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Nordic Journal of Political Economy

Volume 22 | 1995 | Pages 109-126

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Andrew Glyn*

Social Democracy and Full Employment

"The voters, now convinced that full employment, generous welfare services and social stability can quite well be preserved, will certainly not relinquish them. Any Government which tampered seriously with the basic structure of the full-employment Welfare State would meet with a sharp reverse at the polls" (Antony Crosland in The Future of Socialism [1956] p 28).

As Scharpf (1991 p 22) emphasises Keynesianism had rescued social democracy from the paralysis of the inter-war period and provided it with a viable economic programme.

"As long as capitalist crises could happen at any moment, whatever gains unions and social democratic parties might have achieved in the redistribution of incomes or the expansion of public services must have seemed extremely insecure. Indeed the unions had been helpless during the Great Depression of the early 1930s, as the welfare state collapsed under the burden of mass unemployment. Social democrats could thus make their reluctant peace with capitalism only if they could also hope to avoid its recurrent crises or at least dampen them sufficiently to assure the continuous economic growth that was necessary to maintain full employment and expand public services. The hope was provided by Keynesian economics. It was only in alliance with Keynesianism that social democratic concepts could achieve the intellectual hegemony that shaped the post-war era."

The fundamental claim of social democratic economics was that economic inequality and insecurity in capitalist economies could be radically reduced by government intervention without impairing economic performance. With unemployment a major source of economic inequality and insecurity, as well as representing a glaring example of economic inefficiency in terms of the potential output foregone, the guarantee of full employment represented "the first marriage of equity and efficiency" (Van Parys 1992). But as Schmitter and Streek noted

* Corpus Christi College, Oxford. Thanks to Per Gunnar Bergland, Erling Barth, Amit Bhadhuri, Wendy Carlin, Tom Cusack, Peter Hall, Bob Hanke, Makoto Itoh, Karl Ove Moene, Ronald Schettkat, David Soskice, Juhana Vartiainen and anonymous referees for comments and discussion.

"Governments in the early 1980s felt hard pressed or saw a golden opportunity, depending on their political complexion, to withdraw the political full employment promise of the post-war period and yield control over the restoration of prosperity and employment in the internationalised national economies to 'the market' including the deregulated labour market" (1992 p 212). Most damning of all, perhaps, "the major social democratic parties are rapidly abandoning social democracy and embracing market liberalism" (Moene and Wallerstein 1993 p 222).

This paper sets the disastrous collapse of social democratic aspirations in the context of the decline of the "golden age" of post-war rapid growth. The first section explores the two problems of achieving full employment, the 'Keynesian' issue of how to secure sufficient demand and the 'Kaleckian' problem of how to deal with the conflicts which arise at full employment. The following outlines the achievement of full employment and welfare state redistribution during the golden age and evaluates the problems of maintaining high employment in an era of weaker investment and more internationalised economies.

The Costs of Full Employment

Wages, Inflation and the Free Lunch

Przeworski argues that the decisive feature of Keynesian full employment policies from the social democratic point of view was that they "suddenly granted a universalistic status to the interests of workers"(1985 p 37). An increase in government expenditure financed by borrowing yielded benefits to all those using the expanded infrastructure or public services, as well as those finding work in or for the public sector and in industries on the receiving end of the multiplier effects on consumption. If all the spending could be covered by borrowing the generality of taxpayers could even gain from the fall in unemployment benefit and rising tax take. Additional employment yielded extra real resources which implied that at least some sections of society would be better off. Since there was no economic constraint dictating that any group must be worse off, nobody need pay for full employment with reduced living standards. It was a rare example of a true Pareto improvement.

