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Preserving the Social Democratic Welfare State

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Preserving the Social Democratic Welfare State[1]

The Nordic social democratic welfare states have enjoyed an international reputation for combining generous welfare state entitlements with rapid economic growth, low unemployment and very high levels of labor force participation, particularly among women. As recently as 1988, Sweden, Norway, and Finland appeared as international exceptions maintaining very low levels of unemployment while not only having maintained but actually having expanded welfare state entitlements in the previous decade. Denmark, with a decade of high unemployment and attendant economic problems seemed to be the outlier.[2] Within five years, all three countries experienced historically unprecedented increases in unemployment.

For the viability of the Nordic welfare state model, the unprecedented rise in unemployment is less important than the perception, held by actors across the political spectrum, that it will not be possible to return to the low levels of unemployment that characterized the countries previously. Thus, the welfare state entitlements which before could be maintained at prevailing levels of taxation were no longer 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. Taxes have to be raised or benefits cut or both. Given the already high levels of taxation in Scandinavia, benefit cuts have born the brunt of the burden of deficit cutting and are likely to do so in the future.

This raises the question of which benefits should be cut. Voices from both the left, the right and, above all, from the agrarian center have recently argued that the earnings related tier of transfer payments which, they contend, primarily benefit middle and upper income groups are now an unaffordable luxury and that they should get the ax first. In this article, I contest that view. I contend that maintenance of the earnings related tier is necessary to preserve the essential features of the Nordic welfare state model - the comprehensive institutional welfare state model with its strongly redistributive profile

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-and to restore elements of the employment/growth model which was an essential complement to that welfare state model. To foreshadow my conclusions, I will argue that an earnings related, actuarially sound system will at the same time (1) provide investment sources for growth and thus employment, (2) facilitate wage restraint, (3) preserve the redistributive profile of the social democratic welfare state, (4) insulate the social insurance programs from deficit driven cuts, and (5) maintain middle class support for the welfare state.

I anticipate that the idea that this solution will retain the redistributive profile will provoke controversy. Can such a system really be in the interest of workers? That earnings related transfer payments contribute to redistribution is counterintuitive; as Korpi and Palme (1994) have recently argued, it is a paradox. In making my argument I will draw on two bodies of evidence. First, I will review recent analyses of income distribution data by Korpi, Palme, Kangas and others which demonstrate that earnings related transfer payments are associated with less income inequality. Second, I will examine the historical development of the Swedish welfare state to demonstrate that the working class movement both accurately perceived the distributive consequences of earnings related transfer payments and pressed for them for that reason. I focus on the development of pension legislation in Sweden to illustrate my argument, but with some modifications and reservation this can be extended to Norway and Finland and to other transfer programs in all three countries. But before I move to my argument, it is necessary to briefly outline the contours of the Nordic model of social and economic policy.

The Nordic Model

Before moving on to the analysis of earnings related transfers, let me situate these programs within the whole Nordic welfare state regime as these programs are only part of that regime, though an important part of it. Moreover, this welfare state regime is intimately and necessarily linked to an employment/labor market regime which in turn was enabled by a set of economic policies which produced growth. Together these make up the Nordic Golden Age model.

Social Policy

A good starting point for characterizing the Nordic welfare state is Palme's (1990: 82 ff.) 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 basic 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 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 programs (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 Nordic pension systems provide basic security. Moreover, all four Nordic countries provide child allowances which are flat rate and housing allowances which are generally related to need. Thus, these benefits contribute to basic security.

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 labor market expenditure and so on, transfer payments make up less than half of total expenditure. This is particularly true of the Nordic 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.

Thus, very broad, usually universal, coverage, high income replacement rates, services and some transfers as a citizenship right, and service intensity are three of the basic institutional parameters of the Nordic welfare states. Additional dimensions of the social policy side of these welfare states are liberal qualifying conditions for benefits, comprehensiveness, and statism.[3] 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 Nordic welfare states are statist in the sense that services are provided by the state rather than provided 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. 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 Nordic welfare states, above all the socialist parties and unions of manual laborers but also the white collar unions and the agrarian parties,[4] the institutional parameters (universalism, high income replacement rates, service intensity, etc.) themselves were not the primary goal in the legislation. The most important of these were security, decommodification, labor training and mobilization, and redistribution. It is my contention that these welfare states achieved these goals to a degree unrecognized by even their supporters. I discuss security, decommodification, and labor training and mobilization at length elsewhere (Stephens 1995). The question of redistribution will be dealt with below.

Economic Policy

As Esping-Andersen and Kolberg (1992) have argued, the Nordic welfare state pattern has been associated with a distinct labor market regime. By the end of the Golden Age, all three countries were characterized by very low unemployment, high labor force participation among women, and high levels of public health, education, and welfare employment compared to other advanced industrial democracies. It is useful to view the labor market regime as the intersection of Nordic economic and social policy and all three as being interlinked in a more or less coherent welfare state/labor market/economic model. With regard to the employment regime, 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-sixties, the employment/growth models along with the vigorous growth of all advanced capitalist economies had produced high rates of labor force participation and very low unemployment among males. Unlike the Northern continental countries, the Nordic countries limited recruitment of non-Nordic foreign labor, which provided greater job opportunities for women in the private sector. More important for female employment, the Nordic 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 of which, in turn, provided jobs to the new female entrants. The rise in female labor force participation then stimulated demands on the part of women for further expansion of these supportive transfers and services.

