the nation (Solsten & Meditz, 1990). The other fundamental laws were concerned with the structure of government and laws that guaranteed the sole authority of Franco. Additionally, Catholicism was re-established as the religion of Spain and the Catholic Church was granted more power in education policies. Political parties were outlawed as these were considered to be the reason for the Spanish Civil War and advocating anti-Franco opinions were considered to be treason.

Liberalization occurred after returning all private ownership that was seized during the nationalization efforts preceding the Spanish Civil War. Due to the alignment of Franco with the Axis powers during the second World War no benefits were received from the Marshal Plan. Because of the fear of an Allied invasion during the war import substitution via the promotion of autarchy was implemented to remain independent. However, in 1953 the Pact of Madrid was negotiated with the United States in which Spain would be granted yearly loans, grants and military aid totalling 2.8 billion dollars until 1988 in exchange for the establishment of American military bases in Spain (Solsten & Meditz, 1990). The technocratic advisors of Franco created a stabilization program together with the IMF in 1959 in which inflation was targeted, government economic controls were reduced and the Spanish economy slightly adjusted towards integration within the European Community (Solsten & Meditz, 1990). A new tariff structure was introduced and at least 50% of the imports were liberalized. A new foreign investment law was implemented facilitating the attraction of
foreign capital (Aguado, 2011). This resulted in an increase in trade openness from 15.3 in 1960 to 22.4 in 1966 (World Bank, 2016). However, the growing economic prosperity led to a higher dissatisfaction with the authoritarian government. After years of conflict followed by the demise of Franco in 1975 the Spanish society started the transition towards a democracy.

The first democratic government was faced with an economic crisis in the form of an oil shock that quadrupled the oil prices. Due to the international integration efforts from the stabilization program and the modernization of various industries Spain had developed a dependency on foreign oil. In 1975 70% of all energy that Spain used was imported from mostly middle-eastern countries (Solsten & Meditz, 1990).

The difficult transition from the authoritarian regime to a democracy resulted in a targeted attention towards the difficulties associated with this political shift and a lesser importance attached to the consequences of the oil crisis of 1973. It was not until the new government of Suárez had been installed that attention was shifted towards the high inflation, unemployment rates, and the energy crisis. Between 1973 and 1977 the costs of the import of oil shifted from 72.8 million pesetas to 383.2 million pesetas, which meant that the percentage of oil import in total import increased from 13% to 28.4% (Garcia Alonso, 1983)(P.6). The rising oil cost and the inadequacy to respond due to the transition resulted in decreasing GDP growth rates and the creation of a current account deficit in contrast to the current account surplus in the years before (Banco de Bilbao, 1983)(P. 121) (the International Monetary Fund, 1972-1982). Before the oil crisis a current account surplus of 557 million dollars was maintained, which slowly deteriorated to a deficit of 4.6 billion dollars in 1976 (Harrison, 1985)(P.175). Additionally, the pre-crisis GNP growth level of 5.4% decreased to growth rates of around 2.9% during the period between 1976 and 1978 (Banco de Bilbao, 1983)(P.6).
As reflected in the figure on GDP an increase is seen in the period following 1977 in which three factors determined an increase in GDP, GNP and the current account. Firstly, the peseta was devaluated by 20% before the instalment of the first democratic government to boost exports. Secondly, due to the newfound stability in democracy the amount of foreign investment doubled in 1978 from 631 million dollars to 1,204 million dollars (Banco de Bilbao, 1983)(P. 177). Thirdly, the renewed stability propelled the foreign tourism industry that covered almost the entire balance of trade deficit (Banco de Bilbao, 1980)(P. 181) (Banco de Bilbao, 1983)(P. 150/175).

However, these factors did not resolve the difficulties regarding the structural economic deficiencies. The inflation rate was at an average of 17.2% during the period between 1974
and 1982 and the economic decline resulted in unemployment levels of 2.94% in 1974 to 6.82% in 1977 and 17.06% in 1982 (Banco de Bilbao, 1983)(P. 127). Due to the rise in nominal wages, a reversal of migration trends and the increase in employers’ contributions to social security payments the production costs increased rapidly and the competitiveness of the Spanish industries declined (Solsten & Meditz, 1990)(P. 144) (Harrison, 1985).

Hence, the rising oil prices severely affected the GDP of Spain as well as the inflation and unemployment levels. This presented the primary challenge for the first elected cabinet after the fall of Franco. In 1977 the conservative Union of the Democratic Centre (UDC) was elected and the single-party minority cabinet led by Suárez was formed. The newly elected cabinet had 47.1% of the seats in parliament and was hence dependent on the cooperation of other political parties to achieve policy change. Moreover, the UDC was newly formed out of the more reformist Francoists and moderate democrats creating a slight ideological division (Solsten & Meditz, 1990)(P. 57). Due to the parliamentary minority and the transition to the democracy the cabinet of Suárez had to face a relatively high level of political constraints.

Attributable to the relatively high level of political constraints an economic policy program was drafted together with the Socialist and Communist opposition parties to achieve a majority (Harrison, 1985)(P. 178) (Solsten & Meditz, 1990). The result was the Moncloa Pact that was signed on the 25th of October 1977 by all parties. The Pact was partially based upon advise of the IMF, which agreed to the proposed economic policies and provided the Spanish government with a loan totalling 290 million dollars as a result (Haggard & Webb, 1994)(P. 92). However, no other loans were solicited to prevent the IMF from becoming too influential (Haggard & Webb, 1994)(P. 92). The Moncloa Pact contained a variety of forms of monetarism even though the usage of fiscal policy was also applied. After the devaluation of the peseta by 20% in July 1977, by the then Vice President of Economic Affairs, the first act of the Moncloa Pact was to raise direct taxation as to remove the practices of tax evasion (Leal, 1982). Additionally, a twenty-two percent wage ceiling was created for the public sector to prevent the wages from increasing even further and thus deteriorate the competitiveness of the Spanish industries (Solsten & Meditz, 1990)(P. 58) (Medley, 1982)(P. 234). Additionally, the wage ceiling was intended to reverse the current unemployment trend and lower the inflation rate.
To combat inflation, the concept of monetarism was introduced. The Moncloa Pact targeted the money supply via M3, which has the most extensive inclusion of forms of money (Parkin, Powell, & Matthews, 2008). The increase in M3 money supply was restricted at 17 percent for the year 1978 thus contracting the economy even further in comparison with the 21 percent target of the year before (OECD, 1985). Additionally, a form of expansionary policy was implemented to gain the approval of the more left-wing oriented opposition parties and the cooperation of the Spanish unions (Solsten & Meditz, 1990)(P. 58). The increased expenditure would target the effects of unemployment, therefore fiscal reforms would be implemented to relieve pressure on unemployed Spanish citizens as well as increase spending on housing and social security.

On the matter of trade policy, a further reduction of tariffs and protectionist measures were introduced to prepare Spain for accession to the European Community and to meet the requirements for accession into the GATT and the EFTA (Aguado, 2011). In 1979 Spain joined the EFTA and in 1980 the GATT resulting in further eradication of trade tariffs and quantitative restrictions towards the members of these agreements. In this period the openness of the economy also rose to 31.6 in 1980 in comparison with the 27.8 in 1978 (World Bank, 2016).

However, the measures proposed by the Moncloa Pact did not yield the results that were desired beforehand. The inflation rate remained at a high level even if it did decline slightly, unemployment levels continued to increase and the trade unions and lower class workers started to complain about the negative effects of the measures (Rodriguez Arramberri, 1979). The cabinet of Suárez decided to implement a new plan before the elections of March 1979 to demonstrate the willingness of the cabinet to solve the experienced difficulties. The election was won by the UCD of Suárez, however, the party remained in a single-party minority government with 48% of the seats in parliament and a similar level of political constraints. Additionally, due to the relative failure of the Moncloa Pact and the adverse effects it had on the workers the socialist party (PSOE) and the communist party (PCE) no longer wished to cooperate with the UCD of Suárez. The new plan was labelled the Programa Economico del Gobierno (PEG), which entailed the acceptance of a bigger money supply at 19.5%, the possible introduction of a wage band at around eleven to fourteen percent and further liberalisation of the Spanish industries in line with the accession conditions of the European Community (Ministerio de Economia, 1979). However, the second oil shock
complicated the economic recovery even further and internal disagreements arose within the UCD of Suárez about the proposed economic policies (Bar, 1988)(P.112-113). The continuous decline of the economy because of the rising oil prices and relative uncompetitive economy, led to enormous strikes of 2.5 million Spaniards in the first quarter of 1979 and further dissatisfaction with the current government. This dissatisfaction preceded the failed coup d’Etat of Colonel Tejero on the 23rd of February 1981 followed by internal disputes within the UCD and the resignation of Suárez on the 25th of February 1981.

Leopoldo Calvo-Sotelo was voted for as the replacement of Adolfo Suárez and became the new prime minister on the 25th of February in the still conservative single-party minority government of the UCD. The internal disputes and the struggle for power of the various factions within the UCD led to the demise of the political party and the division of the UCD into three different political parties (Bar, 1988)(P.113). This meant that new elections had to be held in which the socialist party arose to power.