Keynes himself foresaw a less favourable position in the General Theory since he believed that the real wages of those already in work would have to decline in order to make profitable extra employment at declining productivity. This cut in the real wage would simply be passively accepted by workers provided it was achieved by a one-off increase in the price level rather than being imposed by uncoordinated wage cuts. However he was soon persuaded that the evidence did not support such anti-cyclical behaviour of real wages, and subsequent empirical work found no consistent cyclical pattern (Michie 1987). Moreover with increased productivity in an upswing as labour is used more intensively, a constant (or even moderately rising) level of real wages would still allow profits to rise faster than output. As Kalecki noted (1990 [1943] p 349), there seemed to be a unity of economic interest, covering the unemployed, the employed and the employers in expansionary policies to create jobs[1].

But the fact that everybody can gain from expansion does not preclude heightened distributional struggle. By tilting bargaining power towards workers, and relaxing the pressure of product market competition on employers, the scene is set for a wage-price spiral. The crucial question concerns the

nature of the spiral. If lower unemployment simply implied a higher and constant rate of inflation, as embodied in the original Phillips curve, then, until the trade-off became very severe, some additional inflation could be widely regarded as a price well worth paying for more jobs. But Friedman (1968) devastated this position with his argument that as high inflation became anticipated this would lever the inflation rate up again and again, eliminating any stability in the inflationary price for high employment. As reformulated in bargaining rather than competitive terms[2] (Rowthorn 1977, Carlin and Soskice 1990, and Layard et al 1991), the NAIRU could occur at relatively high unemployment rates and form an inflation barrier to the implementation of Keynesian policies. A necessary condition for moving to sustainable high employment is that wage setting does not lead to such an inflationary pattern. The more real wages can rise with an expansion the less likely is persistently rising inflation, but a host of historical, political and institutional circumstances will shape the outcome as well.

It is assumed, implicitly above and explicitly in the bargaining models, that profitability is maintained in an expansion. A profit squeeze offers the prospect of accommodating the wage pressure from an upswing in employment by allowing a faster growth of real wages than labour productivity -a resolution of the distributional struggle to labour's advantage. The problem is that any drastic reduction in profitability is liable to damage investment, precisely the opposite of what is supposed to happen if a Keynesian upswing is to made durable by priming the pump of private sector accumulation. Theoretical analysis of the combined impact of expansion and reduced profit margins on investment is ambiguous (Bhadhuri and Marglin 1990); empirical work suggests however that at the very least the impact of expansion on investment will be reduced, perhaps very substantially, by profit squeeze (Bhaskar and Glyn 1992). Moderating wage pressure by "raiding" profits would be feasible only if the cost was born by consumption out of profit incomes whilst maintaining investment constant. But policies to engineer this are difficult to devise. Whilst the expansionary effects on consumption of increasing the share of wages have often been pointed to, especially by trade unions, a general squeeze on profitability has not been in the core of the social democratic programme.

The likelihood that full employment would bring serious distributional conflicts was not a discovery of the 1960s and a brief historical digression is instructive. In 1943 Keynes noted that "the task of keeping efficiency wages [wages per unit of output] reasonably stable...is a political rather than an economic problem" and in the following year he wrote that "I do not doubt that a serious problem will arise as to how wages are to be restrained when we have a combination of collective bargaining and full employment" (quoted by Winch 1988 p 107). Kalecki's famous 1943 article on the political aspects of full employment, praised by Keynes as "very acute" (Kalecki 1990 p 573), probed rather deeper. He started with the assertion that a majority of economists believed that "even in a capitalist system, full employment may be secured by a government spending programme" (1990 [1943] p 347) but that "a first class political issue is at stake here" (p 349). Popular pressure could overcome business opposition to expansionary policies in a slump, but "the *maintenance* [Kalecki's emphasis] of full employment would give new impetus to the opposition of business leaders. Indeed, under a regime of

permanent full employment, the 'sack' would cease to play its role as a disciplinary measure. The social position of the boss would be undermined, and the self-assurance and class consciousness of the working class would grow. Strikes for wage increases and improvements in conditions of work would create political tensions. It is true that profits would be higher under a regime of full employment than they are on average under laissez-faire; and even the rise in wage rates resulting from the stronger bargaining power of the workers is less likely to reduce profits than to increase prices, and thus affect only the rentier interest. But 'discipline in the factories' and 'political stability' are more appreciated than profits by business leaders. Their class instinct tells them that lasting full employment is unsound from their point of view, and that unemployment is an integral part of the 'normal' capitalist system" (p. 351).

