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THE SCANDINAVIAN WELFARE STATES

ACHIEVEMENTS, CRISIS AND PROSPECTS

by John D. Stephens

June 1995

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◆ Preface

The following paper was prepared within the framework of an international dialogue on **The Future of the Welfare State**, organized by UNRISD as part of its programme of work for the Social Summit. Under the direction of Gøsta Esping-Andersen, experts on social policy in seven regions of the world were asked to trace the response of different welfare regimes to the challenge of global economic restructuring. Their conclusions were presented in Copenhagen on 8 March 1995, at a conference hosted by the Danish Ministry of Foreign Affairs, and co-sponsored by UNRISD and the Danish National Institute of Social Research.

Scandinavian countries have enjoyed an international reputation for combining generous welfare state entitlements with rapid economic growth, low unemployment and very high levels of labour force participation, particularly among women. Over the past few years, they have nevertheless confronted serious economic difficulties, involving historically unprecedented levels of unemployment. Some analysts have linked poor economic performance with the requirements of welfare states, arguing that expensive entitlements make Scandinavian economies uncompetitive in world markets. This critical view appears to have won a degree of acceptance even among the principal architects of the welfare state, the Social Democratic parties and trade unions, which have recently agreed to cuts in some entitlements.

In his study of the Nordic experience, however, John Stephens argues that welfare state entitlements have played little part in the current economic problems of the Scandinavian countries. Far from undermining competitiveness, a well-trained and secure work force increases the ability of these economies to compete in international markets. Furthermore, in his view, there is no reason to assume that with the opening of the European market, the competitive advantage of low wages will be more important than that of capital intensity and highly qualified labour.

High levels of unemployment stem from the increase in international interest rates and a simultaneous internationalization of financial markets, which have affected a key element in the post-war model of growth in Scandinavian countries: the ability of the government to maintain low interest rates and to privilege borrowing by industry over other consumers of credit. Moreover, the decline in centralized bargaining has affected another important tool of macro-economic management in Scandinavia: negotiated wage restraint. Finally, stagnation in other advanced industrial economies has reduced international demand, on which the export-oriented economies of the region are heavily dependent.

With the rise in unemployment, demands on the welfare state increased, while revenue for social security contributions and taxes fell, making the existing level of entitlements unaffordable. In consequence, a series of reforms were made. Stephens discusses these changes on a country-by-country basis. In general terms, one can say that qualifying conditions have been tightened in a number of programmes; the level of benefits has been reduced, as people recuperate a lower proportion of lost income from unemployment, illness, and so forth; and there has been some trend toward privatization of social service delivery, although these programmes are still funded by the state.

The author concludes that these steps toward retrenchment do not represent a qualitative change in the Scandinavian welfare system. With very few exceptions, benefits today are still more generous than they were in 1970. There is, however, a longer-term shift in emphasis: fewer resources are being destined to maintaining the guaranteed level of income through citizens' entitlements (independent of participation in the labour force); and more is being invested in strengthening labour training and mobilization. There has also been an increase in the use of market principles to evaluate public services.

Will the Scandinavian states eventually be forced to adjust their welfare programmes to the "least common denominator" in the international arena? Stephens does not think so. The Nordic economies have high levels of labour productivity. They are also particularly resistant to changes induced by international competition because their export-oriented growth models have long depended upon competitiveness: increasing internationalization represents a quantitative, but not a qualitative, change in the existing economic environment.

Finally, the welfare state enjoys broad political support in Scandinavia, extending far beyond the social strata and parties originally responsible for establishing the world-famous programme of social protection. Short-term reform is therefore of a limited nature. Profound changes would require longer-term secular shifts in party support throughout these countries.

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Dharam Ghai
Director

◆ Contents

INTRODUCTION 1

PART I: THE SOCIAL POLICY PATTERN OF THE SCANDINAVIAN WELFARE STATES: COMMONALITIES AND CONTRASTS 2

PART II: THE ECONOMIC MODEL IN THE GOLDEN AGE: COMMONALITIES AND CONTRASTS 8

PART III: THE CRISIS OF THE SCANDINAVIAN MODEL 14

- Sweden 14
- Norway 25
- Finland 26
- Denmark 28

PART IV: CONCLUSION 29

- Future Scenarios 32

- References 36

◆ Abbreviations and Acronyms

ATP	earnings-related tier of the Swedish pension system
EC	European Community
GDP	gross domestic product
LIS	Luxembourg Income Survey
LO	Swedish, Danish and Norwegian blue collar workers' centrals
NIC	newly industrialized country
SAF	Swedish employers' association
TCO	Swedish white collar employees' labour central

INTRODUCTION[1]

The Scandinavian welfare states have enjoyed an international reputation for combining generous welfare state entitlements with rapid economic growth, low unemployment and very high levels of labour force participation, particularly among women. They seemed to have achieved the elusive combination of social equality and economic efficiency. As recently as 1988, Sweden, Norway and Finland appeared as international exceptions, maintaining very low levels of unemployment while not only maintaining but actually expanding welfare state entitlements in the previous decade. Denmark, with a decade of high unemployment and attendant economic problems, seemed to be the outlier. Within five years, all three experienced historically unprecedented increases in unemployment. Indeed, in Sweden and Finland, the turn of economic events was widely termed a “crisis” which equalled or exceeded that of the Great Depression.

Many analysts have linked the poor performance of the Nordic economies to their welfare states. The generous entitlements are expensive and, it is argued, they have made the Scandinavian economies uncompetitive. This problem has been accentuated by the processes of economic internationalization and European integration, which make international competitiveness all the more imperative. This critical view of the Nordic welfare states appears to have found some acceptance even among their principal architects, the Social Democrats and trade unions, as they have recently agreed to cuts in some entitlements, such as lowering replacement rates and introducing waiting days for benefits. Moreover, trade unionists and Social Democrats, in Scandinavia and elsewhere in Europe, have expressed fears that the long-term result of the 1992 initiative would be to reduce welfare state provisions to the lowest common denominator within the European Union.

This paper examines the development, achievements and current crisis of the Scandinavian welfare states. Although the main focus is social policy, it is impossible to understand the development of the latter without consideration of complementary economic policies which produce growth and thus employment. The paper will argue that, taken as a whole, welfare state entitlements have made little if any direct contribution to the current economic problems of the Scandinavian countries. In fact, many of these entitlements may actually have created competitive advantages. The problem is rather that the Scandinavian growth and employment model, which was so successful during the Golden Age of post-war capitalism up to the mid-1970s, is much less effective in the contemporary world. This, in turn, has made welfare state entitlements which were affordable in the past no longer

[1] I have accumulated a number of debts in the process of researching and writing this paper. Research in Sweden in May 1992 was supported by a grant from the Swedish American Bicentennial Foundation. The Swedish Institute provided valuable help in arranging interviews and the Institute for Social Research, Stockholm University, provided a stimulating and supportive environment. Evelyne Huber collaborated with me in this research. Joakim Palme and Olli Kangas provided valuable figures and Francis Castles, Gøsta Esping-Andersen, Evelyne Huber, Jonathon Moses, Joakim Palme, Olli Kangas and Bo Rothstein useful comments on an earlier draft of this paper.

affordable. Quite simply, as unemployment rises, more people draw on the social welfare system and fewer contribute to it, making precisely the same set of entitlements now excessively expensive.

I begin in parts I and II with a description of the Scandinavian welfare states at their pinnacle, and of the supportive economic policies pursued in the Golden Age. In part III, I analyse the current crisis, and conclude in part IV with some speculation on future trajectories of economic and social policy in the region. Throughout the paper, I focus on Sweden and deal with the other three countries as comparisons and contrasts to the Swedish case. I do this not only because treating all four cases in equal depth would make this paper inordinately long but also because Sweden is frequently singled out as the paradigmatic example of the achievements (and limitations) of Social Democracy. Moreover, Sweden was a leader in social and economic developments, and actors in the other three countries frequently attempted to emulate (or avoid) Swedish policies.

PART I: THE SOCIAL POLICY PATTERN OF THE SCANDINAVIAN WELFARE STATES: COMMONALITIES AND CONTRASTS

In reaction to an earlier generation of welfare state research which simply arranged nations' "welfare effort" along a single dimension — usually measured by level of expenditure — recent scholarship, inspired by Titmuss's (1974) tripartite "models of social policy", has attempted to develop typologies of welfare states (see e.g. Esping-Andersen, 1990; Palme, 1990; van Kersbergen, 1991; Huber, Ragin and Stephens, 1993; Korpi and Palme, 1994). Following Esping-Andersen (1987; 1990), these typologies have generally distinguished three types of welfare states: the Social Democratic or institutional; the corporativist, Catholic or work-merit; and the liberal or residualist (however, see Castles and Mitchell, 1990; Ragin, 1994; Kangas, 1994). Esping-Andersen and Kolberg (1992b) have argued that these social policy types are associated with patterns of labour market entry and exit, and employment, characterizing the intersection of these two as "welfare state régimes". Moreover, in the case of Scandinavia, many analysts have connected the social policy pattern to policies promoting growth and employment, in order to designate a "Scandinavian model" of the full employment welfare state.[2]

Earnings, Replacement Rate and Coverage
in Major Transfer Programmes, 1985

[2] This is not to imply that welfare state régimes clearly cluster into three groups, particularly if one includes the employment régime and related economic and industrial policy. I have criticized this view elsewhere (Stephens, 1994b). However, the designation of three types can be defended as ideal types, with Sweden being the closest empirical example of the Social Democratic or institutional type. Moreover, of the three groups, the Scandinavian group shows the most empirical tendency to cluster (Ragin, 1994; Kangas, 1994).

Earnings replacement rates for an average production worker (% of working wage)				
	Sweden	Norway	Finland	Denmark
Pensions				
minimum	48	48	48	54
full qualifications	77	67	69	56
Sick pay				
(26 week absence)	90	100	74	77
Maternity/parental leave				
(26 week absence)	92	83	77	83
Unemployment				
(26 weeks)	72	61	56	59
Coverage (%)				
	Sweden	Norway	Finland	Denmark
Pensions	100	100	100	100
Sick pay	87	85	92	81
Maternity/parental leave	100	100	100	81
Unemployment	75	90	63	80

Sources: Hagen (1992:141,147,151,154); Kangas and Palme (personal communications).

A good starting point for characterizing the Scandinavian welfare state is Palme’s (1990:82ff) analysis of pensions. In Palme’s classification the institutional pension model combines “basic security” and “income security”. In practice, such a pension system combines a flat rate pension which is a right of citizenship (that is, all citizens receive it regardless of work history) and an earnings-related pension with a relatively high income replacement rate. To extend this to the welfare state as a whole, we can say that the institutional model combines citizenship benefits which are equal for all citizens with income security for the working population in cases of temporary (illness, unemployment) or permanent (retirement, work injury) interruption of work. The major transfer programmes (pensions, sick pay, work injury, unemployment compensation, maternity/parental leave) are designed to provide income security. In addition, the flat rate citizenship pensions which form the first tier of all of the Scandinavian pension systems provide basic security, and some of these countries provide additional citizenship benefits such as sickness and unemployment allowances. Moreover, all four Scandinavian countries provide child allowances which are flat rate and housing allowances which are generally related to need. Thus these benefits contribute to basic security.