In the elections of 1982 the Partido Socialista Obrero Español (PSOE) or the Spanish Socialist Workers’ Party won the majority of votes and could therefore form a left-wing single-party majority government. Due to the parliamentary majority the cabinet of González had fewer political constraints in comparison with the cabinet of Suárez, hence policy change became easier to implement. The cabinet was led by González and actively campaigned for the creation of 800,000 jobs in the next four years (Harrison, 1985)(P. 184). However, the first implemented macroeconomic measures were the eight percent devaluation of the Spanish peseta and the increase in energy prices by an average of twenty-one percent (Cambio 16, 1982). Additionally, the Rumasa holding company was nationalized to save 60,000 threatened jobs with the promise that it would be privatized as soon as possible (Harrison, 1985)(P.184). Furthermore, a variety of unprofitable state enterprises were closed down to prevent further depletion of government funds (Solsten & Meditz, 1990)(P. 145). The new minister of Economics of Spain declared that neither an inflationist nor deflationist macroeconomic policy stance would be adopted, but a reform of the current economic system (Harrison, 1985)(P.184). Additionally, further trade liberalization measures were implemented to meet the European Community accession conditions. Therefore, tariffs were reduced to zero for members of the European Community resulting in a trade openness indicator of 39.8 in 1983 in comparison with the 28.1 in 1973 (Aguado, 2011).
6.1.3 Italy

Italy was a founding member of the European Economic Community (EEC) established in 1957 with the ratification of the Treaty of Rome. The European Economic Community was established as a method to increase economic integration between the six founding member states via the removal of protectionist measures. Hence, the Italian economy has been relatively open to the international market after the fall of the fascist government of Mussolini and the acceptance of the American help via the Marshall plan. To receive the funds of the Marshall plan a long-term economic plan had to be created. This plan was formed on the basis of increasing productivity investments to squeeze costs and stimulate exports. These measures would increase the competitiveness of the Italian economy and would function as the basis for the funding of the current account deficit (Zamagni, 1993)(P. 327) (Sassoon D., 1986a)(P. 15-16). Additionally, Italy was completely dependent on foreign oil, coal or iron, hence international openness was required to grow. The openness of the Italian economy has grown relatively slowly and stably throughout the years (World Bank, 1960-1983).
In the years preceding 1963, Italy experienced an economic miracle due to industrialization and growing international demand for Italian products. Through the low wages Italian industries were able to compete effectively internationally and hence annual economic growth grew to 6% until 1963 (Zamagni, 1993)(P. 338). In 1963 the first round of wage-claims was introduced by the recovered trade unions leading to a loss of competitiveness on the international market. However, the introduction of the first credit squeeze prevented escalation of the crisis and Italy quickly recovered to pre-1963 growth levels (Zamagni, 1993)(P. 338). Additionally, the introduction of the Common Agricultural Policy (CAP) in 1962 highly effected the smaller agricultural companies in Italy due to the CAP pricing policy benefiting the larger and more cost efficient farms (Sassoon D., 1986b)(P. 55,56) (Fabiani, 1977)(P. 165).

The European development led to higher unemployment figures in the south of Italy whereas the northern part of Italy benefited from the renewed agricultural policy. This resulted in an internal migration towards the north and increased spending on welfare in the south due to the invention of the disability fund of which the costs eventually tripled to 10% of GDP between 1970 and 1975 (Sassoon D., 1986a)(P.57). Due to the perceived relative weakness of the trade unions after their single victory in 1962 it was believed that instead of capital investment in the industry it would be more beneficial to further squeeze current employees by increasing overtime and speeding up the assembly lines (Sassoon D., 1986b)(P. 58)
Due to the high level of nationalization of Italian industries (around 50% (Executive Intelligence Review, 1977)) the measures could more easily be implemented. These developments eventually led to the ‘hot autumn’ of 1969 in which enormous strikes were organized in the north of Italy to protest against the current working conditions.

The causes of the hot autumn of 1969 are mainly directed towards the deteriorating working conditions after the squeezing of current labour in factories, a general dissatisfaction about the quality of life, the poor welfare conditions for the workers and the incapacity of the state to adequately deal with these developments (Sassoon D., 1986b)(P. 62,63) (Zamagni, 1993)(P. 338). The strikes led to a loss of 302 million hours of work, however, they resulted in an improvement of the Italian social security system. As a result of the strikes wages were now growing at a higher rate than productivity, increased pensions, improved social security for the unemployed, mothers and children and the introduction of various measures leading up to the National Health Service in 1978 (Ferrara, 1984) (Baratta & Amendola, 1978). At the same time the extreme communist group Red Brigade commenced terrorizing the country with bomb attacks and kidnappings resulting in the label the ‘lead years’ (Zamagni, 1993)(P.339) (Ginsborg, 1990). The traditional advantage of low wages was lost due to the social developments and the rise in public spending without increasing public revenue resulting in a current account deficit. Combined with the public unrest concerning the increased terrorism Italy was faced with the first severe economic crisis since the second World War. These developments resulted in a highly fluctuating GDP growth rate varying from almost 6% in 1970 to -2% in 1975 whereas the GDP continually grew throughout the period showing only an insignificant slow down (Trading Economics, 1962-1976) (Trading Economics, 1962-1976).
With the inflationary policy used to regain competitiveness from the increasing wages an unpredicted even higher inflation was reached after the oil crisis of 1973 leading to inflation rates of 19.4% in 1974, 12.4% in 1978 and 21.1% in 1980 (Toniolo, 2012)(P. 31) (Parboni, 1981)(P. 79). Therefore, wages increased comparatively with the inflation rates meaning the
Italian industry lost even more of its competitiveness forcing the Bank of Italy to devaluate the Lira to boost exports (Bank of Italy, 1972-1978). Nevertheless, the devaluation of the lira solely affected the large export centred companies while disadvantaging the small and medium sized enterprises. To regain the competitiveness of the Italian industry, the large companies within the industries decided to decentralize the production towards the hidden or ‘black’ economy in which the government could not exercise control over the wages and working conditions. Hence, the traditional advantage of low wages was regained resulting in the increase in GDP (Sassoon D., 1986b)(P. 74,75). An increase in taxation after the tax reforms of 1973-1974 was implemented after the stand-by agreement with the IMF, in which the reduction of the current account deficit was negotiated. Together with the wage controls of 1975 based on equal pay increases for everyone economic growth stabilization of the current account deficit was achieved (the International Monetary Fund, 1972-1978) (Sassoon D., 1986b)(P. 82) (Zamagni, 1993)(P.339).

Between 1944 and 1983 Italy has seen forty-four governments resulting in an average amount of time in government of slightly less than twelve months (Sassoon D., 1986b)(P. 178). During this time period the Christian Democratic party has consistently been the biggest political party resulting in a continuous inclusion of the political party in all cabinets. However, the Christian Democratic party never achieved a sole majority forcing it to form coalitions with the smaller political parties (Pappalardo, 1978) (Cotta, 1988)(P. 126,127). The biggest opposition party was the Communist Party (PCI) with which none of the other political parties dared to form a cabinet for reasons of uncertainty about the effects of it on the Italian democracy (Cotta, 1988)(P. 127). Therefore, the Italian cabinets in this time period can be characterized following these three definitions:

- The necessity for coalition building hence concessions had to be made
- Consistently the Christian Democratic Party with smaller political parties
- The relatively short duration of the cabinets due to internal conflicts typifying the political instability

Between 1977 and 1982 there have been nine cabinets in Italy thus confirming the political instability and indicating the political conflict regarding the approach towards the difficulties faced by the Italian economy. To facilitate a study of the cabinets the various cabinets pertaining to a particular stream of thought will be grouped together. Hence, from 1976 until
1979 multiple national solidarity left-centred cabinets were in power. This meant that the Christian Democratic Party was in power supported by the Communist Party and all small centrist and leftist political parties to facilitate the austere measures that needed to be undertaken (Cotta, 1988)(P.182). As of 1979 until 1982 a variety of left-centrist cabinets were in power with the Christian Democratic Party once again as the biggest party and supported by centre-left political parties (Cotta, 1988)(P.183).

In 1976 the historical compromise was realized in which the Christian Democratic Party and the Communist Party for the first time ever formed a coalition in government to support the severe measures to be taken. The Christian Democratic Party would take all positions in the cabinet and the Communist Party supported the policies so a single-party minority government was formed under the reign of Andreotti. The political constraints were relatively low also due to the support of the Communist Party and various smaller political parties. Additionally, the amount of veto players was close to zero providing the opportunity to implement unpopular measures (Jahn D., 2010).

After having relied on monetary policy to control the growth of the economy for almost thirty years the agreement with the IMF implied the first implementation of fiscal policy to influence the economy (Toniolo, 2012)(P. 31) (the International Monetary Fund, 1972-1978)(P.444-448). However, after the reduction of the current account deficit in 1974, following the stand-by agreement with the IMF, the Italian government decided to use a reflationary policy in 1975 by increasing the wages through the wage indexation principle and increasing public spending. Thus, the current account deficit was once again increased and the cabinet of Andreotti had to approach the IMF again for funds to finance the government debt (the International Monetary Fund, 1972-1978)(P. 451).