Kalecki's prediction of the conflicts that full employment would bring obviously extends beyond wages to include issues of productivity ("conditions of work", "discipline in the factories") and even political stability. On the narrower question of wage pressure he wrote later that it was difficult to say whether trade union bargaining at full employment would yield inflationary wage increases and how inflation could be prevented: "This would depend on the institutional arrangements of the regime of full employment. It is no good to conjecture too much about the future functioning of such a regime. Let us have it and try it out" (1990 [1946] p 408)[3]. 'Full employment capitalism', he noted "will, of course, have to develop new social and political institutions which will reflect the increased power of the working class. If capitalism can adjust to full employment a fundamental reform will have been incorporated in it" (1990 [1943] p. 356). To engineer this adjustment was social democracy's historic challenge.

Deficit financing and Investment Dynamism

The multiplier effects on employment and output of deficit financing express the fact that the increased government spending does not need to be paid for by any section of society in the form of reduced consumption. Indeed total consumption rises due to the exercise of the extra claims created by the additional employment. The accompanying rise in private sector saving is absorbed by an increased government deficit. Does such a budget deficit imply problems however?

The deficit may be shortlived, representing temporary "pump priming", which disappears when private investment expands sufficiently to drive up incomes and tax revenues. Such a situation, where private investment is "high" at full employment, is also most favourable for avoiding the distributional conflicts arising from persistently high levels of employment. This is because the higher investment the faster will be productivity growth and the more likely that competing claims for real income increase can be contained[4].

But there is no guarantee that the propensity to invest (relative to private sector savings) will be sufficiently strong to eliminate budget deficits at full employment. Government debt will build up at a rate which reflects the size of the "primary deficit" (ie excluding interest payments) and the interest rate which has to be paid on outstanding debt. The economy should be growing as well, but beyond some limit (difficult to define at all precisely - see Buiter et al 1993) the prospective rise in the ratio of debt to GDP will be regarded by the financial markets as "unsustainable". Falling bond prices

and rising interest rates would result. Confidence would be undermined and the expansion choked off. How should this veto power of the financial markets be understood?

Essentially such a fall in bond prices reflects a refusal of bondholders to take the risk that they will retrospectively be forced to bear a heavy cost from the expansionary policies. This would occur if higher inflation in the future cuts the real value of their assets. A build-up of government debt inevitably raises the potential for distributional struggle, always inherent in full employment, as the extra interest payments increase claims on output. The likehihood of inflation is increased, for example as workers attempt to offset taxes raised to pay the interest. The temptation for governments to accommodate such inflation is strong, since the real value of its outstanding liabilities is thereby reduced. Only a higher interest rate can compensate lenders for this risk.

But even weak private sector investment does not inevitably imply budget deficits at full employment. An alternative policy to deficit financing is to increase government spending even further but to simultaneously increase taxation in parallel. According to the famous balanced budget multiplier (see Peston 1987) this increases GDP and employment, either within the public sector or in industries supplying it. The extra taxation redistributes consuming power from taxpayers to those finding work. Although total consumption remains unchanged the extra employment now has to be "paid for" by the reduced consumption of those who had jobs anyway and other taxpayers. They benefit from the improvements in the public services or infrastructure. But there is no longer a free lunch in the literal sense of nobody having to pay in reduced consumption for full employment. With the budget balanced financial markets do not face the prospect of rising debt ratios, but voters have to be convinced of the justification for higher taxation. Further, the more the share of taxation rises as part of a full employment programme the tighter are the constraints on real wage increases and thus the greater strains on wage and price discipline[5].