Replacement rates and coverage rates in the major transfer programmes for an average production worker are shown in the table. It is apparent from these figures that the Nordic welfare states do approximate the institutional model. Both coverage rates and replacement rates are high. The effect of the basic citizenship pension can be seen from the figures for the minimum pension, that is, that which a single person without labour market experience would receive. The Luxembourg Income Surveys (LIS) clearly show that citizenship pensions have been effective in reducing poverty among the aged for the three Nordic countries for which there is LIS data: only 5 per cent of aged Norwegians, 4 per cent of aged Finns and less than 0.5 per cent of aged Swedes live in poverty.[3]

The pension data in the table show that Denmark does not approximate the institutional model to the extent that the other three Scandinavian countries do. The second tier of the Danish pension system provides for modest supplementary pensions which are related to work experience but not to income level, and thus the income replacement rate falls steeply as income rises. By contrast, in the other three countries, supplementary pensions are earnings-related, rising with income to ceilings which are set at 7.5 or 8 times a “base amount” in Sweden and Norway (approximately three times the wages of an average production worker) or without a ceiling in the case of Finland. Because the replacement rate figures in the table for sick pay, parental leave, and unemployment insurance refer to the average production worker, they do not reveal the extent to which replacement rates in Denmark for higher paid workers fall to a much greater extent than they do in the other three countries. Danish legislation generally provides for a replacement rate up to 90 per cent of the pay of an average industrial worker. Swedish and Norwegian replacement rates generally are 90-100 per cent and are paid up to the same ceilings as the public pensions, thus providing high replacement rates well up into the ranks of white collar workers. Finnish provisions vary but are closer to the Swedish and Norwegian pattern with regard to income replacement rates for better paid employees.

The Finnish transfer system does differ from the other Scandinavian countries in one regard: a substantial portion of it is administered outside the state apparatus and does not appear in the public budget and in the figures in the table. This is true of the first week of sick pay and work injury insurance. In both cases, the programmes are established by legislation but not administered by the state bureaucracy.

If the welfare state is conceived broadly to include not only transfers and health care but also services such as education, day care, elderly care, public transit subsidies, housing subsidies, active labour market expenditure and so on, transfer payments make up less than half of total expenditure on welfare. This is particularly true of the Scandinavian institutional welfare states which are service intensive, in contrast to the Catholic welfare states which are transfer intensive (Huber, Ragin and Stephens, 1993). In Scandinavia, health care, education and, to a lesser extent, day care are citizenship or residence rights provided to all residents free or with a small co-payment. In all four countries, these three make up the bulk of service expenditure and thus can be said to strengthen the citizenship or basic security profile of the Nordic welfare states.

It is worth underlining how distinctive the Scandinavian welfare states are in terms of size of the public welfare service sector and its recent expansion. This, along with parental leave, has been the main area of welfare state innovation in the last two decades. As Cusack and Rein (1991) show, in the mid-1970s, welfare state employment (i.e., public health, education and welfare employment) accounted for an average of 15.4 per cent of the

[3] The poverty level referred to in the text is 50 per cent of median income. The figures were kindly provided to me by Joakim Palme and Olli Kangas. For further analysis, see Palme (1993).

working age population in the four Scandinavian countries, compared to 5.1 per cent in six continental European countries (roughly equivalent to the category of Christian Democratic welfare states) and 6.1 per cent in the four Anglo-American countries (the Liberal welfare states). From 1975 to 1985, the increase in welfare state employment as a percentage of the working age population was 5.6 per cent in Denmark, Norway, and Sweden compared to only 0.3 per cent for the other six countries for which comparable data is available. [4]

Thus very broad — usually universal — coverage, high income replacement rates, services and some transfers as a citizenship right, and service intensity are four of the basic institutional parameters of the Scandinavian welfare states. Additional dimensions of the social policy side of these welfare states are liberal qualifying conditions for benefits, comprehensiveness, and statism. As we pointed out above, basic pensions and most services are provided on the basis of citizenship or merely residence. In the case of other transfers, the qualifying conditions (e.g. number of waiting days before benefits begin, number of weeks or years worked to qualify for partial or full benefits) are liberal compared to similar requirements elsewhere. Means, needs or income testing for benefits is not frequent in the Nordic welfare states. Housing allowances, special pension supplements for those with no and/or small earnings-related pensions, and social assistance are usually the only programmes of importance where such tests are required.

By comprehensiveness, I mean that the social provisions in the Nordic welfare states cover virtually all areas in which the state provides services or benefits in any advanced industrial democracy. Finally, the Scandinavian welfare states are statist in the sense that services are provided by the state — rather than by non-profit institutions (e.g. religious organizations) on the basis of a subsidy from the state or subcontracted to private firms — and the transfer systems are administered by the state. As pointed out above, Finland is a partial exception here. The result of all these characteristics (universalism, high replacement rates, citizenship benefits, liberal qualifying conditions, comprehensiveness and statism) is that public provisions crowd out private alternatives such as negotiated collective benefits or private insurance. These alternatives, though not absent, play a much smaller role in providing services, consumption and security in Scandinavia than in other advanced industrial countries.

For the social and political forces that shaped the Scandinavian welfare states, above all the socialist parties and unions of manual labourers but also white collar unions and agrarian parties,[5] institutional parameters (universalism, high income replacement rates, service intensity, etc.) themselves were not the primary goal in the legislation. The most important goals were security, decommodification, labour training and mobilization, and redistribution. It is my contention that these goals were achieved to a degree unrecognized even by their supporters. In the case of security and decommodification, this is an uncontroversial statement, as it can be read off

[4] Recalculated from Cusack, Notermans and Rein (1989:478).

[5] The question of which social forces shaped the Scandinavian welfare states is still contested terrain (compare Baldwin, 1990; Immergut, 1992; Esping-Andersen, 1985; Korpi, 1983; Olsson, 1990). The view expressed in the text is my own view and is the most common one. See Stephens (1979; 1994a) and Huber and Stephens (1995) for elaboration.

from the institutional characteristics themselves. High income replacement rates, citizenship benefits, liberal qualifying conditions and comprehensiveness all contribute to security. They also “decommodify” (in Esping-Andersen’s terms), since citizenship — rather than market participation and market position — forms the basis for entitlement to income or publicly provided goods and services, and individuals suffer relatively small losses of income from exiting paid work temporarily or permanently.

Turning to labour training and labour force mobilization, it would take us too far afield to provide a comprehensive assessment of the effectiveness of Scandinavian education and labour market training systems in providing a highly skilled workforce. Suffice it to say that labour quality is a major comparative advantage for these countries. In the case of labour mobilization, the figures on labour force participation and, until the late 1980s, unemployment speak for themselves. Nevertheless, it is important to point out here that labour mobilization and decommodification can conflict with one another; and those features of the Scandinavian welfare state, which arguably reduce incentives to work among the healthy working age population, have been under attack in recent years. It is a common contention among economists, journalists and politicians (and not only those on the right) that the high taxes and generous transfers of the advanced welfare states constitute work disincentives. As contributors to Atkinson and Mogensen (1993) demonstrate, however, the empirical evidence on this account is much more mixed than the common wisdom would assume. Some robust findings stand out: generous early retirement pensions do contribute to early exit from the labour force, and the array of policies aimed to facilitate women’s labour force participation (parental leave, public day care, etc.) have had their intended effect. Otherwise the negative effects on labour supply are generally small or insignificant; and positive effects (i.e., backward bending supply curves) are not infrequent for some sub-groups, such as men of prime working age. Moreover, variations across programmes are relatively great and findings for one country do not necessarily hold for another. For example, in the case of sickness insurance, which has provoked heated debate in Scandinavia over the past decade and a half, Gustafsson and Klevmarken (1993:95) present evidence to show that increases in sick pay replacement rates (but not decreases in waiting days) are strongly associated with increases in absenteeism in Sweden. By contrast, in Kangas’s (1991) cross-national study, fewer waiting days but not high replacement rates were associated with high absenteeism. Esping-Andersen and Kolberg (1992a) find that although Sweden, Norway and Denmark all have generous sick pay provisions, they vary greatly in rates of absenteeism.

Two points are worth underlining with regard to redistribution, both of which are of considerable importance for our concluding discussion on future directions for the Nordic welfare states. First, as Mitchell’s (1991) work on the redistributive effect of direct taxes and transfers shows, the welfare state under Social Democratic auspices has been massively redistributive. Saunders’s (1991) work, also on LIS data, indicates that the inclusion of the distributive effect of public services would further strengthen the redistributive effect.[6] Second, though the apparent effect of earnings-related benefits would seem to lessen the redistributive impact of the institutional welfare state, the opposite is the case. Such a counter-intuitive finding is explained by the fact that the institutional welfare state crowds out all other alternatives (such as negotiated occupational benefits, private insurance and personal savings), all of which are much more unequal than earnings-related public benefits. This has been demonstrated conclusively in recent work by Kangas and Palme on pensions (Kangas and Palme, 1993; Palme, 1993) and in work by Korpi and Palme (1994) on a broader range of welfare state benefits. Kangas and Palme (1993) present LIS data on 10 countries showing that other sources of support for the elderly are vastly more unequally distributed than public pensions (with gini coefficients for the former varying from .41 to .82, depending on source and country, compared to the highest gini coefficient of .15 for public pensions). They also show that generous public pensions, those with high replacement rates, do greatly reduce reliance on these alternatives. And although public pension income is unequally distributed in countries with earnings-related pensions, gross income and final disposable income are more equally distributed. For example, the gini index for public pension income in Sweden is .15; in Australia, which has means tested pensions, it is -.07.[7] Yet the gini indices for gross income (including all sources, before tax) and for final disposable income are considerably lower in Sweden (.24 and .14 respectively) than in Australia (.34 and .28 respectively). In their analysis of income distribution among the elderly in Finland at six points in time between 1966 and 1991, Jäntti, Kangas, and Ritakallio (1994) further illustrate this point: the maturation of the Finnish statutory earnings-related schemes which were instituted in the 1960s and early 1970s led to dramatic declines in income inequality as the squared coefficient of variation declined from .57 in 1966 to .16 in 1991. The authors conclude that "despite their income-graduation, legislated universal programmes have equalizing effects by crowding out more regressive components of the income package of the elderly".

[6] I realize that my claim of "massive redistribution" is controversial and that the data I present here will not convince skeptics. For a more extensive analysis, see Stephens (1995) and Huber and Stephens (1995).

[7] Since these gini coefficients are calculated on the basis of final disposable income, it is possible to have a negative number, indicating that lower income recipients get larger pensions than higher ones.