Though the policy goals of all three countries were broadly similar, the specific economic/employment policies of the Nordic countries vary more than their welfare state regimes. Nevertheless, one can identify a general Nordic type which fits none of the countries perfectly.[5] 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 was 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.

Nordic 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, cooperation of the sitting government was necessary and from a union point of view this was facilitated by the frequent government position of the Social Democratic party, which is closely allied to the blue collar union central organization. Thus, a pattern of tri-partite bargaining ("corporatism") over wages, economic, and social policy emerged in Scandinavia in the course of the post-war period.

Given these underpinnings in the power balance in society, the domestic structure, and the international 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. The core of the long term growth/employment policy, however, and this cannot be overemphasized, was supply side. The supply side policies extended beyond general supply side policies; such as education, infrastructure, cheap credit policies, generalized support for R and D, and active labor market policy; to selective policies; such as credit policies favoring 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 Nordic 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.

Within these parameters, economic policy varied between the three countries. In the Finnish and Norwegian models, there was much more state direction of investment than in the Swedish. The attempt of the Swedish labor movement to move in this direction 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 as Swedish industry, particularly export industry, has been dominated by a small number of privately owned, internationalized and internationally competitive, oligopolistic firms since the very onset of industrialization. As a consequence, it has not only had the economic capability to direct industrialization independent of the state, it also had the political capability to resist state intrusion (Stephens 1995). As a result the Swedish version of the Nordic supply side model, the famous Rehn-Meidner model, focused on labor supply, influencing investment only indirectly.

Three points from this overview of the Nordic economic models should be underlined as they are of particular relevance for my discussion of the current crisis of the welfare state and the social policy options in the future. First, these economies were dependent on competitive export sectors and the social welfare policies that were developed had to be compatible with this economic necessity. Indeed, it can be said with little exaggeration that these welfare states were shaped around the interests of workers in the export sectors whose unions were hegemonic within the trade union movement in this period. Thus, it is less than surprising that, taken as a whole, welfare state entitlements in these countries, though very generous, did not constitute a competitive disadvantage. Second, the supply side models depended, to a greater or lesser degree from case to case, on providing cheap credit to industry which in turn depended on public sector fiscal surpluses and on a controlled credit market. Third, the generous welfare state entitlements assumed high levels of employment. Compared to continental Christian Democratic welfare states, in the Nordic welfare states, there were many more contributors to the system and many fewer dependents in relative terms (Esping-Andersen 1990).

The Redistributive Impact of the Nordic Welfare States

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 the various analyses of the Luxembourg Income Studies (LIS), have demonstrated, contrary to the claims of Social Democracy's critics, the welfare state under Social Democratic auspices has been massively redistributive. Mitchell's (1991) work provides a summary of the LIS results on the redistributive effect of direct taxes and transfers. As one can see from the last three columns of Table 1, the reduction in inequality, especially in Sweden, is dramatic. Esping-Andersen argues that Mitchell's data overestimates the redistributive effect as those entirely dependent on transfer income such as many pensioners will have no pretax income thus increasing the pre-transfer gini.[6] Presumably, were there no public pension system, many of these pensioners would make at least some provisions for themselves. Nonetheless, one can clearly see that the redistributive effect of Nordic welfare states can hardly be explained away by the fact pre-transfer income is pressed up in such cases, since the final post-tax, post-transfer gini is much lower in the Nordic countries. 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 of the welfare state.

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. This counterintuitive 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. That this is the case has been demonstrated conclusively by recent work by Kangas and Palme on pensions (Kangas and Palme 1993; Palme 1993) and by work by Korpi and Palme on a broader range of welfare state benefits.

The Kangas and Palme (1993) data as well as supplementary data kindly provided by Palme are shown in Table 1. Note that all other sources of support for the elderly are vastly more unequally distributed than public pensions (with ginis varying from .41 to .82 depending on source and country compared to .19 for the highest gini for public pensions). One can see from comparing columns one and seven that those countries with earnings related public pensions also rely on these inegalitarian alternatives to public pensions to a much lesser degree. As Palme's (1990) work shows, it is precisely these countries that have high replacement rates not only at lower income levels but also at medium to high income levels. Moreover, comparing columns one and five, one can see that though public pension income is more unequally distributed in countries with earnings related pensions, gross income is more equally distributed.[7] Gross income inequality is strongly *negatively* correlated with public pension income inequality ($r = -.81$). For example, the gini index for public pension income in Sweden is .15; in Australia, which has means tested pensions, it is -.07.[8] Yet the gini index for gross income (including all sources but before tax) is considerably lower in Sweden (.24) than in Australia (.34). Palme (1993) presents yet more evidence of the egalitarian nature of institutional pension systems, showing that his measure of pension institutionalism (as defined above) has a very high negative correlation with inequality of disposable income among the aged (-.83).