If the private sector requires only a modest nudge from the government to generate full employment then no substantial costs are involved and the free lunch character of full employment policy is preserved. But if the deficits required to generate full employment are substantial and sustained then the future costs of financing are not negligible. Bond markets can disorganise or even abort the expansion as evasive action is taken by bondholders seeking to avoid having to foot the bill. Creating jobs via a tax-financed expansion of public spending avoids this problem, but the pretence of a free lunch has to be abandoned and support gained and maintained for bearing the costs.

Trade and Capital Flows

How does this analysis have to be changed to take account of international trade? The multiplier is obviously smaller in an open economy since part of the additional demand leaks abroad at each round and the resulting balance of payments deficit may not be sustainable. But there is a perfectly straightforward response to this: allow the exchange rate to depreciate sufficiently to generate the extra exports required to prevent balance of payments deterioration.

The problem is that depreciation imposes real costs on the economy in terms of the higher real cost of imports. This would reduce the additional resources available for moderating distributional conflict; in

particular workers' real wages would have to decline (relative to the trend in productivity) if competitiveness was to be maintained. The old notion, that additional employment could only be obtained at the cost of lower real wages for those already in work, reappears in a new guise. Even where additional employment would otherwise have been profitable on the existing capital stock without real wage cuts, the deterioration in the terms of trade makes them necessary. If internationalisation leads to an increased import propensity, the cost in terms of real wages of expanding employment is raised.

The free movement of financial capital has been the most spectacular aspect of internationalisation with the implication that individual countries no longer have the freedom to determine both interest and exchange rates. Interest rates which are lower than the "world" rate are feasible only if the exchange rate is expected to appreciate. In general the best support for an expansion will be low interest rates combined perhaps with a steady fall in the real exchange rate. But under conditions of free capital mobility an expansionary programme is liable to lead to a much larger fall in the exchange rate to include:

(a) all of the expected fall in the long-term real exchange rate implied by the expansionary programme;

(b) the future nominal appreciation implied by the lower level of interest rates compared to world levels;

(c) all the anticipated impact of the expansionary programme on the inflation rate (which implies a correspondingly lower nominal exchange rate in the future).

Very large depreciations could result[6]. Moreover they would not occur smoothly over the life of the programme, as and when real depreciation became necessary or higher inflation occurred. Rather they would tend to happen in a rush, simply on the anticipation of such developments. Financial markets will not wait for difficulties to actually arise. They have no interest in giving expansionary policies the benefit of the doubt, if historical experience suggests a substantial inflationary impact. On the contrary they are geared to anticipating *possible* future problems and portfolios are shifted to avoid the consequences[7]. Such anticipations will tend to "front load" the impact on real wages of an expansionary programme by generating large initial depreciations. At the very least the task of holding the line on distributional conflict must be made more difficult by the likely response of foreign exchange markets.

Advance to, and Retreat from Full Employment

Keynesianism, Full Employment and Redistribution in the Golden Age

Although the golden age is widely designated the Keynesian period this perhaps exaggerates the role of policies to expand demand in the achievement of full employment. In the first place OECD governments were more or less in budget balance for the period as a whole (data for Europe as a whole and for Sweden as representing advanced social democracy are given in table 1). So private investment was sufficiently high (relative to private savings) to render deficits unnecessary. The social democratic bastions, Norway and Sweden, actually ran the largest budget surpluses of all OECD countries in the 1960s, Moreover discretionary demand management had only mild effects in ironing out fluctuations (Boltho 1989). It is sometimes suggested that the very willingness of governments to intervene generated sufficient confidence amongst investors to elimina-

te the basic Keynesian problem of weak private investment, making the use of contracyclical policies unnecessary (Matthews 1971). However important this may have been in some social democrat dominated countries, it did not apply consistently in the most important countries (the USA, Japan and, Germany) which only carried out Keynesian expansions in the 1960s (see Hall 1989).