PART II: THE ECONOMIC MODEL IN THE GOLDEN AGE: COMMONALITIES AND CONTRASTS

As Esping-Andersen and Kolberg (1992b) have argued, the Scandinavian welfare states have been associated with a distinct labour market régime. With regard to employment, one can make the following crude characterization as a baseline against which the actual experiences of the individual countries can be compared. By the mid-1960s, Scandinavian employment/growth models, along with the vigorous growth of all advanced capitalist economies, had produced high rates of labour participation and very low unemployment among males. Unlike the northern continental countries, such as Germany, France, Switzerland and Austria, the Scandinavian countries limited recruitment of non-Nordic foreign labour, and this provided greater job opportunities for women in the private sector. More important for female employment, the Scandinavian welfare states were (and are) service intensive and provided employment opportunities for women in public health, education, and welfare. This was facilitated by the expansion of maternity/parental leave and the expansion of day care; the latter, in turn, provided jobs to the new female entrants. The rise in female labour force participation then stimulated demands on the part of women for further expansion of these supportive transfers and services.

Active labour market policy — public spending on employment services, moving allowances, job training, temporary public employment, and subsidized employment in the public or private sectors — has often been viewed as an integral part of the Nordic welfare state/labour market régime. It is true that the Scandinavian countries all do have active labour market policies, and their concentration on active measures as opposed to passive measures (i.e., unemployment compensation) to fight unemployment and its effects does distinguish them from the continental welfare states. However, there is great variation among the four countries which is directly related to growth/employment policy. For reasons we outline below, Sweden is clearly distinctive in this regard and, indeed, the other three countries have copied their policies in large part from Sweden.[8] In 1970, when all four countries were enjoying very low levels of unemployment, Sweden spent 1.1 per cent of GDP on active labour market measures while the other three countries spent no more than 0.3 per cent. In 1987, when unemployment rates were 5.1 per cent in Finland, 8 per cent in Denmark and only 1.9 per cent in Sweden, Sweden nevertheless spent 1.9 per cent of GDP on active labour market measures, compared to only 0.9 per cent and 1.1 per cent in Finland and Denmark respectively.

Though the policy goals of all four countries were broadly similar, the specific economic/employment policies of the Nordic countries vary more than their welfare state régimes. Nevertheless, one can identify a general

[8] The description here follows Furåker, Johansson, and Lind (1990). All the figures cited are from this source except the unemployment figure for Finland which is from OECD (1993).

Nordic type which fits all of the countries except Denmark rather well.[9] They have small, open economies and thus are dependent on having competitive export sectors. That sector has traditionally been based on the countries' raw materials and has been closely linked to financial interests. The economies are characterized by strong industrial complexes which are backward and forward integrated. Their human capital base has been strong and this, combined with rising capital intensity, became increasingly important for international competitiveness as the countries moved beyond the export of raw and semi-processed materials.

Scandinavian unions boast the highest union density rates of industrial societies and are highly centralized. Their employer counterparts are likewise well organized and highly centralized. The combination of strong unions and dependence on competitive exports has necessitated a policy of wage restraint; and the centralization of unions, employers' organizations and the bargaining process has made such a policy possible. The unions' "side payment" for wage restraint has been full employment and the development of the institutional welfare state described above. For this trade-off, co-operation of the sitting government was necessary; and from a union point of view this was facilitated by the predominance of the Social Democratic party, which is closely allied to the blue collar union central organization in all four countries. Thus a pattern of tripartite bargaining ("corporatism") over wages, economic and social policy emerged in Scandinavia in the course of the post-war period.

Given this balance of power in society, as well as the nature of the domestic economy, it is not surprising that the goals of economic policy were full employment and rapid economic growth based on rapid technological change. Fiscal policies were moderately counter-cyclical and backed up by occasional devaluations. Nevertheless, the core of the long-term growth/employment policy — and this cannot be overemphasized — was supply-side. It extended beyond general supply-side measures (such as education and job training, infrastructure, cheap credit policies, and generalized support for research and development) to selective measures (such as active labour market policy, credit policies favouring industrial borrowers over consumers and speculators, regional policies and subsidies or subsidized credit to selected industries). Interest rates were kept low through credit rationing and through public sector surpluses. Accordingly, fiscal policy was generally austere: these countries usually ran budget surpluses. The demand side of the Scandinavian growth/employment models was not internally generated; it was a result of demand for exports created by the vigorous post-war growth in the core advanced capitalist economies of North America and Europe.

Turning from the Scandinavian commonalities to the distinctive features of each country, we can begin by characterizing Sweden. Perhaps the most distinctive feature of Sweden is the character of business. While Sweden shares with Finland and Norway a high degree of concentration in the secondary sector, with particular emphasis on non-agricultural exports, it differs in that industry, particularly export industry, has been dominated by a small number of privately owned, internationalized and internationally

[9] This characterization leans heavily on Mjøset (1986; 1987) and Andersson et al. (1993).

competitive, oligopolistic firms since the very onset of industrialization. More quickly than the other two countries, Sweden turned from export of raw materials and semi-processed goods (in forestry and mining) to export of capital goods and finished consumer products.

As noted above, the common features of Scandinavian economies fostered high degrees of employer and union centralization, and union organization. In the Swedish case, the character of the business sector encouraged the development of aggressive policies on the part of the employers' association (SAF) aimed first at defeating the nascent union movement and then, when this failed, at limiting its political influence; and finally, when even this failed, the goal of the business sector was reduced to preserving private ownership and employers' prerogatives in the workplace and private sector direction of the overall investment process.[10]

After the re-election of the Social Democrats in 1936 for a second term, the employers' federation abandoned its attempt to defeat the labour movement and entered into negotiations with the blue collar workers' central (LO), resulting in the Saltsjöbaden agreement of 1938. Korpi (1983:47-48) characterizes the long-term effects of this "historic compromise" as an agreement by both parties to co-operate in creating economic growth. The labour movement would be granted greater influence over the results of production; and employers would retain the right to control the productive process and the direction of investment. The co-operative arrangement paved the way for labour peace and later for the centralization of collective bargaining at the national level.

The **post-war programme of the labour movement** contained elements of more ambitious planning that would have moved Sweden closer to the more statist direction of investment characteristic of Norway and Finland. Such a move was cut short by the Social Democratic retreat in the post-war "planning debate". The difference in outcome, I would contend, was certainly due partly to the differences in the character of national capital in the three countries. As a result the Swedish version of the Scandinavian supply-side model focused on labour supply, influencing investment only indirectly.

The contours of this policy emerged in the famous Rehn-Meidner model named for the two LO economists who developed it. The model called for LO to demand equal pay for equal work across the economy, the so-called solidaristic wage policy. This wage policy would force labour-intensive, low-productivity enterprises to rationalize or go out of business. The displaced labour would then be moved to high-productivity sectors through the active labour market policy. Wages in high-productivity, often export-oriented, sectors would be restrained to facilitate international competition and encourage investment in these sectors.[11] The active labour market

[10] This is not to imply that such attitudes were absent among employers in Norway and Finland. They were simply less able to resist state initiative than their Swedish counterparts. Perhaps more important, it was much more difficult for Norwegian and Finnish employers to claim that they could mobilize the capital necessary for rapid industrialization without state assistance or even direction.

[11] For a formal analysis of how this policy simultaneously promoted equality and efficiency, see Moene and Wallerstein (1994).

policy, by reducing structural unemployment, would further facilitate wage restraint and thus reduce the trade off between unemployment and inflation, moving the Phillips curve down and to the left.

According to the model, restrictive economic policy should be pursued in order to facilitate wage restraint. In the face of restrictive macro-economic policy, full employment would be achieved through the active labour market policy and other selective measures, including loans at low interest rates from public savings such as pension funds. State controls in currency and credit markets facilitated macro-economic adjustment. Acceptable distributive outcomes for labour were achieved by tight fiscal policy which dampened domestic demand and thus profit levels,[12] and by expansion of transfer payments and free or subsidized public goods and services. Given modest profit levels, levels of business investment adequate for economic growth were to be achieved through low-interest loans from public savings. The tax régime also heavily favoured investment over distribution of profits.

As I mentioned above, the demand side to this essentially supply-side model was taken care of by growth in demand for Swedish export products in the rapidly growing capitalist core economies. The growth of the economy was, of course, essential for the expansion of the welfare state that occurred in this period. An expanding pie made it easier to expand the welfare state share. At least as important was the pattern of employment production that was generated by the welfare state/employment/growth régime. Low levels of unemployment and high levels of labour force participation meant that high proportions of the total population were working and thus supporting the welfare state with taxes and contributions, while lower proportions (in relative terms) were entirely dependent on it. Thus the same level of entitlements in Sweden, and elsewhere in Scandinavia, was much less costly than it would have been if these countries had been characterized by the labour force participation rates of the continental European countries, not to mention the unemployment levels that some of the latter began to suffer beginning in the mid-1970s.

Norway and Finland lacked the internationalized *haute bourgeoisie* which characterized Sweden. The economic, and hegemonic, weakness of Norwegian and Finnish (as compared to Swedish) capital helps explain why, at a time when the idea of economic planning was under intense attack by SAF and the non-socialist parties in Sweden, the latter accepted state leadership in economic planning in Norway and even initiated it in Finland. In large part, this reflected the objective reality that it would be difficult for Norwegian and Finnish business to mobilize the capital necessary for an ambitious programme of industrialization and structural transformation, and in part it reflected their weaker ability to oppose such a programme had they wanted to do so.

The Norwegian model was characterized by direct intervention of the state through active industrial policy and low interest rates, and by the channelling of credit to industry, which was facilitated by extensive state ownership of industry and banks. Credit policies of the government were so central an

[12] At least in theory. In fact, profits in the export sector could not be controlled by tight fiscal policy.

element in growth and employment policies that Mjøset et al. (1986:121) have characterized the Norwegian model as “credit socialism”.

Active labour market policy was less central to the Norwegian model. One reason for this was the possibility of direct intervention to support employment in declining areas. Thus Norwegian policy has always had a strong regional element to it, in sharp contrast to the Rehn-Meidner model, which hastened the decline of peripheral regions in Sweden to such an extent that it stimulated policies in the 1970s to counteract these effects. As a result, Norwegian industrial policy implies greater micro-efficiency problems than in the Swedish case.

If anything, the state was more involved in the industrialization process in Finland than in Norway, not only promoting and subsidizing industrial diversification but also directly owning and creating new industrial concerns. Like Norway and Sweden, the state used low interest rates and channelling of credit to spur industrial transformation. In order to create public savings, the model was fiscally very conservative, running consistent surpluses. Unlike those two countries, labour was ideologically divided, both on the union and party side, and was largely excluded from the planning process in this period. It is a case of what Lehmbruch (1984) calls “concertation without labour”, bearing similarities to Japan and East Asian NICs (Vartiainen, 1994). Due in large part to the exclusion of labour, the Finnish welfare state lagged far behind the other Scandinavian countries as of the mid-1960s.

The mid-1960s marked a shift in the Finnish model, which moved strongly in the direction of Swedish and Norwegian models. The 1966 election resulted in a left majority in parliament and ushered in a period of Social Democratic rule in co-operation with the Communists and/or Agrarians. In the same period, divisions in the trade union movement were overcome and union membership began to increase rapidly. As result, the Finnish model moved from “concertation without labour” to tripartite corporatism: agreement on a comprehensive incomes policy in 1968, the first of its kind in Finland, symbolically marked the transition. Social policy followed a similar pattern. New affluence permitted the centre-left political alignment to carry out a series of social reforms over two decades, extending into the period of slowdown or retrenchment in the other three Scandinavian countries, in which the Finnish welfare state caught up with its neighbours.