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) demonstrate the same phenomenon through time in one country. They show that 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. They conclude that "despite their income-graduation, legislated universal programs have equalizing effects by crowding out more regressive components of the income package of the elderly."

The data are unambiguous. The question is why the apparently inegalitarian earnings related benefits should have such egalitarian effects. In explaining what they term the "paradox of redistribution", Korpi and Palme present the following simple formula for the redistributive effect of transfer payments: *Redistribution = size of transfers x redistributive profile.* Presenting data similar to that of columns six and seven in Table 1, they note that countries with "encompassing welfare states", which are the equivalent to our institutional model and thus include an earnings related tier, are much larger and thus, though the benefits profile is much less redistributive, they effect more redistribution. Their explanation is essentially a political one. They argue that encompassing or institutional welfare state programs are much larger because they enjoy wide political support that reaches far beyond the working class. The earnings related benefits are a main reason for the wide middle class support. In and of themselves, earnings related benefits apparently make little if any contribution to redistribution. It is the basic security tier of welfare states which is responsible for their redistributive effect. This is made explicit in Åberg's (1989) formal analysis of the redistributive effect of welfare state programs: social benefits which accrue to the recipients in proportion to their income and which are financed by proportional taxes result in no redistribution. Ståhlberg (1990) provides empirical support for this point in the case of Swedish pensions: the flat rate Folkpension is strongly redistributive; the earnings related ATP only very modestly so and to the extent that it is this is due to deviations from income proportionality such as the ceiling on benefit levels.

I agree with Åberg that it is the basic security tier of welfare states that is the most redistributive and with Korpi and Palme that the earnings related tier of social insurance programs create middle class support and thus legitimates larger welfare states and consequently greater redistribution. However, I argue that the earnings related programs are *directly* redistributive. I contend that the counterfactual implicit in their analysis and explicit in other analyses of the redistributive effects of social programs, such as that of Ståhlberg (1990) on the Swedish ATP or of Åberg (1989), is wrong. Most analysts' counterfactual is that if, for instance, a payroll tax of x% were not there, the money would go to employees in exact proportion to their current income. Thus, as in Åberg's analysis, an exactly proportional tax which would fund earnings related benefits which accrue in exact proportion to the individual's (lifetime) income would effect no redistribution whatsoever. For instance, the Swedish ATP and even more so the earnings related tier of the Finnish pension system which lacks the benefits ceiling of ATP effect little if any redistribution, according to this view. The counterfactual assumption here is that wage and salary compensation equivalent to the benefits paid for by an employer's payroll tax (as in the case of ATP) would go to the employees in exact proportion to their wage or salary level in the absence of the program and thus of the employer's contribution. This is an unwarranted assumption. Employers might have attempted to keep at least some of the revenue that would have gone to fund the program for themselves, and to the extent that they did use it all for employee compensation, they would probably have used it in a way that benefited upper level employees disproportionately to their income. Perhaps my point here would be more clearly stated by saying that public earnings related pensions, even if exactly proportional to income and financed by a proportional tax, are egalitarian in effect because they prevent the development of more inegalitarian, private or occupationally negotiated, alternatives.

Let me cite three pieces of evidence to support my contention on this point. First, the figures in Table 1 indicate that even "private pensions" (column 3), which include union-negotiated plans, are much more inegalitarian than not only public pensions but also, and more to the point, than pre-tax, pre-transfer income among the population as a whole (column 8).[9] With the probable exception of Finland, private and occupational negotiated pensions are far more inegalitarian than overall pre tax, pre-transfer income inequality. Second, comparative evidence from the US also supports this contention: Blue collar workers outside large capital intensive enterprises and the public sector rarely receive adequate retirement pensions through negotiations. By contrast, upper level employees, especially in high productivity enterprises, typically receive very generous benefits. Organized workers in such enterprises lie between these two groups. Third, developments in Sweden outlined below indicate that, even in a country in which unions are very strong and very centralized, blue collar workers will not receive benefits equal to that of white collar workers, much less upper managerial and professional employees via union negotiations. With the risk of repetition, let me emphasize that, in the case of cash benefits such as sickpay, work injury insurance, unemployment compensation, and pensions, by equal benefits I mean the same income replacement rate, not equal benefits in absolute terms.

The Historic Development of the Nordic Model: The Case of Swedish Pensions

As outlined above, the institutional welfare model combines a basic security tier of citizenship benefits (both services and some transfers) with an income security tier of earnings related transfers. Most of the other characteristics listed above (comprehensiveness, liberal qualifying conditions, provision of a broad range of services) simply specify that these welfare states are generous and "complete" in that they cover all areas and squeeze out private alternatives. Here I want to focus on the basic security and income security benefits since they have different distributive profiles and therefore potentially different constituencies.