Of undeniable significance, however, was the increased share of government spending after World war II and its steady increase thereafter. On average the share of government spending in GDP rose from 18% in major OECD countries in 1929 to 27% in 1950 ; by 1973 the share had risen by a further 10% (Maddison 1991). Balanced budget multiplier effects ensured that this contributed to high and growing demand even without systematic deficits; moreover the increased weight of automatic stabilisers as shares of taxation and spending grew, contributed to reducing cyclical fluctuations (Boltho 1989). Both effects must have helped generate and sustain the high level of private investment.

The level of household income inequality was generally lower at the beginning of the golden age than pre-war (in the UK and USA the share of the top 5% fell by one quarter, though redistribution was less in Europe) and as were wealth inequalities. During the golden age inequality of household income (Sawyer 1976) fell quite strongly (USA, Japan, Sweden, France) or more modestly (UK, Germany, Netherlands). Yet this was also the period when Europe achieved an unprecedented "catch-up" to US productivity levels over and above what could be explained by capital accumulation (van der Klundert & van Schaik 1993). At the very least efficiency and equality appeared capable of long-term cohabitation.

The cost of the expansion of government spending was that workers consumption had to grow much more slowly than productivity. In both Sweden and Norway (taken as the vanguard of social democratic advance), workers in the market sector increased their productivity by around 4% per year over the period 1965-73, whilst their consumption grew about 1 1/2% per year. The difference represented the increased taxation required to fund increases in transfers and employment in the welfare services (Glyn 1992a).

In Sweden in particular an additional restraint was put on the consumption of the higher paid since solidarity wage bargaining was eroding their wages relative to the average.

Whilst profits were squeezed (of which more below) the overwhelming proportion of the cost of egalitarian redistribution was met out of wages -redistribution within the working class broadly defined. The crucial point is that the dynamism of private sector allowed this redistribution to occur within the context of growing consumption per worker.

It would be misleading to suggest, however, that the dynamism of private investment resolved all distributional struggles in the golden age. From the early 1960s the upsurge of industrial conflict, the acceleration of the inflation rate and, less well known, the very widespread profit squeeze (table 1) all attest to the conflicting claims that accompanied prolonged high employment (see Armstrong et al 1991 for an interpretation along these lines). Whilst avoiding the open industrial conflict of much of the rest of Europe the leading social democratic countries suffered a similar upsurge in inflation and fall in profitability. The impact on output growth, investment and employment

of this conflict was relatively small before 1973 (see table 1). But that does not mean the pattern was sustainable.

What changed after 1973

Domestic Constraints - Investment and Distributional Conflict

The central change in the functioning of the advanced countries after 1973 was the weakness of business investment. Thus the growth rate of the business capital stock in Europe of 5.2% per year during 1960-73 had practically halved by 1979-89 (2.9%); in manufacturing where the largest increases in productivity had been recorded in the golden age, the slowdown in capital accumulation was from 5.1% per year to a paltry 1.3% per year. On most accounts this slowdown in capital stock growth played a major role in the parallel decline in productivity as compared to the golden age (see for example Armstrong et al 1991). It also represented the stagnation of what had been the most dynamic element in demand -in Europe the level of gross investment grew by 1.8% per year between 1973 and 1990 as compared to 5.6% per year before.[8]

Weakness of private investment is the classic Keynesian problem. Government deficits had to rise, or the share of government expenditure to increase to make up for this shortfall in demand. Keynesianism became increasingly necessary to sustain demand but, with ebbing growth of productivity, distributional conflicts at high employment were likely to be even more difficult to reconcile. Free riding on capitalist dynamism became more and more precarious for social democracy. But why has investment been so weak?

