Economic Policy Adjustments in the 1970s and 1980s

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CHAPTER 13
AN OVERVIEW

This chapter surveys the economic policy responses of our case countries in the troubled period since the first oil shock of 1973/4.

The discussion of the different countries will be uneven. We shall focus on features which seem relevant in comparison with Ireland, not intending to give a comprehensive analysis of all the contrast cases. The Danish experience will be treated in some detail, since we have seen that there are close similarities between Ireland and Denmark. There is also a striking similarity of problems: relatively high unemployment, and a current account deficit which creates a heavy debt burden. However, Ireland experiences these problems to a greater degree.

The project description that has given rise to this project specifically requires it to consider the relationship between consensus-sustaining institutional frameworks and economic performance (cf. Chapter 2.1). We shall, in Chapter 14, touch upon some earlier studies of this relationship, studies which relate to the recent period of world economic instability (1973 and onwards). But it is clear that we have chosen — within the limited time resources available — to give priority to the study of earlier time periods.

FIGURE 13.1
Business Cycle Movements Since 1973

Note: Western European industrial production. Cyclical movements around the trend line. Source: Norwegian Central Bureau of Statistics.

This reflects our conviction that the roots of the different developments in Ireland versus the contrast countries really lie in these earlier time periods. After all, Table 13.1 below shows that the growth of Irish GNP in the period 1973-89 was at the OECD
average, while three of the five contrast countries grew at a much lower pace. The gap must have opened up earlier. In fact, we may in this chapter be able to demonstrate that in certain respects, institutional legacies from earlier periods also influenced the particular problems that Ireland encountered during this troubled period.

All the countries we analyse are small countries, heavily dependent on what goes on in their economic environment. Figure 13.1 provides a glimpse at the fluctuations of industrial output in Western Europe, as a proxy for the business cycle movement of that period. The figure also includes a rough periodisation of Western European economic policy routines, and a specification of some major movements in the oil price.

### Table 13.1

<table>
<thead>
<tr>
<th></th>
<th>AUT</th>
<th>DK</th>
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<th>IRL</th>
<th>SW</th>
<th>CH</th>
<th>OECD-AV</th>
</tr>
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</tr>
<tr>
<td>1974</td>
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<td>4.3</td>
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<td>2.1</td>
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<td>-6.7</td>
<td>-0.8</td>
</tr>
<tr>
<td>1976</td>
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<td>0.4</td>
<td>-0.8</td>
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<tr>
<td>1977</td>
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<td>1979</td>
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<tr>
<td>1980</td>
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<td>1.7</td>
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<td>1981</td>
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<tr>
<td>1982</td>
<td>1.1</td>
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<td>-0.7</td>
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<td>-0.9</td>
<td>0.8</td>
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<tr>
<td>1983</td>
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<td>2.5</td>
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<td>-1.6</td>
<td>1.8</td>
<td>1.0</td>
<td>1.7</td>
</tr>
<tr>
<td>1984</td>
<td>1.4</td>
<td>4.4</td>
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<td>2.3</td>
<td>4.0</td>
<td>1.8</td>
<td>2.6</td>
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<tr>
<td>1985</td>
<td>2.5</td>
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<td>2.2</td>
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<td>2.6</td>
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<tr>
<td>1986</td>
<td>1.2</td>
<td>3.6</td>
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<td>2.8</td>
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<tr>
<td>1987</td>
<td>2.0</td>
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<td>5.0</td>
<td>2.8</td>
<td>2.0</td>
<td>2.7</td>
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<td>1988</td>
<td>3.9</td>
<td>0.9</td>
<td>5.4</td>
<td>1.4</td>
<td>2.3</td>
<td>2.9</td>
<td>3.8</td>
</tr>
<tr>
<td>1989</td>
<td>4.0</td>
<td>1.1</td>
<td>5.2</td>
<td>5.0</td>
<td>2.1</td>
<td>3.5</td>
<td>3.5</td>
</tr>
<tr>
<td>1990</td>
<td>4.6</td>
<td>1.6</td>
<td>0.0</td>
<td>5.7</td>
<td>0.3</td>
<td>2.6</td>
<td>2.6</td>
</tr>
<tr>
<td>TOTAL</td>
<td>47.6</td>
<td>35.0</td>
<td>57.3</td>
<td>48.3</td>
<td>35.4</td>
<td>27.6</td>
<td>45.8</td>
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<tr>
<td>AV 73-79</td>
<td>3.2</td>
<td>2.2</td>
<td>3.0</td>
<td>3.7</td>
<td>2.7</td>
<td>2.1</td>
<td>0.2</td>
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<tr>
<td>AV 80-89</td>
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<td>1.7</td>
<td>3.7</td>
<td>1.7</td>
<td>2.0</td>
<td>2.2</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Note: OECD computation on the basis of 1987 GNP/GDP weights expressed in 1987 US dollars. GNP for Ireland.

Source: OECD, Economic Outlook, 49, July 1991, Table R 1.

Before we turn to a more detailed treatment of each case, we shall comment on some aggregate figures, to show that the measure of success during this period depends to some extent on the indicators used.

If we look at aggregate growth (GDP, GNP in the Irish case; Table 13.1), it turns out that Ireland did quite well, at least in the 1970s. Considering growth from 1973 to 1989, Ireland (total growth of 46.2 percent), was roughly at par with Austria (43 percent), second only to Finland (57.3 percent). Sweden (35.1 percent), Denmark (32.2 percent), and especially Switzerland (26.3 percent) had much lower total growth. In the 1973-9 period, Ireland was the fastest growing country, and annual average growth was higher than the European OECD average, meaning that Ireland was at that time catching up with OECD-Europe. The big setback for Ireland, as Table 13.1 shows, was the period 1982-86, with negative growth rates in 1982, 1983, and 1986, and below average growth all through the period. 1987 and 1989 growth rates show strong improvement again, with top ranking in 1987 (Irish had also ranked first among the countries here selected in 1974, 1977, 1978 and 1981). But of course, the point of departure was low: Ireland's level of GNP was much lower than all the others.

Other indicators, however, show that the adjustment problems faced by Ireland were much harsher than those faced by the other countries. As Figure 13.4 shows, Ireland's level of inflation was much higher than that of the others, and as we shall see below, the same goes for the current account deficit, unemployment and the debt burden.

Note that our crude empirical exercise with growth rates above indicates that there is no clear-cut connection between the rate of economic growth and the ability to solve the problems of current account deficit, unemployment and external debt. In a more detailed investigation, Glyn & Rowthorn found that economic growth was only loosely correlated with unemployment. It may therefore well be that the institutional features which help explain differential performance with respect, for example, to full employment may not help explain differences with respect to economic growth.

Among our case countries, Ireland and Switzerland often turn out to be polar cases. While Ireland had some of its best years in the 1970s (1974, 1977, 1978), Switzerland had some of its worst years (1975, 1976) at that time. This contrast may be generalised: while the 1973/4 downturn mainly created problems in the core of the world economy, third world countries did not really face major problems before the second oil shock struck in 1979/80. Most of the large Western countries actually used third world markets to compensate for the glut of demand for production inputs in the core, and third world countries contracted cheap credits to repay these expenses. At that time, offshore credit markets were overliquid (partly thanks to the so-called petrodollars generated by the first oil price shock), real interest rates were negative and aggressive financial institutions easily talked third world governments into further borrowing. But in the late 1970s, U.S. monetary policies changed. Being the hegemonic core of the world economy, U.S. domestic policy changes had repercussions throughout the whole world economy. The debt crisis of the third world unfolded throughout the 1980s.
A look at the current account position (Figure 13.2) of our case countries in the 1973-85 period clearly confirms the view that Ireland was closer to the third world pole. Again, the polarity of Ireland and Switzerland is brought out. Being a world creditor nation, Switzerland runs a persistent high surplus (with the exception of 1980).

A look at the general government financial balance (Figure 13.3) confirms this picture, with a skyrocketing Irish deficit in 1977-82, Table 13.2(A) shows that by 1988, the indebtedness of Ireland was much greater than that of any of our contrast countries. At that time, Ireland’s debt/GDP ratio was the highest among industrialised countries, and in fact maybe (with Israel) the highest in the world.5

### TABLE 13.2 The Irish Debt Burden

<table>
<thead>
<tr>
<th></th>
<th>GENERAL GOVERNMENT DEBT % OF GNP/GDP</th>
<th>NET GOVERNMENT DEBT INTERNAL % OF GNP/GDP</th>
<th>NET INVESTMENT INCOME PAID ABROAD % OF GNP/GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>IRELAND</td>
<td>132.8</td>
<td>54.4</td>
<td>11.4</td>
</tr>
<tr>
<td>SWEDEN</td>
<td>59.0</td>
<td>14.2</td>
<td>1.6</td>
</tr>
<tr>
<td>AUSTRIA</td>
<td>58.6</td>
<td>18.4</td>
<td>4.1</td>
</tr>
<tr>
<td>DENMARK</td>
<td>55.6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SWITZERLAND</td>
<td>17.5</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: OECD, Economic Outlook, 49, July 1991, Table R 14.
Since we shall refer to it in the later analysis, we also provide a figure for inflation (growth of the consumer price index). Even here Switzerland and Ireland are polarities. Ireland had the highest rate of inflation among the six in the period 1974-77 and 1979-84, while Switzerland generally had the lowest rate. We shall later comment on the convergence between the two in the late 1980s.

**FIGURE 13.4**
*Inflation (Private Consumption Deflators)*

![Inflation Graph]

*Source: OECD, Economic Outlook, 49, July 1991, Table R 11.*

Another indicator of the larger degree of structural heterogeneity in the Irish case is unemployment. In connection with this indicator, Chapter 14 provides a more detailed discussion. The aggregate picture is provided in Figure 13.5, but note that the figures are not strictly comparable, since they are based on national definitions (standardised unemployment rates are not available for Switzerland, Ireland or Denmark).

**FIGURE 13.5**
*Unemployment Rates (National Definitions) 1973-1990*

![Unemployment Graph]

*Source: OECD, Economic Outlook, 49, July 1991, Table R 20.*
CHAPTER 14
COMPARATIVE STUDIES OF LABOUR MARKET PERFORMANCE

There have been several comparative studies of labour market performance in the period since 1973. Some early studies investigated the correlation between full employment and social democratic dominance, but it was soon noted that a commitment to full employment survived also in countries where the elites displayed a paternalist concern for the working masses.

Evidence of this conservative road to full employment in the crisis was provided by Japan and Switzerland. But note that in addition to the alleged paternalism, these countries dispose of quite excellent national systems of innovation.

A classification of countries according to their modes of policy coordination was presented in Table 7.2. It showed that the European countries are generally those with a high or medium strong working class, while non-European countries like the U.S., Canada, Australia, are characterised by weak labour movements. Using this classification, Schmidt often employs an overall dualism between strong and weak welfare states. Both are subdivided into two groups.

The strong European welfare states with corporatist regulation are full employment cases. In the pluralist/sector oriented case, a medium strong working class has succeeded in getting generous compensation to modify the effects of unemployment. Schmidt puts Ireland in this group. But it is open to discussion how close this correspondence between modes of regulation (corporatism and the pluralist-sectoralist mode) and working class power really is. As we already mentioned in Chapter 8, Schmidt also finds full employment and mass unemployment cases among the countries with a weak welfare state. The mass unemployment cases are the countries with a pluralist mode of regulation.

The paternalist cases of Japan and Switzerland are the cases in which the correspondence between mode of regulation and working class power really breaks down. We refer back to Chapter 9 for a discussion of the special features of Switzerland, which generates such a full employment result and a social security system without generous compensation despite a "non-European" distribution of class forces. Switzerland even has decentralised wage negotiations, that is, an absence of corporatism in that sense either.

Full employment is a result which can be achieved in many different ways. To evaluate labour market performance more properly, a broader range of indicators (provided in Table 14.1) must be studied, as has been done both by Therborn and by Rowthorn and Glyn.

### TABLE 14.1 Labour Market Indicators

<table>
<thead>
<tr>
<th>UN</th>
<th>EMP</th>
<th>PAR</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>TOT</td>
<td>F</td>
</tr>
<tr>
<td></td>
<td>TOT</td>
<td>F</td>
</tr>
<tr>
<td></td>
<td>TOT</td>
<td>F</td>
</tr>
<tr>
<td>CH</td>
<td>0.9</td>
<td>1.1</td>
</tr>
<tr>
<td>SW</td>
<td>2.8</td>
<td>2.9</td>
</tr>
<tr>
<td>AUT</td>
<td>4.2</td>
<td>3.6</td>
</tr>
<tr>
<td>FIN</td>
<td>4.9</td>
<td>4.4</td>
</tr>
<tr>
<td>DK</td>
<td>7.3</td>
<td>8.2</td>
</tr>
<tr>
<td>IRL</td>
<td>17.6</td>
<td>13.5</td>
</tr>
</tbody>
</table>


The most aggregate figures of Table 14.1 may be synthesised into profiles of unemployment, cf. Table 14.2.

### TABLE 14.2 Profiles of (UN)Employment in Descending Rank from a Labour Point of View

<table>
<thead>
<tr>
<th>UN</th>
<th>EMPLOYMENT</th>
<th>EMPLOYMENT GROWTH</th>
</tr>
</thead>
<tbody>
<tr>
<td>NORWAY</td>
<td>Low (2.5)</td>
<td>High (75.4)</td>
</tr>
<tr>
<td>SWEDEN</td>
<td>Low (4.8)</td>
<td>High (79.7)</td>
</tr>
<tr>
<td>AUSTRIA</td>
<td>Low (4.2)</td>
<td>Medium (63.0)</td>
</tr>
<tr>
<td>SWITZERLAND</td>
<td>Low (0.9)</td>
<td>High (70.7)</td>
</tr>
<tr>
<td>FINLAND</td>
<td>Low (4.9)</td>
<td>High (72.7)</td>
</tr>
<tr>
<td>DENMARK</td>
<td>High (7.3)</td>
<td>High (74.2)</td>
</tr>
<tr>
<td>NETHERLANDS</td>
<td>High (13.0)</td>
<td>Low (51.2)</td>
</tr>
<tr>
<td>BELGIUM</td>
<td>High (12.3)</td>
<td>Low (54.4)</td>
</tr>
<tr>
<td>IRELAND</td>
<td>High (17.6)</td>
<td>Low (49.9)</td>
</tr>
</tbody>
</table>

**Note:** This table uses the same criteria as G. Therborn, *Why Some People Are More Unemployed Than Others*, London 1986, Table 32, p. 88, but for the period 1973-85. High unemployment = above 10 percent in 1985, low = less than 5 percent; high employment = above 70 percent of population of working age 15-64 in 1985, low = below 60 percent; high employment growth 1973-85 = growth higher than 10 percent. Within identical categories, countries are ranked according to the underlying absolute figures.

**Source:** Table 14.1, with Norway, Belgium and the Netherlands added from the same sources.
According to Therborn's typology Norway and Sweden are the "general success stories", since low unemployment goes together with high employment and growth of participation. Austria and Switzerland are "selective successes". Finland is a case of "mediocrity plus". Ireland would surely be placed with the U.K., Holland and Belgium, as "labour market disasters", "general failures". Denmark is described as a "special failure", due to its ability to maintain a high level of employment. In Belgium, Therborn finds that "huge gender and generational divisions significantly affect the way that class structures the labour market". Belgium has a "compensated exclusionist unemployment"; it hits women and youth in particular, and the long term share is high. Unemployment benefits are generous, and of unlimited duration. Denmark has a "compensated shake-out unemployment"; no large youth unemployment, an even male/female distribution, and relatively generous unemployment compensation. Ireland has much higher unemployment among men than among women (who have much lower employment and participation rates, the difference in the participation rates between men and women — according to Table 14.1 — being 11 in Denmark, 23 in Belgium, 35 in the Netherlands, and 50 in Ireland).

As for labour market policies, Therborn employs the following typology of labour market policies: Preventive policies influence the demand and supply sides of the labour market by measures which further labour mobility, retraining, public works and employment subsidies. Restrictive policies limit the supply of labour (early retirement, reduction of foreign labour supply, discouraging female workers, reducing working hours). Finally, compensatory policies compensate for unemployment by means of unemployment benefits, disability pensions, etc. Denmark and Ireland obviously have mainly compensatory policies, while Sweden is the standard example of preventive labour market policies. Finland is perhaps somewhat more like Sweden. In the "paternalist" Swiss case, labour market policies were obviously restrictive. As we shall see, foreign workers served as a safety valve, and also the participation rate was reduced. If the number of foreign workers and the overall participation rate had remained constant since 1973, unemployment would have been 15 percent in 1983. Austria has elements of the same mechanism.

Rowthorn and Glyn strongly emphasise the role of structural change, establishing the two following conditions for maintaining a low unemployment rate:

(i) Industrial Employment. Wholesale redundancies must be avoided and any decline in industrial employment must be gradual. If this condition is not satisfied, the result will be structural unemployment which cannot easily be eliminated through the creation of additional service employment.

(ii) Service Employment. Sufficient service employment must be created to absorb new entrants to the labour market (be they young or married women) plus transfers from the industrial sector (on the modest scale assumed under condition (i)). If condition (ii) is not satisfied the result will be an increase in measured unemployment even if industrial employment holds up reasonably well.

Glyn and Rowthorn discuss the three undisputed full employment cases in our selection: Switzerland, Sweden and Austria. In the 1973-85 period, they share the characteristics listed in Table 14.3.

<table>
<thead>
<tr>
<th>TABLE 14.3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common Features of the Full Employment Cases</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>STRUCTURAL CHANGE</strong></td>
</tr>
<tr>
<td>Only a gradual decline in employment</td>
</tr>
<tr>
<td>Service employment grows to absorb potential labour surplus</td>
</tr>
<tr>
<td><strong>INDUSTRIAL PRODUCTION</strong></td>
</tr>
<tr>
<td>Growth of industrial production</td>
</tr>
<tr>
<td><strong>WAGES AND CONSUMPTION</strong></td>
</tr>
<tr>
<td>Consumption per cap.</td>
</tr>
<tr>
<td>Pre-tax real wages growth</td>
</tr>
<tr>
<td>Employment</td>
</tr>
</tbody>
</table>

*Note: Data refer to 1973-85. *Therborn's judgement, cf. Table 14.2.

Source: Rowthorn & Glyn, as in Table 14.1, p. 240-243.

As for Austria and Sweden, Glyn and Rowthorn regard them as varieties of the "democratic corporatism" model, which they relate to centralisation of labour market negotiations, rather than features of state policies (as in Schmidt's definition). They argue that a "durable compromise between social classes", with employers and workers represented by "comprising" organisations, allows "full employment to be maintained as a main objective". Sweden (and Norway) are quoted as countries which show such a unique degree of solidarity. In Sweden manufacturing output and industrial production per capita were almost stagnant 1973-85. But government policy ensured that industrial employment declined slowly and that many service jobs were created. This state support for labour hoarding, as well as extensive labour market programmes and the policy of increasing public sector employment have been criticised. The extent to which Sweden was able to restructure its industrial base under conditions of full employment will be discussed in Chapter 16. Unlike Norway, which had oil revenues, Sweden had to import all its oil and faced stagnant industrial production: "The full-employment programme was therefore financed through a combination of wage restraint and higher taxes. This meant a considerable fall in real take-home pay for the average worker. There were, of course, compensations. Public services were greatly improved and family pay was often boosted through the provision of additional work for married women. Even so, the policy required enormous restraint on the part of well-organised workers in the more secure areas of the economy. Of all the OECD-countries, Sweden exhibits the highest degree of social solidarity in the face of adversity over the past 15 years. The basis of this solidarity is a well-organised, disciplined and politically conscious
According to Rowthorn and Glyn, Sweden’s (and Norway’s) success relied on “post-tax” wage restraints in order to finance the expansion of employment in the public services and programmes to temper the rate of, and ease the burdens of structural change (slowing down the decline of old sectors and, in the case of Sweden, financing retraining programmes). Others have claimed that the general notion of corporatism obscures the many peculiarities of labour market arrangements in different countries. Therborn argues that the difference between “the all-embracing ‘Social Partnership’ in Austria”, and “the informal co-ordination of labour market organisations in Sweden”, organisations which jealously guard their independence, is too significant to allow the use of one overall concept like corporatism. Therborn finds no single indicator which explains low unemployment, but strongly emphasises the “national context”, and pleads for a comparison of national models. His most explicit conclusion is that: “The existence or non-existence of an institutionalised commitment to full employment is the basic explanation for the differential impact of the current crisis”. This institutionalisation involves an “explicit commitment to maintaining/achieving full employment”, and it may be found both in cases with a dominant labour movement, and in conservative regimes with concern for social order. There must also be Keynesianism, or rather “the existence and use of counter-cyclical mechanisms and policies”. Also required are “the existence and use of specific mechanisms to adjust supply and demand in the labour market to the goal of full employment”, as well as “a conscious decision not to use high unemployment as a means to secure other policy objectives”. For instance, Switzerland and Austria have adjusted labour supply (through immigration policies); Sweden has influenced labour demand, as well as the quality of labour supply; Japan, Norway and Austria have used investment policies and Norway and Austria have also influenced price and cost structures.

This emphasis on national political voluntarism is not satisfactory. It fails to take into account the fact that the nature of the pressure may differ from country to country and between periods. As for country differences, we shall see below that Ireland is a case in point. As for differences in external pressures across periods, we need to draw a distinction between the 1970s and the 1980s. Studying oligopolistic “inflation games” at the national level, Schaarff provides such a distinction. The players are the government and the union movement. In the 1970s, incomes policies became more important, since a key objective was to make wages a policy variable. The problem, however, was that in Western liberal democracies unions are not parts of the state. A social democratic government gives priority to full employment. This puts unions in a strong position. If unions push their wage claims too far, however, the resulting inflation may undermine the government’s parliamentary strength. Hence, attempts were made to arrive at corporatist exchange solutions in the early 1970s. If unions would adjust their wage claims, ensuring that unit labour costs did not exceed the inflation rate, the state — especially in the cases where social democrats ruled on the basis of a considerable accumulation of power resources by the labour movement — would tackle the unemployment problems by a traditional expansionary mix of fiscal and monetary policies. Economic policies would be coordinated by means of a division of labour in which unions restrained wage growth, and the government would look after demand. This would secure full employment. (see Figure 1.6, In Schmidt’s terms, this is exactly the coordinative advantage of corporatism as a mode of regulation.) Schaarff finds that the institutional legacy of the high growth, Golden Age, period determined whether the attempts at concerntation of monetary, fiscal and incomes policies succeeded.

With competitiveness as the main goal, governments through the 1970s could work on the creation of new jobs, pursuing new goals regarding the environment and energy, defining aggressive technology policies, conducting regional policies, implementing measures for small and medium sized firms, pursuing labour market policies for increased mobility and education of labour power, conducting rescue operations for firms in trouble, supporting various economic sectors, and providing export insurance and financing. The instruments employed were direct subventions, such as credit on beneficial terms, coverage of credit costs, once and for all transfers, public venture capital, support for wage payments and public guarantees. There were also indirect instruments such as tax escape clauses, as well as non-financial instruments: advice and diffusion of information. As for subventions, Sweden and Norway had defensive and quite high support, while Finland had lower support.

Schaarff concludes that a coherent social democratic or Keynesian economic policy — one which gives priority to the full employment goal — was “objectively possible” in the 1970s. The comparison with England shows that such a policy required an institutional framework marked by encompassing organisations, but the case of West Germany shows that this was not a sufficient condition: in addition, a coordination of government and central bank strategies was needed.