In what has become the most widely accepted though hardly unchallenged view, Korpi (1983), Esping-Andersen (1985), and I (Stephens 1979) have argued that the Swedish, and to a lesser extent, the Scandinavian welfare states have been a product of two sequential class coalitions in which the blue collar unions and the allied Social Democratic parties were the main pivot. Briefly, the farmer worker coalition cemented in the thirties and dissolved in the fifties was responsible for building a system of tax financed citizenship benefits. This was followed by the passage of the income security tier which was the work of the blue collar - white collar employee (i.e. wage earner) coalition and was, in this view, part of an explicit attempt of Social Democracy to construct such a political coalition.[10]

This view has recently been challenged by Baldwin (1990), who argues that universalism was a bourgeois, primarily agrarian, achievement. Moreover, Baldwin contends that supplementary earnings related pensions were a concession to the middle class; thus, the Nordic welfare states were not (and by implication are now not) a workers' welfare state at all, a directly contradictory position to the earlier view.[11]

Based on my own research on the development of Swedish pension legislation (Stephens nd) and recent historical research on other welfare state programs and other Nordic countries (e.g. see Kangas 1988, 1991, Salminen 1993, Stephens 1994), I contend that both views contain some truth on the question of the development of the citizenship tier of benefits. More important for the argument of this article, based on my research on Swedish pensions as well as evidence on the developments in other Nordic countries and in other transfer programs, I will challenge the interpretation of the origin of earnings related benefits contained in both views. I contend that earnings related benefits were supported by blue collar workers' unions because they correctly perceived them to be in their material interests, not because of ulterior political motives.

As to the role of farmers, there is no question that farming interests played a unique role in Nordic welfare state development. However, in the Swedish case, farming interests did not initiate social policy development.[12] It was the rising labor movement and the Bismarckian conservative and liberal reaction to it that played that role. Rather, as in the case of the 1913 pension reform, once the issue was on the agenda, the political representatives of farmers pressed to insure that the reforms did not benefit wage earners alone but that their constituency was covered, thus pressing for universal coverage. Thus the farming interests did make a contribution to the early development of universalism. In addition, they pressed for tax financing rather than contributory financing, thus lightening the contribution of their constituency to the financing of the reform. So they did make an important contribution to universalism and tax financing as Baldwin (1990) contends.

The 1930s were a watershed but more for the political alignments and labor market compromises which laid the basis for the post-war model rather than for the innovations in social policy. The farmer-worker coalition that was consummated in this period dominated social policy development until the ATP struggle in the fifties. With regard to transfers, the Agrarians followed their previous pattern in this period: They were not the policy initiators, but once a policy was initiated they sought to insure that its structure was favorable to their primary constituency, family farmers. In the case of transfers, this generally meant the Agrarian Party favored flat rate, universalistic, tax financed benefits -in a word, citizenship entitlements.

The position of the Social Democrats and LO, the allied central organization of blue collar trade unions, on the major transfer programs was more complex. The Social Democratic Social Minister, Möller, favored uniform, flat rate benefits and thus shared common ground with the agrarians. Others favored combining citizenship benefits with income tested benefits either because they saw it as more just to concentrate benefits on the needy or because the savings would allow additional reforms in other areas. In part because of the coalition with the agrarians and in part because the Social Democrats did not want to be upstaged by their bourgeois opponents, the "flat rate for all" line won out in the case of most of the immediate post war "harvest time" reforms, not only in the case of pensions but also child allowances. Thus the wide to universal benefits side of the Swedish welfare state pattern was firmly established by the end of the 1940s.

In addition to the two aforementioned positions on transfers, a segment of the labor movement, LO and above all the unions in the higher paid manufacturing unions, favored earnings related benefits. Most analysts have mistakenly assumed that this emerged on the Social Democratic agenda first with the supplementary pension struggle as part of the party's effort to appeal to white collar workers. In fact, this first emerged in a dispute between the Social Democrats and their Agrarian coalition partners on cost of living areas for pensions in the 1930s in which LO and the Social Democrats favored higher benefits for urban dwellers. It then emerged in the debate on sick pay during the harvest time reforms. The then existing voluntary, but state subsidized, sick pay funds provided earnings related benefits. The initial post war legislation provided for flat rate benefits but was postponed twice and never implemented, in part, because LO favored earnings related benefits, which the 1955 law eventually provided for.

Finally, as we will see below, it was LO that took the initiative on the issue of earnings related pensions. While this is generally conceded, it is often forgotten that LO's position favoring earnings related pensions had already emerged in the late forties. Throughout the late forties and fifties, LO was the driving force behind this legislation. LO and the Social Democrats favored compulsory, earnings related, fully indexed, public pensions with a large public pension fund. SAF, the Conservatives, and the Liberals favored voluntary pensions negotiated by the labor market partners. They were particularly adamant in their opposition to the formation of large pension funds under public control. Consistent with their previous line, the Agrarians favored large increases in basic pensions along with state subsidies to voluntary supplementary pensions.