The fact that both the Danish industrial structure and economy differ from other Nordic countries goes far toward explaining why the Danish welfare state régime and employment/growth model are also different. Denmark’s only natural resource is fertile soil. Thus agricultural products, above all processed foods from the dairy and animal husbandry branches, dominated exports until the 1960s. In particularly sharp contrast to Sweden, industry was traditionally small-scale and craft oriented. Even after the “second industrial revolution” beginning in the late 1950s, small-scale manufacturing dominated the new niche-oriented manufacturing export industries. Moreover, Denmark lacked the finance-industry linkages achieved through the concentrated industrial-financial conglomerates in Sweden or via the state in Norway and Finland.

As a consequence, agrarian interests were stronger and the left weaker in Denmark than in Sweden or Norway, craft unions carried more weight in the Danish labour organization and there was (and is) a separate union for unskilled workers within the latter. Thus, the union movement was more decentralized, more diverse in its interests, and not dominated by industrial unions in the export sector as in the other Nordic countries. Given the Social Democrats' weakness and need for non-socialist coalition partners, it is not surprising that the Social Democrats' post-war statist planning initiative went nowhere (Esping-Andersen, 1985:206). Nor did a supply-side policy (modelled along Swedish lines, to encourage industrial development and structural rationalization) emerge. The petty bourgeois character of both the rural and urban sectors, as well as the lack of finance-industry ties, militated against this, as did the character of the union movement itself. In Sweden, such a policy was based on the hegemony of export-oriented manufacturers and industrial unions, and on a high degree of centralization on both sides — all of which were lacking in Denmark. In sharp contrast to the other Scandinavian countries, Danish financial markets were strongly integrated with international credit markets in the Golden Age; and therefore interest rates were higher than in the other countries (Mjøset et al., 1986). With no long-term supply-side policies, government efforts to combat unemployment were predominantly short-term Keynesian demand management measures which fuelled inflation, thus threatening the balance of payments and consequently leading to contractionary measures — the "stop-go" cycle familiar to students of British political economy (Esping-Andersen, 1985:207).[13]

These same economic and political characteristics strongly influenced the social policy outcome. Except for short periods, the Social Democrats could not dispense with their coalition with the agrarian Radicals. Therefore the former failed in their efforts to create earnings-related supplementary pensions. Similarly, as we saw in the initial section of this paper, other replacement rates for transfer payments fall rapidly as one moves above the income level of the average production worker. The character of the Social Democrats' union base contributed to this pattern. The industrial unions, especially in the export sector — which were the main promoters of earnings-related benefits in Sweden and Finland — were weak, and the skilled and unskilled workers divided in their interests. Thus, for example, the Danish LO, in sharp contrast to its Nordic counterparts, was ambivalent about earnings-related supplementary pensions, with the unskilled workers favouring increased flat-rate benefits and the skilled workers favouring wage increases rather than increased pension benefits (Salminen, 1993:275-76). The petty bourgeois character of Danish employers is one reason (probably the main reason) why, in contrast to the other Nordic countries, employers' contributions to social security financing are very low and tax financing very high. Finally, as outlined in the previous paragraph, the structure of industry and unions discouraged structural rationalization policies and thus favoured passive measures over active labour market policy.

[13] Denmark and Britain share characteristics which underpin this policy orientation: strong, decentralized unions, low concentration in industry, few links between banks and industry, and strong international integration of financial interests.

PART III: THE CRISIS OF THE SCANDINAVIAN MODEL

"Crisis" is perhaps the most overused word in studies of the political economy of advanced industrial societies. In the 1970s, it was frequently used to characterize the qualitative change in the operation of advanced capitalist societies and the resultant advent of low economic growth. In truth, in longer historical perspective, the end of the Golden Age simply marked a return to the average growth rates of the hundred years before the Second World War. Nonetheless, the advanced political economies have gone through a sea change in recent decades which can be conveniently dated as beginning with the break-up of the Bretton Woods system of fixed but flexible exchange rates in 1971 and the OPEC oil price increase of 1973. The sea change was produced by these events combined with a series of long-term secular changes: increasing internationalization of trade; internationalization and multinationalization of capital; internationalization and deregulation of financial, capital and currency markets; the decline of the industrial sector and the rise of the service sector; and the decline of "Fordist" (assembly line) semi-skilled manufacture and the rise of "flexible specialization" and skill-differentiated manufacture. These trends have been held responsible for what truly is a crisis of the Scandinavian models. In this section, I will argue that they did have a major impact on the employment/growth and labour market models but only indirectly affected the welfare state via the resultant increase in unemployment.

◆ Sweden

As in the other Scandinavian countries, Swedish governments initially treated the new economic era as if it were a temporary downturn.[14] Thus the Social Democratic government reacted with counter-cyclical measures. As the difficulties wore on, the series of non-socialist coalition governments, which took power in 1976, introduced a combination of restrictive and expansive measures which Mjøset et al. (1986) characterize as "fumbling". These governments were eager to defend unemployment and welfare state entitlements in order to prove that Social Democratic charges against them were incorrect. While no major social policy innovations were passed, neither were there any significant rollbacks. To fight unemployment the governments subsidized some industries and took over failing ones, leading to unprecedented budget deficits. In part in reaction to the deficits, but also as a result of a neo-liberal turn on the part of the conservatives and the aggressive neo-liberal posture of SAF, the government began to introduce some very modest entitlement reforms in 1980, such as reducing compensation for part-time pensions and introducing one waiting day for sick pay (Marklund, 1988).

That the latter became a major issue in the 1982 election, which brought the Social Democrats back to power, indicated the support for the welfare state

[14] For an analysis of policy in this period, see Martin (1984; 1985).

in Sweden as well as the policy mandate of the new government. This government knew that it faced a changed world and that new policies would be necessary. Before entering office, leading Social Democratic economic analysts had come to the conclusion that it was impossible to expand public expenditure as a percentage of GDP. Thus any reforms would have to be financed by other cuts in public spending or by GDP growth (Feldt, 1991). In office, the Social Democrats not only cut spending as a percentage of GDP (while, remarkably, actually introducing some new reforms), but also cut state intervention in the economy in other ways, notably deregulating financial markets in 1985-1986, directing all state enterprises to make profitability their only goal, and partially privatizing some state enterprises.

There is no doubt that some of these policies followed the preferences of Finance Minister Feldt and his advisors, whose neo-liberal bent (or, at least, neo-liberal within the context of Swedish Social Democracy) went further than many in the labour movement, above all the leadership and economists of the latter. With regard to the size of the welfare state, however, there was agreement. Prior to the 1986 LO conference, a group of LO policy experts (who would hardly count among Feldt's allies) issued a report which argued that it was not necessary for the welfare state to grow as a percentage of GDP in order for it to achieve its goals. In part, this report simply stated that the Swedish welfare state was fully developed; it was already comprehensive, coverage was universal or near universal in all programmes, and replacement rates were very high. Putting the LO report and the Feldt group's assessment together, one can say that, in comparative terms, the promoters of the welfare state in Sweden had less to do than before, but because taxes and expenditure had reached close to saturation level, they also had less to do it with.

While still in opposition, the Social Democrats supported a tax reform, proposed by the Centre-Liberal government, which lowered marginal rates in the middle and higher brackets. This presaged the 1989-1990 "tax reform of the century" in which the Social Democratic government, in co-operation with the Liberals, reduced the rates of marginal taxation for those in higher income brackets to 50 per cent, apparently turning its back on redistribution and accepting business arguments about the relationship between marginal taxation and work motivation.[15]

The "third road" (between Keynesian reflation as pursued by the French Socialist government in its early months in office and Thatcherite austerity policies) was a response to these developments. Through devaluing the Swedish crown by 16 per cent, on top of a devaluation of 10 per cent the previous year, the Social Democratic government created a substantial competitive edge for Swedish industry. Wage restraint contributed to a boom in profits and a redistribution of income from labour to capital. Aided by a turnaround in the international economy, the national economy picked up and unemployment and deficits fell. Based on this performance, the Social Democrats won the 1985 election. By the 1988 election, the "third road"

[15] It should be noted that while lowering marginal tax rates, the reform also eliminated many deductions and tax loopholes. At the same time, child allowances were increased. An independent simulation study (Schwarz and Gustafsson, 1991) confirmed government simulations that the reform as a whole was distributionally neutral. The public perception, though, particularly among supporters of the Social Democrats, was otherwise.

seemed wildly successful: budget deficits, which had been 8 per cent of GDP when the Social Democrats assumed office, had been eliminated; unemployment was under 2 per cent; the balance of trade was in surplus; and new social reforms had been passed. With these successes as a base, the Social Democrats campaigned in 1988 on promises of a new round of social reforms: the introduction of a sixth week of vacation, extension of parental leave insurance from 9 to 15 months, and provision of public day care places for all pre-school children over the age of one and a half.

Within a year of their re-election, the bubble burst, and it was impossible to deliver on any of these promises. In response to the sharp deterioration of the economy, the government introduced an austerity package in February 1990 which called for a pay freeze and a strike ban, reversing its commitment to non-interference in relations between unions and employers. Though lack of parliamentary support for the package caused the fall of this government, it was reconstituted; two months later, with Liberal support, it passed a similar austerity package (though without the offensive labour market features) which, among other things, reduced the replacement rate for sick pay from 90 per cent to 65 per cent for the first three days and to 80 per cent for days four through 90. In the fall of 1990, the Social Democrats reversed their stand on membership in the EC, joining the Liberals and Conservatives who had long favoured entering the Community.

Since the electoral success of Swedish Social Democracy was largely built on the public's perception that it possessed a unique capacity simultaneously to institute social reforms and to manage the economy effectively, it is not surprising that the apparent failure to do either resulted in 1991 in the worst election result for that party since 1928. But the economy continued to worsen under the Conservative-led minority coalition. Open unemployment increased from 1.6 per cent in 1990 to 7.7 per cent in 1993; counting those in active labour market programmes the increase was from 2.1 per cent to 12.5 per cent (OECD, 1994:36). GDP growth was negative in 1991, 1992 and 1993. The government, with the support of the Social Democrats, was initially committed to defending the value of the crown which had been fixed since the 1982 devaluation. During European currency turbulence in the fall of 1992, the government and Social Democrats went to extraordinary lengths to defend the crown, agreeing to two "crisis packages" including significant reductions in entitlements, such as cutting the sick pay replacement rate, the introduction of a waiting day, and the reduction of pensions. In the end, these measures were unsuccessful and the crown was floated. Though the decision to float meant that the basis for agreement was now absent, it is clear that all political actors regard the current economic situation as a crisis and agree that cuts in entitlements will be necessary. Some of these have already been instituted. What makes these cuts necessary is the widespread conviction that Sweden will not be able to return to anywhere near 2 per cent open unemployment (with no more than an additional 1 per cent in labour market measures) in the foreseeable future. The fact that the new policy of self-financing of the unemployment insurance system assumes a normal rate of unemployment of 5 per cent shows that policy is already being made on this assumption.[16] Thus, though

[16] Interview with Willy Bergström, June 1993.

the budget was in surplus in 1989, before the recent (modest) cuts, it is assumed to be in structural (and not just cyclical) deficit now.