This argument can be put more generally, with reference to the periodisation in Figure 13.1 above. During the first years of the crisis, economic policies generally reflected the priorities as set by the domestic policy process. In this phase, the Golden Age routines, relying on the domestic power distribution, were largely maintained. In many countries this was the phase of reliance on Keynesian macroeconomic policy management. Finland, however, with its procyclical model, illustrates that during the Golden Age, many approaches worked. But whether the original routines were Keynesian or non-Keynesian, the reliance on old routines produced largely unintended outcomes, usually (but not always) in the form of a combination of external imbalance and growing unemployment. This led to a phase of “fumbling” (or “muddling through”), which reflected the contradiction between domestic priorities and economic feasibility. This in phase neo-liberal and Keynesian policies uneasily coexisted. Policymaking was disoriented because it suddenly seemed to lack the means to fulfil the traditional goals of economic policy. These two phases — continued routines and muddling through — are characteristic of the 1970s. During the phase of muddling through, a number of structural changes in the world financial system occurred. The crisis of 1980-2 marked the transition from muddling through to a new set of policy routines, often called “neo-liberal”.

The new routines gained dominance at various points early in the 1980s. In this third phase, the conflict between domestic priorities and economic feasibility was
resolved through a change of domestic priorities. Internationalisation of financial markets requires that the process of domestic policy-making is “emancipated” from the specific requirements of the national distribution of power. The trend was for macroeconomic policy to reject the responsibility for the short term development of unemployment, and to focus instead on stabilising prices and improving the external balance. At the same time we see the increasing importance of industrial policies in trying to deal with industrial restructuring. The new routines (even in the most social-democratic/corporatist countries like Austria and Sweden) might have solved the dilemma between domestic priorities and economic feasibility. But the solution created a new dilemma at the international level. Through the stress by these policies on a positive external balance and international competitiveness, there is a real danger of a vicious circle of “beggar thy neighbour” policies at the international level.

According to Scharpf, this new type of external pressure makes the social democratic strategy of the 1970s impossible to realise in the 1980s. Corresponding to the full deregulation of international banking, a “conservative-monetarist constellation” evolved at the national level, one which implies an inevitable “compulsion to supply side-oriented redistribution”. None of his four case countries (Britain, Austria, Sweden and Germany) have tried to insulate their capital markets. Deregulation of financial markets and rejection of monetary policy autonomy is a general trend. In the late 1980s, even small countries were forced to admit that their currency is the object of international speculative transactions. Scharpf concludes that there is no way around a policy of cost reductions and improved international competitiveness: “with the internationalisation of capital markets and the rising level of international interest rates, the “terms of trade” between capital, labour and the state have been altered in favour of capital. This is why in the early 1980s the attempt to defend or recapture full employment in the private sector can only be paid for by a massive redistribution in favour of capital incomes. At most, the question is by whom and in what way this price shall be paid”. 23

The social democrats have great difficulties in responding to the conservative-monetarist constellation. Social democrats lack an explicit theory for “the inevitable adjustment of national economies to the compulsion of international capital markets”. 24 Austria and Sweden have muddled through, but the real effect has been redistribution in favour of capital. Scharpf notes that Swedish real wages declined more than in comparable countries in this period. 25 Neither Swedish nor Austrian wage earners have been better protected against the pressure for redistribution than have their British or Japanese colleagues.

In such a problematic economic situation, claims Scharpf, unions are very vulnerable. The British experience brings this out: a conservative-monetarist government pursuing stability as its major goal is in no way dependent on encompassing collective actors. But social democratic governments in a “conservative-monetarist constellation”, must not necessarily alienate a centralised union movement. Scharpf rejects the neoclassical arguments about a trade off between union strength and full resource utilisation. Centralisation may counteract monopoly on the employer side, improving economic efficiency. Furthermore, there is no effective competition between employed and unemployed, which is assumed in the market model. Wage formation is a collectivised process. Rather, medium sized, decentralised unions may push up wages, due to a combination of scarcity wages and comparability claims. With a strong central organisation, responsible action and concern for solidarity is more likely. In the late 1980s, unions must accept that a larger share of the net product is not their ultimate goal: “granted that the full employment goal still has priority, and furthermore assuming that under the given economic conditions full employment can only be achieved through a dramatic increase in profits, then income renunciation need not be interpreted only as a sign of economic weakness, but also as a proof of the organisational strength of solidaristic unions”. 26

Thus, even in the supply side oriented 1980s, the centralisation of unions is still important. Decentralised unions (like those of the U.S., Japan, and England) are likely to be egocentric on behalf of their specific sectors or firms. They are of no help to a government which aims at distributing the costs of adjustment in a “fair” way (what Scharpf calls “socialism in one class”). For that purpose, the recent policies in Sweden and Austria have proven more effective. Scharpf holds that the defence of full employment in the present situation must either rely on an active labour market policy (as in the case of Norway or Sweden), or on more work sharing (which is Scharpf’s proposal in the German case). In the first case, wage earners must accept a rather high tax burden to finance the labour market policies. In the second case, the available jobs must be shared without wage compensation.

If we prefer to use the term corporatism, we must be aware that the term has entirely different implications in the 1970s than in the 1980s. In the 1970s, some optimism was perhaps warranted, since full employment was possible to achieve. In the 1980s, corporatism is a second best and quite defensive approach. 21 It seems like a last resort for labour after a major redressing of the balance of power between labour and capital. It expresses the loss of power on the part of labour, rather than of power equilibration. 28 As we shall see below, Ireland’s labour relations in the 1970s were closer to the British case, so attempts at corporatism failed. After the major setback in the 1980s, however, the “defensive” type corporatism also emerged in Ireland.

Scharpf shows that different labour market policies may still make a lot of difference, given a strict restraint on macroeconomic policies. It must be emphasised that the restraints that emanate from open financial markets are purely quantitative (they only require stable currency relations). Such restraints do not necessarily lead to high unemployment. However if an unemployment problem develops, it becomes virtually impossible to fight it by means of traditional macroeconomic policies. The traditional measures — expansive fiscal or monetary policies — are all blocked by the external restraint. But within these quantitative limits, there are qualitatively different policies available, and there will be an interplay between national structural conditions and institutional legacies. Two types of “qualitative” policies seem particularly important: active labour market policies (as emphasised by Scharpf) and industrial policies. Although an active labour market policy may require substantial funds and therefore is subject to similar constraints as expansionary demand management policies, its employment creating potential must be considered far
greater. One reason for the good Swedish employment performance lies in its preference for labour market policies rather than traditional demand management policies.

The following Chapters provide overviews of economic policy adjustments in our six case countries. We distinguish three phases of adjustment (continued routines, fumbling (muddling through), and new routines), and we also discuss industrial restructuring in a somewhat longer term perspective.

We shall pay specific attention to financial deregulation. As already mentioned, this seems to be a crucial external factor involved in the emergence of the new routines. Among our case countries, the specific position of Switzerland in world finance has already been spelled out. As for Sweden, Finland, and Austria, we saw in Part III, that they all developed "credit based" financial systems during the Golden Age. Such financial systems are dominated by financial intermediaries. The opposite type is the capital market-based type, dominated by organised capital markets. These are the financial systems of the U.S. and Britain, where the stock exchange was always a very important institution. We shall see below that the credit-based type was exposed to pressure for change. The changes in financial systems were due to stronger real integration and external imbalances in the 1970s.

CHAPTER 15
DENMARK

Continued Routines 1973-1979

A general feature of Danish adjustment since 1973 has been the re-emergence of the stop-go pattern, a trade-off between an emphasis on the current account balance and on reduction of unemployment. Economic policies 1973-90 have taken the form of "packages", "total solutions", "diets", "cures", all designed to solve the imbalance between the internal balance (level of activity, avoiding unemployment) and the external balance (current account), i.e. a problem of compatibility between an internal and an external equilibrium. Table 14.3 indicates the trade-off relationship: if unemployment increases (positive change in the figure), the current account deficit is reduced. Whenever unemployment stops growing or is reduced (1976, 1979, 1984-86), Denmark records its worst current account deficits.

Following the first oil price shock, "the balance problems in the Danish economy had changed (...). Until the first energy crisis, the problem was a relatively moderate external problem in a society with high economic growth. Since then, the situation is marked by large external and internal balance problems in a society characterised by sluggish growth. This change cannot be explained from external relations alone. The problems must be explained with reference to a reduced ability to conduct adjustment in the economy."

FIGURE 15.1

Denmark — Current Account, Changes in Unemployment and Real GNP

Source: OECD, Economic Outlook, 44, Dec. 1988, Tables R 1 (Changes in real GNP), Table R 20 (Current balance in percent of GNP), R 18 (Changes in unemployment, commonly used definition).

Unlike, for example Sweden, there was no immediate Keynesian, i.e. expansive, response to the problems of the mid-1970s. In 1974, the government argued that the
disfunctioning which had evolved in 1973 was still too strong, so expansive fiscal policies could not be pursued. During the first half of 1974 fiscal policies were further tightened. Unexpectedly, the downturn lasted (cf. Fig. 13.1). At that time, the unemployment problem was felt for the first time since the late 1950s. In the second half of 1974, some restrictions on fiscal policy were lifted, relating to residential construction and public investments. Direct taxes were reduced on January 1, 1975. An international upturn in 1975 was expected. Some not very effective attempts were made to conduct incomes policies.

By September 1975, it was evident that the short term expansive policy had counteracted unemployment, but worsened the current account deficit. Decision makers concluded that the current account restricted their freedom of action: in the short term, there were few possibilities to reduce unemployment by stimulating demand. Reduction of unemployment was inevitably dependent on an external upswing. If the necessary exports were to be achieved, the long term strategy had to ensure that Danish costs were kept down (long term structural policies would move resources to the “competitive” sectors, i.e., “balance of payments sectors”). But the real result of the (moderate) counter-cyclical experiment was to stimulate demand which involved many imports. In this sense, Danish policy makers also continued “Keynesian routines”, but not as enthusiastically as, for example, Norwegian or Swedish policy makers. The re-emergence of the external deficit/unemployment trade off in 1975, signalled the departure from demand management policies (based on Phillips curve considerations), to an emphasis on competitiveness.32

As for monetary policies, Denmark, unlike Finland and Sweden, never experienced negative real interest rates as an unexpected consequence of the continuation of routines. The Danish krone has always been strongly linked to the Deutsche Mark. There was a “passive” exchange rate policy, i.e., following the D-mark. The Danish capital market has been very open, and since the late 1960s the level of interest rates had been high. Monetary policies were tight, with high interest rates in the mid-1970s. The upward movement of nominal interest rates at the international level did not create immediate problems for Denmark. Later, however, the high interest rates were to be a major problem for Denmark because of its high external debt.

The 1976 upturn became much weaker than expected. The current account deficit grew while the unemployment situation did not improve (Figure 15.1). Denmark was the victim of lags: the first step to expansion had come too late, and it had been too strong, partly due to a lowering of income taxes (effective from 1975), which was not countered by less generous public spending.33 In the second half of 1976, a delayed restrictive response followed. If action had been taken earlier, the effects on unemployment would have been better and the current account would not have deteriorated as strongly. The expansive fiscal policies were not linked to incomes policies aimed at reduced costs. As for labour market policies, there were employment plans, and even talk of “working time policies”, but such policies have been applied only to a very limited degree in the “active” Swedish sense, as a tool of structural policy.34 Continuous current account deficits from 1976 increased the balance of payments restraint. This imposed tighter limits on the extent to which economic policies could deviate from European (and international) conditions. This restrained options for expansion. A long term policy based on more pessimistic judgments was launched. It had four elements: wage/price policy, increased taxes and surcharges, public savings, and employment/labour market policies. These policies were to switch demand away from “import-heavy” to “employment-heavy” economic activities. This was an attempt to solve the Danish paradox, i.e., to reduce at the same time the current account and unemployment.35 Taxes and surcharges were raised, in order to squeeze private consumption, which had a high import content. Simultaneously, there were employment programmes intended to support demand with a lower “import-content”.

Compromises in the Parliament during August 1976 and 1977 tried to grapple with this dilemma: areas such as energy-saving, and support for employment creation in local government were given priority.36 Despite this commitment to full employment, this period has been characterised as an exercise in “learning to live with unemployment.”

The SV-Government (of the Social Democrat and Liberal parties) in 1978 declared that their goal was to reduce the current account deficit. If an external debt was allowed to accumulate, they argued, there would be less chance of reducing unemployment. The public sector budget deficit had to be reduced by spending cuts and the creation of new incomes.

As for monetary policy, the currency appreciated until early 1977, then there was stability to early 1979, then devaluation. Devaluation and incomes policies blocked cost increases, an “effective policy for competitiveness”.37 The new oil shock of 1979/80 obscured these good results. Rosted claimed that the 1977-79 adjustment was successful: demand was switched, labour market policies increased employment (with reduced unemployment in 1979).38 Taxes and surcharges restrained import-heavy consumer demand. In 1977-79 incomes policy brought wage growth down below the international average.39 The current account deficit was reduced in 1978, but in September 1979, the second oil shock again worsened Danish terms of trade.

The new deterioration of the current account triggered off a new tightening of economic policies in the summer of 1979. Without the second oil shock, OPEC II, claims Rosted, the current account deficit would have been brought down gradually, by means of a combination of “moderate incomes policies”, “mild fiscal austerity” and “employment-creating arrangements”, giving a balance in the mid-1980s.40 Given the worsening external conditions, the requirements on the export sector became still more demanding. To expand production enough to reduce the current account deficit, its competitiveness would have to be very strongly improved (by 2-3 percent per year). The Social Democrats argued in the fall of 1980 that their long term goal was a balance on the current account in the second half of the 1980s. This balance would make it possible to reduce unemployment. Together with investment, private demand has the strongest impact on the current account. Since investments
were needed to promote export competitiveness, private demand had to be held down. At this point, the growth of the public sector was questioned by several parties. It was claimed that it crowded out private sector activities, and that its growth rate should be brought down to zero.

Productivity growth had been very slow in the period since the crisis started (1973/4–82), partly due to expansion of public and private services (with inherently low productivity). In the period 1973-82, another 250,000 were added to the 500,000 already working in the public sector. Female participation increased, reaching the second highest level among the countries in Table 14.1 (but the growth was slower than many others).

Rosted claims that the only limit to such demand switching — which effectively reduced the problem of the “double balance” — is public opinion.41 The switching operation reallocates resources to the public sector. But that requires tax increases, which alienates public opinion, since it squeezes private consumption. Such a fiscal policy is politically impossible without tax increases. To avoid this dilemma, wage policy and exchange rate policy were added in the 1970s. Such policies are effective in a medium term perspective. They led to profitability increases. The labour/capital distribution was tilted in favour of capital. The expectation was that this would lead to increasing investment, increased production and increased employment. To accept these workers require either guarantees that their wage restraint will actually lead to investments or concessions regarding economic democracy, so that they can take part in investment decisions. Employers have rejected this. Rosted’s conclusion is that “basic conflicts and class contradictions in the present social system” block economic policies.42 The attempt to implement such a policy led to the break-up of the SV-Government, which was followed by minority Social Democratic governments 1979-82.

Fumbling 1979-82

In response to the second oil shock, there was a temporary reorientation of exchange rate policies. This is the only example in the postwar era where exchange rate policies were used actively to improve the competitiveness of the export sectors. Generally, inflationary risks connected to a devaluation have created a “fear of devaluation” throughout the postwar era in Denmark.43 This fear or “pessimism” was broken only in the 1979-82 period, but this happened in connection with a more “general feeling of crisis and disaster” in Danish economic development.44

From 1979, the DKK was strongly devalued. Denmark joined the European Monetary System (EMS) from the start in 1979, but devalued via the realignments. Wage growth was contained.45 There was a net devaluation of about 20 percent (1979-82). Real wages fell by 8 percent in 1980 and 1981. Although this caused profits to soar for firms, there were few effects on investment in the competitive sectors: “The reason was the dismal international business cycle situation, and a too generous fiscal policy. The growing deficit both on public account and on the current account generated expectations of continued devaluations and this led to a strong rise in the level of the interest rate.”46 Private investment activity faltered. The external debt started soaring, and from 1982 the debt problem gained the status of Denmark’s major problem. In the first half of 1982, however, there was instability in the EMS, involving Belgium and Denmark.47 Denmark experienced significant capital outflows, bolstering the high level of interest rates.

In 1982, the Social Democrats faced the following dilemma: there was no more room for devaluation, and incomes policies would only work in the very long term. The public budgets had to be tightened strongly, and the Social Democrats could not do it. The government simply gave up, and the non-socialist “four-leaf clover government” lead by Poul Schlüter, took over in September.48

Neo-Liberalism 1982-87

Responding to the monetary turmoil, the new government explicitly declared its monetary policy to be a “hard currency” one. The crucial decisions (wage agreements, fiscal arrangements and exchange rate decisions) were made between October 1982 and May 1983. The expectations of further devaluations were to be removed, and the interest rate differential reduced.

The new government indicated new priorities; previously the current account balance had always ranked above the reduction of unemployment, but now a reduction of both the public deficit and inflation also ranked above it.49 With the announcement of the hard currency option, the whole responsibility for competitiveness was laid on incomes policies alone.50 In a sense Schlüter could cash in on what had been prepared by the Social Democrats. In 1982-3, wage growth remained low (Danish wage costs dropped 16 percent compared to other countries), while international conditions improved. Fiscal policy was still geared to “demand switching”, but increasingly tight. All fiscal spending would be frozen, except contributions to structural change and spending on unemployment measures.51 At that time, the advantages of the new mix of exchange rate policy and wage policy could be reapplied. As fiscal policies had become tighter, investment optimism spread and expansion in private sector employment took place.

In incomes policies, a price and wage freeze was implemented: in the long term, a 4 percent wage increase was the goal. Indexation was suspended for the settlement period 1983-5. These measures were passed into law by the Parliament. Total wage growth in each firm was to be restrained by the employers’ association (DA) in collaboration with the firms. Adjustments would be allowed only 3 times during the two years. These were “the most wide-ranging incomes policy measures ever seen in the Danish economy”.52 As a result of these policy measures, the capital outflows were halted.

Following the changes in monetary policies, the government set out to dismantle the few remaining restraints on international capital movements between Denmark and the wider world. From May 1, 1983, Danish residents could buy assets in other countries, and non-residents could buy Danish treasury bonds. The final restraints on residents’ options of buying financial assets in other countries were lifted on January 1, 1984. Further liberalisation of currency restrictions on June 1, 1985, made
it even easier to borrow abroad. By 1987/88 there were very few restrictions left.\(^5\) The 1983 measures generated a certain stability and large capital imports followed (net sales of krone-denominated bonds abroad). With the liberalisation of capital movements an independent Danish monetary and interest rate policy was no longer possible. Foreigners now have a leverage on Denmark as capital movements are free and there are large numbers of “krone” bonds abroad.\(^6\)

As for incomes policies, the “four-leaf clover” government agreed with the Radical Liberals in the spring of 1984, that suspension of indexation was to be continued. This implied a reduction of ambitions with respect to distribution. Transfers were to grow by only 2 percent in 1985/6. Furthermore, tripartite discussions would be conducted after March 1984. There were discussions on work time flexibility in September 1984. Later the government made “suggestions” about moderate wage developments, but no quantitative guidelines. Labour market policies culminated in 1983, and mostly created more employment in the public sector. From July 1984, the job creation programme was dismantled.\(^6\)

Indexation has not been reintroduced since 1983; instead, the state defines the room for negotiation. In 1985, a direct law established a 3.5 percent limit for wage increases in 1985-7. There was even some regulation of profits, but mainly this was a wage policy.

The hard currency monetary policy and stricter incomes policies explicitly aimed at an increase in the profit share at the cost of the wage share. Together with reduced inflation, this would lead to increased private sector employment, the public deficit would be abolished, and the current account would be balanced. In this way, Denmark would manage the two deficits, even with a fixed exchange rate.

In the spring of 1985, negotiations became very complicated. The “official mediator” gave up, and by March 1985, there was a major dispute, terminated by law a week later. Wage growth was 2 percent in 1985 and 1.5 percent in 1986. There was a one hour reduction in working hours with full compensation. The employers’ association, DA, was still expected to restrain wage drift among its members. Only two rounds of negotiations would be possible in the two years. This “total solution” involved a reduction of employers’ social security contributions, and also regulated non-wage-earners’ incomes. The solution was no great success, the problem was partly wage drift.

Domestic demand grew slowly 1983-4, but accelerated 1985-6, as the savings rate was reduced. Private consumption increased by 5 and 4 percent (1985-6), production and employment grew at about 3.4 to 4 percent yearly. Tight fiscal policy and moderation, both regarding taxes and public spending, were intended to generate “crowding in”.\(^7\) Reduction of the budget deficit was to be achieved by cuts in public employment and in transfers.

The crowding in effects of the tight fiscal policy came faster than expected.\(^8\) 1984-6 saw the interest rate falling,\(^9\) with investments in services and housing going as projected. But, as just noted, consumer demand adapted much faster than expected to the falling interest rates and increasing personal wealth. Thus, the current account deficit reached a record 5 percent of GDP (Figure 15.1), despite the international upturn and terms of trade improvements in 1985/6. This was mainly because of an increased propensity to consume (dissaving) on the part of the households. Domestic expansion became stronger than planned, imports of consumer goods surged. On the positive side, this reduced unemployment somewhat.

As a response to the consumption boom, it was decided that domestic consumer demand and expansion in the housing sector should be moderated. What followed was the most contractionary policy ever seen in Denmark’s postwar history. In October 1986, the so-called “potato cure” was accepted by Parliament. This cure took the form of a 20 percent surcharge on the net interest rate payments of households. The idea was to strangle consumption based on credit and to spur savings.\(^10\)

Unemployment was reduced more rapidly (see Figure 13.5), and the budget balance turned into surplus in 1986 more rapidly than expected. It was of some importance that incomes policy towards public employees was successful, but above all tax-pressure was simply increased (against the promise of the government).\(^11\) The successful fight against the budget deficit 1982-6, was “astonishing and without international parallels”.\(^12\)

But in this period, as employment grew in the private sector, there was surprisingly little productivity growth.\(^13\) The consumption boom proved that incomes policies were insufficient, and pessimism spread as to the possibilities of a quick solution to the balance of payments problem. “The question of the structure of the economy and more long term economic growth now had to be emphasised more”.\(^14\) Short term demand management received less attention, and the question of competitiveness was increasingly linked to structural policies.

As a consequence of the new policies, competitiveness (in terms of Unit Labour Costs) improved by about 20 percent. Throughout 1976-79, the profit squeeze had depressed investment. In the period 1983-86, we observe adaptation to the new situation created by incomes policies and devaluation. Growth of GNP was above the OECD average (Table 13.1); growth of employment in the manufacturing sector was high by international standards, and investment soared. But in 1985/6, balance of payments problems exploded (Figure 13.2 and Table 14.3), and the positive development was brought to a halt. GNP growth stagnated (Table 13.1), while the rest of OECD-Europe grew at around 3 percent. Employment also stagnated. Danish firms lost market shares both in the domestic market and in international markets. The improvement in wage-cost competitiveness was successful in the short term, but if competitiveness is judged according to market shares, it deteriorated in the medium term.\(^15\) If the basic idea behind these policy choices was that major cost reductions for firms would translate into improvements for firms involved in international competition, this idea had not survived the test.