My emphasis on the origins of ATP in LO's concerns is not meant to indicate that the ATP struggle did not become part of a new strategy on the part of the Social Democrats to woo the rapidly growing strata of white collar workers and that this entailed abandoning the farmer-worker alliance. One can see the strategic element in LO-Social Democratic strategy in concessions to TCO such as cutting the contribution period for full benefits from 40 to 30 years and making pensions dependent on the 15 best earning years rather than the 20 best earning years. But the idea of statutory earnings related pensions came from blue collar quarters. An LO affiliated social democratic member of parliament was responsible for the appointment of the original investigation in the forties. LO strongly supported the move while DACO (TCO's forerunner) and of course SAF strongly opposed it. From then on LO was the main supporter of the concept of statutory earnings related pensions. In the struggle of the late 50s TCO was actually divided on the issue. My point here is that LO support for earnings related transfer payments both in the cases of pensions and sick-pay clearly pre-dated the Social Democratic attempt to construct a new political alliance with white collar workers. It was the union leadership's perception of the material interests of their members, not strategic political considerations, which underpinned their position.

It is worth underlining why LO supported earnings related benefits. Any flat rate scheme could not, by its nature, provide a very high income replacement rate for an average production worker, not to mention a well paid skilled worker. Were such a scheme to provide a high flat income replacement of, for example, 90% of an average production worker's wage in the case of sickness, injury, unemployment or retirement, it would actually result in raised remuneration for lower paid workers thus creating highly perverse work disincentives. Thus, an earnings related scheme was necessary.

In the case of pensions, LO believed that it could never achieve equality with white collar workers through negotiations. In LO's view, only a statutory, obligatory system would cover the needs of all workers. A variety of historical evidence indicates that LO was correct.[13] First, at that point in time, it was true that fewer manual than non-manual workers were covered by supplementary schemes and their replacement rates were lower (Classon 1986: 30-40). Moreover, even the employers' federation's (SAF) own proposal for voluntary negotiated pensions was opposed in internal discussions by textile and clothing employers who contended they could not afford it, which casts some doubt on whether a generous scheme could have emerged from negotiations. The fact that, when they did turn to negotiations for the third tier of pensions in the 1970s, the benefits negotiated by LO, (the STP scheme) were inferior both with regard to the benefits ceiling and to retirement age to those in the scheme (ITP) negotiated by the white collar central organization, TCO, supports the view that blue collar workers were unlikely to reach parity (in relation to work income of course) with white collar workers via negotiations, even in a country with unions as powerful as Sweden (Von Nordheim Nielsen 1991, Ståhlberg 1990: 114, Kangas and Palme 1994). The evidence and arguments cited here pertain to pensions but do, I contend, apply with equal force to other transfer payments. Throughout the post war period, LO frequently resorted to legislation to extend coverage to, increase benefit levels of, or reduce waiting days of blue collar workers similar to those already achieved by white collar workers through negotiations.

Conclusion and Reflections on Future Options

The Nordic Social Democratic welfare states approximate the institutional or encompassing welfare state model. They combine basic security with income security: coverage is universal or nearly so, income replacement rates are high, services and some transfer payments are provided on the basis of citizenship, a wide range of services are provided, and qualifying conditions are liberal. As a result, they effect the greatest redistribution of income of any welfare state model. Another consequence of this pattern is that these welfare states are expensive and taxes are high.

The commonplace assumption has been that these very generous welfare states should experience the greatest downward pressure as a result of economic hard times and increased international competition. Indeed, entitlements have been cut in Sweden and Finland and it is arguable that Norway would have suffered the same fate were it not for North Sea oil. However, in neither case did these cuts come before the unemployment crisis of the past five years, a decade and a half after the advent of the current post Bretton Woods, post OPEC era of slowed growth and increased international competitiveness.

Their welfare state does not make these countries uncompetitive.[14] Ultimately, maintaining a generous welfare state, like maintaining high wages, is dependent on maintaining international competitiveness. A high social wage and a high market wage are dependent on high levels of labor productivity, on low unit labor costs. This is an obvious point, but its implication is not always fully drawn out in discussions of the effect of internationalization on social policy. The assumption that market integration will necessarily exert a strong downward pressure on social provisions is based on the assumption that, with the opening up of the European market, the competitive advantage of low wages will be more important than the advantage of capital intensity and highly qualified labor. To put this another way, it assumes that the non-tariff barriers to trade existing up to the end of 1992 discriminated more against low wage countries than the other members of the European Economic Area. This is far from clear.

In the case of the Nordic Social Democratic welfare states the whole edifice was built up around the interests of workers in the export sector, insuring the competitiveness of export industry. Increased trade openness had little if any impact on these countries and their welfare states. They were built in a open economy in the first place. Arguably, many of them, such as active labor market policies, education, day care, and other investments in human capital and labor force mobilization, actually result in competitive advantages. Rather, I contend that the Nordic growth and employment model, which was so successful during the Golden Age of post war capitalism up to the mid-seventies, holding unemployment in the range of 1-3% and producing world record high levels of labor force participation, is much less effective in the contemporary world. This, in turn, makes welfare state entitlements which were affordable in the past no longer 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.