The negotiations surrounding the possible second stand-by agreement created some controversy in the media and the Communist Party about the contractionary policies that were imposed by the IMF on the cabinet of Andreotti in 1976 and 1977 (Executive Intelligence Review, 1977) (Executive Intelligence Review, 1977). The conditions were mainly centred around the reduction of the current account deficit via the application of contractionary fiscal policies and a control of the inflation rates, which would imply a reduction in economic growth (the International Monetary Fund, 1972-1978)(P. 454) (Executive Intelligence Review, 1977). The fiscal policy was aimed at the reduction of public spending on welfare. Moreover,
a tight monetary policy via high interest rates was used to stabilize the exchange rate of the Lira (the International Monetary Fund, 1972-1978)(P. 456). The implemented tax reform during the first stand-by agreement, the contractionary policies of the second stand-by agreement and the international demand for the lowly priced Italian products resulted in the creation of a current account surplus (the International Monetary Fund, 1970-1982). Additionally, after a negative growth rate in 1977, during the implementation of the contractionary policies, the GDP started growing rapidly again in 1978 due to the favourable international demand for the products (Trading Economics, 1976-1982) (the International Monetary Fund, 1972-1978)(P. 458-459). However, even though inflation was lowered it was still not at the desired level and the wage indexation caused general wages to grow faster than the other countries in the European Economic Community (Sassoon D., 1986b)(P. 82) (Zamagni, 1993)(P. 339). Even though the current account was in a surplus the public spending on welfare and social security continued increasing via the reformed National Health Service and pension system (Zamagni, 1993)(P. 344).

Table 5


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<td>4.059</td>
<td>0.014</td>
<td>-0.109</td>
<td>-0.078</td>
</tr>
</tbody>
</table>

Figure 9

The kidnapping of former Prime Minister Moro in 1978 by the Red Brigade and the killing of the former Prime Minister by this organization led to fractions within the current coalition as the Communist Party was blamed for the situation (Leonardo, 2016). The continuous disagreement about policies resulted in four different cabinets in power during the period between 1976-1979 of which all were composed by the same parties.

Due to the incorrect association of the Communist Party with the Red Brigade the former lost a majority of its votes in the election of 1979 as copious voters no longer wished to be associated with communism (Sassoon D., 1986b)(P. 238). Hence, a left-centre minority coalition was formed in 1979 that was in power until 1982 in which in a total of five cabinets were installed. In this period an average of 5 veto players was found in the political decision making and political constraints were slightly higher than the cabinets faced between 1976-1979.

In 1979 Italy joined the European Monetary System in which an agreement was reached upon the stability of the European exchange rates thus preventing the usage of currency depreciation as a means of economic recovery (Toniolo, 2012)(P. 32) (Zamagni, 1993)(P. 343). Additionally, the inflation targeting practice of the German Bundesbank was adopted by all members of the European Monetary System, which forced Italy to significantly lower its inflation rates (Toniolo, 2012)(P. 32). In the same period, the second oil shock occurred resulting in an increase in prices that further pressured the inflation rates in Italy. The wage indexation further increased the wages leading to higher productivity costs and the economic contraction as seen in figure 9. The various state interventions to limit the consequences of the economic downturn meant that a current account deficit was created totalling up to 10.5 billion dollars in 1980 (the International Monetary Fund, 1970-1982).

In 1978 the minister of the Treasury, Mr. Pandolfi, proposed the Pandolfi plan, which would ensure the compatibility of the Italian economy with the requirements of the European Monetary System (Sassoon D., 1986b)(P. 82). This three-year plan concerning the period 1979-1981 was centred around three objectives. Firstly, decreasing public spending by 20% via the reduction of expenditure on welfare, social security and pensions. Secondly, a freeze on increases in real wages was proposed resulting in a strict income policy andthirdly the mobility of labour had to be increased (Toniolo, 2012)(P. 32) (Sassoon D., 1986b)(P. 82) (Gardner, 2005)(P. 193). Unfortunately, public spending could not be further reduced and it
was solely established that the increases in spending on social security, pensions and welfare were slowed down, which is reflected in the figures concerning the current account deficit (Gardner, 2005)(P. 193) (Zamagni, 1993).

The economic downturn resulted in internal conflicts within the various centre-left coalitions resulting in a total of five cabinets in power during the 1979-1982 period. This confirms the political instability and conflict regarding the macroeconomic policy (P. 193). It was not until 1983 that a stable cabinet was installed in the form of a socialist government that dealt with the high inflation rates whilst the issue of public debt remained unsolved (Sassoon D. , 1986b)(P. 83).

6.2 SUMMARY OF THE DEBT CRISIS

Pre-crisis situation

Leading up to the debt crisis occurring from 1977 to 1982 it can be stated that a variety of expansionary measures were applied in all studied cases confirming the pro-cyclical approach towards the expansion phase of the business cycle. In Portugal a form of Socialization and Planning was used via the strict state intervention of the dictatorial regime, which prevented the nationalization of business and facilitated the economic boom of the 1960’s in Portugal. Moreover, in Spain a protectionist stance was adopted via import substitution and after involvement of the IMF liberalization efforts were introduced as well as multiple measures supporting economic growth and increased prosperity. Additionally, in Italy industries were nationalized via the Socialization and Planning strategy of the government and via the wage increases and social welfare reforms the involvement of the cabinets in these matters is clearly demonstrated.

Portugal during the debt crisis

During the debt crisis a clear path can be distinguished in which Portugal, Spain and Italy are forced to implement austerity measures as a result of the economic crises. The left-wing cabinet of Soares in Portugal had to implement austerity measures to combat the declining economic growth and increasing government deficit. Due to the inability of the cabinet to tackle the economic difficulties the IMF and the Paris Credit Supply were approached that forced Portugal to implement further austerity measures via wage reduction, devaluation and
restrictions on loans for the public system. As a result, the government deficit was reduced significantly and economic growth seemed to have recovered leading to the application of an expansionary policy by the right-wing cabinet of Sá Carneiro and Pinto Balsemão. The expansionary policy included tax cuts and increased spending on welfare that unfortunately increased the government deficit resulting in the approach of the IMF once again in 1983.

Spain during the debt crisis

In Spain the conservative centrist cabinet of Suárez was forced by the economic situation the country was in to implement contractionary measures via the deflation of the economy. Via the help of the IMF the Moncloa Pact was established in which the Peseta was devalued and direct taxation increased. However, public expenditure increased via finances related to social security payments to support the vulnerable families and persons albeit of lesser influence than the contractionary measures. The left-wing cabinet of González that arose to power in 1982 implemented a combination of contractionary and expansionary policies via the nationalization of a private company to save jobs while at the same time privatizing various other industries to promote efficiency. Additionally, energy prices were increased to prevent further dependence on oil supply and oil shocks.

Italy during the debt crisis

During the debt crisis in Italy the international influence was clearly noticeable in the implementation of austerity measures by the centrist cabinet of Andreotti. The cabinet was forced to approach the IMF to fund the increasing debt levels and declining economic growth. Public spending was reduced and a tight monetary policy was applied to contract the economy. In 1979 Italy joined the European Monetary System that prevented the application of currency depreciation as a means of economic recovery and limited the usage of monetary policy tools for this purpose. In the left-centred cabinets that followed the usage of monetary policy was restricted hence resorting to the application of fiscal policies to combat the economic crisis following the second oil shock and the demand of the EMS to lower inflation. Therefore, these cabinets had to resort to the freezing of public spending and further contraction of the economy to meet the demands of the European Monetary System and its member states.
6.3 Cross-case comparison

During the economic crisis of the 1980’s three of the policy styles of Gourevich (1986) are clearly visible. Firstly, Spain and Portugal still have a high degree of protectionist measures to protect itself from international competition and exercise a degree of control over the domestic industries. Moreover, the macroeconomic responses to the debt crisis vary between the classical liberalism style via the austerity measures and the demand stimulus approach via the expansionary policies. Only the González cabinet in Spain applied a socialization and planning strategy in 1982 whereas in all other cases contractionary classical liberalism or expansionary demand stimulus style is applied.

In all cases the influence of the International Economic Regime is visible in the removal of protectionist measures in the economy. Italy joined the European Community as a founding member, which means that protectionist measures had to be eradicated gradually. Moreover, Portugal and Spain wished to join the European Community thus eliminating the protectionist measures slowly to meet the accession criteria of the European Community. In Italy and Portugal, the influence of the economic regime is visible through the stand-by agreements with the IMF that attached various conditions to the provision of loans. Hence, the influence of the international economy on domestic economic decision making can be considered of fair influence due to the stand-by agreements with all cabinets and the pressure of the accession criteria for the European Community.

In all studied cases no clear relation can be established between the partisan ideology in cabinet and the applied macroeconomic policies. The application of contractionary policies is applied by all partisan ideologies with no clear distinction noticeable between the left, right or centrist cabinets. In almost all cases the hypotheses regarding the expected direction of influence of partisan ideology is rejected hence disconfirming the hypotheses that partisan ideology can be a sole determinant of the variation in macroeconomic policy making.