Before outlining the changes instituted in response to the crisis and likely future changes in the Swedish welfare state, it is important to point out that a number of reforms were already planned prior to the crisis. Three are worth mentioning here.[17] First, due to the demographic changes that will occur with the retirement of the "baby boom" generation, the earnings-related tier of the pension system ("ATP") faces a future crunch: it is only partially funded and involves a generational transfer. Since the plan that emerged before the crisis would have to hold for long periods of time, all of the parties in the parliamentary committee working on it committed themselves to compromise. A quickly agreed-upon base line was that the system would have to be fully actuarial; each generation would have to pay for its own pensions. A full pension would be based on 40 years of contributions with no special consideration for "best earning years"; benefits would be based on lifetime income. In a fundamental change of principle, the new system will be one of defined contribution, not defined benefit. Also in contrast to the previous system which was financed by an employer tax, the new system will be funded from equal contributions by employers and employees of 9.25 per cent of the payroll. As compared to the present ATP system, this basic design benefits manual full-time, full-life-cycle (read "male") workers. It was immediately recognized that women and, to a lesser extent, workers with higher education would be disadvantaged by the system and that adjustments had to be made. Therefore the bill agreed upon in principle in 1994 by the governing parties and the Social Democrats provided for extra pension points for child care, studies, as well as compulsory military service. Some redistribution is built into the system through a benefits ceiling (indexed to real economic growth), but contributions would be paid above the ceiling — albeit at half the rate as below.

Second, the rapidly rising costs of both sick pay and work injury insurance had already evoked considerable concern by the late 1980s. In the case of work injury insurance, court decisions in the early 1980s liberalized qualifying conditions, which led to rapid increases in the number of claims and costs without compensating adjustments in financing. The abolition of the waiting day for sick pay and improved compensation was accompanied by increased absenteeism and increased costs (although, interestingly, the increase in absenteeism was greatest among the long-term ill whose benefits did not change). Before the emergence of the employment crisis, some reform of these systems was imminent, in the direction of the "work line" that emerged from the Working Environment Commission of the late 1980s as a possible way to economize while maintaining generous benefits. According to this view, the costs of work injury insurance and early pensions — and, by extension, sick pay — could be reduced by rehabilitation and other efforts to keep people in the workforce. One approach to this would be to provide workers and employers with the proper incentives to keep working and keep people working rather than resorting to social insurance. For instance, shifting the cost of work injury insurance, sick pay, and early pensions to those firms where there was a high incidence

[17] For more details on these reforms, see Huber and Stephens (1993), which is based on research in Sweden in June and November 1992, including interviews with politicians and interest group experts working on social policy questions.

of work-related injuries and sicknesses would provide an incentive for them to improve the working environment.

Third, in the course of the 1980s, the delivery of public services came under fire. First, consumers of social services increasingly expressed dissatisfaction with the delivery of welfare state services in general. Specifically, many (though by no means all) citizens in their roles as clients, patients and parents felt that they had no choice as to which types of service to obtain and where to obtain them. Local government and the service providers themselves made decisions about locating service centres, about opening hours and so forth. This left many consumers with a feeling that they could have little or no influence on the delivery of these services. Large sectors of the population came to perceive the providers of welfare state services as distant bureaucrats and their agents, rather than as human beings caring about the welfare of those in need of the services they were charged with providing. Second, with budget constraints politicians became increasingly concerned about the cost of all public services, including welfare services.

The conservative answer was to promote privatization and competition in order to improve the quality of service delivery and reduce its cost, while the Centre Party promoted decentralization. The Social Democrats, in general — and Palme, in particular — attributed the electoral losses of the 1970s in part to the issue of an unresponsive and distant public bureaucracy (Feldt, 1991) and they were eager to address the issue once they returned to office in 1982. After some false starts, the government settled on a programme of action which emphasized decentralization of authority in the delivery of services to lower levels of government and introduction of market models in the public service, such as payment by output (Olsson, 1990; Rothstein, 1992).

Initially, the Social Democrats resisted any movement toward the privatization of public services, especially welfare services. But for the first time in a very long time, the non-socialist parties won a debate on basic principles of future development of the welfare state — that is, that private providers should in principle be allowed to compete with public providers of services.[18] Let us be clear here: Swedes favour allowing choice between public and private providers. They do not think that private providers would necessarily be better. On the contrary, in the case of every major service except child care, very large majorities believe “state or local authorities” are “best suited” to deliver the service in question and even in the case of child care, a plurality thinks state and local authorities are best suited, followed by the family (Svalforss, 1991; 1992).

The Social Democrats have come to accept the option of private providers competing with the state, albeit within the parameters of state regulation and financing. The Conservatives on their part have backed off from their neo-liberal ideal of privatization and deregulation and have come to accept the need for continued state regulation. Nevertheless, subtle but important differences remain with regard to the goal of equality for the recipients of services. Many Conservatives favour allowing private individuals and families to pay extra for services, whereas the Social Democrats are firmly

[18] For further discussion of this issue and its contribution to the Social Democrats’ defeat in 1991, see Rothstein (1992).

opposed to this on the grounds that it would create a two- (or multi-) class system of services. Furthermore, the Social Democrats along with most Liberals insist that any private alternatives must avoid the problems of selectivity and social dumping. For instance, they oppose admissions tests by schools which could lead to a situation where private schools admit only good students, and students with any kind of learning or behavioural problems would be dumped on public schools.

Three important changes in service delivery have been introduced so far. First, in education, the non-socialist government introduced a voucher system under which parents can choose any public or private school. For those choosing a private school, the government will provide a voucher equivalent to 85 per cent of the cost of educating a student in a public school. Schools are allowed to charge fees beyond the amount provided by the vouchers. Second, the option for private providers to offer day care under the same conditions as public providers was also introduced. Third, a so-called "house doctor" system was introduced which, by allowing individuals to freely choose their own doctor, expanded the possibilities for private practice. At this writing (early 1995), it cannot be said that private providers have become significant in any of these areas: only 8 per cent of health care, 1.5 per cent of schooling, and 2 per cent of day care are now private.[19]

The government elected in 1991 implemented a number of cuts in social benefits, most of them with Social Democratic support.[20] Early retirement pensions will no longer be given due to slack labour markets. Sick pay was reduced to 80 per cent after 90 days. Pensions were adjusted downward to 2 per cent below the base amount — that is, the basic pension will now be 98 per cent of the base amount. Industrial injury insurance was co-ordinated with sick pay, which entailed a reduction of the replacement rate. Qualifying conditions were sharpened for both benefits. Employers must now cover the first two weeks of sick pay. Since this was accompanied by a corresponding decrease in employer contributions to the system (and thus represents no savings for the government), this move was primarily designed to reduce absenteeism by increasing employer surveillance of employees' claims. A five-day waiting period for unemployment benefits, which was eliminated by the Social Democratic government of the 1980s, was reintroduced; and replacement rates were reduced to 80 per cent. As in the case of the new supplementary pension system, employees will now make contributions to the sick pay insurance scheme. While the Social Democrats opposed the changes in the unemployment system and many of the changes in the work injury system, they have announced that they will not raise the replacement rates now that they are in the government. Indeed, they plan to lower the replacement rate for parental insurance from 90 per cent to 80 per cent to make it consistent with unemployment compensation, sick pay, and work injury insurance.

The cuts in replacement rates and increases in qualifying conditions in the sick pay, work injury, and unemployment insurance systems were accompanied by increased spending on active labour market policies. The

[19] These figures were provided by Bo Rothstein.

[20] The changes mentioned here, as well as a number of other changes of lesser import, are outlined in DNISR (1994).

new Social Democratic government has promised to devote still more resources to active labour market policy and other measures to increase employment. Thus, taken as a package, these reforms can be seen as an effort to follow the “work line” mentioned previously. Nevertheless the emphasis has changed from the original formulation, in which employees were to be provided increased training and rehabilitation, and other positive incentives to remain in the active work force, while employers were to be provided both “carrots” and “sticks” to reduce absenteeism and work injury. The policies implemented in the past few years contain many “sticks”, along with a few “carrots”, for employees. They entail modest steps toward an increase of the market incentive to remain employed and, when employed, to remain at work — steps toward “recommodification” of the Swedish welfare state. Clearly, the change in emphasis was in large part motivated by the savings that the cuts entailed; and thus it can be directly associated with the economic crisis and rise in unemployment, and the resultant huge increase in the government budget deficit.

The cuts did have some of the desired effects. Even before they were instituted, absenteeism began to decline substantially due to the rise in unemployment. The reforms of the work injury and sick pay insurance schemes did result in the elimination of deficits in these two programmes. However, the unemployment insurance scheme is still in substantial deficit.

The sequencing of events offers compelling evidence that the recent rollbacks in the Swedish welfare state were a product of the rise in unemployment and the belief that unemployment would not return to its previous levels. The argument that entitlements *per se* make Swedish industry uncompetitive is untenable, particularly after the float of the crown which reduced Swedish wage costs by one quarter in a year. Yet high unemployment, and thus pressure to cut entitlements, persists.

This turns our attention to the causes of the problems of the growth/employment/labour market model in the post-Golden Age era. As Pontusson (1992) has argued, many of the problems faced by Social Democracy were products of the structural changes in the advanced industrial economies alluded to in the opening paragraph of part III. However, policy mistakes were made which interacted with these structural changes to produce the crisis; and it is important to disentangle these two factors in order to make some assessment of where the Swedish economy, and thus the Swedish welfare state, is going. I begin with the changes in structural constraints.[21]

A number of parallel developments in the international and Swedish economies served to undermine the existing macro-economic/labour market/distributive strategy. The world economy became increasingly

[21] In addition to Pontusson (1992), this analysis draws on Erixon (1985), Pestoff (1991), Pontusson and Swenson (1992), the memoirs of Feldt (1991) — who was the Social Democratic finance minister from 1982 to 1990 — and 25 interviews with politicians, academic economists, and economists for unions and employers conducted in Stockholm in May 1992, November 1992, and June 1993. These interviews are also the basis for much of my analysis of contemporary social policy development. Finally, I draw on two excellent comparative analyses of parallel developments in Norway and Sweden, Moene and Wallerstein (1993) and Moses (1994).

internationalized as the volume of trade grew modestly, the multinationalization of enterprises greatly, and the volume of financial transactions dramatically. The collapse of Bretton Woods ended the régime of fixed but flexible exchange rates. OPEC halted the long-term secular decline of energy costs which had served to subsidize post-war growth. Following the first oil shock, international interest rates increased dramatically, partly as a direct result of attempts by governments across the advanced industrial world to fight recession with deficit spending. The internationalization and deregulation of financial markets made it very difficult for governments to deviate from international interest rates if they chose to fix exchange rates. Only governments with large trade surpluses could pursue low interest rate policies without putting great pressure on exchange rates. As Moses (1994) points out in his comparison of Norway and Sweden, the current era is one of financial **and** trade openness, in contrast to the inter-war period in which trade was regulated and the post-war Golden Age in which financial flows were regulated. Thus neither capital controls nor trade regulations (tariffs, quotas, etc.) can be deployed to defend the external balance, leaving governments one tool shorter than in these two earlier periods.