In Norway, Sweden, and Finland, the dramatic increases in unemployment came in the late 1980s and early 1990s, as Norwegian and Swedish unemployment neared or surpassed double digits and Finnish unemployment hit 20%. Three factors contributed to this development: (1) The simultaneous rise in international interest rates and internationalization of financial markets made it impossible for theses countries to maintain low interest rates and to privilege borrowing by industry over other consumers of credit, a key element of these countries' supply side growth/employment models. (2) Governments in all three countries of different political colorings made an identical series of decisions on the timing of financial deregulation, income tax changes, and exchange rate policy which had strong pro-cyclical effects, contributing to the overheating of the economy in the late eighties and aggravating the crash of the nineties. (3) For different reasons, the employment "bridging strategy"; in all three countries, the expansion of the public social service sector; in Norway, sheltered employment in public enterprises; and in Finland, expansion of Soviet trade; had exhausted itself by the end of the 1980s (Huber and Stephens 1995).

In all three countries, significant rollbacks were resisted until it appeared that it was impossible to return to the previous low levels of unemployment. With the rise in unemployment, demands on the welfare state rose while the intake of social security contributions and taxes fell, making the then prevailing level of entitlements unaffordable. Thus, replacement rates were cut, waiting days introduced, qualifying conditions increased, and services cut. While many of these changes are still under discussion, it is clear that the depth of the cuts reflects the depth of the employment crisis, with Finland cutting the most and Norway very little.

From the point of defense of the Nordic institutional welfare state model, one can ask two questions. First, is it possible to resurrect features of the Golden Age employment/growth model in order to achieve the levels of employment that prevailed in these three Nordic countries up to the mid-eighties? Or alternatively, can a new employment/growth model be found which could achieve the levels of employment achieved earlier. Second, if higher levels of unemployment are inevitable, how can the welfare state be restructured to preserve the essential elements of the institutional welfare state model including its strong redistributive profile?

Not surprisingly, I do not have a satisfactory answer to question one. However, I do have some suggestions for the second question which will, in turn, contribute to the answer to the first question, so let me begin with the restructuring of the welfare state. It seems likely that no employment policy has the possibility of bringing unemployment under 5% in the short to medium term future, thus the Nordic welfare states will have to undergo some restructuring, some which has already been accomplished. While some savings have been made by increasing the efficiency of the public services and more could be made, the bulk of the adjustment will have to be made by increasing taxes and/or cutting benefits. For Sweden and Finland, there is widespread agreement that the structural budget deficit was so large and the tax burden so high that this could not be done entirely or even mainly by increasing taxes (though I will suggest below that some opportunities here were underutilized).

The strategy of the current Swedish Social Democratic government has been both to increase taxes, restoring the level of taxation to where it was when the non-socialist government took office, and to cut entitlements.[15] The cuts are to be concentrated in the transfer system, while cuts in the social services are to be minimized. This makes sense for two reasons. First, preserving the social services also preserves employment. Second, social services are generally citizenship benefits. While it is generally true that upper income groups utilize them more than lower income groups, they do not do so nearly in proportion to their income. That is, for example, an upper income group with four times the income of a lower one will not use nearly four times the health care, day care, elderly care, education, and so on that the lower income group uses (Åberg 1989). Given that, in Sweden, the services are funded primarily by a combination of income taxes and the VAT which taken together are at worst only mildly regressive, this strategy will preserve the most redistributive elements of the welfare state and will preserve much of the basic security profile. The cuts to date in Sweden have come from the transfer system and, given the Social Democrats' commitments, this is likely to continue. Replacement rates for sickpay, work injury insurance, parental leave, and unemployment insurance have been reduced to 80% and the current government proposal is to reduce the replacement rate in some of these programs to 75%. Developments in Finland have gone in a similar direction but to a greater extent.

Moreover, the transfer system in Sweden has become more insurance like. This is most obvious in the case of the supplementary pension system in which each generation will pay for its own pensions; there will be a shift from a defined benefit to a defined contribution system; and contributions to fund the system will be shifted from employers only to half employers and half employees. The work injury and sickpay insurance systems have been made self-financing and employee contributions introduced for sickpay insurance. A similar shift to employee contributions can be seen in Finland.

These shifts toward what amounts to a system of compulsory insurance might appear to make the system less attractive from a Social Democratic point of view and certainly not worth expending major political capital to defend. As a consequence, politicians from both the right and left within the socialist bloc have advocated abandoning or modifying the earnings related benefits. Former Finance Minister Kjell-Olof Feldt and some of his former colleagues in the ministry have advocated a return to the basic security model of generous flat rate benefits only. The Left Party favored cutting the benefits ceiling, initially to 5 times the base amount, later settling on 6 times (DNISR 1994: 42).