Moreover, the political constraints and veto players seem to play a minor role in the determination of the macroeconomic policy making in all cases as it is visible that higher political constraints lead to the application of contractionary policies whereas fewer constraints result in expansionary policy in general.
6.4 **European Monetary Union, Financial Crisis and Sovereign Debt Crisis 2007-2012**

The European Monetary Union (EMU) was implemented in 1999 concerning the fixing of the exchange rates via the introduction of the Euro as of 2001. Additionally, the European Central Bank, which regulates the monetary policy for the members of the European Monetary Union, was created. The EMU is a result of a three-step transition in which the first stage ran from 1990 until 1994. During this period the member states had to remove all remaining barriers on the movement of capital and the ensuring of political independence of central banks. In the second stage (1994-1998) the member states had to commit to the macroeconomic discipline via the convergence criteria. The convergence criteria entailed the following (Wallace, Pollack, & Young, 2015)(P. 170):

- No more than 1.5 percentage points above the three best performing states on the harmonized index of consumer prices
- No more than a 3% government deficit of the GDP
- No more than a 60% government debt of the GDP or attempts to reduce this towards the measure
- No more than 2 percentage points above the three best performing states on the long term interest rates
- Participation in the second European Exchange Rate Mechanism for more than two years without severe tensions

The third stage, as of 1999 included the relinquishment of both monetary policy and trade policy by the member states as a means of recovering from economic crises. Moreover, the European Central Bank has to ensure price stability which is achieved through inflation targeting at around 2% (European Central Bank, 2016).

Additionally, the Stability and Growth Pact was created in which the fiscal discipline of member states were targeted to prevent excessive accumulation of government debt and a government deficit. This could threaten the stability of the European Monetary Union (Hix & Hoyland, 2011)(P. 266) (Wallace, Pollack, & Young, 2015)(P 184). The Stability and Growth Pact targets a maximum 3% government deficit as a percentage of GDP and a 60% government debt as a percentage of GDP. Therefore, member states could no longer increase government debt or temporarily expand the government deficit without sanctions. The increase in money supply to the market, to stimulate growth, is also constrained due to the
common monetary policy being centralized at the European Central Bank. Moreover, as a part of the common monetary policy, the interest rates are determined by the European Central Bank. These apply to all the member states even though their economies might be in a different part of the business cycle (Hix & Hoyland, 2011)(P. 266).

Even though copious factors have been attributed with being the cause of the financial crisis of 2007-2008, the main cause is considered to be the collapse of the US subprime loan market. The loans were provided to borrowers with a poor credit rating who eventually were having trouble repaying the loans as the house prices plummeted (Shiler, 2008). The financial crisis exposed the lack of regulation on banking practices from which multiple banks benefited via packaging multiple lower tier loans together as mortgage backed securities and provided them with a higher credit rating to resell them on the market (Lins, Picard, & Lemke, 2013)(Ch. 3). When the subprime market collapsed the inter-bank market halted and loans to companies and individuals reduced significantly. Through the defaults of the subprime loans various banks suffered losses leading to the bankruptcy of Lehman Brothers in 2008, followed by difficulties for European banks as well. To save these banks two trillion euros were set aside by the EU member states to stabilize European banks in the short term (Wallace, Pollack, & Young, 2015)(P. 176). However, the credit crunch resulted in a contraction in international trade leading to economic slowdown in almost every country on the world. Countries with highly productive economies and relatively low government deficits were able to recover quickly. Countries with high levels of government debt, low levels of productivity or bursting housing bubbles such as Spain, Italy and Portugal further increased their budget deficit leading to a sovereign debt crisis. Additionally, the financial market lost confidence in the capability of these countries regarding the repayment of public debt leading to higher interest rates, which further complicates economic recovery.

6.4.1 Portugal
During the second half of the 1990’s Portugal experienced an economic boom, which was partially due to the adopted measures in the second phase of the EMU (Financial Liberalization) and the convergence with the lower real interest rates with the ECB. These lower real interest rates increased domestic demand and the demand for housing, hence initiating the commencement of the housing bubble (Royo, Portugal and Spain in the EU, 2012)(P. 196). Additionally, the convergence criteria of the second stage were reached
through the transformation of the financial sector, liberalization of regulations and the removal of restrictions of international capital movements (OECD, 1999)(P. 13), the privatization of almost one hundred state owned firms and the adoption of labour market reforms via the Social Pact of 1996 (Royo, Portugal and Spain in the EU, 2012)(P. 187-189). The Social Pact included labour market reforms and wage constraints that boosted international competitiveness, which were accepted by management and labour (Royo, A New Century of Corporatism, 2002).

However, the economic boom pushed wages up resulting in a loss of competitiveness, while economic growth slowed down due to the ending of Expo 98 and finalization of major infrastructure projects. The interest rates were now determined by the European Central Bank, which applied monetary easing through the lowering of interest rates to accommodate growth in the European Union (OECD, 1999)(P. 10-11). These lower interest rates occurred in a period of a credit boom in Portugal leading to increased borrowing and lower interest repayments on the government debt creating the illusion of a decreasing government deficit. Additionally, fiscal consolidation was reduced after meeting the convergence criteria of the EMU and the accession to the Eurozone resulting in a continuously growing public expenditure, while public revenues did not increase (OECD, 1999)(P. 11).

After 2000, economic performance decreased even further due to low productivity levels, increasing unemployment rates and the public expenditure on welfare. Furthermore, public revenues declined resulting in a further deterioration of the government deficit up to 6.1% in 2005 (the International Monetary Fund, 2000-2008). As a response multiple public spending freezes were introduced to narrow the public deficit as well as an increase in indirect taxes (Magone, Portugal (2003), 2004). This resulted in a decrease of the government deficit in the years 2002 and 2003 after which it increased sharply to 6.1% in 2005, because of the declining government revenue due to poor economic performance (the International Monetary Fund, 2000-2008) (Royo, Portugal and Spain in the EU, 2012)(P. 190-193).

In 2005 a socialist cabinet was established that had a single-party majority in the parliament under the leadership of Prime Minister Sócrates. The cabinet had to deal with a relatively high level of political constraints in comparison to the political constraints of the cabinets in 2010 and 2011 due to the national perception of the necessity for severe measures. Moreover, the amount of veto players was extremely low in 2005 at 0.7 thus facilitating the implementation
of necessary measures as a response to the increasing government deficit and debt (Jahn, Behm, Düpont, & Oberst, 2014).

To tackle the increasing government deficit an austerity program was created by the left-wing cabinet of Sócrates to modernize the public administration and health care system to reduce public expenditure (Magone, Portugal (2006), 2007) (Royo, Portugal and Spain in the EU, 2012)(P. 193). The austerity program was created under the pressure of the European Commission through the excessive deficit procedure since Portugal ran a higher government deficit than allowed in the Stability and Growth Pact (the European Commission, 2005) (Magone, Portugal (2006), 2007). Hence, the value-added tax was increased by 2% almost directly after the election. Structural reforms were implemented in the sector of public administration in which a new promotion process was introduced as well as removing several excessive benefits for people working in public administration (Magone, Portugal (2006), 2007). Additionally, the pension system was reformed in which people were expected to contribute more to the pensions while through a recalculation of the pensions it was expected that pensions will be reduced by 10% in the next twenty years (Royo, Portugal and Spain in the EU, 2012)(P. 194). Privatization efforts were also continued as the sale of public enterprises resulted in a 2.4-billion-euro public revenue.

The efforts of the cabinet of Sócrates resulted in a decrease of government deficit and being ahead of the proposed plan towards the European Commission by achieving a government deficit of 3.1% in 2007.

Figure 10

Additionally, the modernization measures also resulted in an economic growth in Portugal increasing from 197 billion dollars in 2005 to 262.01 billion dollar in 2008. Unemployment, however, continued to increase throughout this time period and would be even further affected by the financial crisis of 2008 (Royo, Portugal and Spain in the EU, 2012)(P. 195).

*Figure 11*


At the start of the financial crisis it was intended to continue with the structural reforms of the public administration sector and the public sector. However, trade unions increasingly organized strikes as an opposition towards the proposed austerity measures complicating the
execution of the government program. Moreover, the financial crisis caused difficulties for various European banks including the Millenium Banco Comercial Portugues (Millenium BCP) and the Banco de Negocios Portugues (BNP). Eventually, the BNP was nationalized after which it was discovered that it had a debt of 700 million euros and used malicious business practices (Naumann & Lima, 2009). Subsequently, to stimulate demand, the cabinet of Sócrates implemented a recovery program costing 2.18 billion euros through which various infrastructure projects were encouraged (Magone, Portugal (2008), 2009). Hence, the protests regarding the austerity measures, the economic difficulties caused by the financial crisis, the nationalization of the BNP and the recovery programme led to an increase in the government deficit as well as a decreasing GDP (Armingeon & Baccaro, 2012) (Trading Economics, 1995-2011). Additionally, taxes were increased through the Robin Hood Tax in which oil companies had to pay 25% of taxes to fund social expenditure in Portugal and attempting to decrease the government deficit (Royo, Portugal and Spain in the EU, 2012)(P. 196).

*Figure 12*


![GDP Chart](image)

*Figure 13*

In 2009 new elections were held in which the socialist party of Sócrates remained the biggest political party, but lost a high amount of voters due to the imposed austerity measures of the Sócrates government. As a result, the socialist party could no longer form a single-party majority government, but had to form a single-party minority government in which it had to rely on other political parties for the implementation of policy programs. Within a year, three Stability and Growth Pacts were created by the cabinet of Sócrates as a response to the increasing demand of the European Commission regarding the attainment of the criteria set in the Stability and Growth Pact (Magone, Portugal (2010), 2011). The Stabilization and Growth pacts all involved increases in taxes, reduction in pensions and wage constraints to increase public revenue and decrease expenditure. This resulted in the declining government deficit in 2010 and 2011 (Trading Economics, 2006-2016) (Magone, Portugal (2010), 2011). However, as the austerity measures became harsher in every proposed programme dissatisfaction among the trade unions and Portuguese people increased resulting in the general strike of November 2010 (Armingeon & Baccaro, 2012) (Magone, Portugal (2010), 2011).