Productivity growth was very sluggish through these years. A recent Danish investigation argues that few firms responded to the profit boom of the 1983-6 period in a rational way.\(^16\) Rather, it found a number of different responses: some firms simply transformed higher profits into a more moderate pace of work, both for
workers and management; other firms over-invested in both new employees and new technologies, while others again accepted a reduction of productivity in the short term in order to work towards a long term improvement (experimenting, for instance, with new technologies and management strategies). The investigation points out that while investment in new technologies lagged before 1983, the short phase 1983-86 saw a very rapid acceleration of high-tech investments. Many firms tried to solve organisational problems by introducing new technologies. In fact, there is evidence that they were victims of an exaggerated fascination with new technologies. The single most important reason for the weak development of productivity in the mid-1980s, according to this investigation, was a disregard of human capital and an absence of emphasis on management in a situation in which many new employees were hired into the relatively small/medium-sized Danish firms.

In 1987, wage negotiations were decentralised and concluded long before the deadline. There was a four year agreement, with negotiations after two years. Between 1987-1991, weekly working time would be reduced (stepwise) from 39 to 37 hours, with full wage compensation. The possibility of local wage negotiations was restricted.

It was expected that this settlement would reduce wage competitiveness somewhat, since reduced unemployment would create more wage drift. In decentralised negotiations, employers are more concerned about the single firm. Also, there would be a reaction to the tight regulations of 1983 and 1985. There were also still inflationary expectations among the organisations. By 1987, this development was seen as a threat by DA (the employers' association). In December 1987, tripartite negotiations agreed to improve competitiveness. Employer taxes were reduced and there was an "export package". Tripartite negotiations on this continued during 1988.

**Industrial Restructuring**

Certain postwar developments in the Danish industrial structure were discussed in Part III. We shall here briefly discuss some developments in the 1970s and 1980s.

The success of Danish agro-industry since 1973 must be understood in the light of EC's Common Agricultural Policy. In 1974, an EC committee cancelled export subsidies for cheese exports to the U.S. Instead, Denmark received subsidies for exports to the Mediterranean countries. Technological developments in the Danish dairy industry made it possible to produce feta cheese from cow milk, although it has traditionally been made from goat milk. This resulted in a famous "cheese adventure" for the Danish dairy industry since the late 1970s. Cheese exports to the Middle East boomed and Iran, in particular, became a major outlet. But this success rests on vulnerable conditions, not only because of the instability of these parts of the world, but also due to the fact that the whole subsidy system of EC agricultural policies are subject to change. It has also been argued that EC membership revived some of the most traditional parts of the Danish agro-industrial complex.

According to Edquist and Lundvall, except for the cooperative slaughterhouses and dairies, Denmark's industrial structure is largely "pre-Fordist". This, however, also means that it has elements of "flexible specialisation". There is a prevalence of small and medium-sized firms. The average size of firms is the lowest in the OECD, and Denmark has the lowest share of multinational companies per capita. Small size makes internal communication easy, and unproductive lines of production cannot be maintained for long. On the other hand, small firms may have problems in export markets, since they lack subsidiaries in foreign markets to help to distribute and market the products of the parent firm. The costs of firing employees are very low in Denmark. This gives flexibility, but flexibility means that the links between management and workers are loose. Given that adjustment to technological change (shifting paradigms) requires learning and development of new qualifications at the firm level, then this flexibility may delay adjustment. "Human capital" is regarded as one among many semi-finished inputs, not really as an asset that firms should try to conserve and develop further. This deficiency may be compensated if the educational system excels in providing broad qualifications and an ability to learn. But Danish labour market policies show certain deficiencies: most resources simply must be allocated to employment relief. This purely compensatory policy fails to educate and retrain the unemployed. The qualifications of the long term unemployed tend to wither away. While the Danish educational system is generally very good at experimenting, this is not fully the case with respect to education of apprentices and other forms of technical education.

In the field of labour market policies, there was a change from job-creation measures to attempts at influencing the supply of labour power, particularly the qualifications of the workers. Educational policy and labour market policy have been knit more tightly together.

Denmark's industries are less influenced by unions, and less science-oriented than Sweden's. Unions are craft-based. It seems that the Danish system is much more "fearful" of technical rationalisation than the Swedish system, which may be related to the fact that the class compromise is weaker than in Sweden. The innovation process is self-organised, not organised by large firms or by the state. The small scale limits funds for R&D, so Danish firms mainly innovate through user-producer interaction, rather than through their own R&D laboratories. The only development block is the self-organised, cooperative agro-industrial complex, which promotes the product innovations of small firms.

R&D spending is low in Danish firms. Danish high-tech firms have found small and specialised niches. Edquist and Lundvall compare them to Sweden: "While the Swedish specialisation in engineering is one where products, normally not regarded as R&D intensive, are incrementally developed through heavy investment in R&D, Denmark, on the other hand, tends to produce R&D intensive products without investing too much R&D effort into them. In the long run both models might prove problematic. The weakness of the Danish approach is becoming more and more apparent. The niche firms have very weak linkages to the rest of the economy and they are, increasingly, taken over by foreign capital. The Danish high-tech position becomes more and more similar to that of Ireland." Neither Sweden nor Denmark have many firms in the most rapidly growing high-tech sectors.

Earlier development blocks related to construction, shipping and agriculture now face falling or stagnating demand, and there is no coherent new high-tech block.
Rather than emphasising a general feature like flexible specialisation, an assessment of Danish possibilities should emphasise the ambivalence of the agro-industrial complex. As the forward and backward linkages leading on to biotechnology show, this sector may generate a number of new processes and products that make the future look bright for Danish competitiveness in the present technology race. But on the other hand, there are many elements of inertia in this complex. The family farm system, earlier a strong factor in the Danish innovation system, now has problems of growing indebtedness, over-investment and a younger generation which hesitates to continue in the farming business. It has also been claimed that the cooperative parts of the agro-industries are in need of new organisational patterns that can further diversification and lessen dependence on agricultural inputs alone. The two separate Ministries of Agriculture and Industry have often hampered the integration of the agro-industrial complex.

Denmark’s manufacturing industry, strongly oriented towards niches in international markets has been quite independent of the state. Only the agro-industrial complex has traditionally enjoyed a lot of support and subsidies. The Ministry of Agriculture has been an important link, very concerned with the needs and demands of the farmer’s organisations.  “The most important function of the Danish state in this context has been, mostly unintentionally, to support innovation through organising and financing professional and advanced demand for specific products. Among important examples of products, originally developed for public induced demand but later becoming high-tech niche products with big international market shares, we find hearing-aids, mobile communication technology, medical instruments and wind-mill technology.”

As regards industrial and technology policies, Denmark may safely be characterised as a latecomer. The whole cooperative structure of the agro-industrial complex went together with a disinterest in industrial policies on the part of the State. Still, much of the support is “crisis help”, and much of this help is defensive. It seems that most of this amounted to saving shipyards. This changed very slowly through the 1970s, and only in 1985 were some major reforms made which put the “Technology Council” as the core of more aggressive industrial and technology policies. The approach is a general “pick the winner” one. In sum, the experience of Danish trial and error, both in industrial and labour market policies, is that general policies have proven ineffective.

A recent study of Danish productivity problems concluded that Denmark’s agro-industrial complex is no longer a “dynamic” development block. Earlier, the cooperative farmers’ movement was really able to be an agent of transformation. But the cooperative type of ownership and control today hampers adjustment. In the 1990s, there are no centres of power (private or public) that will be able to promote efficiently the development of a new dynamic bloc. Elites connected to the old complexes make the decisions about readjustment. The continued predominance of the old complexes condemn Danish exports to markets in which demand is mostly below average. As technologies get more complex and systems-based, this lacuna becomes more grave. Foreign capital seems to take over most of the Danish niche firms.

In Chapter 10, we reached the conclusion that the Danish system of innovation was much stronger than Ireland’s. This brief survey of Edquist and Lundvall’s conclusions, however, shows that even a national system of innovation which adapted quite flexibly to Golden Age change may be hit by increasing problems in a more troubled economic environment. It also shows that an emulation of Denmark’s successful Golden Age system can be no solution for Ireland in the present period.
CHAPTHER 16
SWEDEN

First Phase — Continued Routines

Sweden had an “equilibrium” parliament 1973-6, with a Social Democratic government. In 1976, a bourgeois government took over after 44 years of social democrat rule. Various constellations of the right wing and middle parties formed governments in the 1976-82 period, but after 1982, the Social Democrats were in power again. In September 1991, however, they lost the parliamentary elections, and a Conservative-led coalition took over.

A process of radicalisation and a labour offensive had been developing since the late 1960s. Industrial policy was made more aggressive and there were moves towards industrial democracy. (This development may be seen as a response to the increased push for productivity gains as Sweden’s main postwar export sectors began to experience loss of market share). The Codetermination Act of 1976 required management to negotiate with the unions over any corporate decision affecting the workplace. Earlier such consultation had been informal.80 Finally, LO in 1976 endorsed the 1975 Meidner Report, which proposed wage-earner funds.81 Large firms would be required to issue new stock corresponding to 20 percent of their yearly profit. Shareholder voting rights would be managed by a board consisting of members chosen by the unions and by the firms’ employees. This would moderate the wage claims of workers in profitable firms, since their moderation would generate reinvestments within the firm. Trends towards concentration of wealth would be counteracted, and collectivisation could be achieved in about 35 years, since by then, wage-earners would own 49 percent of the stocks of an average firm. The proposal was made in response to an immediate problem with the strategy of a solidaristic wage policy. This policy had led to super-profits in the early seventies. The answer was to be collective profit-sharing. But the proposal also implied a radicalisation in the sense that the labour movement would aim for more than just control and influence; the movement would start to accumulate property rights. LO accepted the Meidner plan as an inventive solution to an immediate problem, but they also saw the “long term, system-transformative implications”.82 The wage earner fund proposal could be regarded as an attempt to sustain the momentum towards greater equality created by the Rehn/Meidner Swedish model. But it was launched to deal with the problem of an overheated economy. As soon as the depression developed, the views on economic policy strategies began to differ more than before.

As for economic policies, Austria, Sweden, Finland and Norway were all hit by a wage-boom and inflation in the aftermath of the 1973/4 downturn. These forces were stronger in Scandinavia than in Austria. The bourgeois government which took over in Sweden in 1976 was neither able to curtail the unions’ wage claims, nor willing to reject the full employment goal. Many routines developed through social democrat rule during the Golden Age were continued. In some respects, the government even increased state intervention: larger doses of active labour market policies, bailing out firms in trouble. In contrast to Austria, the Swedish state had so far not owned many firms, but starting in the 1973-6 period, the state began to take over crisis sectors, especially shipyards and steel.83 This was a response to the deteriorating competitive position of Sweden’s traditional export sectors. Furthermore, public employment was expanded, including female part-time labour. The cost of this policy was very high taxes. According to Scharpf the conditions for coordination between the three peak wage earner organisations in Sweden (LO, TCO, SACO) had deteriorated in the 1970s.84 Wage growth could not be curtailed, which was also partly a result of instabilities created by the sequence of a raw materials boom and recession.85

A major instance of continued routines, which also separates Sweden even from its Nordic neighbours, was a selective employment policy, and in particular its company-oriented elements (stock-piling support, in-plant training to meet the threat of lay-offs, temporary employment assistance to firms employing elderly persons, and to firms of significant regional impact). This genuine “preventive” labour market policy had first been applied to relieve the 1958 downturn, later being used to manage the labour market through the Golden Age. From 1974 it again became a main weapon against unemployment.86 While Swedish GDP declined, the unemployment rate decreased during the recession.

During the counter-cyclical period of 1976-8, the current account deficit grew (+2.1 percent in 1976, +2.6 percent in 1977; Fig. 13.2). As a consequence of a total devaluation of 16 percent (see Table 16.1.), the deficit had nearly disappeared in 1978, but at that time a new deficit began to accumulate. This deficit had to be covered by borrowing abroad, and monetary policies were tightened considerably to stimulate Swedish private residents to contract these credits abroad.87 But the interest rate was kept low, due to traditional concerns for cheap credits for residential construction. Another requirement was that the central government budget deficit should be financed without the creation of too much liquidity. As long as the budget deficit was mainly financed by placing state papers (treasury bonds) in the banking system, such an increase of liquidity could not be avoided.

The correlation between industrial expansion and domestic demand growth became weaker. Towards the end of the 1970s, there was a stronger emphasis on a policy of cost competitiveness, rather than a Keynesian policy of stimulating domestic demand. It also turned out that large export-oriented firms managed the crisis better than smaller ones. The share of domestic market oriented industries (like textiles, food, construction) declined throughout the 1970s. Multinationalisation weakened labour. The foreign production of the 12 largest Swedish multinationals increased strongly in the periods 1973-7 and 1979-81 and they could now more easily respond to a profit squeeze by moving out. Engineering, especially, became more foreign-oriented. The new SAF (employers’ association) leadership of 1978, perhaps strengthened by the non-socialist electoral victory, cancelled the neutral
employer strategy, instead opposing more firmly the wage-earner fund proposal. An early departure from the Rehn/Meidner model was the decision — as early as the mid-1970s — no longer to use the investment reserve funds as an instrument of stabilisation policy. Rather than counter-cyclical ambitions, the ambition was to improve the liquidity of firms.

The Phase of Fumbling

The distinction between continued routines and fumbling is not easy to draw. We shall here argue that the last three years of the centre-party dominated governments represent the Swedish phase of fumbling.

From 1979, the problem of the external balance became more pressing (between 1978 and 1984, the central government budget deficit exceeded 8 percent of GDP, peaking at 13 percent in 1982; Fig. 13.3). There was also the second oil shock (record current account deficits in 1980 and 1982 at 3.6 percent, cf. Figure 13.2) and the increase in international interest rates. Swedish interest rates responded: the discount rate moved to 9.5 percent in 1980, and the “issuing interest rate” on long state loans from 9.5 percent 1979 to 12.5 percent in 1980. Until 1982, the routines of monetary policies were entirely geared at regulating the supply of credit by banks; thus, it remained a credit-based system with critical prices administered by government.

The Central Bank — closely collaborating with the Department of Finance — influenced the conditions for the banks’ loans. But there was also more direct regulation under the mid-1970s “Law on instruments of credit policy”. Its origin was the programme for residential construction, which used “liquidity quotas” whereby banks were required to place some of their funds in housing and Treasury bonds (state paper). There was also a system whereby other financial institutions had to apply for permits to issue bonds, and there was direct regulation of the banks’ interest rates. There was, from time to time, even direct regulation of the banks’ loans (through a ceiling) for other than housing purposes, but borrowing abroad could be exempted from such a ceiling. The rule of thumb was that the domestic credit market should be just so tight that direct investments, export credits, etc. were balanced by a private inflow of capital, while the balance of payments deficit should be covered by state borrowing abroad. This system of regulation enabled the Central Bank to manage total credit, thus keeping interest rates lower than in the case of a free market system.

As regards monetary policies, we see in this phase that continuation of the old routines led to unexpected consequences. Given the problems of the early 1980s, monetary policy had to block the liquidity creation which followed as a consequence of large budget deficits. In line with the old routines, the Swedish government tried to lock as much “state paper” as possible into banks and credit market institutions, applying a ceiling on lending and on regulation of the interest rate. Regulations became increasingly tight, but also increasingly ineffective. To evade regulations an unrestricted “grey market” developed outside the banking system. Here interest rate formation was unregulated, and increasingly moved away from the regulated level. The flourishing financial innovations emerged from financial institutions, but also non-financial firms. Banks were squeezed, and started to bid up the interest rate on business sector deposits. A number of well-known international financial innovations, such as certificates of deposits related both to banks and firms, emerged to mediate between liquid firms and firms which were in need of credit. An expansion of credit occurred, one which did not show up in the balances of the banks. The expanding credit volume was fed by the budget deficit liquidity flow to firms, and by the good profits in these years.

Fumbling can also clearly be seen in the fate of the wage earner reform proposal. While LO had endorsed it in 1976, the Labour Party was more sceptical. Various joint party/LO committees worked on the proposal, and in 1981, a much more moderate version was launched. The earlier plant-specific approach implied that a part of the profits would be transformed into shares, not to be sold on the market but kept in the firm as a basis for votes by workers and local representatives. The new approach was a tax on profits and wages, to be collected in a central pool and redistributed to regional funds, where workers and local representatives would vote on how to allocate them. In 1978 there was a joint LO-SAP proposal for wage-earner funds, which started the dilution of Meidner’s proposal. Following big conservative gains in the 1979 elections, both TCO and the middle parties (Liberals and Agrarians) became increasingly critical of the wage-earner fund idea. The Liberals had initially worked for a compromise with Labour over the funds, but now retreated.

The employer’s association (SAF) not only firmly opposed the wage-earner funds; even the whole solidarity wage policy was rejected, as larger wage differentials were demanded. These tensions led to the “great conflict” of 1980, a lock-out over wages. In addition, a nuclear power referendum created unusual divisions. At this time it was quite obvious that the consensual elements of the Swedish model had broken down. It has been argued that this increasing level of conflict reflected the determination of the labour movement to challenge capital’s power. But it seems more realistic to see here a case of fumbling for new routines and institutions. The result of the first really serious confrontation between the Swedish labour market parties was a stalemate. The deteriorating economic performance at that time — zero GDP-growth in 1981 (Table 13.1) record current account deficits (Figure 13.2), record budget deficit (Figure 13.3), inflation at peak levels (Figure 13.4), and unemployment on the rise, although from a very low level (Figure 13.5) — deprived the bourgeois governments of any credibility. When Labour won the 1982 election, however, there was no return to the Rehn/Meidner model, nor to the wage-earner funds. Rather the Social Democrats tried to find a “Third way” which would reduce the cost pressure on Swedish firms without creating unemployment. This approach was promoted as differing from both Thatcherism and Keynesianism.
Whereas in the 1970s new public sector jobs had been created, the Social Democrats now accepted the view that the growth of this sector was bidding up wages, interest rates and inflation, hampering investment in the private sector. Thus, fiscal policy was held generally tight, and slimming the public sector would, it was argued, create crowding in effects.

The new strategy — also supported by the Liberals — basically implied emphasis on cost competitiveness, full employment, public sector restraint and tax reform. Export industries would gain market shares through lower relative prices and high industrial profitability. Through the 1982-6 period, the approach was to devalue and change the composition of the currency basket. This had to be supported by incomes policies. There was wage restraint, and Swedish real wages declined more than in comparable countries. The argument was even that cost competitiveness would improve employment (a view that in the 1950s would have been discarded as "pre-Keynesian"). The main aim of the policy was to improve the balance of payments by cost reductions, avoiding a one-sided demand restraint. As in Denmark, a profit explosion resulted. The profit share of value added rose to 1950s levels and the rise was steeper in Sweden than in any other OECD country.

As for wage settlements, there has been a decentralisation of bargaining: peak-level bargaining between LO and SAF broke down completely in 1983-4. There was a separate agreement between engineering employers and their workers. But since 1985, there has still been coordination within the union movement concerning wage settlements, although the system is no longer formally centralised. By the end of the 1980s, statistics on wage dispersion did not show any major departure from the principle of solidarity wage policy, while on the other hand there was no further closing of wage gaps. And it should be remembered that even in the Golden Age period, centralisation did not exclude the acceptance of numerous local claims at a decentralised level. The employers' push for decentralisation is somewhat ambiguous, since they have benefited from solidarity wage policy and the responsibility exerted by the central union movement. Actually, Erixon argues that without social democracy, such a policy involving unfavourable real wage development with a profit (and stock market) boom, would not have been possible. As for labour market policy, earlier routines were continued, but training programmes became increasingly tied to the demands of export industries. Due to this policy, unemployment remained low.

We saw that during the phase of fumbling, attempts to hold down the interest rate became increasingly difficult. As a response to these problems, an entirely new way of financing the central government deficit was devised in 1982: the state would borrow in the market outside the banks, that is from firms and the general public. This made it possible to avoid strong liquidity creation. The result was a more market-oriented monetary policy, with less rationing and more latitude for interest rate policy. The domestic interest rate would move towards the international level. In 1983, liquidity quotas were abolished. Short term money market interest rates (CDs and state debt bills), which had been up to 16 percent in early 1981, were down to about 11 and 12 percent in early 1983.

### Table 16.1

Devaluations (per cent) in the Nordic Area

<table>
<thead>
<tr>
<th>Month/Year</th>
<th>DK</th>
<th>FIN</th>
<th>NOR</th>
<th>SW</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/1976</td>
<td>4</td>
<td>1</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>4/1977</td>
<td>3</td>
<td>6</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>8/1977</td>
<td>5</td>
<td>2</td>
<td></td>
<td>10</td>
</tr>
<tr>
<td>10/1977</td>
<td>3</td>
<td></td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>2/1978</td>
<td>8</td>
<td>8</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10/1979</td>
<td>3</td>
<td></td>
<td>8</td>
<td></td>
</tr>
<tr>
<td>11/1979</td>
<td>5</td>
<td>-2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10/1981</td>
<td>10</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2/1982</td>
<td>35</td>
<td>3</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>8/1982</td>
<td>3</td>
<td></td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>9/1982</td>
<td>3</td>
<td></td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>10/1982</td>
<td>8</td>
<td>18</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3/1983</td>
<td>3</td>
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<td>8</td>
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<td>2</td>
<td></td>
</tr>
<tr>
<td>5/1986</td>
<td>12</td>
<td></td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>1/1987</td>
<td>3</td>
<td></td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>Pegging to ECU</td>
<td>*</td>
<td>3.6.1991</td>
<td>22.10.1990</td>
<td>17.5.1991</td>
</tr>
</tbody>
</table>

* Member of EMS since its founding in early 1979.


### New Routines

Labour devalued (by 18 percent, according to Table 16.1) on their first day in office in 1982. Between 1983 and 1988, they eliminated the budget deficit (Table 13.5), avoided cutting welfare entitlements, achieved more stable growth (between 2 and 3 percent, cf. Table 13.1), turning the trade deficit into a surplus, and lowered the rate of unemployment. They were re-elected in 1985.

Pushed by the LO, Labour had to present a bill to establish wage-earner funds. Business declined to take part in the discussions on how to organise them. The final proposal was even more limited in scope than the earlier ones. Five funds would operate in a fashion similar to private portfolio investors, being essentially passive owners. The party also emphasised that no further legislation would follow. The bill has been interpreted as a way in which the party ensured further support by LO for its policy of devaluation and public sector austerity.
By 1985, the Euromarket interest rate (LIBOR) was rising, and there were problems of capital outflows. The Central Bank conducted open market operations and increased the penalty interest rate, raising money market interest rates to 14 percent by mid-1984. In 1984, exchange controls were moderated. The government decided not to borrow abroad, leaving it to private actors to balance Sweden’s external accounts. But there were more capital outflows in 1984 and in the Spring of 1985. The domestic interest rates were up to 16 percent by mid 1985. In 1985, interest rate regulation was discontinued and the ceiling on lending for banks and insurance companies abolished. The interest rate differential towards Eurodollars was 8 percent. This gave rise to capital inflows, and the interest rate moved down to about 12 percent by late 1985, being further lowered by 1986. However, a “safe” interest rate differential was maintained.

The deregulation implied a redirection of funds from the “grey” to the official credit market. There were still attempts to restrain the credit volume. Reserve requirements were increased from 1 to 3 percent, and an “interest rate ladder” was introduced to vary the interest rate according to the size of the sum the bank would borrow from the Central Bank (relative to its own capital). Penalty interest rates were no longer needed. Open market operations were used more often. Following the deregulations of 1985, credits from the financial institutions have boomed, both from investment banks and from housing institutions.