The clear implication of the analysis I have developed is that such moves toward a basic security model would be a huge mistake. First, as Korpi and Palme (1994) argue, in the long run, reduction of earnings related benefits is likely to erode support for the welfare state and in the end lead to reduction of basic security and thus greater inequality and greater poverty. Second, again going beyond their argument, I contend that abandoning or significantly modifying the income security tier would lead directly to greater inequality. Here let me state my argument in its most radical form for the case of earnings related pensions. I contend that a statutory and compulsory earnings related pension system with a high replacement rate, completely individualized, financed entirely by employee contributions with benefits based solely on past contributions would be significantly more egalitarian in outcome than the same system with a lower replacement and lower income ceiling or no earnings related pensions at all. My contention is based (1) on the assumption that the employee contribution as well as the benefit level are proportional to working life income and (2) that all private alternatives; private savings, negotiated occupational plans; voluntary company benefits, etc.; would be more inegalitarian, that is much more unequal than proportional to income. Given the changes in class structure over the past four decades, which have weakened the manual-nonmanual divide, and the weakening of centralized bargaining, I would predict that sectoral differences in these private alternatives would be as important if not more important than class differences, with employees in the most profitable and capital intensive industries, such as export manufacturing, receiving the best benefits. Indeed, one sees a movement in this direction in Sweden as the Metal Workers Union has recently contracted with Folksam, the cooperative insurance company, to raise the sick pay replacement rate from 75% to 90%.

Let me hasten to add that I do not advocate a solution quite as extreme the purely proportional system outlined in the previous paragraph. Ceilings and floors could be built into the system and special provisions to address the social justice concerns of disadvantaged groups could be added, such as pension credits for child care, to increase the redistributive profile of the system. Two points I would insist on. First, raising employee contributions in order to avoid lowering the replacement rate or the benefits ceiling is clearly better from a distributive view than the alternative. Moreover, raising contributions may be one of the few tax increases that is feasible at this juncture since the evidence indicates that the public is much more willing to accept tax increases in cases in which they see a clear connection to benefits they will receive. Second, each social insurance system should become like private insurance in the sense that each system is fully self-financing and at least steps should be taken to make each system fully funded. In addition to maintaining middle class support and preserving egalitarian outcomes, these steps would have three further beneficial results. One, it would make the social insurance systems more resilient to cuts in the face of adverse economic development such as those of the past five years. Two, funding the insurance systems would create public savings and thus sources of investment which would restore at least one element of the Golden Age supply side model. Three, at least in the long run, it would facilitate wage restraint and thus help reinforce another element of the Golden Age model.

When I referred to 'fully funded' in my prescriptions above, I meant much more than provided for in the proposed Swedish system. The new Swedish system is a "defined contribution system" which is structured such that each generation will pay its own pensions. The new system will be funded by equal contributions of employers and employees of 9.25% of the payroll each. However, it is not fully funded as only two percent of the employee's 9.25% contribution will be invested, in this case, in an individualized account. What I have in mind is the level of funding characteristic of the occupational pensions in the United States. In these programs, the totality of employer and employee contributions are invested in a diversified portfolio of stocks, bonds, money markets, and other financial instruments and the employees' retirement income is dependent on her/his contributions and the return on investments. The size of these funds is far greater than that which will result from the new Swedish system and thus the boost to savings and investment much larger. In the United States, these funds already accounted for over a quarter of the shares on the stock market in the late seventies despite the fact that most American workers were covered by wholly inadequate pensions above Social Security, if any at all. In fact, it is almost certainly the case that, if not only the Nordic supplementary pensions but also the other major transfer systems were funded in this or a similar way, the Nordic financial markets would be incapable of absorbing the inflow of funds and thus the level of funding would have to be adjusted downward accordingly. The technical details here are not important. What is important is that these new public insurance funds would be a new source of massive savings and investment for a new Nordic supply side model.

My point on wage restraint is stimulated by Scharpf's (1991) work on Social Democratic economic policy in the "crisis" era, that is, in the seventies and eighties. Scharpf argues that successful attempts of Social Democratic governments to defend employment, exemplified above all by Austria were a product of a policy which combined fiscal and monetary stimulation with wage restraint. From a distributive point of view, Scharpf's conclusions are not comforting to Social Democrats as he concludes that a successful Social Democratic crisis policy for employment will necessarily involve a shift of income shares from labor to capital . This would not matter if capital and labor were merely economic categories, but they are not; because of the skewed distribution of capital they are classes of people and such a shift involves a shift from a poor class to a richer class. Scharpf speculates that part of the Austrian success in being able to carry out such a policy was contingent on the fact that, more than in the other countries, capital and labor are categories. The state sector is much larger than in the other countries he analyzes and the Social Democrats and unions much more deeply involved in running that sector.

In my view, Scharpf's analysis of Social Democratic employment policy is incorrect or, better said, radically incomplete. His recipe is only for cyclical unemployment and does not address cross cycle policies for producing employment, which for Austria as well as for the Nordic countries was a supply side model with cheap credit and regulated credit markets at its core. However, my formula for increased investment via social insurance fund accumulation would also involve wage restraint to pay for capital accumulation and thus would be similar to Scharpf's in that, in the short run, it involves a shift in income shares from labor to capital. Nevertheless, in the short run, it should be more acceptable to labor because it would strengthen the social insurance system. In the long run, it would move in the direction of making more and more labor and capital categories and thus would further facilitate wage restraint.[16]

My suggestion is hardly a panacea for the creation of a new employment/growth model. Two problems stand in the way of that. First, even if these funds are invested in Nordic enterprises, there is no guarantee that those enterprises will use this new infusion of capital in a fashion that will produce jobs in those countries, given the internationalization and deregulation of financial markets and the multinationalization of Nordic enterprises. Moreover, these reforms will do nothing to restore the demand side of the Golden Age model, which, as I have emphasized, was not internally generated in that period. Nonetheless, at the very least, these reforms would protect the income security tier of the Nordic models, help secure continued middle class support for the welfare state, ***and contribute to the egalitarian outcomes*** which have characterized the Nordic Social Democratic welfare state to date.