In the Swedish case, the internationalization of Swedish business and the internationalization of financial markets led to deregulation of Swedish financial markets, beginning under the non-socialist government of 1976-1982 and completed by the Social Democrats in the 1980s. This deprived the government of essential elements of its supply-side policy that in the past had been used to facilitate combining full employment, price stability, growth and the desired distributive outcomes. Active labour market policy was increasingly the sole tool the government could rely on. Business cycles could be counteracted with fiscal stimulation but this was even less effective than in earlier periods due to increasing trade openness.

A number of special features of development of Swedish industry aggravated this situation. From the 1950s on, Swedish industry became increasingly export oriented and, especially from the 1970s on, increasingly multinational (see especially Erixon, 1985:45ff). In the same period, with the decline of industries such as ship-building, Swedish capital also became increasingly detached from its Swedish raw materials base. The international character of Swedish business dealings, the unstable exchange rates and the greater role of research and development in total investment made investment more risky, and thus would have reduced the propensity of Swedish business to borrow for investment purposes even in the absence of the large increases in interest rates that occurred. Therefore investment depended on profits policy to a much greater degree than assumed by the Rehn-Meidner model, which supposed that business would be willing to borrow to finance investment.

The development of Swedish industry had broader ramifications for the Swedish growth/employment model, as it changed the interests of capital and the balance of power between labour and capital. Because of increasing export orientation, multinationalization, decreasing dependence on Swedish raw materials, and increasing reliance on self-financing of investment, Swedish business became markedly less interested in a compromise with domestic labour which entailed an increase, or even just maintenance, of domestic consumption; more interested in lowering wage costs; more concerned about competition for labour with the growing public sector; and more concerned about access to foreign markets. This was one root of the new political offensive begun in the late 1970s by the employers' federation (SAF) and other business organizations, criticizing the welfare state and advocating privatization, deregulation and EC membership (Pestoff, 1991; Pontusson, 1992). In addition, these same trends (increasing export orientation, multinationalization, detachment from Swedish raw materials), as well as the growing strength of the non-socialist parties, served to increase the power of Swedish capital vis-à-vis labour. Certainly the offensive was encouraged by the perception that it was likely to be successful.

The increasing strength of capital and the change in its interests contributed to the end of Swedish tripartism: first to the decline and, in 1990, the termination of centralized bargaining, and then in 1991 to the withdrawal of SAF representatives from the boards of all state agencies. As Pontusson and Swenson (1992) argue, and our interviews with union and employer economists confirm, the decline in Fordist production led employers in the crucial engineering sector to set a higher value on wage flexibility and thus to oppose centralized bargaining and the solidaristic wage policy. They were particularly opposed to LO's extension of solidaristic wage policy from the earlier position, which simply required equal pay for equal work, to compression of wages between low- and high-paid work. The latter made it difficult to attract and reward the skilled labour necessary, in their view, for the new post-Fordist production patterns. Wage compression was effectively ended in the 1980s, giving way to a rise in wage dispersion (Hibbs, 1990) which is certainly one reason for the modest rise in income inequality in the decade, reversing the post-war trend (Fritzell, 1993).

Pontusson and Swenson's argument for the end of Swedish centralized bargaining is incomplete. It does explain the reasons for the end of the wage policy of solidarity. However, the Austrian case demonstrates that one can have centralized bargaining without solidarity wage bargaining. While ending centralized bargaining did facilitate the end of solidarity wage bargaining, it makes the implementation of wage restraint more difficult — an obvious cost for employers. Interviews at SAF and LO indicate that an additional reason why employers ended centralized bargaining was to weaken LO, both vis-à-vis its constituents in wage bargaining and politically. Employers felt that the individual unions making up LO were more flexible in the bargaining process. More important, the repeated resort on the part of the LO to legislation (first on industrial democracy and then on wage earner funds), when negotiations with SAF failed to produce the desired result, made SAF see the political weakening of LO as highly desirable. If one takes up the broader issue of "corporatism", the post-Fordist argument has nothing to say about why SAF withdrew its representatives from all corporatist institutions in 1991. This had nothing to do with flexible wages. It had everything to do with SAF's perception that these institutions co-opted employers and strengthened the influence of labour/the left.[22]

[22] See Martin (1991) on the political implications of the decentralization of collective bargaining.

The differentiation of organized labour also contributed to the decline of collective bargaining and to growing difficulties in agreeing to wage restraint. The hegemonic position of the blue collar unions in the private sector (and, among them, the metalworkers' union, which was largely in the export sector) declined. White collar unions in the employees' labour central (TCO) grew relative to LO, and within LO public sector unions grew relative to private sector unions.

To turn to policy errors, it is now clear that despite medium-term success the "third road" strategy was not successful in the long run. By 1989, benefits of the devaluations had been eaten up by insufficient wage restraint in the context of relatively low productivity growth.[23] Insufficient wage restraint was due, in part, to the factors outlined above: a decline in the hegemony of blue collar, private sector unions and the weakening of centralized bargaining. In addition, sluggish GDP growth and the fact that the welfare state had "grown to limits" (in both the government's and LO's view) limited the government's ability to compensate unions for wage restraint through offering social policy innovations.

But these structural changes did not determine the outcome. The high profits policy combined with a tight labour market encouraged employers to offer wages above the negotiated levels. The government's continued expansion of public sector employment in this context aggravated the situation. Above all, the deregulation of credit markets was poorly timed. This was done in 1985 when there were still generous tax deductions for consumer interest payments,[24] and it fuelled an unprecedented credit boom and consumer spending orgy at a time when the economy was already beginning to overheat. As the Rehn-Meidner model would predict, this made wage restraint impossible.

With this over-stimulation of the economy, and thus wage increases far above productivity increases, Swedish export industries became uncompetitive. Despite the failure of wage restraint, the government and its non-socialist successor refused to give up the hard currency policy and float the crown, effectively devaluing it and thus restoring the cost competitiveness of export industry. This was not done until the economy was in deep recession and much damage had been done in terms of failed businesses, lost markets and lost jobs.

Both the Social Democratic and non-socialist governments continued to follow policies which inadvertently had strong pro-cyclical effects on consumer behaviour, this time in the context of a deep recession. As the economy moved into recession in 1990, the tax reform significantly reduced the tax rate on capital income. With falling inflation and stable nominal interest rates, this meant a substantial upward shift in real after-tax interest rates. The bust which came after a real estate boom added to the problem by reducing the wealth of many households below the probable desired level. All this contributed to a household savings rate of 10 per cent in 1993, by far

[23] Erixon (1991) contends that the large devaluation itself was partly at fault. He argues — and now many industry spokesmen admit — that the devaluation of 1982 was too large. It was too easy to make money; there was no competitive pressure on industry to rationalize and upgrade productivity, which contributed to the decline in productivity growth in Sweden.

[24] These were eliminated with the tax reform of 1990.

the highest level in over two decades, and a correspondingly depressed level of personal consumption in the midst of a depression (OECD, 1994:16-17).

This same set of circumstances — the asset boom and bust caused by speculation in the wake of financial deregulation — left many banks holding sufficient bad debts to become insolvent. The government bail-out operation cost the public 74 billion crowns (5 per cent of GDP) in 1991 and 1992 alone, thus adding to the already spiralling budget deficit (OECD, 1994:129).

With a higher level of productivity growth, the burden would not have fallen so heavily on wage restraint to maintain international competitiveness. Here it can be said that Sweden was suffering from the problems of all advanced capitalist societies, as its average annual productivity growth was at the OECD average for the post-Golden Age period (1973-1989). It was somewhat below the average for OECD Europe, but this difference was entirely due to the initially higher level of Swedish productivity (Moene and Wallerstein, 1993). Nonetheless, productivity growth was lower in this period than before; and one reason is that a key tool of the Swedish supply-side model — the provision of cheap credit to industry and the favouring of industrial investors over other potential users of credit — was no longer available because of high international interest rates and the internationalization and deregulation of financial markets. Another reason for low productivity growth lay in the increasingly international orientation of Swedish business, which meant that profits were increasingly invested abroad rather than at home. There was a particularly large increase in investment in EC countries in the wake of the announcement of the Single European Act in 1985 (Pontusson, 1992:322). Thus the high profits policy did not have the desired effect on domestic investment.

◆ Norway

Since it can count upon revenue from oil exports, which now contribute 16 per cent of GDP, Norway has avoided the severe unemployment crisis of the other Scandinavian countries and thus has also escaped the welfare state rollbacks that occurred recently in Sweden and Finland, and earlier in Denmark. On balance, the past decade cannot be characterized either as one of rollback or of innovation. There were significant expansions of maternal leave in 1986, 1987 and 1993. The new provisions allow for 52 weeks with 80 per cent income replacement (or 42 weeks at full pay), second only to Sweden in generosity. In addition, since 1990, qualifying conditions for unemployment compensation have been liberalized. But there have also been reductions and restrictions in certain areas: indexation of benefits has been modified; the replacement rate in the supplementary pension plan has been cut by 3 per cent; work requirements for unemployment compensation have been strengthened; the qualifying conditions for disability tightened; and strictly medical criteria for sick pay (re)introduced. While the Norwegian authorities are now also committed to a “work line”, this has only been manifested in the stricter qualifying conditions for unemployment, disability, and sickness benefits and in greater efforts at rehabilitation. In contrast to the other Nordic countries, replacement rates have not been cut, nor have waiting days been increased. For instance, the replacement rate for sick pay is still 100 per cent and there are no waiting days.

Underlying this mixed picture are serious difficulties in the Norwegian economic growth/labour market model, similar to those suffered in Sweden and Finland but partially masked by revenues from the oil sector.[25] Financial liberalization has weakened the ability of the government to direct credit and investment, although resources from the oil sector still give the state considerable leverage compared to Sweden. As in Sweden and Finland, deregulation of credit markets in the mid-1980s led to a consumer spending boom which was followed by a spate of bank failures and consumer retrenchment. Also as in Sweden, governments of different political persuasion pursued hard currency policies which certainly aggravated the problem of competitiveness in industry until Norway was forced to float the crown in the fall of 1992 (with less dramatic consequences for the value of the currency than in the Swedish case). Even the Labour government has prioritized fighting inflation over unemployment (Moene and Wallerstein, 1993).