In 2011 a fourth austerity program was forced by the European Commission on Sócrates. However, due to the single-party minority the cabinet had and the unpopularity of the measures, this program was rejected by the parliament leading to the resignation of Sócrates (Magone, Portugal (2011), 2012). Due to the resignation of Socrates speculation started in the credit rating markets resulting in a further downgrade of Portuguese bonds and the increase of interest rates for the Portuguese government. This resulted in the application for the bailout through the European Finance Stability Facility, the IMF and the European Finance Stability Mechanism (Armingeon & Baccaro, 2012). In the elections of 2011, the social democrats won the elections resulting in a right-wing minimal winning coalition led by prime
minister Passos Coelho. Due to the recent application for a bail-out and the common perception of political parties for necessary austerity measures, the political constraints for the cabinet were relatively low.

Further austerity measures were necessary to prevent a debt default and reduce the government deficit, so a recovery program was established with the Trojka on May 3 in 2011 (Magone, Portugal (2011), 2012). The recovery program had six main points (Trojka, 2011):

- Reduction of budget deficit via fiscal policies from 8.5% to 3% by 2013
- Reform of financial sector regulation and supervision
- Reducing public spending via privatization, streamlining of budgetary framework, thinner public administration and merger of various revenue administration units
- Increase flexibility in labour market and reform education sector
- Reform of the housing market and further liberalization of goods and services
- Improvement of framework conditions

To achieve these points wage freezes and tax increases were introduced as the more immediate measures as well as fiscal consolidation to regain competitiveness in the international industry and recuperate the economic growth of pre-crisis levels (Armingeon & Baccaro, 2012) (Trojka, 2011).

6.4.2 Spain

Spain experienced a period of continuous growth during the second stage and the commencement of the global financial crisis in 2008. Due to the nominal interest rate alternation after joining the European Monetary Union, from 13.3% on the short-term nominal interest rates and 11.7% on the long-term nominal interest rates in 1992 to 3% and 4.7% in 1999 (Dehesa, 2007), investment in housing surged among the Spanish citizens facilitating the construction boom that accelerated the economic growth and increased housing prices (Royo, Portugal and Spain in the EU, 2012)(P. 183). Housing prices increased by 150% between 1998 and 2006 whereas the construction and housing sector accounted for 18.5% of GDP in 2006 (Munchau W. , 2007) (Munchau W. , 2007).

Through the application of a conservative and continuously fluctuating fiscal policy the government deficit was maintained relatively low and even achieved a surplus in the years 2005 and 2006 as public revenues increased sharply due to the high employment rates and
economic growth. A variation of expansionary and restrictive fiscal policies was used between the period of 2000 and 2009 with the aim of using a counter-cyclical fiscal policy to control the government debt and deficit (Ferreiro, Gomez, & Serrano, 2013)(P. 588) (Royo, Portugal and Spain in the EU, 2012)(P. 197). Through the structural labour market and welfare reforms the labour market became more flexible resulting in pushing down unemployment rates from 23% in 1996 to 8% in 2007 (Trading Economics, 1996-2008). The introduction of more flexible firing rules, promotion of new fixed-term and part-time contracts, encouragement of self-employment and tax breaks for start-ups led to the decreasing unemployment rates (Martin, 2002) (Delgado & Lopez Nieto, Spain (2002), 2003).

Figure 14


Simultaneously, inflation remained at a higher level than the European average and the economic boom caused an increase in wages whereas productivity remained relatively low (Royo, Portugal and Spain in the EU, 2012)(P. 185). As a result of the increased wages, the relative unit labour costs started to increase in Spain leading to a further deterioration in the international economy for the demand for Spanish products and services (OECD, 1996-2008). This facilitated loans and household investments in housing and property resulting in a quickly accumulating household debt putting a large amount of people at risk in an economic downturn (Trading Economics, 1996-2008).

Figure 15

Due to the economic growth in the period between 2000 and 2008 and the public and political concern regarding the terrorist attacks of the Euskadi Ta Askatasuna (ETA) attention was distracted from the structural economic deficits. The declining productivity, increasing wages and inflation resulting in a loss of competitiveness and the increasing household debt due to the housing bubble were thus less targeted. Hence, when the financial crisis and associated bursting of the housing bubble occurred in 2008 the Spanish government had to act quickly to prevent a rapid corrosion of economic growth and the effects of such an event.

In the elections of 2004 the left-wing socialist party was rewarded with a majority of the votes resulting in the formation of a single-party minority cabinet led by prime minister Zapatero. The cabinet in 2004 was faced with a relatively high amount of political constraints compared to the cabinet of Rajoy. Political constraints were slightly higher because of the formation of a single-party minority cabinets after years of having a single-party majority government. Additionally, a relatively high amount of 6.8 veto players was active at the initiation of the Zapatero cabinet compared with the 3.3 figure at the start of the second cabinet formed under Zapatero in 2008 (Jahn, Behm, Düpont, & Oberst, 2014). During the first four years the economic policy of the previous right-wing government was continued due to the economic boom and the relative success of the policies. After the elections of 2008 in which Zapatero was re-elected a different stance was required to respond to the ensuing financial crisis (Royo, Portugal and Spain in the EU, 2012)(P. 201). The Zapatero cabinet of 2008 was also a single-party minority government albeit with slightly more seats in the parliament resulting in lower political constraints and veto players.
After the commencement of the financial crisis in 2007, the cabinet of Zapatero decided to implement an expansionary fiscal policy towards the declining economic growth to stimulate consumption and regain economic growth through a demand stimulus package (Armingeon & Baccaro, 2012) (Ministry of Finance: Spain, 2009). The declining economic growth was mostly caused by the bursting of the housing bubble after the commencement of the financial crisis. This caused a reduction in consumer expenditure and a slowdown in the construction industry that had facilitated economic growth. As a result, the expansionary fiscal policies were directed at investments in the construction and infrastructure sector as well as increasing the unemployment pensions to maintain consumption levels (Villarejo, 2009) (Ministry of Finance: Spain, 2009) (Armingeon & Baccaro, 2012). Simultaneously, the European Central Bank applied a restrictive monetary policy by increasing the interest rates thus a conflict arose between the fiscal and monetary policy. This led towards a further declining economic growth and public revenue, whereas public expenditure increased due to the expansionary fiscal policy (Ferreiro, Gomez, & Serrano, 2013). Therefore, the government deficit surpassed the 3% government deficit of the Stability and Growth pact as agreed upon in the third stage of the EMU (Trading Economics, 1995-2010).

*Figure 16*


The private sector had used external funds to finance company growth resulting in increased indebtedness internationally and through the collapsing of several banks and the housing market a myriad of losses was incurred, which increased the levels of indebtedness of banks.
and businesses (Suarez, 2010). The declining economic growth, increasing government deficit and the poor state of the private sector combined with the restrictive monetary policy of the European Central Bank resulted in the ineffectiveness of the used expansionary fiscal policy.

Due to the lost faith in the recovery from the financial crisis and the fear of investors that Spain would default on its debt, increased the prices of Credit Default Swap (CDS) on the Spanish debt. The increasing government debt complicated the possibility to lend money on international markets to finance the debt (Armingeon & Baccaro, 2012)(P. 21). As a result, the government decided to remove the previously introduced expansionary fiscal policies and resorted to a more restrictive, contractionary policy to regain the trust of the investors (Ministry of Finance: Spain, 2010) (Armingeon & Baccaro, 2012)(P. 12). Additionally, the international pressure mounted due to the inability of the Spanish cabinet to meet the criteria of the Stability and Growth Pact thus forcing the government to adopt restrictive fiscal policies through the excessive deficit procedure to reach these criteria again in 2013 (the European Commission, 2010) (Delgado & Lopez Nieto, Spain (2009), 2010) (Ministry of Finance: Spain, 2010).

The austerity measures were centred around two pillars; the increase of public revenue via the augmentation of value-added tax and other taxes whereas public expenditure was significantly reduced by 2.6% of GDP (the European Commission, 2010) (Delgado & Lopez Nieto, Spain (2009), 2010). The decrease in public investment in infrastructure and construction projects, a restructuring of the labour market and pension system that increased the retirement age and a recalculation of the pensions by extending the period counting towards the calculation, are the causes for the reduction in public expenditure (Armingeon & Baccaro, 2012) (Delgado & Lopez Nieto, Spain (2010), 2011). Additionally, wages were cut by 5% on average in the public sector and a new employment protection reform was implemented that reduced the severance pay and eased the criteria for dismissal, thus increasing flexibility in the labour market (Sanz de Miguel P., 2010) (Sanz de Miguel P., 2010).