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Notes

1 In developing the ideas contained in this article, I owe a deep intellectual debt to Joakim Palme. His own work has been a source of inspiration for my ideas, and, in addition, he has provided me with figures and commented on drafts of my historical analysis of the development of pension legislation in Sweden. I would also like to thank the editors of the Nordic Journal of Political Economy for feedback on an earlier draft of this article.

2 The analysis here will concern Norway, Sweden, and Finland only. Denmark fits the Nordic model less well both in terms of its welfare state regime (Korpi and Palme 1994, Stephens 1994, 1995) and, even more so, its growth/employment model (Mjøset et al. 1986, Huber and Stephens 1995). Correspondingly, the solutions to its problems are also somewhat different.

3 For further discussion of these dimensions, see Stephens (1995).

4 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 view. See Stephens (1979, 1994) and Huber and Stephens (1995) for elaborations.

5 This characterization leans heavily on Mjøset (1986, 1987) and Andersson et al. (1993).

6 Comments on a paper by Stephens, Huber, and Ray at the conference on the "Politics and Political Economy of Contemporary Capitalism," University of North Carolina, Chapel Hill, NC, September 9-11, 1994.

7 Since the difference between columns five (gross income) and six (net after tax income) is a product of the tax system and not the sources of income, the impact of public pensions on overall inequality can best be evaluated by comparing columns one and five.

8 Since these ginis are calculated on the basis of final disposable income, it is possible to have a negative gini. It indicates that lower income recipients get larger pensions than higher ones.

9 The most relevant point of comparison here would be pre-tax, pre-transfer income among the working age population, but I do not have figures for enough countries to merit inclusion in the table. Figures for the countries I do have indicate that the complete data would strengthen my argument since pre-tax, pre-transfer income among the working age population is more equally distributed that pre-tax, pre-transfer income among the total population for the obvious reason that many pensioners live largely from transfer income and thus have little pre-transfer income (see Fritzell and Saunders 1993).

10 This periodization ignores what might be termed the gender relations phase. See my discussion in

Table 1

Income Inequality among the Aged and Total Population

	Aged Population							Whole Population		
	1	2	3	4	5	6	7	8	9	10
	Public Transfers	Earnings	Private Pensions	Capital Income	Gross Income	Net (after tax) income	% public	Pre-tax trans Gini	Post tax trans Gini	Tax trans Redistribution
Australia	-.07	.74	.61	.63	.34	.28	59	.41	.29	31
Canada	-.02	.61	.53	.58	.33	.30	58	.39	.29	24
Finland	.19	.66	.36	.53	.29	.	69	.	.	.
France					.	.34	68	.47	.31	35
Germany	.12	.73	.61	.41	.29	.28	70	.41	.25	38
Ireland					.	.	55	.51	.34	34
Italy					.	.	72	.44	.31	29
Netherlands	.04	.67	.66	.82	.33	.27	69	.47	.29	37
Norway	.11	.77	.60	.54	.30	.24	82	.39	.23	39
Sweden	.15	.78	.49	.44	.24	.14	86	.42	.20	53
Switzerland					.	.36	71	.41	.34	19
UK	-.01	.73	.53	.61	.31	.26	67	.39	.26	33
USA	.08	.63	.52	.60	.38	.34	60	.43	.32	25

Sources: Kangas and Palme (1993); Esping-Andersen (1990:85): Palme, personal correspondence, Mitchell (1991).
All cell entries are ginis except columns 7 and 10. Column 7 is public pensions as a percent of total income.
Column 10 is the percent reduction in pretax and transfer inequality effected by taxes and tranfers.

Stephens (1994).

11 Baldwin charicatures the views of Korpi and Esping-Andersen in attributing to them the position that the Scandinavian welfare states were entirely the work of the working class movements whereas in truth both scholars present, as noted in the text, a class coalitions theory.

12 This is true for the other Nordic countries also for the most part. See (Kangas 1991, Salminen 1993, Stephens 1994).

13 The following briefly summarizes my argument in Stephens (nd).

14 This section summarizes Huber and Stephens (1995). See that work for a fuller treatment of these issues.

15 The cut in the VAT on food in the spring of 1995 does not fit this pattern and, from the point of view of preserving social protection, this piece of legislation is counterproductive.

16 For space reasons, I ignore the obvious political difficulties of instituting such a system, especially in Sweden in the wake of the wage earner fund controversy. This will be addressed in the conclusion of a manuscript in progress by Evelyne Huber and myself. To foreshadow, we will argue that wage earner funds were so controversial because they invovled a bid for union or societal control of capital. What is being suggested here is passive ownership. American pension funds, whose share ownership far exceeded that of Swedish pensions funds and wage earner funds (before their abolition), nevertheless provoke no political controversy because they are not linked to a bid for societal control of capital.