Centralized bargaining has been weakened as local level bargaining accounts for a larger proportion of wage increases (Moene and Wallerstein, 1993). But “corporatism” has not broken down. After briefly considering withdrawal from public committees, as its Swedish counterpart had done, the Norwegian employers association joined an initiative of the Social Democratic government, aimed at promoting industrial innovation, which includes leaders of business, the government and the central labour organization (Mjøset et al., 1994:71). The contrast with Sweden is certainly related in part to the character of national capital in the two countries. Norwegian capital is less multinational and more tied to domestic resources than Swedish capital, and the state owns the most important natural resource (oil). Thus both the power of Norwegian capital vis-à-vis labour and its interest in domestic class compromise are different from its Swedish counterpart.

As a consequence of the economic developments just described, unemployment began to rise in the mid-1980s, reaching 5.9 per cent in 1992 with an additional 3 per cent in active labour market programmes. Moreover, the rise in unemployment was accompanied by a steep increase in the number of people receiving disability pensions for which medical certification was not required. The OECD estimates that unemployment would be 2.2 per cent higher if those on non-medical disability insurance were counted. Since the “real” unemployment rate is thus in excess of 11 per cent, it is not surprising that even Norway has adopted some economizing measures.

◆ Finland

As already noted, Finland’s period of vigorous social reform extended well past the end of the Golden Age (Marklund, 1988:35-38). This is the case not only because Finland was a laggard, and thus its welfare state had not “grown to limits”, but also because Finnish economic growth rates were good relative to other OECD countries. In fact, between 1979 and 1989, the

[25] For a more in-depth analysis of the recent development of the Norwegian political economy, see Moene and Wallerstein (1993), Moses (1994), and Mjøset et al. (1994).

per capita rate of economic growth of Finland (3.3 per cent per year) was second only to the Japanese (3.4 per cent) (Korpi, 1992:64). Finland did experience higher unemployment than Norway or Sweden in the 1970s and 1980s, moving to nearly 8 per cent in the late 1970s and then back to 3 per cent by 1990; and this helps explain why welfare state expansion was punctuated by bouts of retrenchment. Nonetheless, things looked rosy as late as 1989 when, after the revaluation of the markka, statisticians of the Industrialists' Association announced that Finland had surpassed Sweden and Norway in terms of per capita income (Andersson et al., 1993:30).

The crash was as catastrophic as it was rapid. GDP growth fell to 0.4 per cent in 1990 and turned negative in 1991 and 1992 (-6.4 per cent and -3.6 per cent respectively) (OECD, 1993:14). Unemployment increased dramatically to 17 per cent of the labour force. Significant cuts in expenditure, which will affect a wide range of transfers and social services, have been instituted. Stricter qualifying conditions for unemployment benefits have been imposed and the replacement rate cut by 3 per cent.[26] The replacement rate for sick pay has been reduced (from 80 per cent to 67 per cent in the case of the average production worker), contributions increased and waiting days increased from seven to nine. Replacement rates for parental leave have been cut from 80 per cent to 67 per cent and the benefit period cut from 275 to 263 days. Subsidies to prescription drugs have been significantly reduced. The replacement rates for the earnings-related tier of public employee pensions has been cut from 66 per cent to 60 per cent and an employee contribution of 6 per cent of income introduced. Further cuts in the replacement rate, to 55 per cent or even 50 per cent, for all employees, as well as a change in the calculation of the replacement rate on the basis of lifetime and not final income, are planned. A number of new taxes and fees have been introduced.

Part of Finland's problem is idiosyncratic: the collapse of Soviet trade. Otherwise we see a familiar pattern. Deregulation of financial markets led to a (pro-cyclical) boom in consumer borrowing, inflation of asset prices and overheating of the economy, followed by banking collapse and consumer retrenchment. The banking crisis in Finland was the most severe of the three countries: the bailout operation imposed a cost on the government and central bank equal to 7 per cent of GDP. As in Sweden and to a lesser extent Norway, economic difficulties were further aggravated by the attempt to follow a hard currency policy, which ultimately failed as Finland was also forced to devalue. The traditional pro-cyclical policies of the Finnish government worsened its economic plight (Andersson et al., 1993).

Although these policy errors certainly contributed to the deteriorating situation, this should not be allowed to obscure the fact that the Finns were affected by the same long-term changes in the domestic and international economies that challenged the Swedish and Norwegian models. Financial internationalization and deregulation, as well as high international interest rates, undermined important features of supply-side policies. On the demand side, the decline in Finnish exports to the core capitalist countries was temporarily offset with Soviet trade; but this is no longer an option. The

[26] The sources for these social policy changes are DNISR (1994) and Olli Kangas (personal communication).

Finnish business sector, like the Swedish, also became increasingly internationalized, especially in the second half of the 1980s when direct foreign investment increased substantially. Thus, even to the extent that government policy could encourage investment, it became more difficult to ensure that such investment would take place in Finland.

◆ Denmark

Danish unemployment began to rise almost immediately after the first oil shock, increasing from 0.9 per cent in 1973 to 5.1 per cent in 1975, to a peak of 10.5 per cent and then subsiding in the 1980s, only to increase to a new peak of 11.3 per cent in 1992 (Furåker et al., 1990:148; Kosonen, 1993:27). Denmark's liberal economic policies, its lack of an industrial policy and active labour market strategy, as well as its concentration on consumer exports all contributed to its greater international vulnerability and to the rise in unemployment. In fact, the period of full employment in Denmark lasted only a decade and a half, and can be attributed to a combination of foreign consumer demand during the Golden Age and the rise in welfare state employment in the 1960s.

Economic difficulties, and particularly the rise in unemployment, made existing entitlements increasingly expensive. Successive Danish governments have responded with significant welfare state cuts, which have nonetheless only prevented expenditure on social security benefits and total government expenditure from rising as fast as they otherwise would have done. A variety of measures have been taken, including increases in the selectivity of benefits, introduction of income testing, modifications of indexing, temporary de-indexation, increases in qualifying conditions and introduction of waiting days. Many of the cuts have been directed at the system of unemployment compensation, with the result that the effective replacement rate has fallen dramatically from 80.5 per cent in 1975 to 59.2 per cent in 1985 without actually lowering the nominal replacement rate for a worker with full qualifications (Hagen, 1992:154; Marklund, 1988:31-35; Nørby Johansen, 1986:362-63). Some improvements in benefits have also been made but, with the exception of a substantial increase in maternity leave (from 98 to 144 days), these too have been responses to the unemployment crisis: eased conditions for pre-retirement pensions, increased subsidies for industries employing new workers, increased severance pay, and introduction of active labour market measures (Hagen, 1992:145; Nørby Johansen, 1986:363). More recently, the Danish government has developed its version of a work or "active line" (DNISR, 1994:29). This features a combination of positive incentives (e.g. improved vocational and job training) and negative incentives for both workers (ceilings on wages for public employment programmes) and employers (responsibility for the first two days of unemployment compensation). In a significant departure from past principles, the citizenship pension for those over 70 was subject to an income test beginning in 1994.

PART IV: CONCLUSION

There is little doubt that the Scandinavian model is under assault. In all four countries unemployment has increased to levels which, if not of crisis proportions, would have been intolerable for any government before the mid-1970s. In Norway, Sweden and Finland, a main contributor to the increase in unemployment has been the simultaneous rise in international interest rates and the internationalization of financial markets, which made it impossible for these countries to maintain low interest rates and to privilege borrowing by industry over other consumers of credit — a key element in their supply-side growth/employment models. Moreover, the decline of centralized bargaining has made another important tool of macro-economic management in Scandinavia — the imposition of wage restraint — more difficult. Finally, demand — which was never internally generated — has suffered due to stagnation in other advanced industrial economies.

As Moene and Wallerstein (1993) point out, the welfare state has been the most resilient part of the Scandinavian model. While **expansion** of entitlements did slow, even before the onset of the unemployment crisis (at different times in the four countries), difficult economic times were only one, and perhaps not the main, contributor to this development. These welfare states had truly “grown to limits”: they were comprehensive, covering all major programme areas, and in each programme coverage was universal or near universal, replacement rates in transfer programmes were very high, and publicly provided services enjoyed a near monopoly in their sector. Even in social services, which were the main area of Nordic welfare state innovation in the 1970s and 1980s (outside of Finland), there were no longer pressing needs except for expansion of day care. As a result, tax burdens were extremely high; and it can be argued in fact that they had reached the saturation point. This is not to say that there was nothing to be done, but rather that there was less to do, and less to do it with.

In all four countries, significant **rollbacks** were resisted until a severe employment crisis hit — a crisis in which not only did unemployment increase dramatically but, more important, it appeared impossible to return to the previous low levels of unemployment. With the rise in unemployment, demands on the welfare state rose while the revenues from social security contributions and taxes fell, making the prevailing level of entitlements unaffordable. Thus replacement rates were cut, waiting days introduced, qualifying conditions increased, and services cut. Moreover, the depth of the cuts reflects the depth and duration of the employment crisis, with Finland and Denmark cutting the most and Norway very little.

Do these steps represent a qualitative change in the Scandinavian welfare states? To answer this question, let us return to the institutional characteristics (high income replacement rates, citizenship benefits, service intensity, liberal qualifying conditions, comprehensiveness and statism) and goals (security, decommodification, labour mobilization and redistribution) outlined in the initial section of this paper. In terms of the institutional characteristics, qualifying conditions have become more stringent for a number of programmes in all four countries; and all but Norway have experienced significant reductions in replacement rates in major transfer programmes. There has been some trend away from statism toward privatization of service delivery within a framework of public financing. However, it would be difficult to claim that these amounted to a fundamental change. Only in the case of replacement rates for Danish unemployment benefits are these rates in major transfer programmes below what they were in 1970. By contrast, coverage rates in unemployment insurance today are far higher than they were then in all four countries (Hagen, 1992). In the fields of parental leave and public services, which were the two main areas of innovation in the 1970s and 1980s in Scandinavia, welfare state programmes are far more generous, even after the recent cuts, than they were two decades ago. In the case of service privatization, the move in this direction to date has been far too modest to be described as a fundamental change, although it may be an area of significant future change.

One can say, however, that recent developments represent an important change in emphasis, greatly strengthening the goals of labour training and mobilization at the expense of decommodification. We should note that, except in Denmark, this goal shift — which can be traced to the rise of the “work” or “active” line — pre-dated the employment crisis and resulting budgetary crisis. Thus, even in the hypothetical (and unlikely) event of a return to 2-3 per cent unemployment, this shift in emphasis would be likely to survive.

Before moving on to the goal of redistribution, let me briefly touch upon some changes in the institutional arrangements of Scandinavian welfare states which did not figure in my initial list of basic characteristics. First, the Swedish earnings-related pension system has been altered from one of defined benefit to one of defined contribution. Second, in all of the Scandinavian countries, employee contributions have been introduced; and in a number of programmes, such as the Swedish and Finnish earnings-related pension plans and the Swedish sickness insurance scheme, these contributions are now very significant sources of financing. Third, the aim of a number of recent reforms of transfer programmes has been to put them on a self-financing basis. Together, these three changes represent a trend to “marketization” of the transfer system; each programme is to be self-financing and is to be financed at least in part by the beneficiaries of the programme.