The restructuring of the labour market contributed to the increasing unemployment rates in combination with the declining economic growth (Delgado & Lopez Nieto, Spain (2011), 2012). The increasing unemployment further decreased the public revenue whereas public expenditure increased due to social welfare expenses, even though, these were severely

The continuous labour market reforms and increasing unemployment led to general strikes by the main trade unions and a public dissatisfaction with the implemented austerity program, which was expressed in the regional elections of 2011 won by the People’s Party. This led to resignation of prime minister Zapatero and the call for early elections that were won by the centrist conservative People’s Party (Delgado & Lopez Nieto, Spain (2011), 2012). The cabinet of Rajoy gained a majority of the votes hence the formation of a single-party majority cabinet, which was severely restrained by the commitments towards the Stability and Growth Pact. The amount of veto players decreased to 2.9 from 6.8 due to the formation of a single-party majority cabinet also slightly reducing the political constraints (Jahn, Behm, Dupont, & Oberst, 2014).

The newly formed cabinet committed itself to the previously set target of meeting the criteria of the Stability and Growth pact by 2013 and hence continued the contractionary fiscal policies (Delgado & Lopez Nieto, Spain (2011), 2012). Additionally, a banking reform was implemented to regain the trust of international investors since the ensuing European Debt Crisis caused losses at various European banks, which in the event of a default could further harm the declining economic growth (Delgado & Lopez Nieto, Spain (2012), 2013). Hence, an agreement was reached with the European Stability Mechanism in which funding worth 41.3 billion euros was distributed to the Spanish government to restructure the banking industry and recapitalize the various banks at risk (European Stability Mechanism, 2016). The recapitalization of the banks was expected to lead to renewed confidence in the Spanish industry paving the way for economic recovery (Delgado & Lopez Nieto, Spain (2012), 2013).

6.4.3 Italy

Between 1992 and 1997 a series of structural reforms were introduced in the labour market in Italy for the convergence with the European Monetary Union (Bassanetti, Bugamelli, Momigliano, Sabbatini, & Zollino, 2014)(P. 74.). Wage moderation was implemented to increase competitiveness and the labour market became more flexible through the introduction of flexible part-time contracts and the promotion of part-time jobs (Brandolini, et al., 2007). The introduction of this flexibility increased the employment rate in Italy severely, however no reforms were introduced in the social protection system leaving the
workers with a flexible contract vulnerable to economic downturns (Bassanetti, Bugamelli, Momigliano, Sabbatini, & Zollino, 2014)(P.65). Nevertheless, the increase in employment reduced the public expenditure on welfare benefits and increased public revenue due to the increased taxes (OECD, 1992-2008).

*Figure 17*


To meet the criteria of the Stability and Growth Pact, the structural high levels of government debt had to be tackled. Through the convergence with the EMU, Italy saw its short and long term nominal interest rates decrease rapidly facilitating the borrowing at a lower interest rate to finance the government debt and create the illusion that the debt was structurally lowered (Erber, 2011)(P.333). Additionally, the lowering of the nominal interest rates facilitated the public consumption and investment in real estate enabling the economic growth of the construction sector as a driving force of the low economic growth in Italy during 1998 and 2007.

Nevertheless, Italian industry faced a decreased competitiveness due to the increasing relative unit of labour costs and the slow growth of productivity in comparison with its European counterparts (Crafts & Magnani, 2013) (Trading Economics, 1991-2016) (OECD, 1995-2012). The slowly growing economy masked the decreasing state of the industry as it saw its advantage of being a low-cost producer of manufactured goods disappear. The surge of China in the global economy and the inclusion of various Eastern European states in the European economy further deteriorated the competitiveness of the Italian industry (Erber, 2011)(P.333).
Moreover, due to the rising employment figures and the slowly growing economy there was no perceived need of structural reforms, especially since the comparison with Germany during the same period showed a similar pattern of low growth figures. However, the German government implemented several structural reforms that damaged economic growth, but made it sustainable in times of economic downturn, whereas the Italian government relied upon the slow growth to continue in the stable European environment (Bassanetti, Bugamelli, Momigliano, Sabbatini, & Zollino, 2014)(P. 70-71) (Erber, 2011)(P. 336-337). As a result, a slight expansionary fiscal policy was applied in which mostly the tax burden was reduced for workers thus, decreasing the public revenue, whereas public expenditure remained similar throughout the period between 1998 and 2005 (Bassanetti, Bugamelli, Momigliano, Sabbatini, & Zollino, 2014)(P. 71). Even though the weaknesses of the Italian industry were identified, the institutional framework of Italian politics impeded any structural reforms mostly due to the continuous conflicts between the various political parties (Crafts & Magnani, 2013).

Due to the inability of meeting the criteria for the Stability and Growth Pact, at a debt-to-GDP percentage of around 110% in the period between 2000 and 2004 and the excessive government deficit of 3.1% in both 2003 and 2004, an intervention of the European Commission through the establishment of the Excessive Deficit Procedure in 2005 was deemed necessary (the European Commission, 2005)(P. 2). Based on the Commission’s recommendations Italy was forced to implement a restrictive fiscal policy to consolidate fiscally, decrease the government deficit and reduce the excessive government debt (the European Commission, 2006) (Bassanetti, Bugamelli, Momigliano, Sabbatini, & Zollino, 2014)(P. 71). In the period between 2005 and 2007 a contractionary fiscal policy was applied through the usage of various one-off measures that reduced public expenditure in health care and local government and increased taxation to boost public revenues (the European Commission, 2006).

In the elections of 2006 the left-wing cabinet of Prodi was elected in a minimal winning coalition with other socialist oriented political parties. The political constraints were relatively low compared with the cabinets reigning in the 1990’s mostly because in the 1990’s the convergence criteria had to be implemented. Additionally, the amount of veto players was only 1.6 in 2006, but rose to 9.6 the next year due to internal conflicts within the cabinet.
(Moore, 2008) (Jahn, Behm, Düppont, & Oberst, 2014). Hence, the internal conflict and the forced fiscal consolidation led to no important reforms and eventually resulted in the resignation of Prodi in 2008 followed by another round of elections (Ignazi, Italy (2007), 2008). The fiscal consolidation through the targeting of tax evasion and public service wage restraints did lead to a reduced government deficit and economic growth (Ignazi, Italy (2007), 2008) (Trading Economics, 1995-2010).

In 2008, elections were won by the prime minister that was in power before Prodi, Mr. Berlusconi. His right-wing minimal winning coalition took office in 2008 and had few political constraints in 2008, which quickly increased in the following years of his reign due to the increasing European pressure and political opposition. Additionally, the amount of veto players was relatively low and constant at 2.77 through his years in power that lasted until 2011 (Jahn, Behm, Düppont, & Oberst, 2014).

As a response to the ensuing crisis, a slightly expansionary fiscal policy program was adopted in November 2008 to combat the results of the crisis (OECD, 2013) (Bassanetti, Bugamelli, Momigliano, Sabbatini, & Zollino, 2014)(P. 90). However, the fiscal stimulus was solely achieved by a redistribution of the public finances, maintaining the budget balance through increases in taxes on asset re-evaluation and cuts in public expenditure whereas transfers were made to low income families (OECD, 2013). However, due to the contractionary policy of the European Central Bank the financing of these activities became more expensive and the effects of the financial crisis became clearly visible. The lower GDP, increasing unemployment rates and the increasing government deficit due to decreasing tax revenues and increasing social expenditure were a result of the effects (Trading Economics, 1995-2010) (Trading Economics, 2006-2010) (Trading Economics, 1995-2010).

Figure 18

GDP Italy 1995-2010 (Trading Economics, 1995-2010)
In national politics much of the attention was diverted towards the political scandals surrounding the Prime Minister Berlusconi and the continuous conflict between the government party and the opposition parties (Ignazi, Italy (2010), 2011). Hence, less attention was directed towards the economic policies and the financial crisis, especially since a form of recovery seemed to have been achieved in 2009-2010 resulting in a slowly growing economy (Ignazi, Italy (2010), 2011) (Bassanetti, Bugamelli, Momigliano, Sabbatini, & Zollino, 2014)(P. 89). As the economy was faced with the second dip in the recession in 2011, the public criticism regarding Berlusconi started to increase due to the poor management of the economy, the various sex scandals of which he was accused and the losses in local elections.
resulting in his resignation in November 2011 (Ignazi, Italy (2011), 2012). The European Commission pushed for further fiscal consolidation measures that could not be fulfilled to the satisfaction of the European Commission by the Italian cabinet of Berlusconi. This resulted in a distrust of international investors in the credibility and trustworthiness of the Italian economy (Ignazi, Italy (2011), 2012) (Bassanetti, Bugamelli, Momigliano, Sabbatini, & Zollino, 2014)(P.90).

What followed was a unique situation in which a non-partisan caretaker government was appointed by president Napolitano in 2011, in which solely non-elected technocrats were selected based on their expertise (Ignazi, Italy (2011), 2012). The technocratic cabinet was led by Prime Minister Monti and was mainly appointed to bridge the gap until the next election. The cabinet also had to deal with the sovereign debt crisis as no political party was considered to be adequate to deal with the economic crisis (Ignazi, Italy (2011), 2012).