In 1986, there were improvements thanks to the decline in the oil price and the dollar exchange rate. The Swedish current account moved from a 1 percent deficit in 1985 to a 1 percent surplus in 1986 (Fig. 13.2). In these circumstances, a credit-based consumption boom could not be avoided in 1986-7. From about 1986, a fixed exchange rate policy has been followed. But fixed the basket pegging, there has been a certain de facto depreciation: about 4 to 5 percent, since the heavy weight of the dollar in the basket has dragged the krona down. Depreciation against the DM has been 14 percent (1986). The Central Bank has managed to keep the interest rate differential down. It was at 3 percent in 1986, but the real interest rate has moved slightly upwards (from 4 to 5-6 percent in the fall of 1986), since inflation has been reduced. The interest rate could not be reduced due to the persistence of a large central government deficit (1982-86; Fig. 13.3). Inflation is still somewhat higher in Sweden than in its “most influential competitor countries”.

At that time, Sweden had proceeded towards full liberalisation of capital movements. Transactions relating to the financing of trade and to external borrowing by Swedish firms are in practice deregulated. Firms can also use “leads and lags”, i.e. manipulate the time of payments, thereby creating capital movements. Multinationals can move funds between different subsidiaries. This may explain many of the recent capital movements in and out of Sweden. In the case of devaluation expectations, “leads and lags” cannot be prevented, but Sweden maintained regulations which prevented firms from paying back their foreign debts too early. Such accelerated repayments could have been a dangerous pressure on reserves. “Exchange regulations have in this way held down capital outflows in times of devaluation expectations, thereby easing the pressure on interest rate policy.”

A 1985 report noted that only measures which are decisive in securing a satisfactory monetary and exchange rate policy should be excluded from liberalisation. The report referred particularly to short term capital flows (both foreigners moving into SEK, and Swedes moving into foreign currencies) which are strongly sensitive to expectations relating to the interest rate and the exchange rate. Still, Thunholm in 1987 found that there is a close similarity between the movements of Swedish and Euro-interest rates. Even the long term interest rate is starting to correlate.

This sequence may be typical of the countries which maintained a state-regulated credit-based system into the 1980s. There was first a period in which the domestic financial system is deregulated. By 1987, the only instruments left for Sweden’s Central Bank and government were the regulation of the commercial banks’ cash ratio, interest penalties (concerning commercial banks borrowing from the central bank), discount rate regulation, and open market operations. Then followed a next phase, where external control was deregulated. In Sweden’s case, this period was 1987-91.

We do not intend to analyse all aspects of the transition from domestic to external deregulation here. Let us just note that in the case of an expected devaluation with capital controls, people holding the national currency cannot move into another currency (as they would do in the absence of capital controls). Instead, they may turn to objects that may earn them gains due to inflation. In this perspective, investments in housing, in art or other precious objects may serve as functional equivalents to capital flight. This may have been one factor behind the Swedish consumption boom of 1986-7. Attempts by labour parties to control this are discouraging, as their political opponents can easily criticise the “command economy” principles in which they seem forced to engage.

However, it would seem that the domestic financial system could be deregulated, without further external deregulation. Evasion at that level is more difficult than at the domestic level, and firms’ creation of capital movements by means of leads and lags can be controlled. It turns out, however, that the Swedish Social Democrats moved on to accept even repeal of capital controls.

In the late 1980s, a number of problematic consequences of the new economic policy strategy began to be visible. Swedish exporters did not lower their prices. Hence, their profits soared, but not the volume of production. The current account, in fact, benefited more from the American import boom. By 1987, domestic inflation had cancelled out the effects of the devaluation. Swedish industry again faced problems in international competition. Inflation was also fuelled by deregulation of financial markets which created a massive credit boom. Furthermore, productivity growth was slow. Tax reform tried to address this problem, which was also very marked as bottlenecks emerged in the labour market by the late 1980s. This situation, together with the new and more decentralised bargaining system, stimulated wage drift.

The current account deficit was back to the 1982 level (Fig. 13.2), despite very low growth of wage costs. Thus, expansion triggered off by devaluation (as well as by favourable prices on traditional export items) and the profit explosion had generated an overheated economy, leading to a wage-price spiral, and a setback for the solidaristic wage policy. The main failure was not so much the 1982 devaluation as
As if there was a correlation, support for the Social Democrats started to crumble once these problems emerged. Support for SAP in the polls started to falter in 1989 following the tax reform, modelled on the American supply side tax reform of 1986. The economy was overheated and inflation was above the OECD average (cf. Figure 13.4). To cope with inflation, the government presented an austerity package in February 1990. While in other case countries, like Denmark and Ireland, governments had resigned due to the non-acceptance of such packages by parliament even in the early 1980s, this was the first time such a thing happened in Sweden. With just a few changes, however, both the government and the package came back. Austerity measures involved various expenditure cuts, but not the ban on strikes which had originally been proposed.

While the traditional rhetoric of the “Swedish model” of the 1960s had pictured social democracy as innovative, the point has been made that both expansion of the 1982-88 period, as well as the austerity measures, were not very original. Economic policy initiatives were similar to those of the neo-liberal ‘blue’ wave all over Europe, and also in line with the ideas of earlier bourgeois governments: focus on cost-competitiveness, partial privatisation, deregulation of financial markets, reorganisation of public services, and tax reform. Furthermore, the sudden application for membership of the EC during the summer of 1990 was a response to pressure from organised business and the bourgeois parties. Sweden was no longer a model for the rest of the world. Furthermore, the austerity strategy with a profit explosion and wage restraint had created severe tensions between the Labour party and LO.

**Industrial Restructuring**

The heyday of the Swedish (Rehn/Meidner) model corresponded to the spread of Fordist sectors in the Swedish industrial structure. The formula “Fordism and standardisation combined with welfare and democracy” is an apt one.

As already emphasised, the Golden Age model implied pressure on the weakest firms. Labour market policies also promoted structural change by upgrading the qualifications of the labour force. Both the Swedish and the Danish states had extensive labour market policies, but in Sweden resources are directed to retraining and re-employment, while in Denmark, most spending consists of unemployment insurance payments. In Denmark, there are few restrictions on the employer’s rights to lay off workers, while in Sweden this freedom was restricted in the 1970s. It has been claimed that the Swedish class compromise has influenced the focus of the Swedish innovation system on process technology and rationalisation rather than on development of new products. High wages and a statist image policy may also have contributed to such a bias. This may also be connected to the dominance of engineering industries (e.g. the car industry), and the high concentration of manufacturing industry in Sweden.

Sweden is the only Western country that has kept pace with Japan concerning the diffusion of automation in the engineering industry during the period of crisis. Edquist and Lundvall argue that this is not only because of the importance of the car industry in Sweden, but also due to the fact that the Swedish class compromise pattern makes workers positive towards structural change, since they know that the Social Democratic government maintains a commitment to full employment. In addition, official technology policies contribute towards this feature.

The work enrichment efforts may be regarded as a response to the combination of full employment and a statist wage policy. As wages could not be increased very much, work enrichment and a very good work environment became functional equivalents to wage drift. Profit-sharing, bonus systems and other “non-collective bargaining remuneration” have also been used. The labour/capital relationship now shifts towards corporatism at the firm level. Despite the talk about Sweden’s high density of industrial robots, etc., productivity growth has been slow, and the recovery strategy may have alleviated the pressure on firms to innovate, since corporate profits were allowed to explode, and wage solidarity was undermined.

In the late 1960s, there was an intensification of rationalisation efforts, leading to numerous mergers. But from the mid-1970s, the potential for this was being exhausted. At this time, the Fordist sectors (as well as the other parts of engineering industry) became more export-oriented, and the connections to the older sectors (steel, shipbuilding) faltered as production became more knowledge-intensive. Pontusson holds that three consequences of this have undermined the Swedish class compromise: multinationalisation of capital, less willingness by firms to finance investments by borrowing capital, and management strategies to promote flexibility (cf. Chapter 4.5 above).

Concentration of business is high in Sweden (as in Switzerland). In 1981, 20 corporations accounted for 50 per cent of Swedish commodity exports, and 10 corporations accounted for 36 per cent. As noted in connection with Table 7.4, these firms spend considerable amounts on r&d, in fact as much (in relative terms) as Japan (and the U.S.). But the share of high-tech exports in total Swedish exports has been quite low. According to Ericson this is not a paradox: “Most of the largest Swedish corporations were established before World War I and have gradually received a strong position in oligopolistic world markets. In ‘mature’ markets where major innovations already have taken place, high r&d expenditures for product differentiation and higher production efficiency are necessary to retain and strengthen a competitive position.” However, the Fordist engineering firms of the interwar period must be emphasised. The five largest are Volvo, Electrolux, Ericsson, ASEA and SKF. They accounted for 20 percent of total value added in manufacturing in 1982, accounting for a quarter of total exports in 1976.

In Austria, firms with a workforce greater than 500 account for 65 percent of r&d spending, while this share in Sweden is 95 percent. The large firms are also important as users of high-tech inputs. An OECD study found that, in the sectors where advanced technologies were most widely diffused (metal-working, machinery, surface-treatment, electronics), production of automation technologies was also very important (following Japan and the U.S., Sweden is the world’s third largest producer of industrial robots). In Austria, on the other hand, large firms in the electronics sector were not important as demanders of high-tech inputs.
features together help to explain the high rate of diffusion of advanced technical and organisational solutions in the Swedish production process.

It also turned out that the large Swedish firms coped with the 1970s crisis much better than smaller firms. Sweden’s problems were mainly connected to middle sized and small firms. The Swedish system of investment support also discriminates against small firms: tax advantages for investment funds, for instance, are larger for large firms. The priority given to the large firms has created a dualistic situation that may not be a blessing for Sweden in the future, since there are reasons to believe that smaller, more flexible firms cope better with present day challenges.  

Sweden’s strength has been a very high rate of diffusion of advanced technology and organisational solutions. As for the Swedish weaknesses, Edquist and Lundvall state that “while Sweden seems to be very strong in its capacity to absorb new process technology, its capability to establish production of new product families, developed elsewhere, seems to be quite limited.” We have seen that by the early 1970s, Sweden’s continued specialisation in a number of mature products created many problems. Developments in biotechnology and materials technology may create continued problems in the form of dwindling demand for some of these traditional export items: wood products, pulp, paper, iron ore, steel. Furthermore, a major problem is that home-based multinationals are increasingly emigrating. The old model was based on the mutual dependence between the social democratic state and the big firms, but this dependence is no longer present.

While the Rehn/Meidner model devised a permanent squeeze on profits, the social democratic ‘third way’ of the 1980s created a profit explosion, as we have seen. It has been claimed that the policy of cost reduction has hampered the rationalisation of Swedish industry, as more firms with low productivity could continue, and the movement for restructuring of production was slowed down.  

As capital becomes increasingly mobile internationally, a profit explosion like that of the 1980s may lead mainly to investment abroad. Swedish firms have not escaped to places with lower wage costs; rather they have tried to position themselves within the EC, and they have acquired firms in other countries in order to improve their sales organisation. The lack of willingness to borrow is generally due to increased uncertainty and higher interest rates, and the higher risks associated with R&D investments today. Borrowed capital is no longer a good substitute for equity capital, so following the devaluations Swedish firms increased their profit margins (rather than their market shares via lower prices), basically to raise equity capital. SAF changed their definition of the latitude for wage increases; rather than referring only to productivity in the exposed sectors, it would now refer to total productivity (which included the public sector, with a low productivity growth). The government had abandoned its approach to industrial policy and collective ownership (wage earner funds), and thus, they had no way to ensure that profits would be devoted to productive industrial renewal.

In sum, it would be misleading to claim that the non-socialist government which took office in the fall of 1991 is about to start the dismantling of the Swedish model. Such a dismantling, as we have seen, started with the new strategies of the Social Democrats from the early 1980s and onwards.

CHAPTER 17
FINLAND

Analysing Sweden and Denmark, we have distinguished a sequence of continued routines — fumbling — neo-liberal routines, adding a final discussion of industrial restructuring. The following brief account of recent Finnish developments is organised somewhat differently: Finland experienced an initial crisis in 1976/77, signifying phase of continued routines. But then, from the late 1970s and all through the 1980s, the Finnish economy prospered. We briefly analyse industrial restructuring as one element behind this relative success. In a final subsection, we discuss the present crisis of the Finnish economy.

The Finnish Golden Age model was a non-Keynesian one. The discretionary aspect of fiscal policy very often worked in a procyclical way. It was mainly limited to management of demand aggregates. Supply side measures that would influence prices and costs were less important. As mentioned in Ch. 9, Finland’s “soft currency” approach — with devaluations about every tenth year — was different from all the other contrast cases, and also from Ireland. As in Sweden, monetary policies were credit-based and government-directed, mainly aiming to provide beneficial financing for exposed sectors. Interest rates were held low. The money supply was managed through the banks’ need for refinancing in the Central Bank.

As for regional integration, Austria and Finland are the only ones among our case countries with large eastern exports in the postwar period. The USSR is Finland’s main trading partner, with around 15 percent of Finnish exports in the 1980s, while other Eastern European countries accounted for 3 percent. Austria, on the other hand, shipped about 15 percent of its exports to other Eastern European countries and only about 3 percent to the USSR.

The early seventies were marked by distortions of relative prices, affecting many raw materials, not just oil. These distortions influenced the Nordic countries. In the years before the 1974-6 crisis, escalating raw materials prices strongly stimulated to the dominant Nordic export-sectors, such as the wood and metal industries of Finland and Sweden and the Danish food-exporting sector. Profit margins in these sectors increased.

Real wages increased rapidly through the boom 1971-73. At the same time, Finland experienced a wage explosion and labour unrest was particularly strong in 1973. Then the international downturn was felt. As Figure 13.2 shows, the Finnish balance of payments deficit worsened in 1974, becoming the largest among our case countries in 1975. Efforts to reduce inflation and to improve competitiveness were now given first priority. Both monetary and fiscal policies were kept tight. The public budget surplus increased in 1976 (Figure 13.3). Growth of real-wages tapered off earlier than in Sweden. Domestic demand was reduced. Unemployment reached a postwar record of 7 percent in 1977. Thus, Finnish wage earners in the mid-1970s experienced a reduction of real wages and increasing unemployment, while in the same period, wage-earners in Denmark enjoyed increasing real wages, but also...
increasing unemployment, and Sweden’s wage-earners enjoyed both increasing real wages and full employment.

As for credit policies, Sweden, as we have seen, maintained insulated credit markets in order to secure an interest rate at a lower level than the international average, despite internationalisation of credit markets and a rush of financial innovations at the global level. Even Finland defended a low interest rate. With the quite unexpected surge in inflation, real interest rates became heavily negative. This might have modified the tightness of Finnish policies, but such effects are difficult to judge, since the distribution of credits are determined by a complex network of institutions. Depending on these institutional arrangements, expansionary credit policies may support private consumption or industrial investments or public investments, but not necessarily all at the same time.

While there are similarities between Sweden and Finland in terms of credit policies, the fiscal policy routines were Keynesian in Sweden and non-Keynesian (prycylical) in the Finnish case. Finland refrained from implementing expansionary measures in 1976. Austerity continued. Through 1977, however, a new (but weak) upturn was on its way. At that moment Finnish policy-makers started to show concern for unemployment. Policy then became expansionary, lowering the tax level and supporting firms in trouble. With the Finnish Markka linked to a basket of currencies, there had been a slight revaluation in 1972-6. But in 1977 the government devalued the currency, a traditional move in the Finnish model. The external deficit diminished, inflation came down and the public finances improved. Increasing demand would now primarily follow from exports and private investment, whereas public investments were supposed to grow at a slower rate.

In terms of effective exchange rates there were devaluations, starting from 1977 in Finland and Sweden, and from 1979 in Denmark. Such a trend towards competitive devaluations disturb trade relations, and this may be one of the factors behind the decline in inter-Nordic trade in the 1970s, compared to the 1960s.

Towards the end of the 1970s therefore, the situation in Sweden and Finland had changed from one of low interest rates and revaluation to one of higher interest rates and devaluation. But in 1979/80, there was again a revaluation of the Finnish Markka. Since 1983, there has been a stable nominal effective exchange rate. The high real interest rates are due to a restrictive monetary policy, and institutional changes (discontinuation of interest rate control, openness). Denmark, with a different organisation of its financial system, displayed chronically high interest rates. As for industrial investments, higher interest rates added to the pressure against sectors with a low degree of self-financing (although this could be counteracted by systems of interest subsidies). It also harms countries with a high debt burden.

A main motivation for the policies pursued in Finland and Sweden up to 1981, was the wish to compensate a deteriorating position with respect to labour costs and to improve returns for industry. But despite incomes policies this approach was only partly successful. Especially in Finland, real wage increases — except for 1977-78 — overshot the gains in price competitiveness. Despite a more corporatist pattern of policy making than in the 1950s and early 1960s, wage earners mobilised, struggling to regain the losses they incurred due to the devaluation. Broad wildcat strikes occurred in the late 1970s, but the FCS (the central trade union federation) was passive.

At the political level, the system of broad collaborative Centre-/Left-governments — established in the late 1960s — prevailed. Neither red nor green protest waves have been able to disturb this parliamentary alliance. The most articulate voice of protest has been the Communist party minority, but its loud protests against consensus-policies and its support of any strike has only served to promote deep splits within the party, since the Majority holds a reformist view and did (until 1983) take part in the government. During the worst year of unemployment and protest strikes, a Communist labour minister remained in office. In the autumn of 1985 the Majority expelled the Minority. These splits weakened the party and frightened voters away from the electoral association (People’s Democrats) led by the Communists. Here one may trace a possible “Scandinavisation” of Finnish politics: the left-wing of the Social Democrats will be split in small parties and the position of the Social Democrats will improve.

From 1983, the broad Sorsa government consisted of the Social Democrats, the Agrarians, with the smaller parties SF (Svenska Folkpartiet; The Swedish People’s Party) and LP (Landsbygdspartiet; The Rural Party). Following the election of 1987, however, an entirely new alliance emerged. As a consequence of the rather unstable 1950s and 1960s. Finland had 34 governments (omitting 6 short periods with governments of “non-political experts”) since 1940. The Agrarians had been part of 32 out of these 34. In 1987, they were out, while the Conservatives (Samlingspartiet) — a party which had only taken part in 4 governments, the last one in 1966 — entered the government. For the first time, the prime minister was a Conservative (Harri Holkeri), and also for the first time, the Conservatives allied with the Social Democrats. Such a blue-red government alliance, could not have been arranged in any other Nordic country. Throughout the 1987-90 period, this government presided over a hectic superboom at the end of the long 1980s boom. In 1987, the TFM was revalued. By 1988, Finland had the highest current account deficit among the countries plotted in Table 14.3. In 1989-90, the unemployment rate went down to its lowest level (around 4 percent) since the mid 1970s (Fig. 13.5). This period saw banking deregulation and a housing boom. We cannot analyse this period in detail here, but there were obvious similarities with Sweden’s devaluation, as analysed above. When problems started to accumulate, the blue-red government was accused of playing a game of political business cycles, implementing loose fiscal and incomes policy, while being unwilling to see the clear signs of overheating of the economy in 1989.

Industrial Restructuring

Finland turned out to be the Nordic “economic miracle” of the late 1970s and 1980s. In the late 1970s, Finland’s price competitiveness did not improve. Relative export prices rose, and there was a less “favourable” development of RULC (Relative Unit Labour Costs) compared to Sweden in the early 1980s. But despite this, Finland won market share. Finnish export industries managed well during this period.
Aggregate growth was also spectacular, as Table 13.1 shows, Finland’s growth rate of 7.3 percent in 1979 was the highest in the 1973-89 period among our case countries. In a broader comparison, it was in fact only surpassed in the 1980s by Japan’s.

Throughout this period, Finnish trade with the East has been of great importance. Trade relations with the Soviet Union were a continuation of the postwar reparations, which Finland had to pay to the USSR by means of manufacturing products in the late 1940s. Each of the two large oil price increases (1973, 1979) served to increase the value of the Russian oil imported to Finland. Hence, the value of Finnish exports to the USSR also rose, since this trade was organised as semi-barter trade in which Finland swapped advanced manufacturing goods for Soviet oil. This is actually one of the few counter-cyclical aspects of the Finnish political economy.

In 1974-6 Finnish manufacturing exports also benefited from the advantage of being less involved in markets in which there was a change from oligopolistic to competitive pricing. This problem hit Sweden much harder. But thereafter relative export prices — as already mentioned — have also increased in Finland.

The “counter-cyclical” timing of the oil-price increase was even better in 1979/80 than in 1973. In 1979/80 additional exports were so huge that deliveries to the West had to be delayed. Quite apart from the fact that oil prices rose again in 1979, there were new credit arrangements which made possible a Finnish trade surplus with the USSR. The share of Eastern trade in total Finnish exports increased from 16 percent in 1979 to 29 percent in 1982.

However, there is a significant difference between 1973 and 1979. In the wake of the 1973 export boom there were huge increases of imports due to the familiar inclination of the export sector to over-invest. The result was a growing balance of payments deficit, which spurred the pro-cyclical austerity policies of 1974-5, as mentioned above. A certain rise in imports occurred also in 1981, and policies were tightened during 1982-3. There was an 8 percent devaluation of the FIM in connection with the Swedish devaluation late 1982 (cf. Table 16.1). But the share of external deficit did not increase. In comparison with the Swedish manufacturing sector, the Finnish manufacturing sector also made progress in Western export markets in 1979-80. This occurred despite the fact that Finnish large firms have become nearly as concentrated as Swedish ones.

These features indicate a shift in the structural conditions of the Finnish model. Besides the counter-cyclical effects of Eastern trade, this must be explained by the successful adaptation of the Finnish manufacturing export sector to external conditions. Some particularities of Finnish firms may help explain this. Let us start by comparing with Austria and Sweden. Austria’s large firms are either owned by the state or by foreigners. Privately owned domestic industries are mainly small or middle-sized. Sweden has a large group of home-based multinationals, and very few firms are owned by the state or by foreigners. Finland is quite similar to Sweden, but the large firms are not as internationalised as the Swedish ones. Finland also has more state-owned firms. In fact, most of the large Finnish firms were founded by the State. If we compare only the large private firms in Finland and Sweden, the Finnish ones have clearly emerged from traditional staple-based activities. In comparison with the ten largest private Swedish firms, the ten largest private Finnish firms are concentrated in paper, wood and steel. But if the state-owned companies are included, the production structure looks more modern: state-based companies like Nestle, Valmet and Kemira were founded not only to process domestic raw materials and to secure the supply of energy, but also to diversify the industrial structure. Finnish machinery exports are particularly concentrated in wood-processing machinery, based on linkages to mining, food-processing and the chemical industry. It has been argued that since Finnish firms are less “mature” than Swedish ones, their investments were more aggressive than those of Swedish firms through the seventies. It is also interesting to note that throughout the whole postwar period, Finnish firms have been protected from challenges by foreign capital. The Restricting Act of 1939 “not only limits foreign equity ownership to 20 percent, and under special permission up to 40 percent, but it also prohibits foreigners from establishing businesses in key areas like refining, mining, forestry, shipping, real estate, transportation and securities trading”.

In sum it seems clear that the economic structure of the Finnish model has been adjusting more flexibly to the external pressures than the Swedish economic structure. The political alliances within the Finnish model were to a large extent able to contain internal pressures. Since there was also a remarkable lack of external pressure, Finland was in the late 1970s and until the late 1980s, the most successful instance of crisis-management in Scandinavia. There was even a peak trend towards counter-cyclical policies. At that time, the Finnish model seemed unique among the Nordic models in that things actually changed for the better during the crisis. A thorough discussion of trends in the Finnish national system of innovation cannot be given here. Only such a discussion would enable us to decide whether the Finnish success of the 1980s is explained only by the favourable environment, or whether throughout this period, Finnish firms have been able to improve their potential for further adaptation. If the latter is the case, the Finnish economy may be able to recover again from its present deep crisis, to which we now turn.