These changes have complicated effects on the goal of increasing income equality. On the one hand, lowering the ceiling on income replacement rates should lead to greater egalitarianism since the possibility of earning a high public pension is reduced. But in fact, private employers tend to step into the breach — voluntarily or as a result of negotiation — and to provide additional benefits to their higher-level employees. Since they do not compensate manual workers in the same way, the trend may well be toward slightly greater inequality.

If the retrenchments to date do not represent a fundamental change in the Scandinavian welfare states, one must still ask whether this is this just the beginning. Will further cuts, which do change the fundamental character of the Nordic welfare states, be necessary? In order to provide a baseline for speculation on the future of the Scandinavian welfare states in an increasingly integrated European — and world — economy, it is useful first to explore why these very generous welfare states have been so resistant to rollback. First, on a general level, and contrary to conservative hopes and Social Democratic fears, there is little reason to suppose that economic integration *per se* will exert a levelling influence on national welfare states, bringing them down to the lowest common denominator. Ultimately, maintaining a generous welfare state, like maintaining high wages,[27] depends upon maintaining international competitiveness. A high social wage and a high market wage are made possible by high levels of labour productivity — by low unit labour costs. This is an obvious point, but its implication is not always fully drawn out in discussions of the effect of economic internationalization on social policy. The belief that market integration will necessarily exert a strong downward pressure on social provisions is based on the assumption that with the opening of the European market, the competitive advantage of low wages will be more important than the advantage of capital intensity and highly qualified labour. To put this another way, the argument assumes that non-tariff barriers to trade existing up to the end of 1992 discriminated more against low wage countries than against the other members of the European Economic Area. This is far from clear. On the contrary, the logic of the EC's structural funds was that the low wage areas would be hurt by the integration process.

Second, and moving now from the general to the specific, Scandinavian welfare states are particularly resistant to changes induced by international competition because they were built around welfare state/labour market/growth models in which the competitiveness of the manufacturing export sector was central. Thus unlike Latin America and the Antipodes, where the agricultural or mineral export sector essentially subsidized entitlements of workers in a protected manufacturing sector and in non-tradables, the end of tariff barriers represented no change for Scandinavia; and the increasing internationalization of trade implied only a quantitative shift, not a qualitative change in economic models.

Finally, the political coalitions supporting the welfare state at both the party level and the level of public opinion are very broad, extending far beyond the strata and parties that originally supported the reform (Pöntinen and Uusitalo, 1988; Svalforss, 1991; 1992). Thus it is not surprising that only a widespread perception of crisis can lead governing parties to cut benefits. The conservative parties and their supporters on the right of the political spectrum are the only groups ideologically in favour of welfare state rollback; and only long-term secular shifts in party support would allow changes under the aegis of a series of conservative dominated governments. As can be seen from other countries as well, the politics of welfare state expansion are different from the politics of welfare state rollback (Pierson, 1994; Stephens, Huber and Ray, 1994). It is very difficult to eliminate entitlements, especially the universal ones typical of Scandinavia, once they are instituted.

[27] This parallel between the social wage and the market wage is largely missed in the literature. It is rarely argued that there will be a massive downward pressure on market wages as a result of European integration, in contrast to the general assumption about the strong downward pressure on the social wage. For an exception, see Edling (1992).

◆ Future Scenarios

What is the future of the Scandinavian welfare states: further rollback, stagnation, or even new innovations? If the stress in this paper on the centrality of unemployment is correct, it would seem, on the surface of it, that prospects are not good. Denmark has passed through a decade and a half of high unemployment, and recent developments in Sweden — and particularly Finland — are of crisis proportions. Only Norway, with its oil revenue, has escaped; but its oil wealth has masked, or better said enabled, the development of the least efficient manufacturing economy of the Nordic countries. Without oil, Norway would surely face wrenching economic restructuring, rivalling the process that is currently being endured in Finland.

Fortunately, this picture is too negative. Finland surely faces a number of difficult years, but this is due in part to the collapse of trade with the Soviet Bloc and to a banking crisis, not to fundamental flaws in its international competitiveness or its welfare system. In Sweden, Norway and Finland, the current crisis was not simply structurally determined but rather grew out of the interaction of structural change with a series of policy decisions which greatly aggravated the present situation. Still, the prospects for getting back to 2-3 per cent unemployment are not good. As a result of financial internationalization and deregulation, an essential element of the supply-side of the old model cannot be restored; at best selective measures can be used to supply cheap credit and encourage investment on a much more modest scale than in the Golden Age. The demand side depends heavily, as always, on the economic health of other countries. An unemployment rate of 5 per cent seems the best achievable outcome in the mid-term. If government budgets are not in structural balance at that level of unemployment, which apparently is the case in Finland and Norway (but not in Sweden), then further cuts will be forthcoming.

It is not at all clear what sectors would produce the new jobs required to reduce unemployment below 5 per cent. Job growth in Scandinavia has been almost entirely a product of the expansion of public services in the past two decades, and it is widely agreed that this pattern cannot continue in the future. Manufacturing is not producing significant increases in employment, in relative terms, in any of the advanced industrial economies. The high wage structure of the Scandinavian countries has prevented the rapid growth of private sector services along American lines (Esping-Andersen, 1990). Recent legislation in Denmark attempts to encourage small business development by offering a two-year subsidy to new business, and also to encourage the growth of household services by directly subsidizing them. In Norway, individuals setting up independent businesses are now eligible for a six-month extension of unemployment compensation (DNISR, 1994). More flexible wage schemes which would allow employers to hire youths at lower wages have been suggested in Norway and Sweden but have been met with scepticism by the unions. In all of these cases, the schemes are too new to assess whether they have significant promise.

There are too many unknowns to say what the longer run possibilities for employment creation are. Recent history does, however, provide one lesson for the future which seems relatively clear. The Scandinavian countries had difficulties restraining wages to maintain competitiveness during the 1980s.

The decline of centralized bargaining is bound to contribute to these difficulties. The negative experience of all of these countries when they attempted to follow a hard currency policy in the late 1980s and early 1990s suggests that until they find a sure method of controlling wage developments, they will need to be able to resort to devaluation. Thus it would be advisable to stay out of the European monetary union (or, in the case of Norway, to avoid rigidly fixing its currency to the ECU, which is the functional equivalent of monetary union). Indeed, given asymmetric shocks in a recessionary period, countries in a monetary union must be able to **lower** wages when their economies are particularly hard hit.

Within these macro-economic parameters, we can speculate about the near to mid-term future of the Scandinavian welfare states. First, the support base for the welfare state is broad, but more diverse in its needs than in the past, thus requiring policy adjustments in some areas. Second, programmes which positively support international competitiveness and/or conform to the requirements of the market are most likely to survive the axe, and those which do not are likely to be restructured. Let me illustrate these alignments and options using the current Swedish situation.

While the welfare state enjoys wide support among the Swedish public, there are divisions on the kinds of programmes and benefits which should have priority. The growth of public employment, services, white collar employment and women's labour force participation, as well as the decline of Fordist production and increase in skill differentiation — all have created a more differentiated constituency for the welfare state. This generates pressures for more differentiation in welfare state services and for a deepening of the post-Fordist and feminist profile of the welfare state. The long-term trend toward shaping policy to enable women to enter the labour force and support dual income-earning families is likely to be intensified in the future. The institution of day care, parental leave, flexible work schedules, and so on over the past two to three decades, which have permitted the Scandinavian welfare states to adapt themselves to, and facilitate, the "post-Fordist family pattern" are likely to be deepened, resources permitting.

Nevertheless the "Fordist" constituency is still there, and this can create competitive and contradictory pressures for innovation in a situation of limited resources. The struggle within Social Democracy before the 1988 election (Feldt, 1991:357ff) is an example of this: the women's movement pressed for an extension of parental leave while LO urged an extra week's vacation pay. In the end, the party included both demands in its electoral platform, although it appeared unlikely that there would be resources to meet either.

The introduction of alternative private providers of welfare state services (while retaining public financing) represents a significant change in philosophy. Although few citizens have opted for private alternatives, the change does make the welfare state potentially more responsive to increasingly diversified demands from its clientele, not only by making private alternatives possible but also by stimulating diversity and responsiveness in public sector services. Nevertheless there are trade-offs which depend, at least in part, on the design of the particular programme.

The reaction of the current Swedish Social Democratic government to the introduction of private alternatives by its non-socialist predecessor illustrates the bargaining process and gives some indication of likely future alternatives.

With regard to **private schools**, the Social Democrats had called before the election for the abolition of the voucher system — a step which would effectively have eliminated private alternatives for all but the very wealthy. The Social Democrats were deeply concerned about the development of a dual class system of education, which the previous government's reform clearly facilitated by allowing private schools to charge fees in addition to the voucher and to choose their students. Once in office, the party moderated its stand and apparently will only lower the value of the voucher to 75 per cent of the cost of educating students in public schools. In the case of **day care**, no reversal of policy is in sight, if only because very few private providers have offered their services: they cannot operate efficiently in competition with the public sector. The effects of the non-socialist government's **health care** reforms illustrate still another side of the cost problem. The reform generated significant cost increases, in part because private doctors were compensated on a fee-for-service basis which, as the experience of other counties had already shown, created an incentive for the provision of unneeded services. The Social Democratic government responded by making the house doctor system optional for counties, which are the main providers of health care. If cost problems continue, further reversals are likely, either at the county level or by central government mandate.

The recent Swedish experience suggests, then, that future directions in welfare policy will be determined by cost considerations. Part of the argument of the political right for privatization of services has been that the latter would be more cost effective. In the case of day care, this was apparently not true and, in the case of health care, privatization actually increased costs. Given severe budget constraints, privatization of services certainly will proceed where it can be demonstrated that it will result in savings. On the other hand, the case of schooling shows that ideology, and thus political party alignments, are still of great importance where cost considerations are not overriding. Where service privatization results in inequality in access to services, it is likely to be strongly resisted by the left.[28]

To the extent that macro-economic conditions make further cuts in transfer programmes necessary, these cuts are likely to be made in programmes that damage — or at least do not improve — international competitiveness. In other words, they will reflect recent experience.[29] Even without cuts,

[28] It is possible to argue that a voucher system which does not allow additional fees and does not permit creaming off the best students would not be inegalitarian. See Rothstein (1994) for a general discussion of this issue. Interestingly, the political left in Denmark has been a principal defender of private (read alternative) schools, and more than 10 per cent of Danish children attend such schools.

[29] Empirical evidence that transfers and taxes in Scandinavia have adverse incentive effects is thin, even for programmes in which the arguments for such an effect have been most plausible, such as for the sick pay régimes in Sweden and Norway which have provided for 90-100 per cent replacement rates, no waiting days, and no doctor's certification. It is

restructuring of programmes in the direction of the "work line" seems very likely. Further "marketization" of transfer programmes, to put them on a firm financial footing, also seems likely. Not only would such developments eliminate losses which must be absorbed by the state budget, but — if reforms follow the example of the Swedish pension system — they would actually create savings and thus provide a source of funds for reinvestment. This, in turn, could restore one feature of the old supply-side model.

probably more accurate to say that when budget constraints make cuts necessary, provisions which have **plausible** work disincentives are likely to be affected first.

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