A more restrictive set of policies had to be adopted to regain economic growth and due to the Excessive Deficit Procedure initiated once again by the European Commission Italy was pressured into adopted fiscal consolidation and internal devaluation measures. (OECD, 2013) (the European Commission, 2010)(P.26-27). Public expenditure was cut through the reduction of transfers to local governments, wage and hiring restraints in the public sector and postponement of the retirement age by a few months. Furthermore, public revenues were increased through the targeting of tax evasion that should result in an increase of tax revenue by 0.1% in 2011 and 0.5% in 2012 (the European Commission, 2010)(P. 26-27) (OECD, 2013). As a result of the forced fiscal consolidation efforts by the European Commission the Italian government deficit returned once again to the criteria of the Stability and Growth Pact, whereas government debt as a percentage to GDP increased steadily (Trading Economics, 2010-2013) (Trading Economics, 2010-2013).

\[Figure \ 20\]

\[Government \ Budget \ Italy \ 2010-2013 \ (Trading \ Economics, \ 2010-2013)\]
6.5 SUMMARY OF THE FINANCIAL CRISIS

Pre-crisis situation

During the financial crisis and the sovereign debt crisis of 2007 until 2012 the macroeconomic policy tools were severely limited via the introduction of the European Monetary Union and the European Central Bank. These developments led to the implementation of a common monetary policy applied by the European Central Bank and the eradication of protectionist measures to provide a free trade area. Hence, the Portuguese, Spanish and Italian cabinets resorted to the application of fiscal policy to influence their economies. During the second half of the 1990’s the economies of Portugal, Spain and Italy experienced an economic boom. This can be attributed to the convergence with the European Union and the decrease in short and long-term nominal interest rates facilitating domestic demand and economic growth. However, during the 2000’s Portugal already experienced decreasing growth levels and increasing government deficit leading to the application of fiscal consolidation to restore the government deficit to below 3%. Additionally, it continued privatization throughout this time period, modernized the public administration and reformed the labour market. The cabinets of Spain maintained a strict fiscal policy program to continuously meet the criteria of the Stability and Growth Pact and throughout the period a combination of expansionary and restrictive fiscal policies have been used. The pre-crisis period in Italy was mostly defined by a slowly growing economy and increasing employment figures. Hence, a slightly pro-cyclical expansionary policy was implemented in which taxes were reduced and public spending remained in balance. After not meeting the criteria of the Stability and Growth Pact in 2005 an excessive deficit procedure was started by the European Commission in which the Italian government was forced to adopt fiscal consolidation measures. These measures included the
reduction of public spending on health care and local government and increased taxation resulting in meeting the criteria again in 2008.

*Portugal during the financial and sovereign debt crisis*

During the economic crisis the left-wing cabinet of Socrates briefly applied an expansionary fiscal policy via the investment in the construction sector to boost economic growth. After a short period of expansionary policies, it quickly switched to a fiscal consolidation procedure. Due to the inability to meet the criteria of the Stability and Growth Pact a contractionary fiscal policy was introduced via the reduction of public spending and increase in taxes. Throughout the economic crisis the European Commission continuously demanded further austerity measures eventually resulting in the application of the Portuguese cabinet for loans from Trojka. The Trojka imposed further austerity measures via the reduction of the public spending, reforms of the financial sector labour market and continuous privatization. These fiscal consolidation policies were continued by the right-wing cabinet of Passos Coelho.

*Spain during the financial and sovereign debt crisis*

The left-wing cabinet of Zapatero in Spain applied an expansionary fiscal policy as a response to the financial crisis of 2007 in which the driving force of the economy, the construction sector, was provided with investments to restart economic growth. Moreover, unemployment benefits were increased to support the affected families. Simultaneously, a contractionary monetary policy was implemented by the European Central Bank resulting in a growing government deficit. Hence, investors lost faith in the Spanish economy resulting in increasing interest rates on debt financing and forcing the Spanish cabinet of Zapatero to adopt fiscal consolidation measures. These consolidation measures were also due to pressure of the European Commission through the excessive deficit procedure. Public revenue surged via the introduction of tax increases and public expenditure was decreased by removing the previously introduced unemployment benefits. The 2011 elected right-wing cabinet of Rajoy continued the fiscal consolidation efforts under pressure of the European Commission to meet the criteria of the Stability and Growth Pact in 2013. Moreover, a loan of the European Stability Mechanism was accepted in exchange for banking reforms and the recapitalization of the banking system to prevent further deterioration.

*Italy during the financial and sovereign debt crisis*
Due to the early commencement of the excessive deficit procedure by the European Commission in Italy the left-wing cabinet of Prodi had to implement fiscal consolidation at an earlier stage than its Spanish counterpart. A contractionary policy was applied via the reduction of public spending on health care and local governments and the increase in taxes to recover the government deficit to the criteria levels. In 2008 the right-wing cabinet of Berlusconi was elected in the year that the financial crisis started to affect the economic growth of Italy. Hence, as a response an expansionary fiscal policy was applied via the maintenance of the budget balance but a redistribution of income towards low-income families. The expansionary policy combined with the earlier consolidation efforts resulted in a slowly recovering economy until it was faced with the second dip in the recession due to debt default expectations of other Mediterranean economies. The European Commission initiated another excessive deficit procedure demanding a more contractionary stance in macroeconomic policy in Italy. Due to scandals concerning the prime minister and the inability to adequately deal with the economic downturn Berlusconi resigned. The president of Italy appointed a technocratic caretaker government until the next elections, which was burdened with the implementation of the fiscal consolidation efforts. The technocratic cabinet of Monti implemented a contractionary fiscal policy in accordance with the European Commission that restrained wage increases in the public sector, reduced capital transfers to local governments and reformed the pension system to restore the government deficit to the criteria levels.

6.6 Cross-case comparison
During the economic crisis between 2007 and 2012 only two of the policy styles described by Gourevich (1986) were implemented by the Portuguese, Spanish and Italian cabinets. Only the classical liberalism approach via austerity measures and liberalization efforts was used as well as the demand stimulus style at the commencement of the financial crisis by all cabinets. Measures of protectionism, mercantilism and socialization and planning were not applied during the economic crisis mostly due to the restrictions posed by the European Union regarding protectionist measures and impossibility of nationalizing industries.

Throughout the financial crisis and ensuing sovereign debt crisis of 2007 until 2012 the influence of the international economy is clearly visible in the macroeconomic policy decision making process. The criteria of the Stability and Growth Pact and the excessive deficit procedure resulted in an increasing pressure of the European Commission on Portugal, Spain
and Italy. The international pressure has mostly determined the application of contractionary policies as it was required by the excessive deficit procedures. The influence of partisan ideology on the macroeconomic policy making process seems to be minimal seeing that in copious cases the opposite of the expectation is executed by the cabinet party hence establishing the suspicion that partisan ideology is no determining factor in the decision making process. The political constraints varied significantly between the various cabinets during the economic crisis, but did not yield any result in changes in the macroeconomic policy output thus disconfirming the influence of political constraints as the accountable factor for variation in macroeconomic policy tools.

6.7 OVERVIEW OF VARIATION AMONG CASES
To conclude the causal narrative process a table will be presented in which the variation among the cases will be summarized to provide a brief overview concerning the variation between the cases before the continuation to the analysis and discussion section.