Recent Developments

The discussion so far has clearly shown that the Finnish constellation of industrial diversification and stable corporatism was very dependent on the development of Eastern trade. In the period 1973-86, the cycles of this trade have been linked to the movements in oil prices. In 1986, however, this was about to change. At that time, we wrote: “But more recently, oil prices have dropped. The West may face a downturn without increasing oil prices in the late 1980s. In this case, Eastern trade may not work in a perfectly counter-cyclical fashion for the Finnish economy.” We also argued that since favourable external and internal conditions largely explained why the Finnish model had not really changed, it might still respond in a similar way to the new downturn: “the Finnish model has in itself not changed: If there had been an increasing current account deficit, a new and traditional dose of austerity measures would probably follow”.

This seems to have happened in 1990-91. By the end of 1991, the Bank of Finland could conclude: “Both external and domestic factors have contributed to the downturn as a simultaneous shrinking in both exports and domestic demand have pushed the Finnish economy into its worst peacetime recession in this century.”
Part of the explanation was, as predicted, a Western downturn without rising oil prices. In 1990-92, Finland’s Western export markets (especially Sweden, England and the U.S.) were very weak. However, without the dramatic crisis in Eastern Europe, Finland’s eastern exports would at least have remained. But a chain of external events completely destabilised the situation in Finland’s Eastern export markets. In the early 1990s, the semi-barter arrangement with the USSR was abruptly terminated, and other Eastern export markets also disappeared. Finland’s GDP started to contract by the middle of 1990, and in the middle of 1991, GDP had declined 6 percent since a year earlier. Exports declined. The most important single factor is the dramatic decline in exports to the Soviet Union, being more than 60 percent below the 1990 level. Of the 6 percent fall in GDP, 2.5 percent are explained by this setback. Lower capacity utilisation and profitability reduced the volume of private sector investments. There was a sharp fall in the number of new housing starts. The government tried to respond by deficit spending, but budget cuts have been proposed for 1992. In September 1991, the unemployment rate was 9 percent, and the labour market participation rate was declining, hiding even higher unemployment. Inflation was down, and the trade balance improved. The current account deficit also improved 1990/91, since the crisis resulted in sluggish imports.

Following the March 1991 elections, the Agrarians were back with the Prime Minister (Esko Aho), in a government with the Conservatives. This is the first government without Social Democrats in 25 years.

The new government pegged the Markka to the ECU in June 1991 (Table 13). This reflected the government’s (and also business’) conviction that the economic problems could be moderated by a much closer integration of the Finnish economy with the rest of Europe. As the cold war had ended with the breakdown in Eastern Europe, Finland’s earlier concern for neutrality was no longer important. In the same month, the Bank of Finland dismantled all controls on the contraction of credits abroad, thereby completing the abolition of Finnish exchange controls. There was also a package of measures to support the open sector of the economy. The interest rate differential towards the ECU narrowed, but only briefly.

Even before the March 1991 election, it was reported that groups within Finnish industry were asking for a devaluation. With the ECU-pegging, and the crisis already evident, rumours of devaluation started to spread. Politicians repeatedly denied such rumours. The Minister for Finance even accused certain factions within business of organising a capital flight to put pressure on the Finnish government and the Bank of Finland to devalue.

In August, Moscow saw the abortive attempt at a coup to restore the old regime. The consequence was a ban on the Communist Party, Gorbachev’s resignation, and the full fragmentation of the USSR. Finnish elites acted ambivalently during the coup, a fact which symbolises their uneasiness with respect to the events in the Eastern trade: many of their closest contacts had been with the old USSR elites. This may explain why Finnish firms have not so far been able to utilise their experience in Eastern markets to become pioneers in the present attempts at constructing market economies in the Eastern area.

The difficult economic situation in Finland made the weakness of the banks manifest. High interest rates interacted with lower asset prices and increased credit losses. The fourth largest bank in Finland, Skopbank, was threatened by a liquidity crisis, due to a heavy risk burden acquired in the boom years of 1987-9. Arising from concern to maintain confidence in the banking system, the Bank of Finland took control over Skopbank on Sept. 19, 1991.

But interest rates began to rise again due to negative expectations related to the 1992 draft budget. The interest rate differential increased to 4 percent in October. There was strong capital outflow. By mid-October, Finland was very close to a devaluation, and the Central Bank interest rate to banks peaked at 20 percent.

Major budget cuts had been proposed in the early Autumn, and there was a stalemate, with employers asking for 10 to 15 percent wage cuts, while unions signalled that they could accept zero growth. On the suggestion of President Koivisto, incomes policies were tried in order to avoid devaluation. Negotiations were very difficult, and the Government had to appoint a mediator who presented proposals in October 1991. These proposals implied an overall wage cut of 7 percent in employers’ wage costs. Nominal wage costs would be reduced by 3 percent, and employers would also be relieved of some of their contribution to earnings-related pension schemes. This implied that workers would face about a 2 percent cut, work longer hours and get a reduction of their holiday allowance.

This, however, could not prevent a new run against the Markka, in early November. The interbank interest rate how went as high as 50 percent, and currency reserves were down in a few months from 35 bn FIM to ca. 20 bn. On November 14, 1991, the Finnish government declared that the fluctuation limits of the FIM relative to the ECU basket had been raised by 14 percent, corresponding to a 12.3 percent devaluation.

The devaluation spelled trouble for incomes policy negotiations. Metal had accepted the 7 percent wage cuts, but now became sceptical, arguing that export industries (especially forests) now had very generous privileges. The vicious circle of devaluation and compensation claims — so typical of the Finnish model in its earlier days — seems to be back again.

The trouble is still not over. There was renewed pressure in April 1992, and the interbank interest rate also went very high. However at this time, there was support from other Nordic central banks, and from the Bundesbank. Unemployment is expected to emerge at 10 percent for 1992 as a whole; at present (Spring 1991), it is at 14 percent. As for the banking sector, not only Skopbank has troubles, even one of the two financial pillars in postwar Finland, KOP (Kansallis-Osake-Pankki), is in difficulties. Net foreign debt will rise to 33 percent of GDP, and 9 percent of this is central government borrowing. Interest rates are at 13 to 14 percent. Private consumption dropped by 3 percent in 1991. By 1995, the net foreign debt may be 38 percent of GDP. In the period 1975 to 1988, it was between 15 and 20 percent of GDP.

The government has been seeking a 2/3 majority for new cuts. This has caused great strains. One of the most popular ministers from the Prime Minister’s own party (the Agrarian party) resigned from the government, arguing that with such an economic policy, there was no need for a Minister of Social Affairs in the government.
CHAPTER 18
SWITZERLAND

Continued Routines

Switzerland was hit hard by the crisis of the early 1970s. The basic goals of Swiss economic policy have been to fight inflation and restrain public spending. Once inflation threatened, exchange rate and monetary policies implied a harsh cure for industry and labour. Inflation was partly caused by a higher inflation at the world level, but also by domestic factors.

In 1971-2, all attempts to manage the economy failed, since the Central Bank was obliged to exchange dollars for Sfr. In January 1973, Switzerland became the first country to float its currency, leaving the exchange rate realignment arranged by the Americans in connection with the dollar crisis in the early 1970s (the “Smithsonian agreement”). The choice of floating (rather than pegging to the DM), was intended to fight inflation. While in the 1960s exporting industries had benefited from an undervalued Sfr, inflation had now become a problem. There were also labour market bottlenecks. The choice of floating was based on expectations created during the Golden Age that international monetary flows would be based on movements of goods. Thus, floating would not significantly change the effective exchange rate. But capital movements were also based on the need for safe deposits, and Switzerland (conservative, neutral, socially stable, with excellent performance on most economic indicators) was very much trusted. There were expectations of revaluation, so that the Swiss banking system attracted short term capital. There was a large inflow of dollars, seeking security in the stable Swiss context. The Swiss Franc was revalued by 15 percent in the 1971-73 period.

This implied a very strong deflationary pressure on the Swiss economy. There was a fear that the currency would become uncontrollable, and that the real economy would suffer. In 1975, monetary policies were made more expansive, with lower interest rates, and a loosening of credit control. Despite this policy change, the revaluation pressure persisted, and in interaction with other elements, spurred a crisis in the real economy. Judged from the development of GDP in 1975-6 (Table 13.1), Switzerland was worse off than any of our case countries. In the period 1973-9, average GDP growth was 0.2 percent, the lowest among our cases. Real GDP declined by 6.7 percent in 1975.

In a sense, such a dismal economic performance is surprising. Schmidt notes that in the early 1970s, Switzerland should have been well prepared to face the crisis. Its industrial structure seemed flexible, with many small and medium sized firms, with no large “crisis sectors” like steel and shipbuilding. Furthermore, the emphasis on pragmatism, consensus and co-operation should facilitate adjustment.

Still, the Swiss Golden Age model was vulnerable to the kind of external pressure encountered in the 1970s. As we have just seen, a deflationary bias existed due to the fact that Switzerland is the only small European country which is a world financial centre, that is the only small country with a world currency. Financial instability made this situation very difficult in the early 1970s.

But Switzerland’s problems in the mid-1970s must also be related to structural aspects of the earlier growth phase. Through the postwar period, the employment rate had increased strongly, reaching 78 percent in 1973, the highest in the OECD area. Furthermore, while our historical statistics (Table 6.1) showed the persistently high share of industry in Swiss employment, it has been claimed that Switzerland was “over-industrialised”. Despite the much celebrated flexibility, there were structural problems. Often, the introduction of foreign labour served to postpone labour-saving technological change, and only in the 1970s there was a rush into such change under the pressure of increased competition. Third, the Swiss worked long hours, and there were no efforts to change this as the number of jobs started to decline.

Furthermore, the Swiss model was marked by a lack of state interventionism. Switzerland lacked the Keynesian-type “embedded liberalism” which prevailed in most other Western European countries. Its model of political economy, as well as its quite decentralised political system, involved few compensatory mechanisms against the impact of a generally liberal foreign economic policy. There was no tradition of demand management. There was no labour market policy, except for the restrictive policies which implied that foreign workers served as a safety valve. Although Switzerland could solve the unemployment problem by means of such restrictive strategies, the exit of foreign workers also caused overall demand to decrease. These features made the Swiss slump particularly grave.

Not only was the “objective pressure” stronger in Switzerland than in many other countries. The pressure was also more immediately transferred to the labour market than in most other countries, due to openness and the absence of interventionist routines. The norms of the market are more persistent in Switzerland than elsewhere in Western Europe. Employers have more latitude in their decisions about employment. Switzerland had at that time fewer legal defences against layoffs than most other Western European countries. Schmidt holds that the Swiss social partners had become so used to postwar prosperity that such arrangements seemed unnecessary. A restrictive labour market policy has procyclical effects, since the costs are easily shifted on to other groups, like foreigners, women, older and younger wage earners. Swiss policies against various categories of immigrant workers serve to ‘divide and rule’ these groups. As for women, their employment pattern is unfavourable. The public sector, which in other countries employs many women, is relatively small, and furthermore, most women are employed in low-skilled and/or part-time jobs. A return to female tasks in the household is very legitimate in the Swiss social structure (as in Ireland). Most women will not register as unemployed at all, and therefore, much of the Swiss unemployment is invisible. A final specificity is that once an upturn is again on the way, many of the “problem groups” are reabsorbed into the labour market.

In this respect, it is clear that many of the features which work in a procyclical way also spur the upturn: a weak system of warning signals in the case of unemployment, low social costs (other employment-related costs are also low), and the low skills and low wages of these groups.
Employment (Table 14.1) declined more strongly than in any other OECD country in the mid-1970s. Before 1977, Switzerland had no compulsory unemployment insurance. As the crisis hit in 1974, only 20 percent of the employed were insured against unemployment. Thus, numbers for the registered unemployed are very distorted. Most of those hit by unemployment either left the labour market (joining the “quiet reserve army”), or left the country. As noted in Chapter 4.2, in the absence of restrictive labour market policies, unemployment would have been 15 percent in 1983, that is, if the number of foreign workers and the participation rate had remained constant. The number of jobs declined by 10 percent in the 1970s. The very strong openness of the Swiss economy in itself contributed to the problems. The decline in employment particularly hit the watch industry and textiles/clothing, the two dominant domestic export sectors, and also affected construction trades, wood/furniture and the graphical industries (probably more oriented towards the domestic market).

The total reduction in employment in the mid-1970s amounted to 330,000. The number of foreign workers declined from 897,000 in 1974, to 650,000 in 1977, a reduction of 27.5 percent. Thus, foreigners carried about 1/3 of the burden. But 115,000 Swiss (among these 50,000 women) also lost their jobs. These numbers may be compared to the movement of registered unemployment, which was only 1975: 10,000; 1976: 21,000; 1977: 12,000.

From 1977 onwards, monetary policies turned more restrictive again. Further revaluation of the SFr implied a continuing squeeze on Swiss exports and on the tourist business. At that time a major change took place, from a stability-oriented management of the money supply to a deliberate exchange rate policy. In October 1978, the SFr was pegged to the DM, but in a more flexible way than in the case of e.g. Austria. This was due to the status of the SFr as a key currency. From 1980, a more moderate money supply goal was implemented. There was a convergence — despite the absence of explicit co-ordination — of the economic policies of Switzerland and West Germany. Since then, the Central Bank has insisted on applying a money supply target, rather than a goal of exchange rate stability.

Adjustments During the 1980s

In the second period of economic downturn (1980-2, cf. Fig. 13.1), Switzerland again experienced low growth rates. At this time, among our cases, only Ireland did worse according to this most aggregate growth indicator (of course disregarding the level, cf. Table 4.2). Once again, export sectors like watches, textiles/clothing, together with machinery, suffered most.

In the 1982/3 crisis, employment declined by only 65,000, which was much less than in the former crisis, which was described above. Now, more unemployed were covered by compulsory unemployment insurance. Furthermore, by that time, there was a permanent increase in the number of foreign workers, so only Swiss workers had to carry the later crisis.

Switzerland experienced an upswing from 1983 through to 1989. The general world economic upturn (Figure 13.1) implied flourishing demand for Swiss exports of capital goods (machinery and chemicals are the two largest items in the Swiss export basket, watches are third). There was growth of employment and soon there were bottlenecks in the labour market. The labour force increase was mainly due to immigrant workers. In the late 1980s, foreigners comprised 32 percent of the labour force and 17 percent of the population. The economy was simply overheated, with a shortage of manpower and there was even a lack of space for new industrial sites.

In 1987-8, there was an over-relaxation of monetary policies. The Central Bank tightened monetary policies after 1988, and this, together with higher oil prices, higher interest rates and a 10-15 percent over-valuation of the SFr, once again produced a squeeze on industry, especially machinery and chemicals, and on construction activity. Switzerland traditionally had some of the highest labour costs in the world. Previously, this had been compensated by a low interest rate, but the globalisation of financial markets put an end to this also.

Industrial Restructuring

Among our case countries, as mentioned in Part III and in Ch. 12, only Switzerland and Sweden have very strong homegrown multinationals. Such multinationals are even more important in Switzerland than in Sweden. In a ranking of countries most dependent on outward investments in 1982 (indicated by foreign direct capital stock as a proportion of GNP), Switzerland was first with 41 percent, Sweden only came seventh with 7.5 percent. Employment in foreign affiliates as a percentage of domestic manufacturing employment was 26 percent in Sweden (1978), and 70 percent in Switzerland (1980). The output of foreign manufacturing affiliates as a percentage of manufacturing exports from the home country was 44 in Sweden (1975) and 149 in Switzerland (1980; 87 largest multinationals). Finally, the output of foreign manufacturing affiliates as a percentage of manufacturing exports from the home country was 44 in Sweden (1975) and 149 in Switzerland (1980).

It was emphasised in Chapter 6 that Switzerland not only has such strong multinationals, but also a strong group of domestic producers. Table 17.1 traces the most competitive export sectors of the Swiss economy, without distinguishing domestic producers and multinationals. It is interesting to note that not all from multinationals are in complexes which Porter defines as the most competitive. Nestlé, for instance, is in food production, which does not feature among the most competitive export complexes. It is, however, closely related to the health complex (pharmaceuticals — conservation techniques). And of the five largest Swiss multinationals in the 1980s, the other four are all related to the most competitive export activities: in metalworking, there is Alusuisse, in chemicals/health, there are Ciba-Geigy (pharmaceuticals and chemicals) and Hoffman-La-Roche (pharmaceuticals), in precision machinery, there is Brown-Boverie & Cie (machine tools, recently merged with Sweden’s ASEA).
TABLE 17.1
Main Swiss Complexes in the 1980s

<table>
<thead>
<tr>
<th>Upstream Industrial and supporting functions</th>
<th>Chemicals</th>
<th>Organic chemicals, rubber, polymers. *Various machine tools (metal-working); electrical/mechanical hand tools; optical instruments, counters, surveying instruments; precious jewellery, diamonds, coins, artworks; jet reaction engines, fans, blowers; trading, commercial banking, money management, reinsurance, tourism.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business</td>
<td>28.1</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Final consumption goods and services</th>
<th>Textiles</th>
<th>Various sophisticated textile fabrics, sewing, knitting, weaving machines and parts; fibres, yarns, synthetic organic dyestuffs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apparel</td>
<td>11.0</td>
<td></td>
</tr>
<tr>
<td>Health care</td>
<td>7.0</td>
<td>Provitamins, vitamins, vegetable alkaloids, hormones; hearing and orthopedic aids.</td>
</tr>
<tr>
<td>Personal</td>
<td>8.0</td>
<td>Perfume substances, watches, clocks.</td>
</tr>
<tr>
<td>Total</td>
<td>62.1</td>
<td></td>
</tr>
</tbody>
</table>


Porter concludes that Swiss industry has an astonishing breadth of advantage compared to his other cases. This is so certainly also in comparison with our cases. We have seen, however, that there has been considerable pressure on Swiss industry since the early 1970s and that the economic crisis — despite full employment — of the early 1970s and 1980s was quite grave. Still, concerning the present industrial restructuring race, Switzerland’s position is in many — but not all — respects, quite good. The country seems to have a strong manufacturing base, capable of restructuring flexibly. But Switzerland is weak in telecommunications and in computers. Whether the Swiss will be able to maintain their solid tradition of industrial centres cannot be discussed further here. A more worrying scenario for the Swiss might consist of increasing problems of economic policy management, trends towards deindustrialisation, and increasing social conflicts (for instance between domestic manufacturing interests and internationally oriented banks).

Recent Developments

The long upturn came to a halt in 1990. At that time, there was a slowdown of GDP growth, and very high interest rates. Real growth of GDP was 0.7 percent in 1991, despite booming German demand for Swiss merchandise exports, and inflation peaked at 6 percent, the highest rate since 1981. Unemployment doubled to 1.3 percent in 1991. By March 1992, 76,000 people (2.5 percent of the workforce) were unemployed. Unemployment benefits are now more generous, and more people disregard the social stigma traditionally connected to unemployment benefits in Switzerland. Women and foreign workers now do not retreat from the labour market as much as they did before.

Even the Swiss had to feel the effects of deregulation and loosening up of the financial system. Until the late 1980s, mortgage interest rates had been determined according to a carefully balanced compromise. Deregulation, however, introduced the principles of the market even in this area, and the Summer of 1990 saw the climax of a conflict between banks and tenants. This aspect of the present crisis in Switzerland could be compared to the similar problems in Sweden and Finland, but such a comparison cannot be pursued further here.

Present economic policy problems will surely interact with debates on Switzerland’s role in the new Europe emerging in the 1990s. As we have seen in Ch. 2, the Swiss approach through all of the 20th century has been to “stand alone” (Alleingang — literally going alone). In 1986, Swiss voters rejected membership of the U.N. by a ratio of more than three to one. The question of reform of Switzerland’s political system of federalism and direct democracy (26 nominally independent cantons in a federal structure based on direct democracy and a doctrine of neutrality) will probably grow more urgent if further internationalisation emerges as the general answer to the present economic problems. The many referenda are examples of popular restraints that may well hamper the government’s ability to manage the economy. For instance, Swiss farmers enjoy some of the world’s highest subsidies and also exert great political influence. Any attempt to tamper with their interests is bound to lead to a referendum, and the way these are organised, farming regions are favoured. Parliament sits for only four three-week sessions a year. The cabinet size is only seven ministers, distributed according to the ‘magic formula’ with concern also for regions and language groups (cf. Ch. 9 above).

As for economic collaboration, Switzerland has taken part in EFTA’s modest integration. But trade is increasingly concentrated on the EC. In 1988, 56.8 percent of Swiss trade was to the EC, and only 7.2 percent to EFTA. Since 1987 — as it became clear to politicians and corporate decision makers that the programme of the single market was about to be a success — the EFTA countries have been eager to redefine their relationship to the EC. This has been a very important factor in their economic policy strategies ever since. The question of whether Switzerland will allow EFTA to establish closer ties with the EC (via the EEA agreement, signed in early May 1992), or whether this will be blocked by a referendum, is one of the interesting questions today. There are also other external challenges, such as the competition from newly liberalised financial centres, and the U.S.-led initiative for international cooperation in the war against drug trafficking, which challenges Swiss bank secrecy acts. Problems also relate to transit transport through the Alps: mountain cantons refuse to concede the 28 tonnes limit, while the EC requires access for lorries up to 40 tonnes.

For Swiss multinational firms and banks, there is no great problem: they are already strongly integrated into the EC, more so than the firms and banks of certain EC member countries. Swiss banks have subsidiaries in the EC, central bankers meet in Basle, and most European banks have subsidiaries in Switzerland.

The challenge of internationalisation has shown that, despite the celebrated liberal orientation of Swiss politics, a number of protective regulations have been
Continued Routines

Just as in the case of Sweden's response, the Austrian model implied an attempt to bridge the gap when economic problems accumulated in the early 1970s. As noted in Part II, there was an SPÖ (Labour) government between 1970 and 1983. The "Austro-Keynesian" approach of this Kreisky period attempted to compensate for sluggish external demand by supporting domestic demand. It thus involved, first, an expansive monetary policy, maintaining low interest rates, in order to stimulate private investment and employment. It also, second, implied conventional Keynesian deficit spending to stimulate output and employment. Job promotion in nationalised industries was important as employment policy.

As a third component, reflecting the close integration between the Austrian and the German economies, Austrian policy makers maintained the pegging of the currency to the DM, thereby aiming to import the always very low German inflation rate. This meant that the Austrian Schilling appreciated in train with the DM. It has been argued that a hard currency approach does not really allow a counter-cyclical policy. However, in the 1973/4 downturn, the expansive fiscal and monetary policy was consistent with a similarly expansive stance in the German Bundesbank after the end of 1974.

Finally, as the fourth component, the social partnership complex secured wage moderation in incomes policies. As we have seen in Part III, not only wages, but also a large part of consumer and industrial prices are regulated by the Joint Commission.

The hard currency approach is the main difference from Sweden. While there are institutional similarities between Austria and Sweden (interventionist traditions in monetary policies and strong influence by government on the central bank), exchange rate policies played different roles in their policy mixes in the late 1970s and the early 1980s. The Nordic countries used devaluations, aiming at constant nominal-effective exchange rates. Austria has since 1976 only linked to the DM, causing the nominal effective exchange rate to appreciate. In Austria, the direct effect of the hard currency line is to reduce imported inflation, while the indirect effect is that it defines the latitude for the social partners in incomes policies. In Sweden, the soft currency approach aims to maintain price competitiveness. It is an instrument related to the external balance and to employment. Also long term assignments differ: In Sweden, "internal terms of trade" are altered, devaluation leads to an increase in exposed sector profits, investments increase, and resources are moved from the sheltered to the exposed sector, increasing the profit of the exposed sector. A main argument supporting Austria's hard currency approach, on the other hand, is that itputs the exposed sector in a profitability squeeze, thus provoking structural adjustments, forcing firms to improve their competitive potential by innovation which boosts long term productivity.
In the 1970s, the Austro-Keynesian strategy was a success. There was interaction between several of the four elements. For instance, the hard currency policy would also restrain domestic inflation by creating predictability with respect to the outcome of wage settlements. Full employment was secured and inflation was comparatively low, but both the current account (Fig. 13.2) and the budget deficit increased (Fig. 13.3). Average growth of GNP 1973-9 was (like Ireland’s) above the average of OECD’s European members, while all the other contrast cases were below (Table 13.1). The success was probably due both to an accumulated demand for labour following the boom between 1969 and 1974, and the deliberate use of nationalised industries and the public sector to solve the employment problem.

It was pointed out in Ch. 9 that the Austrian state as such is weak. For a brief period in the early 1970s, it seems that the state was somewhat strengthened. It is also said that Kreisky tried to move towards a more Scandinavian model, constructing an alliance between farmers and workers, squeezing the business side of Austria’s social partnership. This highlights the difference between the Scandinavian and Austrian models, as the former models do not have pillars. Kreisky’s approach would effectively have implied a “depillarisation” of the Austrian model. In particular, it would imply the break-up of the close relationship between the farmers and the ÖVP (Conservatives). This policy, however, soon failed, and Kreisky returned to reliance on the traditional partnership structures.

Austria’s adjustment in the 1970s has been compared with adjustments in Britain, Sweden and West Germany. Scharpf finds that only Austria fully succeeded in coordinating its economic policies. Wage moderation occurred immediately, and both monetary and fiscal policies worked counter-cyclically to defend full employment (in 1975-80, unemployment was below 2 percent, quite similar to Sweden’s experience, cf. Figure 13.5). All three crucial policy fields were perfectly “tuned”. Sweden was not as successful: a boom in wages together with expansive fiscal and monetary policies pushed the inflation rate up (cf. Figure 13.4). The difference between Sweden’s and Austria’s inflation rates developed from very little in 1973/4 to more than 5 percent in 1978. Austria’s average rate of economic growth of 3.2 percent compares favourably with Sweden’s 2 percent in 1973-79 (Table 13.1). A further difference is that Austria’s full employment included rapid expansion of employment and a rising labour force participation rate, while Austrian employment increased only moderately (foreign workers were no longer hired) and the participation rate stagnated. In that respect, Sweden’s performance at full employment was more impressive, since the country expanded employment in a situation of modest growth, while Austria avoided open unemployment in a situation of high growth. In tandem with these different employment experiences, labour productivity dropped in Sweden while staying high in Austria.

Scharpf explains these different national strategies by reference to the postwar history of these two countries. They both differ from Britain by way of their centralised union movements, but their corporatist systems are different. As we know from Ch. 9, the Austrian variety of corporatism included cooperation between capital and labour via a large state sector, consisting of both firms and banks. Within this “Proporz” system there was an “unbreakable identity" of interests and perspectives between unions and the state. The Swedish model involved less formalised balances, to the extent that some scholars deny that it can be described as corporatist.

It seems that incomes policies in Scandinavia depend solely on systematisation of collective bargaining between the two voluntary peak organisations. There is no compulsory system of institutions involved. To the extent that constitutionally-backed intervention is involved, it is in the form of a weaker “national arbiter” function. If negotiations fail and a conflict develops, then the state may establish a committee to enforce a solution (Norway). There are few possibilities for the state to exert influence in advance. In Sweden, even such a national arbiter institution is absent. More dramatic moves, such as state-imposed solutions in Denmark, do not point towards the Austrian type, since the Nordic countries have to apply state compulsion ex-post, while Austria has a system in which consensus is achieved in advance. The Austrian system may be better when it comes to containing tendencies towards fragmentation, but it is more vulnerable to problems of legitimation, at least if its pillars erode.

While both Sweden and Austria defended full employment, Scharpf ranks Austria as his ideal case, since Austria had “optimal institutional conditions” for concertation. In other words, fewer changes were made in the Austrian model than in any other West European model of economic policy. However, it should be noted that the Austrian policy of wage restraint was devoid of any redistributive ambitions. Swedish type solidarity wage policy has never been a part of the Austrian tradition. Neither should the structural conditions of Austria’s success be forgotten. Austria’s success must be explained as a consequence of lagged development, with very low wages, increasing foreign investment, and the fortunate timing of the repeal of tariffs towards EC products.

**Modifications of the Model**

Elements of fumbling may be traced since 1977. In 1975-6, there was a marked deterioration in the current account (Figure 13.2). This led to severe capital outflows, threatening the external equilibrium. As a response, the Austrian government set out to curb demand: increasing taxes (e.g. introducing VAT on luxury items, mainly passenger cars), social security payments and reducing depreciation allowances. The budget deficit was reduced to 2.5 percent of GDP in 1977. Furthermore, the Central Bank reduced the money supply. This produced a domestic recession 1977/78, but a world economic upturn was expected.

In 1978, there was a new turn towards expansion, especially in monetary policies, but unlike 1974/5, the German Bundesbank was restrictive. The German interest rate was higher than the Austrian one. The immediate result was much stronger capital movements than earlier. In 1979, Austria lost about one third of official foreign reserves, and demand had to be curbed once again. By the early 1980s, interest rates had to be increased to match the German ones. In 1980, the international business cycle (Figure 13.4) slumped, and unemployment (Figure 13.5) began to rise, hitting specific regions, and also younger age groups. The slower growth had
to be accepted as permanent: the average 1980-89 rate was slightly below the OECD/Europe average (Table 13.1), about the same as the other case countries, except Finland. Although there was still a Socialist Chancellor, the goal of full employment could no longer be maintained, and it was in practice changed to “as little unemployment as possible”. Policy goals were expressed as medium term rather than short term.

As a consequence of tighter fiscal and monetary policies, the current account deficit was eliminated by 1982 (Fig. 13.2), and by then, more expansive measures were tried. The budget deficit (Figure 13.3) however, became worse, and taxes had to be increased again. There were further restrictive measures to restrain demand in 1984-5. The priority was now to ensure external equilibrium. The federal budget was to be balanced. Since the public debt and social policies accounted for increasing shares of expenditure, there would be austerity in all fields relating to public investment. There was also tax reform, reducing marginal taxation of incomes by doing away with numerous tax exemptions; and third, a “restructuring of the nationalised enterprises partly by dividing them into more flexible units and partly by privatisation.” The latter measure, implying that nationalised industries could no longer be used as effectively as before to support full employment, will be further discussed below.

During this period, the Austrian financial system also changed. This system, as shown in Part III, was traditionally a credit based state-interventionist one, with rationing and non-market mechanisms. It had only a weak stock market, with many state-owned and foreign firms. This was similar to Sweden and Finland, but it seems that adjustments in Austria started earlier. Due to earlier “under-valuation” of shares, there was a boom in shares in the early 1980s. For the first time, international actors became interested in the Austrian stock market. There was a lack of venture capital, and a number of measures making investment in stock more attractive were implemented.

In the 1970s, the Austrian money market consisted mainly of an inter-bank market. In the first half of the 1980s, there was considerable differentiation. Besides deregulation, there were institutional changes influenced by the government and the Central Bank, such as the introduction of short term state paper. The revival of the market for “interest-bearing papers” was mainly due to deficit-financing. The large public sector deficits have been reduced in recent years, but in 1991 the target was not met. The external part of national government borrowing has been decreasing (from 31 percent in 1981 to 15 percent in 1990). An auction system for domestic issue of government securities will allow the Austrian government to raise most of the debt in the internal market.

The Austrian banking sector was quite sheltered, with sharp divisions between the savings, cooperative and commercial sectors. Since the late 1970s, these divisions have been dissolved. Austria is still considered over-banked and over-branched. As interest rates were regulated and competition increased in the late 1970s, banks competed by setting up branches. By the early 1990s, Austria still has less than 1,000 inhabitants per branch (including post offices), the lowest figure in Europe. Privatisation and concentration will proceed, but still have far to go. As for foreign exchange controls, the final vestige, which limited individuals' rights to open bank accounts abroad, was lifted in November 1991. In sum, the two expansive components of the Austro-Keynesian approach had disappeared: fiscal and monetary policies. Monetary autonomy — the ability to control interest rates and monetary aggregates independently of external influences — has been shrinking. Such external pressure weakened the position of the social partners. The interest rate could no longer be controlled, and internationalisation restricted the ability of the Joint Commission to influence price formation. Some commentators ironically remarked that Austro-Keynesianism had become Austro-monetarism, as only two of the four elements were left: one is the hard currency policy, and the other is social partnership, implying that the Joint Commission can still organise wage moderation.

Since the mid-1970s, there have also been a number of internal pressures on the Austrian model, in particular important new social movements, addressing issues not covered in the postwar compromise: women’s rights (feminism), peace and ecology. In 1978, the social partners could not agree on the question of nuclear power. For the first time in the postwar era, there was a referendum, deciding by a small margin that the already completed Zwentendorf nuclear plant should not be opened. By the mid-1980s, this plant cost about $75 million a year in repayments and maintenance charges. A similar event was the blocking of the plans for a dam on the river Danube in 1984/5. In 1984, a Green Party won seats at the regional level, and in 1986, they won 8 (out of 183) seats in the parliament (Nationalrat).

In the political system, there has also been a challenge from the right. When the Social Democrats lost their absolute majority in 1983, the small FPÖ (Austrian Freedom Party) had been included in the “small coalition” government as a junior partner to the SPÖ. In 1986, the party elected a new leader and changed its policies significantly. While earlier a centre liberal party, it now became a right-wing populist party influenced by the ideas of German-oriented nationalism. In the 1986 election, the party increased from 12 to 18 seats.

Following that election, the Social Democrats chose to return to the grand coalition with the ÖVP (Conservatives). With crucial questions like Austrian membership of the EC coming up, both large parties obviously considered a new grand coalition useful. Trade with the EC is crucial to the Austrian economy: 66 percent of Austria’s exports went to the EC in the late 1980s, against 55 percent for Switzerland and 45 percent for Sweden. Unlike Swiss and Swedish multinationals, Austrian enterprises have not established plants inside the EC. Membership of the EC was considered so important for Austrian industry that concerns for independence and neutrality were disregarded: an application for membership was presented to the EC in 1989, even before the events in Eastern Europe signalled the end of the Cold War, and independent of problems related to economic policy management.
Industrial Restructuring

In Chapter 9, we mentioned the origins of the nationalised industries in the postwar period. In the late 1980s, 25 percent of Austrian employment was in state-owned firms (including assets of state-owned banks), while foreign-owned firms and private domestic firms accounted for about 37.5 percent each. About 20 percent of the manufacturing sector was owned by the state. More than 95 percent of the iron ore, iron, steel, natural gas, lignite, and more than 85 percent of the bituminous coal, and about 70 percent of the aluminium output was produced by nationalised industries. The textiles sector is also mainly owned by the state. Nationalised industries account for around 25 percent of Austrian exports. The electricity supply sector was largely in state hands, as well as two nationalised banks, which again controlled another 15 percent of the enterprises. The state-owned Danube Shipping Co. was the largest firm, involved in both passenger and freight services, with Linz, Vienna and Krems as major ports. Linz and Vienna, along with Solbad Hall and Graz also have free trade zones, for display, storing or repair of foreign goods, zones which have become permanent display areas for foreign products.

Lumber and paper are among Austria's most important exports. There is a paper/pulp complex, but firms in this sector are mainly owned by foreigners. As for services, the Winter sports industry is of course quite important. The large tourist industry, twice the size of Switzerland's, relieved Austria of serious current account problems in the 1970s. But saturation appeared in that sector in the late 1970s. Austria thus decided to tax transit trade as a compensation. This is still not done by Switzerland. 180

Nationalised industries were concentrated in the raw materials and semi-finished goods sectors. The ÖVP (Conservatives) during the 1960s opposed an upgrading of these firms towards production with a higher value added content. In the 1970s, it seems that these obstacles were overcome, but the restructuring of Austrian state industry was perhaps hampered by a late start. Voest, the nationalised steel corporation tried to move into production of turn-key plants and into electronics, but was hampered by a weak technological base. In the late 1970s and 1980s, capacity in the steel sector was cut all over Europe, only "Austria continued to adhere to the philosophy of adjusting its steel industry by means of internal diversification to new products."

Katzenstein found serious structural problems in Austrian industry, with "persistent and probably growing technological dependence". Austria was, in his view, trapped in electrical-mechanical engineering products, importing most of the electronic steering components. While Austria has a number of state institutions supporting foreign trade, Katzenstein, referring to the early 1980s, notes that there is a growing consensus that a more liberal "Swiss model" of export promotion is the right strategy for the next decades. A similarity to Sweden is that Austria, arising from its neutrality, has a large defence industry (e.g. Steyr-Daimler-Puch), one which has faced severe legitimation problems in connection with its eager promotion of weapons sales in the third world. The same has occurred in Sweden. 182

Reform of the nationalised industries started in the mid-1980s, following a scandal connected to state patronage of one such firm. Numerous workers were laid off, restrictions on competition removed and a programme of privatisation started. The state also makes it clear to banks that there are no guarantees for loans to state companies. But as we have seen, the nationalised industries were still important in the late 1980s. "Austrian industries", a state holding company, accounted for 14.2 percent of industrial sales and 24.8 percent of investment in 1990. As part of a privatisation programme, this firm will issue its first shares in 1992, or 1993, depending on the strength of the stock market, but it will take five years at least before less than 50 percent of the firm is state-owned. Privatisation has thus started, but it is far from completion. 183 Schemes for investment and interest rates subsidies have so far been maintained.

Four elements of the Austro-Keynesian model were discussed above. There was also a fifth feature, namely structural policies for import substitution to reduce the balance of payments deficit. In some sectors this took place, but generally, the Austrian governments seemed content with the effects of the hard currency stance on industrial restructuring. The limited efforts at structural policies were stepped up from 1975 onwards. In contrast to Scandinavia, but like Ireland, Austria tried to attract foreign multinationals. 184 Austrian authorities engaged in a "courtship of foreign multinationals" in order to promote modernisation: large financial incentives, often in direct competition with Switzerland (and Ireland for that matter): high depreciation allowances, low corporate tax rates, credit at subsidised rates. These firms' share of industrial employees went up from 18 percent in 1977 to 28 percent in 1987. The most famous example is probably General Motors, which established a gear-box plant outside Vienna, subsidised at about 1 million Schilling per job created. Many of these firms only do assembly work in Austria.

While this is similar to Ireland, the share of foreign firms is much larger in Ireland. Furthermore, in Austria, foreign investments interact with an environment which is formed by a long tradition of domestic manufacturing production.

Recent Developments

We have seen that the Austrian model has not really changed. It has, however, been reduced, and now consists above all of the hard currency exchange rate policy and corporatist incomes policies. Certain elements of employment policies also remain. 185 As Table 13.1 shows, Austria has recorded high growth rates since 1988. Both foreign and domestic demand have increased. This has happened, as Figure 13.4 shows, at very low levels of inflation. At the time of writing (Spring 1992), optimism reigns in Austria. A recent survey described its economy as "one of the most robust in Europe."

This prosperity stands in stark contrast to the Finnish crisis (Chapter 19). No comprehensive analysis of this striking contrast can be given here, save for a couple of suggestions. First, we have seen in Chapter 19 that Finland's trade was mainly with the USSR, and that the crisis exploded as the semi-barter oil/industrial goods exchange was abruptly terminated. 186 One only needs to look at a map of Europe to understand that Austria's trade is mainly with the smaller Eastern European states. Despite their problems, these are better off than the USSR. 188 Some of the present optimism in Austria is based on the conviction that there is an "Austrian edge" in
dealing with Eastern Europe. Vienna is very close to the central areas of Poland, Czechoslovakia, Hungary, and is expected to regain its pre-1914 position as a major regional centre. These areas share a common inheritance from the Hapsburg bureaucracy, and German is the second language in the neighbouring Eastern countries.

Furthermore, it has been claimed that Austrian manufacturing exports are gaining market share in the West. In particular, the fact that German reconstruction (following the reunification of Germany) sustains a high level of activity regardless of costs and interest rates, strengthens the Austrian economy. Finland, on the other hand, has not been able to compensate for its crisis by increasing sufficiently deliveries to fast-growing markets. The growth of domestic demand is too sluggish. This is mainly due to the financial crisis. Austria’s financial sector seems to have managed the transition out of a credit-based, government-dominated financial system better than both the Swedish and Finnish ones. We have seen that deregulation of the housing market and tax reforms are important elements in the escalation of the Nordic financial crises. Even in Switzerland, whose financial system is much more internationalised, the housing sector has created problems recently. It is not possible to investigate this topic further here, but future research might study the fact that Austria’s housing market still has not been fully deregulated, while tax reforms have already taken place. In the Nordic cases, the timing of such reforms was more unfortunate, with housing deregulation coming earlier, before the incentives to credit-financed housing speculation had been removed from the tax system.

Eastern events have also influenced Austrian labour market developments. The strong inflow of workers from the East, willing to work at low wage levels, legally or illegally, adds an element of market pressure to the already moderating social partnership system. The influx of foreign workers is the main reason for the 6 percent unemployment rate. This means that there is a downward pressure on wages, even if there is a very high rate of job-creation. The main labour market problems are long term unemployment and illegal work. In the case of Finland, there is no such inflow of immigrants.

The Nordic experience, however, may also be turned into a warning for Austria. We have shown that fewer policy instruments are now at the disposal of the government. A constellation involving a solid recession encompassing Germany and the Eastern areas, financial instabilities interacting with a deregulated housing market, large lay-offs in the remaining nationalised industries, increasing unemployment, and continuing large inflows of cheap labour from the east, could create severe destabilisation of Austria’s political economy. Such factors would most likely undermine support for the social democratic pillar. Adjustments in connection with EC-membership might alienate farmers and many liberal professions, thus weakening the conservative pillar. Both the Green and the Freedom parties might gain even more support. While so far Austria’s solid social partnership system has succeeded in keeping these challengers out of the corporatist networks, it remains to be seen whether dislocations like those sketched above would be great enough to bring down the whole solid social partnership system.

CHAPTER 20
IRELAND

1973-79 — Continued Routines

Irish policy makers applied a massive fiscal stimulus during the 1970s. Only in the early 1980s was there a "small and delayed" shift in a restrictive direction.

In the 1973-79 period, GNP growth seemed impressive. Ireland had the highest average among the countries we compare. GNP growth was below 2 percent only in 1976. But there were signs of instability. The current account deficit was much greater than in any of the other case countries over the period 1973-84 (with the exception of Finland in 1975, Figure 13.2). Government financial balances (Figure 13.3) show far larger deficits than in any of the case countries, with the deficit increasing 1973-5, 1977-82 and 1984-5. This had to be financed: the debt burden increased by 3.1 percent of GDP every year between 1975 and 1980 (Table 13.2). Inflation was the highest among our countries in 1975-77 and 1979-82, and as we shall see later, an abrupt change to a much lower level followed after 1982 (Figure 13.4). Unemployment increased from 5.3 to 9 percent 1974-6, went down to about 7 percent 1977-79, but then skyrocketed in the next period (Figure 13.5).

<table>
<thead>
<tr>
<th>YEAR</th>
<th>LABOUR</th>
<th>FINE GAEL</th>
<th>FIANNA FAIL</th>
<th>OTHERS</th>
<th>PRIME MINISTER</th>
</tr>
</thead>
<tbody>
<tr>
<td>45-51</td>
<td>X</td>
<td>Y</td>
<td></td>
<td></td>
<td>Costello</td>
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<tr>
<td>51-54</td>
<td></td>
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<td>De Valera</td>
</tr>
<tr>
<td>54-57</td>
<td>X</td>
<td></td>
<td></td>
<td>Y</td>
<td>Costello</td>
</tr>
<tr>
<td>57-59</td>
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<td></td>
<td>Y</td>
<td>De Valera</td>
</tr>
<tr>
<td>59-61</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Lemass</td>
</tr>
<tr>
<td>61-65</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Lemass</td>
</tr>
<tr>
<td>65-66</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Lemass</td>
</tr>
<tr>
<td>66-69</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Lynch</td>
</tr>
<tr>
<td>69-73</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Lynch</td>
</tr>
<tr>
<td>73-77</td>
<td>X</td>
<td>Y</td>
<td></td>
<td></td>
<td>Cosgrave</td>
</tr>
<tr>
<td>77-79</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Lynch</td>
</tr>
<tr>
<td>79-81</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Haughey</td>
</tr>
<tr>
<td>81-82</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Fitzgerald</td>
</tr>
<tr>
<td>82-87</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Fitzgerald</td>
</tr>
<tr>
<td>87-89</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Haughey</td>
</tr>
<tr>
<td>89-92</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Haughey</td>
</tr>
<tr>
<td>92-</td>
<td></td>
<td></td>
<td></td>
<td>Y</td>
<td>Reynolds</td>
</tr>
</tbody>
</table>

1 — Progressive Democrats Y — Party with the prime minister.

Source: NESC Secretariat.
In Chapter 12, we showed that Ireland, unlike all the contrast countries, has a party system marked by two catch-all parties. Studying the postwar period until the late 1960s, however, it is hard to support the view that more class-based or more polarised party systems are more suited to promote economic growth and industrial transformation than a system of two catch-all parties. In the more troubled period of the 1970s and 1980s, however, a connection can be hypothesised: in a situation with pressure on state finances, the energetic competition for votes in a system of two catch-all parties may spur a spiral of overbidding by each of the parties in terms of welfare benefits and reforms, thus increasing the national debt burden.\textsuperscript{195} Table 20.1 shows that from 1973 onwards, the long spell of Fianna Fáil rule was broken and governments shifted between Fianna Fáil and the Fine Gael/Labour coalition. Ireland’s particular variety of clientelist connections, discussed in Part IV, may also have contributed to such a vicious circle.

There were some fatal delays in the Irish economic policy adjustments in the late 1970s and early 1980s, compared to the contrast countries. A comparison with Austria, for instance, concluded: “Austria responded more promptly and more effectively to the external shocks than Ireland. It had a programme of adjustment in hand even prior to 1979 and it acted quickly when deficits began to rise in the early 1980s. Its institutional system provided flexibility in wages, taxation and government expenditure at a critical time. For various reasons — bad luck, availability of apparently unlimited sources of foreign finance, weak government and under-estimation of the magnitude of the adjustment required of it by external events — Ireland postponed adjustment. It paid a heavy price for procrastination. We are now talking of national recovery, not macroeconomic stabilisation.”\textsuperscript{196}

As for the 1970s, we have seen that wage moderation within a corporatist setting was one of the factors which facilitated adjustment in Austria, and also — although to a lesser degree — in Sweden and Denmark. Ireland is an interesting case when it comes to corporatism. On many of the aggregate variables (like union density, the concentration of labour market partners, etc.), Ireland seems to score high enough to count as a potential neo-corporatist success. And in fact, from 1970, there were attempts to build a social partnership. In the 1960s, with emphasis on technocratic economic planning, there had been corporatist connections between the state apparatus, state-sponsored bodies and private business interests, mainly in connection with the outward-oriented industrialisation strategy. In the late 1960s, a number of conflicts related to incomes issues emerged. Thus, attempts were made to include labour in a more extensive tripartite state/business/labour relationship, focusing more closely on incomes policies.\textsuperscript{197} The first “National Wage Agreement” in 1970 covered only state employees. The “13th round” from January 1971 was successful, even promoting socially sensitive goals.\textsuperscript{198}

In this first phase of the National Wage Agreements, the government was only involved as an employer. General economic policies in that period were moderate. There was no current account deficit. The first deficit was permitted in 1972, reflecting optimism concerning the further expansion of export-oriented industrialisation. Between 1972 and January 1975, a counter-cyclical approach was followed. State revenues were mainly based on taxation of wage earners. The largest trade union federation, ICTU, tried to link acceptance of NWAs to state guarantees that the tax code would be reformed.\textsuperscript{199}

At that time, both the FUE (Federated Union of Employers) and the Central Bank favoured ideas of a “social contract”, partly inspired by similar attempts in Britain at that time. Thus, in 1975, a second period of NWAs can be specified, marked by indirect government intervention. In that year, when inflation peaked at around 23 percent (Figure 13.4), the government intervened to offset the rising costs of living. NWAs had become tripartite, not just bipartite deals. This implied an increased public sector borrowing requirement. Government grants were conditioned on a renegotiation of the NWA which satisfied certain conditions. The 1975 NWA did not imply that a direct trade-off between pay and public policy commitments had become a principle, but it created expectations of close links between NWAs and the budget in future situations as well.