Table 6
Overview of variation in cases

<table>
<thead>
<tr>
<th>Cabinets</th>
<th>Period in Power</th>
<th>International Influence</th>
<th>Political Constraints</th>
<th>Veto Players</th>
<th>Partisan Ideology</th>
<th>Used Macroeconomic Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portugal</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Soares</td>
<td>1976-1978</td>
<td>Yes (IMF)</td>
<td>0.47</td>
<td>6</td>
<td>Left-wing</td>
<td>Contractionary</td>
</tr>
<tr>
<td>Sá Carneiro</td>
<td>1980</td>
<td>Yes (IMF)</td>
<td>0.41</td>
<td>N/A</td>
<td>Right-wing</td>
<td>Expansionary</td>
</tr>
<tr>
<td>Pinto Balsemão</td>
<td>1981-1983</td>
<td>Yes (IMF and EC)</td>
<td>0.4</td>
<td>1.6</td>
<td>Right-wing</td>
<td>Expansionary</td>
</tr>
<tr>
<td>Spain</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Suárez</td>
<td>1977-1981</td>
<td>Moderate (IMF)</td>
<td>0.48</td>
<td>N/A</td>
<td>Centre-Conservative</td>
<td>Contractionary</td>
</tr>
<tr>
<td>Cabinets</td>
<td>Period in Power</td>
<td>International Influence</td>
<td>Political Constraints</td>
<td>Veto Players</td>
<td>Partisan Ideology</td>
<td>Used Macroeconomic Policy</td>
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</tr>
<tr>
<td><strong>Calvo-Sotelo</strong></td>
<td>1981-1982</td>
<td>Moderate (IMF and EC)</td>
<td>0.48</td>
<td>N/A</td>
<td>Centre-Conservative</td>
<td>Contractionary</td>
</tr>
<tr>
<td><strong>González</strong></td>
<td>1982-1996</td>
<td>Yes (EC)</td>
<td>0.48</td>
<td>1.7</td>
<td>Left-wing</td>
<td>Slightly expansionary</td>
</tr>
<tr>
<td><strong>Italy</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Andreotti</strong></td>
<td>1976-1979</td>
<td>Yes (IMF and EC)</td>
<td>0.45</td>
<td>4.3</td>
<td>Centre</td>
<td>Contractionary</td>
</tr>
<tr>
<td><strong>Cossiga</strong></td>
<td>1979-1980</td>
<td>Yes (IMF and EC)</td>
<td>0.45</td>
<td>5.6</td>
<td>Centre</td>
<td>Contractionary</td>
</tr>
<tr>
<td><strong>Forlani</strong></td>
<td>1980-1981</td>
<td>Yes (EC)</td>
<td>0.47</td>
<td>5.2</td>
<td>Centre-left</td>
<td>Contractionary</td>
</tr>
<tr>
<td><strong>Spadolini</strong></td>
<td>1981-1982</td>
<td>Yes (EC)</td>
<td>0.47</td>
<td>4.6</td>
<td>Centre-left</td>
<td>Contractionary</td>
</tr>
<tr>
<td><strong>Portugal</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Socrates</strong></td>
<td>2005-2011</td>
<td>Yes (EMU and Trojka)</td>
<td>0.4</td>
<td>≈ 1</td>
<td>Left-wing</td>
<td>Contractionary</td>
</tr>
<tr>
<td><strong>Passos Coelho</strong></td>
<td>2011-2015</td>
<td>Yes (EMU and Trojka)</td>
<td>0.21</td>
<td>≈ 6</td>
<td>Right-wing</td>
<td>Contractionary</td>
</tr>
<tr>
<td><strong>Spain</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Zapatero</strong></td>
<td>2004-2011</td>
<td>Yes (EMU and EC)</td>
<td>0.31</td>
<td>≈ 4</td>
<td>Left-wing</td>
<td>Expansionary until 2009 followed by contractionary policy</td>
</tr>
<tr>
<td>Country</td>
<td>Period</td>
<td>Participation in EMU and EC</td>
<td>Fiscal Policy</td>
<td>Political Stance</td>
<td>Economic Stance</td>
<td></td>
</tr>
<tr>
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<td>------------------</td>
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<td></td>
</tr>
<tr>
<td>Rajoy</td>
<td>2011- now</td>
<td>Yes (EMU and EC)</td>
<td>0.27</td>
<td>2.9</td>
<td>Centre-Conservative</td>
<td>Contractionary</td>
</tr>
<tr>
<td>Italy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prodi</td>
<td>2006-2008</td>
<td>Yes (EMU and EC)</td>
<td>0.33</td>
<td>≈ 5</td>
<td>Left-wing</td>
<td>Contractionary</td>
</tr>
<tr>
<td>Berlusconi</td>
<td>2008-2011</td>
<td>Yes (EMU and EC)</td>
<td>0.34</td>
<td>2.7</td>
<td>Right-wing</td>
<td>Expansionary until 2010 followed by contractionary policy</td>
</tr>
<tr>
<td>Monti</td>
<td>2011-2013</td>
<td>Yes (EMU and EC)</td>
<td>0.45</td>
<td>2.7</td>
<td>Technocratic</td>
<td>Contractionary</td>
</tr>
</tbody>
</table>
7 Analysis & Discussion

Comparison between the two economic crises

When analysing the used policy styles during both the economic crises it can be stated that fewer options were available to the cabinets during the financial crisis in comparison with the debt crisis of the 1980’s. In both crises the main macroeconomic policy styles used are the classical liberalism approach and the demand stimulus style. During the economic crises in the two time periods austerity measures were applied involving internal devaluation and fiscal consolidation to recover from the economic downturn. Nevertheless, the classical liberalism approach via austerity covered also monetary instruments whereas this option was excluded during the financial crisis due to the European Monetary Union. Additionally, the demand stimulus style was implemented by the cabinets in all countries during the commencement of the financial crisis via investments in the sectors that drove economic growth and/or increases in social welfare benefits. However, a protectionist policy style could no longer be adopted during the financial crisis due to the established free trade area as a fundamental pillar of the European Union. The option of mercantilism has not been applied in either crisis whereas the socialization and planning strategy was barely used during the debt crisis and was non-existent during the financial crisis.

The influence of the international economy was present in both economic crises in all cabinets even though the influence exercising institution has altered between the two crises. Whereas during the debt crisis the IMF exercised control over the macroeconomic policies of the cabinets in Portugal, Spain and Italy the European Union via the Commission and the Central Bank entered this role during the financial crisis. Through the stand-by agreements and advice of the IMF cabinets were forced to implement contractionary policies to regain competitiveness in the international market as well as liberalization of trade to gain access to the European Community. Moreover, the European Central Bank restricted the application of protectionist measures and applied a common monetary policy for all member states. The European Commission exercised control over the compliance of the member states with the criteria of the Stability and Growth Pact and forced member states to implement fiscal consolidation efforts to meet the convergence criteria. In times that international pressure was at a lower level cabinets implemented mostly expansionary policies as can be seen in
1982 in Spain when recovery from crisis was achieved and in 1980 until 1982 in Portugal during the recovery of the economic crisis and the end of the first stand-by agreement with the IMF. At the start of the financial crisis all cabinets met the criteria of the Stability and Growth Pact and hence experienced little influence of the international system facilitating the application of expansionary policies.

Moreover, the expected direction of the influence of partisan ideology on the macroeconomic policy cannot be confirmed due to the absence of a relation between the ideology and macroeconomic policy output. During both economic crises several right and left wing cabinets have been in power in Portugal, Spain and Italy in which it could not clearly be distinguished whether a particular ideology applies a certain macroeconomic policy. For example, the left-wing cabinet of Soares in Portugal implemented a contractionary policy in contrast to the expected expansionary policy whereas the right-wing cabinets of Sá Carneiro and Pinto Balsemão applied an expansionary policy. During the financial crisis the left-wing cabinet of Prodi implemented contractionary policies whereas the succeeding right-wing cabinet of Berlusconi opted for an expansionary policy. Hence, in both economic crises no evidence can be found for the identification of a clear direction of influence of partisan ideology on macroeconomic policy making.

The effect of political constraints on the macroeconomic policy decision making is somewhat relevant during the debt crisis in which the politically less constrained cabinets implemented expansionary policies whereas no clear evidence can be found for this correlation in the financial crisis. The cabinets of Sá Carneiro and Pinto Balsemão experienced fewer political constraints and consequently implemented an expansionary policy and the same occurred in Spain during the cabinet of prime minister González. However, during the financial crisis the relatively unrestrained cabinets of Prodi and Rajoy implemented a contractionary policy whereas the more politically constrained cabinets of Zapatero and Berlusconi opted for an expansionary policy. Hence, the variable of political constraints seems to have a slight effect on the macroeconomic policies although it appears to need the absence of pressure from the international economic regime.
8 CONCLUSION

The factor accountable for the variation in macroeconomic policy tools used during economic crises seems to be the pressure of the international economic regime via the IMF and/or the European Union. Hence, during both economic crises the pressure of the international economic regime played an important role on the direction of the macroeconomic policy tools. Via stand-by agreements or mandatory procedures the macroeconomic policies were strongly recommended and further pressure was applied to achieve compliance. Therefore, the European Union did indeed impose restrictions on the macroeconomic policy making during the recent financial crisis complicating the recovery from said crises. However, a similar international pressure and influence was present during the debt crisis of the 1980’s in which the IMF and EC exercised an almost similar presence in the decision making process. Thus, the withdrawal of the European Union does not necessarily lead to an increased freedom in macroeconomic decision making during economic crises according to the presented data.

The influence of partisan ideology on macroeconomic policy decision making during economic crises can be disconfirmed since no evidence could be found for the expected causal mechanism. During both economic crises left and right-wing cabinets implemented macroeconomic policies contrary to the expectations raised in the academic literature. Additionally, the variable of political constraints seemed to have a weak correlation with the application of expansionary policies seeing that fewer political constraints resulted in cabinets applying a more expansionary policy during the debt crisis. However, during the financial crisis the application of expansionary policies seemed not to be facilitated by fewer political constraints, but through the absence of severe international pressure at the commencement of the financial crisis.

The strength of the thesis resorts in the application of several richly described within-case analyses of cabinets during the economic crises providing an accurate description of the political and economic situation. The usage of the within-case analyses grants the opportunity of considering multiple important aspects of the macroeconomic policy decision making process followed by the usage of a cross-case comparison that grants the opportunity of comparing a high amount of cases on the three important variables in two time periods. The weakness of the thesis is present in the complexity of the macroeconomic policy decision
making process and the impossibility of accurately describing the process leading up to the decision. Additionally, copious other variables such as the globally accepted policy paradigm, the effect of social learning from major trading partners and neighbouring countries or shifting importance and pressure of business and labour could have been considered. However, it was opted to use the three previously mentioned variables due to the importance and relevance attached to these variables in the academic literature.

Contributions have been made to the academic literature via the demonstration of the influence of the international economic regime during two economic crises in differing time periods and multiple cases. Furthermore, evidence is presented to support the statement that southern European economies would experience similar restraints without the European Monetary Union. Hence, a dissolution of the European Monetary Union would not be the solution to the difficult recovery from the financial crisis. Additionally, further evidence is provided regarding the possible non-importance of partisan ideology on the macroeconomic decision making process during economic crises whereas the influence of political constraints on the macroeconomic decision making process deserver attention for further since a weak correlation was found.
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Variation in Macroeconomic Policy Tools Explained


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