New negotiations in 1977 turned out to be the first round of negotiations explicitly referring to budget provisions. This came after a crisis. Employers wanted a pay pause or decentralisation of negotiations. The state had to intervene in this deadlock. The FUE offered an interim pay settlement if a later social contract was negotiated, one with direct government intervention. Employers were in fact the most enthusiastic promoters of tripartism. Pay would be coordinated by government policy on taxation and inflation. Economic planning would be an extension of collective bargaining.\textsuperscript{200} Just days before the January 1977 budget, the terms were ready, implying tax reductions, a promise to reconstitute the profit share, a reduction of negotiated income increases, compensated by government intervention.

In November 1978, the unions withdrew from further NWAs, due to strong grassroots pressure against the highly centralised negotiations. In 1979, NWAs were to be replaced by an even broader National Understanding. Employers remained a main force behind the push for even closer tripartism. Furthermore, control of inflation became increasingly important for the government. This was seen as a key to promote the government’s ambition of restoring full employment in five years. Furthermore, Ireland’s membership of the EMS from March 1979 would leave the government with more responsibility for the control of inflation. Ireland had chosen to participate in this system, abandoning the century-old pegging of the Irish pound to sterling. As England stayed outside the EMS, this above all implied that exchange rate fluctuations between sterling and the Irish pound would now influence the Irish economy, which still of course had numerous trade connections with England.

Tax reforms turned out to be a main problem, and the ICTU hesitated, rejecting a proposal for a package in March 1979. A new initiative from the employers was accepted in July 1979. The First National Understanding focused strongly on the employment problem, implying direct government measures to increase employment. It also included commitments to changes in social welfare and income taxation. The latter was a response to a very strong controversy on the distribution of the tax burden during those years. As for the pay element, it was higher than expected, with much local wage-drift (reflecting many strikes), and scepticism concerning the Government’s non-pay commitments. The budget deficit continued
to increase (Figure 13.3), but policies were still expansive into 1981. The government established a commission on Tax Reform, which in 1980 started to work on a documentation of the situation. Thus, in the short term, very little was done on the non-pay issues.

In January 1980, the depth of the economic crisis was admitted by the Taoiseach. Continuing the First National Understanding proved very difficult because of the second oil crisis. The employment objectives would obviously not be met, and employers felt that the understanding did not prevent the spread of industrial conflict. However, by personal intervention the Taoiseach convinced the employers to take part, thereby securing a Second National Understanding in October 1980. The restrictive 15 month pay agreement involved a pay-pause and increased well below the rate of inflation. Like the former settlement, this agreement included a number of social guarantees (reform of industrial relations, tax reforms, improvements in health care, housing, education and training). When this settlement expired in 1981, it was not possible to reach agreement on a new one. The situation in mid-1981 was very turbulent and in this context, there was a return to decentralised negotiations.

Judging from Hardiman’s analysis, the pressure on the government was too great. This pressure was related to three major features of the Irish model. First, the outward-oriented industrial policy made it impossible to tax foreign firms to any substantial degree. Since farmers had so far also been quite successful in resisting an increased tax burden, most of the burden was on the shoulders of wage-earners.

Second, the problems were related to Ireland’s peculiar demographic pattern. Due to the partial success of the export-oriented industrialisation strategy in the late 1960s, Ireland in the 1970s experienced net immigration for the first time in its modern history. The outward looking strategy and the more expansive fiscal policies attracted a return flow of earlier emigrants. The total labour force was 1.1 million in 1960, increasing to 1.2 million in 1979. The fact that the Irish population actually grew (Table 11.6), created a large unemployment problem once the pace of the world economic growth levelled out. In the 1975-80 period, unemployment hovered between 7 and 9 percent.

**The Phase of Fumbling 1981-87**

The revision of economic policies started only with the second oil-shock. Economic growth was negative in 1982 and 1983 (Table 13.1). Unemployment doubled between 1980 and 1983 (Figure 13.5). Inflation was halved in the same period. Debt servicing and heavy increases in taxation implied strong deflation.

As we have seen, the move towards broader tripartism implied by the National Understandings could not be sustained, and there was a return to decentralised bargaining. Commitments to tax reform and employment creation were not met. On the other hand, the government did not succeed in reducing public spending either (cf. Figure 13.3). As for tax reform, the reports by the Commission on Taxation were awaited, but when these were published in 1982-5, Fianna Fáil was no longer in office. Meanwhile, the tax burden on average and low paid employees probably increased.

The first general election under the new Fianna Fáil leadership was June 1981, and the result was a hung Dail.204 Fianna Fáil lost its majority (being left with 78 seats) and a government was formed by the coalition between Fine Gael (65 seats) and Labour (15 seats). This FitzGerald government lasted only for half a year. In late January, its budget collapsed, and in a new March 1982 election, the result was again a hung Dail. This time, Fianna Fáil gained 81 seats (2 short of a majority), and formed the government. Haughey established a working majority for this government by means of an agreement with independent socialist TDs. Even this government, however, lasted only half a year, which was a very turbulent one politically. In November, the Irish went to vote in their third general election in 18 months. There was a setback for Fianna Fáil (75 seats), and FitzGerald’s Fine Gael/Labour coalition (70 and 16 seats) returned.

**TABLE 20.2**

<table>
<thead>
<tr>
<th>EMS Realignments</th>
<th>IRISH POUND</th>
<th>DM</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.10-81</td>
<td>Unchanged</td>
<td>5.5 % appreciation</td>
</tr>
<tr>
<td>2.2-82</td>
<td>Unchanged</td>
<td></td>
</tr>
<tr>
<td>12.6-82</td>
<td>Unchanged</td>
<td>appreciation</td>
</tr>
<tr>
<td>21.3-83</td>
<td>3.5 % devaluation</td>
<td></td>
</tr>
<tr>
<td>6.3-86</td>
<td>3 % appreciation</td>
<td></td>
</tr>
<tr>
<td>2.8-86</td>
<td>8 % devaluation</td>
<td></td>
</tr>
<tr>
<td>12.1-87</td>
<td>Unchanged</td>
<td>3 % appreciation</td>
</tr>
</tbody>
</table>


Not only politically, but also economically, instability peaked in 1982. As can be seen from Table 20.1 there were frequent changes of government. The interest differential with Germany peaked at about 9 percent towards the end of 1981. It declined again as a political consensus emerged in early 1982, accepting the positive and high real interest rates. Following the brief Fianna Fáil interlude in mid-1982, this new orientation prevailed in economic policies throughout the 1982-7 period. There was a hard currency approach within the EMS. Even in the mid-1982 EMS realignment, the Irish pound was kept unchanged (Table 20.2), but there was a small devaluation in early 1983. Fiscal policy was bent on reducing the budget deficit. As regards incomes policies, decentralised agreements continued. There were government/public sector agreements with modest pay increases. In the private sector, real pay probably stagnated in this period.

With Ireland in and Britain outside the EMS, sterling depreciated strongly against the EMS in 1986-7. Since Britain was still Ireland’s main trading partner, the Irish economy was squeezed. Thus expectations of devaluation gathered, and Ireland had to cede by the second 1986 realignment (8 percent devaluation against the EMS currencies; see Table 20.2). The GNP growth rate again turned negative in 1986. Among the case countries, only Denmark had a somewhat similar downturn in the
mid-1980s. In Ireland, there were new problems with the budget deficit, resulting in capital outflows. Monetary conditions were strongly tightened, with the interest rate rising strongly, increasing the interest rate differential to the DM. Pressure on the Irish pound disappeared only when sterling stopped declining.

Some economists would argue that EMS gave Ireland a “firm domestic anchor” which enabled her to disinflate. Dornbusch, however, argues that stabilisation was a failure. Unemployment stabilised at a very high level, far above any of the contrast cases from 1980 onwards (Figure 13.5). The peak was just below 15 percent 1985-7. The full extent of the problem is illustrated if the new surge of emigrants is added: the net immigration of the 1970s was soon replaced in the 1980s by renewed net emigration. And now the brain drain element was also stronger; more skilled, middle class young people tended to emigrate. As Table 11.7 shows, emigration was now more to Britain than to the U.S. Furthermore, the debt/GDP ratio grew to world record levels. Table 13.2 indicates that Irish debt increased by about 7 percent (of GNP) every year in the period 1980-7.

According to Dornbusch, several factors explain the poor performance 1982-87. First, fiscal contraction reduced real aggregate demand, as there were no expenditure switching policies (real exchange rate appreciation and rising real interest rate). Second, relative labour costs were rising. Budget cuts did not generate crowding in, and the over-valued currency made fiscal adjustments very expensive. Third, Ireland could finance its debt and maintain low inflation thanks to unlimited access to capital. Political stability and the many return payments from immigrants had made Ireland a very attractive borrower for the over-liquid Eurobanks of the 1970s, and even in the 1980s Ireland commanded more credibility than third world borrowers.

Fourth, monetary policy also worked to avoid crowding in. Higher real interest rates are a worldwide phenomenon, but the Irish level also reflected the hard currency policy in a situation where the country did not command full credibility: “Irish interest rates, even with a fixed exchange-rate policy and near-German levels of inflation continue to exceed those in Germany.”

As the mid-1980s recession evolved, difficulties gathered for the Fine Gael/Labour coalition. Economic policies also created tensions. As we shall see in the final subsection below, there was no employment creation in old foreign and domestically owned firms. In January 1987, it was clear that the four Labour ministers could not accept Fine Gael’s tight budget proposal. While Fine Gael had blamed the tight policies on earlier governments’ mismanagement, this argument had no longer much weight. Fianna Fáil mobilised support by their criticism of the government’s “monetarist” austerity policies. There were many conflicts related to decentralised bargaining. In many firms and in the public sector, industrial relations deteriorated to the point where some trade unionists feared fully-fledged Thatcherism.

Attempts at Adjustment 1987 and Onwards

The breakdown of the coalition government led to a new election in January 1987. Again there was a hung Dail, with Fianna Fáil at 81 seats, Fine Gael down to 51 seats, Labour at 12 seats and the new Progressive Democrats (led by two former Fianna Fáil deputies, but taking votes mainly from Fine Gael) were in with 14 seats.

Fianna Fáil was back in office, but the party was in a difficult position: the crisis made control of public spending absolutely necessary, but throughout its opposition period, the party had criticised such tight fiscal policies. Also the unions at that time recognised their weak bargaining position. They sought shelter from the trends towards Thatcherism in Irish working life, trends which had become marked in the 1982-87 period.

The launching of the Programme for National Recovery in early 1987 was a response to this grave crisis. The Taoiseach invited the unions along with the other major social partners to take part in an effort to spur recovery by means of consensus. The programme was concluded in October 1987, despite considerable differences in the preferences of the various collaborators. The settlement was a concordative agreement in a much more explicit sense than the earlier National Understandings, with a clear linking of the pay agreement and government inputs. For the trade unions, the point of departure was not pay increases, but the wish to regain influence over issues like jobs and social inequalities. They wanted measures against unemployment, improvement for workers on low pay, and some concessions on taxation.

The PNR included tax reform, i.e. a reduction in income tax and an extension of the population paying tax. Also the farmers were now included in the tax base. Other fields affected by the PNR were social security and education. Very importantly, a Central Review Committee was established, i.e. a formal institutional arrangement to monitor the agreement.

But there were strict limits to the reforms that could be afforded. Huge deficits and debt forced the government to conduct very austere policies. The main objective was to achieve income restraint and expenditure cuts back, which allowed for very little compromise with the unions. This fits the description — in Chapter 14 above — of the 1980s as a phase in which attempts at corporatist concertation gave few benefits to unions.

Employers were sceptical towards the PNR at the outset, but soon experienced the advantages. In contrast to earlier periods, the profit share in national income increased, and cost pressure was relieved. This was more satisfactory than the outcomes of decentralised collective bargaining.

In the period 1987-1990 incomes policy settlements were much more restrictive than during the 1970s, with pay increases below the expected level of inflation. Labour costs compared to main trading partners improved. Strike activity declined strongly 1987-1990. Growth of GNP (Table 13.1) was above the GDP growth of all the contrast cases except Finland. Inflation was down below the average of OECD/Europe (Table 13.4). The current balance of payments was in surplus throughout the period (Figure 13.3). The debt/GDP ratio declined from 130 to 123. Real disposable incomes increased somewhat between 1987 and 1990. Hardiman judges the strategy as “consistent and effective”, claiming that in contrast to e.g. Denmark, which “had addressed their problems of fiscal deficit through a strategy which minimised reliance on union cooperation, Ireland's approach had been quite different, and depended centrally on the bargained agreements reached between
government and the major economic interests. But unemployment persisted. In 1990, the unemployment rate was down to 14 percent from about 18 percent in 1987, but the differential over the OECD/Europe average had only been reduced from 8 percent in 1987 to 6 percent in 1990. The government’s employment creating incentives had little effect on employers.

In sum, except for unemployment, Ireland’s development was favourable during the PNR period. But as the NESC emphasised, this was not just due to the consistency, continuity and credibility of the PNR, but also due to external factors, such as the general upturn in the world economy (cf. the business cycle movement in Figure 13.1). Based on the positive experience, major collective actors in Ireland began to discuss a long term strategy in which macroeconomic policies aiming at low inflation, low interest rates and control of the national debt would hopefully be combined with fundamental structural reforms, radical tax-reform, and a major offensive to fight long-term unemployment and improve social services. The “social market economy” of Germany was mentioned as one model. While the PNR mainly implied short term coordination, a longer term strategy would need to address the problems of unemployment, emigration, and lack of indigenous industrial development. In the following section, we discuss some aspects of Ireland’s industrial restructuring in the 1970s and 1980s.

**Industrial Restructuring**

According to the analysis in Part IV, a main contrast between Ireland and the other cases considered here, is the weakness of Ireland’s national system of innovation. Earlier, the emergence of the export-oriented strategy was analysed, and in Chapter 12, the fact that the new group of foreign-owned firms had relatively few linkages with the rest of Ireland’s manufacturing sector was emphasised.

Since the 1970s, competition for foreign direct investments from third world countries became fiercer. But in comparison with Ireland, Less Developed Countries lacked conditions such as infrastructure, political stability, proximity to markets, efficient host organisations (IDA, SFADCO), membership of the EC, and cultural ties and a language community with the U.S. and Britain. However, even more developed countries emerged as competitors in this game, including other EC countries. By the 1970s, as we mentioned in Part IV, the wage gap between England and Ireland was about to disappear. Still, recent studies show that many small and internationally inexperienced TNCs continue to choose Ireland as their first country.

The 1970s and 1980s have seen a new layer of foreign firms locating in Ireland. Earlier, mobile capital sought cheap, unskilled labour in rural areas. Since the early 1970s, the sectoral composition of foreign investment has changed: chemicals are now more important, as well as pharmaceuticals, instrument and electrical engineering, office/data and electronics. Although these firms do not relocate their key technological and business functions, they still require a more skilled and professional workforce than one finds in the third world. In aggregate trade statistics showing the high tech content of exports, Ireland looks like a really advanced high tech exporter in the 1970s and 1980s. These firms tend to locate in central regions, where people with professional and technical skills live. This also brings the firms closer to universities and colleges. Due to this development, demand for skilled personnel is increasing by Irish standards, despite the fact that the skilled staff in the Irish divisions of such internationalised firms are fewer than in the divisions located in more advanced economies. After all, the Irish divisions are mainly doing assembly work. But due to the somewhat higher skill content, O’Malley indicates that external economies may develop in such sectors. On the other hand, he also notes that the skill-level of the Irish labour force has not been raised significantly. There may have been some improvement regarding managerial skills.

The situation regarding linkages, surveyed in Part IV, has not improved significantly. Purchase (backwards) linkages have increased somewhat. In 1974, foreign industrial firms (outside the food sector) purchased about 11 percent of their materials in Ireland. In 1983, this share was up to 25 percent. O’Malley estimates that the 25 percent amounted to 6 percent of the sales of indigenous industry, so in that sense, foreign firms made no “major contribution” to the development of indigenous firms. This means that linkages between indigenous and foreign firms are still weak, and such a connection would be crucial for the emergence of a stronger national system of innovation. Indigenous firms spend a larger share of their incomes in the Irish economy than foreign firms. The fastest-growing foreign firms are those with the least spending in Ireland.

Agriculture is still a very important sector in the Irish economy. But even here, linkage effects have largely been barred. Following entry into the EC in 1973, there was a “productivist attempt” to increase agricultural output. Since the mid-1980s, EC policy has tried to change towards production containment, decoupling income support from measures to increase productivity. Given these rural development programmes, the pressure for land consolidation is certainly not so strong. Today, diversification into forestry, agri-tourism, etc. is proposed. Thus, EC policy-making echoes the concerns of national policies of 25 years ago. It is a context in which the persistence of small unproductive farms is inevitable — even desirable. The expansionary productionist model of agricultural development has been replaced by an agri-social orientation in agricultural policy.

Industrial development in the 1980s created a paradox for the development of the total economy. In 1980-85 Ireland had a record growth of industrial output. Above all, output in the new high productivity sectors (pharmaceuticals, office/data processing machinery, electrical engineering, instrument engineering, “other food”) increased. There were also large export increases. But none of these increases was reflected in the development of domestic incomes and employment. Manufacturing employment had peaked in 1979, but as a consequence of the deteriorating conditions and the policy changes since the second oil shock, it again started to decline. Between 1982 and 1987, manufacturing employment declined by 20 percent, the largest reduction since 1922. Although employment grew in new foreign firms, this was more than outweighed by the decline of employment in the rest of
CHAPTER 21

SUMMARY

In Part V we have surveyed economic policy adjustments in all our case countries since the early 1970s. Our periodisation indicates that there has been a sequence starting from continued economic policy routines in the early 1970s, via a phase of fumbling to a situation in which austerity policies prevail in the late 1980s. In this new situation, policy makers have fewer economic policy instruments at their disposal than before. This development must be explained by the interaction of external and internal dynamics. There are interesting similarities and differences between the various contrast countries, some of which have been commented upon above. For a conclusion, however, it suffices to sum up the comparison between Ireland and the contrast countries.

Considering total growth (Table 13.1), we can conclude that the gap in economic development between Ireland and the contrast cases had opened up before the 1970s. We tried to account for this lagging behind in Part IV above. Ireland’s total growth in the 1973–89 period was above the OECD/Europe average. Studying other macroeconomic indicators, however, it is striking that fluctuations are larger in Ireland than in the contrast cases: the current balance of payments deteriorated dramatically 1978–74 (Figure 13.2), the budget deficit and unemployment were far larger (Figures 13.3 and 13.5), inflation was higher before 1982 and then deflation was dramatically quicker than in the other cases (Figure 13.4). Finally, an enormous debt burden has accumulated (Table 13.2).

As for the factors contributing to delayed adjustment and the ensuing vicious circle, most of them are familiar to us from Part IV: the competition between two quite similar catch-all parties, the emphasis on export-oriented production with few linkages to national industries, the fluctuations of population movements, and Ireland’s integration with Anglo-American finance.

As for the period of adjustment after 1987, starting with the PNR, no full analysis can be provided here. But while it has been indicated that the corporatist settlements of the late 1980s entailed few direct benefits for the labour movement, Ireland’s experience with the PNR is better than the experiences in most of the other countries. This may be due simply to the depth of Ireland’s crisis in the 1980s, but also to the fact that certain reforms (e.g. of the tax system), had been delayed for such a long time that they were bound to produce a more favourable situation when they were at last implemented.

It has been argued that Ireland’s loss of indigenous manufacturing employment during the 1970s and 1980s is much more grave than similar processes in more advanced industrial countries such as the contrast cases: “there is an important difference in so far as these other countries were starting (in the early 1960s) from a much more advanced position in industrial development, such as Ireland had never reached, and were shifting resources increasingly into services in line with a changing pattern of demand as high income levels are attained. Ireland, on the other
hand, was simply failing to attain anything like a comparable level of indigenous industrial development (which would have entailed continuing growth of indigenous manufacturing employment long after it had slowed down in more advanced countries). The persistence of unemployment and/or emigration in Ireland indicates that there was a persistent failure to mobilise productive resources, not simply a proportionate shift of resources from employment in Industry to employment in Services as happened in more advanced economies.231

The challenge for Ireland is now to mobilise productive resources in a much less favourable world economic environment than that of the 1950s and 1960s West European Golden Age.

Further conclusions based on the survey of economic policies in Chapters 12 to 20 are included in the first part ("Overview and Conclusions") of this report.

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2. Denis O'Hearn, "The Irish Case of Dependency: An Exception to the Exceptions?", American Sociological Review, 54, August, 1989, p. 387 judges Irish economic growth in the export-led period (1955-1965) to be the "lowest in Europe". But our periodisation shows that the 1973-79 period was an exception.
4. CEPIL, Économie mondiale: La montée des tensions, Paris 1983, Table 1, 12, 2, p. 64.
5. This is the judgement of Rudiger Dornbusch, "Credibility, debt and unemployment: Ireland's failed stabilisation", Economic Policy, 8, 1989, p. 194. Similarly, Crotty emphasises that Ireland could "borrow more money relative to GNP than any other state in the world, and three times as much as Peru, the Latin American country with the relatively largest public debt." Crotty, A Radical's Response, Dublin 1988, p. 58.
10. Rowthorn & Glyn, "The Diversity of Unemployment Experience", op. cit., part IV.
11. ibid, p. 253.
14. Therborn, Why some People are More Unemployed than Others, op. cit., pp. 41, 48, 43.
15. ibid, p. 23. This is close to Schmidt's conclusion, referred to above.
17. See Figure 1.6 above for a stylised version of such corporatist exchange mechanisms.
18. Britain is famous for its fragmented pattern of unionisation, with the TUC being very weak as a peak organisation. After years of very strained solutions, conciliation broke down in the Winter of Discontent 1978/79. The Labour government was unable to secure a full employment solution in its game with the unions, and had to implement restrictive monetary and fiscal policies. This was one major condition of Mrs. Thatcher's victory in May 1979.
20. ibid, p. 141-4, p. 139.
24. ibid, p. 307.
25. ibid. p. 310.
26. ibid. p. 311.
27. Schärf rejects the idea that such cooperation has anything to do with an "exchange" between full employment and moderate wage growth: Fritz W. Schärf, "Inflation und Arbeitslosigkeit in Westeuropa. Eine spieltheoretische Interpretation," Politische Vierteljahresschrift, 1989, p. 31. The state and unions are forced to agree on redistribution, without any guarantee that capital’s gains will be used for productive investments.
28. Comparing small, open economies it seems that the only difference between corporatist and non-corporatist cases is that the corporatist ones are able to achieve voluntarily what others must do by direct state dictate.
32. Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 349.
34. Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 348, p. 326.
35. ibid. p. 145, p. 157, p. 347 calls this the idea of a "demand twist". They refer to the "philosophy" of the late 1970s, "increased supply of public services could be used to combine the wish for increased employment and improvements in the current account."
37. Rosted, op. cit., p. 172 f., with reference to effective exchange rates. But note that in 1976-77, there had been devaluations within the ERM. The effective exchange rate, however, remained unchanged, due to a continued fall of the dollar and sterling exchange rates.
38. ibid. p. 168.
42. Damsgård Hansen, Kjærsgaard & Rosted, op. cit., pp. 354, argue that the Danish current account deficit cannot be explained as a consequence of investment. Denmark borrowed money to finance welfare and housing. The reasons for the deficit lie in the domestic political decision-making process. A political struggle takes place. (i) the ratio of real wages, (ii) wage structure (solidaristic wage policy), (iii) size of social transfers. Together these factors strongly influence the current account problems.
43. Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 264.
44. The minister of finance, Knud Heinesen, resigned in 1979, and before he left, stated that the Danish economy was on the brink of the precipice — "plåafgrundets rand!
45. There was a change in indexation, to halt wage compensation claims, see Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 146. At the same time, Parliament passed a law which froze indexation and introduced an index which did not include energy prices.
46. Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 146.
47. For an account, see Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 252 f.
48. On the "package" proposed, the one which failed & led to the governments resignation: see Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 224.
50. Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 348 f.
51. The "fiscal effect" was neutral, according to Damsgård Hansen, Kjærsgaard & Rosted, op. cit.
52. ibid. p. 147.
53. For a list of measures, see Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 225. Transfer payments were changed, wages would not grow by more than 4 percent, or more specifically, public wages were limited and there was a "suggestion" to the private sector to stay within this limit. Indexation was suspended from 1983.
55. Brink regards this as "politics". Brink, "Den ny økonomiske politik", op. cit., p. 167 f.
57. ibid. p. 49.
58. In 1985 the fiscal effect was zero, in the other years it restrained economic activity by about 1 percent of GDP, Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 147 f.
59. The interest rate differential came down 1982-6. But the main reason was the growth of M2 relative to GDP, which the National Bank allowed after 1982. Brink wonders why they did not go for this even earlier, during the social democratic government, Brink, "Den ny økonomiske politik", op. cit., p. 169. The post-tax real interest rate was 1 percent in 1983-6, against -1 percent 1978-82. In this sense the government did not achieve its aim of bringing the interest rate down.
60. This still involved a kind of demand management, cf. Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 348.
61. ibid. p. 167.
62. ibid. p. 77.
63. This is all the more paradoxical, as the government started out with some good conditions in 1982: an international upswing, falling energy prices, appreciation of the dollar and yen. Furthermore, Denmark benefited from more domestic supplies of oil and gas. Brink claims that the Schröder government "was too interested in the wrong deficit", Brink, "Den ny økonomiske politik", op. cit., p. 177.
64. Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 348.
66. ibid. Chs. 5, 4, 8, and 14.3.
67. ibid. p. 131. Their more general perspective is that the dismal development of productivity 1984-87 must be explained by the interplay between international challenges (a shift of the technological paradigm, cf. Chapter 4.1, 4.5 and 4.6 above), specific structural problems and the specific business cycle at that time.
68. Damsgård Hansen, Kjærsgaard & Rosted, op. cit.,
69. ibid. p. 231.
70. It is unclear, according to Damsgård Hansen, Kjærsgaard & Rosted, op. cit., p. 87, whether incomes policies since 1983 have created new (that is lower) inflationary expectations.
72. Edquist & Lundvall, "Comparing Small Nordic Systems of Innovation", op. cit., p. 45. As our report shows, however, differences between Denmark and Ireland are still substantial.
73. We shall here provide some comparative numbers concerning r/d spending. For the 1970s and 1980s, there are OECD measures of high-tech products available. High-tech products are defined by high levels of r/d spending, and OECD uses a typology of nine product areas with such high levels. (Aeroplane & space technology; office machinery and computers; electronic devices and building elements; telecommunication; pharmaceutical high-tech products; scientific instruments (measuring, control, etc.); electric machinery (generators, transport supervision); non-electric machines; chemical high-tech products. Cf. OECD, Science and Technology Indicators.) An Austrian investigation compared the export specialisation of some of our case countries in these product areas (which are specifically only the r/d intensive parts of the sectors) in 1984/85. It was found that Sweden was above the average in telecommunications and machinery, while it was weak in computers, office machinery and building elements. Finland (and Norway) was not above the average in any of these product groups, but Finland was close in telecommunications (here its specialisation was increasing) and electrical machinery (Norway was close in chemicals). Switzerland displayed a strong above average specialisation in pharmaceutical products, chemical products, scientific instruments and electrical machines. Austria was high in four groups: pharmaceuticals, electrical products, machinery and electronics. Austria was not above the average in any of the electronics product groups. Pichl & Szopo, Industriewachstum und Wirtschaftspolitik in Skandinavien und in Österreich, op. cit., p. 35 ff and Table 3.4. (Denmark is not included in this study.) OECD also calculates r/d quotas in manufacturing industry (r/d spending as a percentage of the output of domestic manufacturing industry). These were 2.4 percent for Sweden, Finland: 0.9, Austria 0.8. (OECD, Determinants of the Impact of Technology on Employment and Investment, DSTI/IND/86/14, Paris 1986, quoted from Pichl & Szopo, Industriewachstum und Wirtschaftspolitik in Skandinavien und in Österreich, p. 37, who claims that the Austrian rate — if properly calculated — would be somewhat higher.) For both Austria and Sweden, they are neutral countries with a significant armaments industry, which pulls them high up on this indicator. Finland lacks an arms sector.

74. Edquist & Lundvall, op. cit., p. 46 f.

75. Ibid., p. 19.

76. Ibid., p. 20.


79. Edquist & Lundvall, op. cit., refer to strong banks and internationalised business as such promoters in Sweden and Germany in the postwar period.

80. As mentioned in Chapter 9 some commentators regarded this as a cancelling of the postwar class compromise, with labour challenging capital’s control over the organisation of production. Walter Korpi proposes such an interpretation, but it can also be found among the employers.


83. For an overview, see Bo Carlson, "Industrial Subsidies in Sweden: Macroeconomic Effects and an International Comparison". Journal of Industrial Economics, XXXII, 1, September 1985.

84. Schafner, Sozialdemokratische Krisenpolitik in Europa, op. cit., p. 246.


86. For an overview of the labour market policies, see Gösta Rehn, "Swedish Active Labour Market Policy: Retrospect and Prospect", Industrial Relations, 24, 1, 1985. A law on increased Employment Security was passed in the early 1970s.


89. Cf. Chapter 4.1.

90. These were first applied for housing credits, then to involve banks in financing the central government deficit. It seems (Thunholm, "Sverige", p. 93) that the maximum level was increased from 32 percent (1975) to 50 percent (1983) — presumably of the large bank’s reserves.


97. See Stenius, ed., op. cit., summary p. 14: Denmark had effective second hand markets for bonds for a long time, since its system had been a capital market based one (cf. the typology in Chapter 4). Denmark had no greenhouse problems. In Sweden, we see now that its credit based system is being weakened. Effective second hand markets came first in the 1980s as the central government deficit was financed by short term treasury bonds.


100. I am indebted to Tor Noretmark for the following points.

101. Lennart Erixon, "Rehn-Meidner Systemen — en ny tredd väg?", LO-Tidskriften, No. 4, January 26, 1990. Pointing to the similarity between the situation of the late 1950s and that of the late 1980s (labour scarcity and profit explosion), Erixon argues that the Rehn-Meidner model could be applied again today. He argues against the view that financial openness makes this impossible. Pontusson, "The Crisis of Swedish Social Democracy", op. cit., however, argues that the Rehn/Meidner model could possibly only work under the specific conditions of the Swedish Golden Age period, that is when the Fordist sectors were being diffused in Sweden. Given the increased internationalisation of Swedish firms, especially the engineering firms, Pontusson argues that they will no longer accept the profit squeeze implied by the Rehn/Meidner model.

102. Pontusson, "The Crisis of Swedish Social Democracy" op. cit., p. 7-8. The application to the EC was accepted by parliament in May 1991, and formally presented to the EC in July 1991. A general condition for Sweden’s application was the demise of the cold war in 1989/90. Before that, Sweden’s neutrality had barred any rapprochement with an EC dominated by NATO members.


104. Figure 7.1 notes a possible influence from the class compromise via the state to the production process.

105. Edquist & Lundvall, op. cit., p. 40 f., cf. p. 18. Denmark, in contrast, maintains craft-based, quite pre-industrial forms of organisation and training systems. The Danish innovation system turns out to be more focused on product innovations.


107. OECD’s studies are summarised in Pichl & Szopo, op. cit., p. 94 ff. OECD’s own summary emphasises five factors: strong firms in key fields, important large end users of advanced technology, workers and unions which are receptive to technical change and have negotiated agreements in such fields, high labour costs, low wage differentials (squashing weaker firms out of business).

108. Cf. our account in Ch. 9., Cf. also Pichl & Szopo, op. cit., p. 97.

109. Edquist & Lundvall, op. cit., p. 44. Exceptions are ASE/ABB’s robots, and Ericsson’s mobile telephone system. But Ericsson failed in computers.

111. Ponttusson, “The Crisis of Swedish Democracy”, op. cit., p. 33 argues that the decision to apply for EC membership was a direct response to the outflow of capital during the fall of 1960.


114. ibid., p. 59-63.


116. Since it is not possible to conduct income policies through broad compromises, economic policy elites turned to devaluation, which improve conditions for export sectors. The response of wage-earners is a struggle to regain the losses they face due to higher inflation generated by the devaluation. The state may ward this pressure off for some time, but such forces then spur procyclical policies in the next business cycle upturn.


119. This bias is connected to the Finnish Constitution, which, for reasons which go back to 1906, requires a 2/3 majority for a “law at the constitutional level”, and in practice any bill that introduces or raises a tax is such a law. This requirement was originally designed to prevent left-wing dominance of the parliament (the fear that the fifty percent majority — which in fact was a reality in the first election, cf. Ch. 8, above — would abolish private property). Qualified majority ensured broad government, and has worked well. At present, however, it is more controversial. It has been claimed that in the present situation, the 2/3 requirement ties the hands of the government, which in fact would press the support of the Social Democrats, now the largest opposition parties. Financial Times, October 4, 1991, p. 31.

120. With economic prosperity and at the same time a low level of welfare state expenditure (a ceiling on tax increases and a smaller public sector than in Sweden or Denmark), Finland did not experience a blue wave in politics. On the other hand, a green wave persists, which is stronger than in most other countries. This was partly an effect of the 1980s prosperity, partly a reaction against corruption in certain local governments, and also an effect of the fact that Finland went through very rapid structural changes in the 60s and 70s. In 1950 the share of population in agriculture was still at Sweden’s 1930 level — in 1980 this difference was evened out. Such a rapid depopulation and structural transformation of agriculture provoked defensive populist protests (Veninamo’s Rural Party in particular). Apart from Veninamo’s right-wing version, there is also a more left-oriented “urban” green movement.


123. In 1990, the Bank of Finland published for the first time estimates of Soviet debt to Finland, which at that time stood at FJM 7.2 bn (≈ 51.96 bn), and 4 bn of this debt was hard currency claims owed by Soviet firms, not by the central government. Financial Times, 12, 10. 1990.

124. OECD, Economic Outlook, July 1983.

125. Pichl & Szepo, op. cit., p. 100.

126. Financial Times, October 4, 1991, p. 31-32, emphasizing that if Finland wants to join the EEA (the agreement between EFTA and the EC), repeal of this act, as well as stricter anti-trust laws, is absolutely necessary.


134. Financial Times, 16 & 17. 11. 1991. The Head of the Central bank, Rolf Kulberg, who accused the government of making too large a devaluation, threatened to resign, but President Kolvist made him stay. Social Democrat Soria left the board of the Central Bank, thereby increasing his chances in the upcoming presidential election. In early 1992, Kulberg resigned and a new head of the Bank of Finland was appointed.

135. A comment in Financial Times, October 4, 1991, p. 30, points to the similarities with the turbulence in the banking sectors elsewhere in Scandinavia, arguing that this is the result of the “step-by-step deregulation that started in the early 1980s”. But this is correct only for Finland. Sweden and Norway, which had credit-based, government-directed financial systems. A later analysis in the same business newspaper puts things right: “Only Danish banks appear to have successfully weathered the storm, with prospects that profits will improve this year”; “Banking crisis echoes in the north”; Financial Times, October 15, 1991.


139. This was obviously linked to the high number of male foreign workers. In 1985, when the overall employment rate (according to OECD, Labour Force Statistics) was down to 70.7, the difference between the male and female employment rate was 86.8: 52.7 = 35.9 in Switzerland. This is a difference similar to the Irish one: 67.5: 31.7 = 35.8, but very different from the Nordic ones: Sweden 83.4: 75.9 = 7.5, Finland 75.1: 70.3 = 4.8, Denmark 79.9: 68.4 = 11.5, while Austria is towards the lower end: 77.7: 48.8 = 28.9.

140. Katzenstein, Corporatism and Change, Ithaca 1984, p. 96, mentions some activism to promote exports, thus avoiding import restrictions.

141. Schmidt, op. cit., p. 40. As already mentioned in Chapter 14 above, the Swiss case of full employment relies completely on restrictive labour market policies, that is policies which limit the supply of labour by different combinations of early retirement, reduction of the foreign labour supply, discouragement of female workers, and reduction of working hours. For Switzerland (and to a lesser degree also for Austria), the reduction of foreign labour supply has been of major importance. This is actually a parallel to Ireland as long as Ireland fails to stem the outflow of emigrants, Irish authorities conduct an at least implicitly restrictive labour market policy. But the industrial tradition is obviously entirely different. Switzerland’s labour market policy is based on exit of immigrants, with very good timing in the 1970s. Ireland’s is based on exit of emigrants, but fails with respect to timing in the 1970s.

142. ibid., p. 23.

143. As for the debate on neo-corporatism and unemployment, Switzerland emerges as an outlier. The corporatist exchange mechanism, mentioned in Chapter 14, requires well-organised collective actors. Switzerland, however, has a fragmented union structure (like cantons, each union is largely autonomous in legal terms). There is no centralised peak employers organisation. Wage settlements are made at the regional or even firm level. Despite this decentralisation, unions have turned out to be very moderate.

144. Katzenstein, Corporatism and Change, op. cit., p. 96. Export shares are 60 per cent for machinery, 85 percent in chemicals, and more than 95 percent in watches. For the watch industry, the Japanese challenge was particularly troublesome.
It should also be noted that the large reduction in foreign workers was (perhaps silently) welcomed by some politicians, since there had been political sentiments in Swiss society, worrying about a too large share of foreigners in the country.

Notermans, op. cit., part 3.2.2.

Schmidt, op. cit., p. 28-31.

OECD, Economic surveys: Switzerland. Paris 1989, p. 34 f., p. 17. Female labour force participation did not increase much (being constant at slightly more than 50 percent). Switzerland is in this respect equal to Japan (at about 56 percent), Austria (at about 50), and Ireland (at about 35). An historical overview (p. 6) shows that Switzerland had strong out-migration 1913-17, and also 1917-31, then migration inflow 1945-1970, with a peak in the early 1960s. Then there was a new outflow (as described above) 1974-9, and thereafter an inflow again.


Ibid., Table A.9, referring also to F. Wehrle, “Veränderungen der Weltwirtschaftlichen Rahmenbedingungen und die Internationalisierung der Schweizerische Industrie”, Discussion Paper, University of Basel, No. 2, 1983.

Porter notes that in all the sectors in which Swiss industry is competitive, there is more than one active firm. Only in some non-competitive sectors are monopolistic conditions found. Porter, The Competitive Advantage of Nations, op. cit., p. 325.

Ibid., p. 325.

Financial Times. 9.5.1992. p. IV.


Financial Times. April 4, 1990. Only 100,000 signatures are required to force a plebiscite, the requirement being unchanged throughout this century, except for a doubling when women got the vote in 1977.

The referendum will be arranged in the middle of 1993.

Financial Times. 9.5.1992. p. II.

Ibid. 9.5.1992, p. II.

At the time of writing, the most recent news is that the Swiss government (four against three votes) has decided to apply for membership of the EC. This decision followed the conclusion of a referendum in which the majority of Swiss people voted (May 17th, 1992) in favour of Swiss membership in the International Monetary Fund and the World Bank. This has been seen to prove that more Swiss citizens — after the end of the cold war — are becoming positive towards international collaboration. It is, on the other hand, clear that Brussels expects very difficult negotiations with the Swiss.

The Austrian interest rate was not always low in the postwar period. But there were arrangements which would relieve investors of the effects of higher interest rates, such as tax-based support for private investment, interventions in resource allocation, and support for state industry.


Brigitte Unger, “Possibilities and Constraints for National Economic Policies in Small Countries: The Case of Austria”, German Politics and Society, No. 21, Fall 1990, p. 68.

The following relies on Pichl & Szopko, Industrieeinsamkeit und Wirtschaftspolitik in Skandinavien und in Österreich, op. cit., p. 188, Ch. 9.4. Sweden is picked for comparison, but the difference is the same with the other Nordic countries.

Helmut Kramer, “The Present State of the Austrian Economy”, in Alan Matthews & Eda Sagarra, editors, Economic Performance in Two Small European Economies: Ireland and Austria Compared, op. cit. p. 14 does not only refer to social partnership to explain this success: “My explanation would be that in a period of very dynamic expansion of manufacturing production and investment between 1969 and 1974 there accumulated a backlog of demand for labour in the service industries and also for government officials of any type (police, teachers, military personnel and so on), which could only be satisfied after 1975”.

Katenzein, Corporation and Change, op. cit., p. 40 f, Austria’s labour market policy is not as far reaching as Sweden’s.

Ibid., p. 71.

Austria avoided both unemployment and high inflation; Sweden avoided unemployment, but not inflation, FRG avoided inflation, but not mass unemployment. Britain had both inflation and mass unemployment.

Scharpf, Sozialdemokratische Krisepolitik in Europa, op. cit., p. 231.

Ibid., p. 241.


Notermans, op. cit., Section 3.2.1.


Pichl & Szopko, op. cit., Ch. 8.


Katenzein, Corporation and Change, op. cit., p. 78.

Anton Pelinka, “Austrian Social Partnership”, in Matthews & Sagarra, editors, op. cit., p. 74. The FPO’s share of the vote went from 9.7 percent to 17.6 percent in the October 1990 election. In late 1991, the party was at 20 percent in the opinion polls. Financial Times, 9.10.1991.

Katenzein, op. cit., p. 58 f.

Kramer, op. cit., p. 16.

Katenzein, op. cit., p. 80-83. It is somewhat striking that Katenzein, who is focusing on flexible adjustment in connection with the industrial policies of small states, emphasizing the importance of corporatism in this respect, actually has to conclude that Austria’s industrial policies have not been very effective. It is plain, namely, that Austria’s social partnership model represents the perhaps most solid case of “democratic corporatism” among the cases he deals with.


Scandinavia, on the other hand, unlike Austria, has strong regional policies, due to the scattered nature of settlements. Such policies are e.g. compensation for transport costs, differentiated social security contributions and subvention of wages. Elements of such policies are found only since the late 1970s in Austria.

Unger, op. cit., p. 70.


Ibid. In 1990, there was a 70 percent increase in Austrian exports to Czechoslovakia, and a 22 percent increase to Hungary. On the other hand, Austria has imposed quotas on certain imports (e.g. concrete) from the East.

Katenzein, op. cit., p. 54, notes disappointment as to Austria’s development of this trade in the 1970s, and increasing trouble in the 1980s. Austrian financial institutions obviously granted much credit to Eastern Europe during the 1970s. Finland’s bilateral trade with oil was a huge success in the 1970s, whereas Austria seemingly did not rely on such barter-type arrangements, thus being more vulnerable to financial difficulties. In the early 1990s, the situation is obviously reversed, as Austrian exports increase.

Finland’s exports to Germany did increase strongly in 1990, but other export markets were not as vigorous.
be able to indulge a low inflation experience. But this has come at the cost of dramatic unemployment because of a lack of crowding in.” Dornbusch, op. cit., p. 195. The lack of crowding in must also be analysed in connection with Ireland’s weak national system of innovation. Cf. below.

208. ibid. p. 196. Dornbusch also mentions seigniorage: with strong growth and moderate inflation, the government can finance part of the budget deficit by money creation.


210. NESC, A Strategy for Recovery, Dublin, November 1986, involved all the social partners represented on NESC defining a common perspective on the problems. For the first time, there was no opposition.

211. Hardiman, “The State and Economic Interests: Ireland in Comparative Perspective”.

212. But underlying differences between foreign owners and Irish owners persisted. The former most often bargain at farm level and use their membership in the employers’ association for information only. They are, furthermore, less sensitive to wage costs, and more willing to pay higher rates. Their commitment to employer solidarity is thus probably less than in Irish owned companies, Hardiman, op. cit.

213. Summarised in NESC, A Strategy for the Nineties, Dublin 1991; Dermot McAleese, “Ireland’s Economic Recovery”, Irish Banking Review, Summer 1990. As one important condition, Hardiman, op. cit., notes the gradual reduction of the organisational fragmentation of the trade unions during the 1970s and 1980s. Especially, the merger between ITGWU and FWU early in 1980, creating SIPTU (Services, Industrial, Professional and Technical Union) was important, constituting more than 40 percent of the ICTU membership. The PNR confirmed that the unions’ decision to move away from the “British model” was a viable strategy.

214. Hardiman, op. cit.

215. This is a rough assessment based on Figure 13.5 which relies on national definitions of unemployment rates, which are not comparable in any exact sense.

216. NESC, A Strategy for the Nineties, op. cit.

217. This was the vision of ICTU. It was hoped that pay restraint and cooperation would facilitate more union influence at the workplace level. “Ireland 1990-2000: A Decade of Development, Reform and Growth”, ICTU, October 1990, quoted from Hardiman: “In devising the strategy we should also learn from the achievements of small open economies such as Austria, Denmark and Finland which have more developed economies, higher living standards and lower unemployment than Ireland. These they achieved through National Programmes of agreed participation and involvement at the level of the individual company.”

218. Considering the electronics industry (office/data equipment and electrical engineering) in detail, O’Malley notes that many EC-states now try to attract “mobile, European-oriented, foreign investment”, Ireland’s earlier colonisers. England, is itself very active, and also the new EC-countries: Greece, Spain and Portugal. There were in the late 1980s some indications of a weakening of FDI inflows. If this is right, Ireland needs more firms in a situation where the supply is in itself smaller and more countries are competing for these investment flows. The 1984 White Paper on Industrial Policy showed some awareness of these problems, and emphasised the need for more active industrial policies. O’Malley, Industry and Economic Development, op. cit., p. 188 ff.

219. ibid. p. 169. Other such countries are Puerto Rico and Mexico.

220. ibid. p. 171, p. 167, with reference to the Telesis report. Ronan O’Brien, “Technology and Industrial Development: The Irish Electronics Industry in an International Context”, in J. Fitzpatrick and J. Kelly, editors, Perspectives on Irish Industry, Dublin 1985, gives the following percentages of unskilled employees in the early 1980s: 60 in Ireland, 90 in Hong Kong, 14 in the U.S. and 39 in Denmark. R&D expenditure is a percentage of sales is below 1 in Ireland, while it ranges between 6.4 and 10.8 in Japan, Finland, Denmark and the U.S.

221. This, however, could not halt the new outflow of skilled emigrants.

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