There is no shortage of explanations for the decline in capital stock growth in the 1970s - declining profitability, rising and then high inflation, deflationary policies and international instability must all have contributed. But the indicators (inflation, profitability,strikes -table 1) suggest that domestic distributional conflict declined during the 1980s (Glyn 1992b) and that by the end of the decade a "stabilisation" had been reached on terms much more acceptable to the employers than those pertaining at the beginning of the decade.[9]

Despite the very general rise in profitability the response of investment was generally rather muted. In the later 1980s investment in Europe grew as fast as during the golden age, but this only pulled the average growth in the 1980s to half that of the 1960s. In European manufacturing capital stock was growing by 2.8% per year in 1989, up from 1.9% in 1979 but well below the rate even at the tailend of the golden age (4.1% in 1973).

Even if conflict had been suppressed through high unemployment, business confidence and government policies may still be strongly influenced by fear of its recurrence. There is little evidence yet that the functioning of labour markets has been altered in a fundamental way. A summary of the results of a recent analysis of the UK experience, where the changes in the labour market must have been as extensive as anyway, concluded "Most authors agree that the Thatcher reforms have had very little effect on unemployment or wage formation" (Barrell 1994 p 13). A cross country analysis found that the NAIRU appeared to have fallen in the 1980s only in Italy of the four largest European countries (Barrell et al 1994). Anxiety that a renewed period of high employment would lead to recurring inflationary pressures and threats to profitability are hardly surprising therefore and this underpins both the hesitancy of employers to

invest and of governments to expand.

The World Economy - Slowdown, Disorder, Integration

Conditions in the world economy have made it more difficult for individual countries to maintain high investment and full employment since 1973. But it is important not to lump all such influences under the heading of "internationalisation". Whilst the extent of economic integration has increased, this should not be exaggerated. Moreover the turbulent conditions in the world economy would have impinged severely on individual economies even without additional integration.

For any individual economy, the slower growth of its markets the slower will be its growth of exports which must have contributed to sluggish investment, especially in the traded goods sector. In this way factors inhibiting expansion within a significant section of the world economy (such as fear of reigniting distributional conflict) will impinge on other countries even where those influences are less important. Moreover one factor in the slow growth in the OECD since 1979 has been the very high level of real interest rates (table 1). These reflect reliance on monetary policy to induce deflation and the suppression of distributional conflict in a situation where fiscal tightening was much more difficult politically. The high interest rates affect private sector demand in individual economies, but also impose tighter limits on government spending if the debt ratios are to be held in check.

In addition to slower growth, there has been increasing disorder in the world economy. Large swings in exchange rates can occur, perfectly rationally, as expectations about the direction of policy, or their success, altered. These movements may be further amplified by the lemming-like speculation (part of the rise in the US dollar in the early 1980s is often explained thus). This makes much less predictable the profitability of investments which depend for their returns on international competitiveness. On the trade front the rise of imports from extremely low wage sources, with which OECD producers cannot possibly compete, has injected another source of unpredictability for future profitability of investment. The general weakness of manufacturing investment, and its weaker relationship to profitability in the 1980s was probably explained by these factors undermining the predictability of future returns (Glyn 1994). The growing internationalisation of financial flows is indisputable. As a ratio to world GDP the stock of cross-border bank lending has grown from 6% in 1972 to 37% in 1991 (UNCTAD 1994). The daily turnover of the foreign exchange market is four times the total gross central bank intervention during the 1992 ERM crisis ($270 billion) (Eichengreen and Wyplosz 1993). Its undoubted role in contributing to international financial instability means that it must bear some responsibility for the weakness of the traded goods sector.

The growth of trade is much less spectacular, however. As table 2 shows the shares of exports in European GDP does not much exceed that of 1913. There was a sharp rise in the mid-1970s as exports were expanded to pay for oil imports. But since then the rise has been rather modest[10]. There has been a sharp increase in international competition *within* manufacturing, as shown by the import penetration data. But greater competition within manufacturing has been offset (in terms of its effect on average import propensities) by the declining importance of manufacturing within the OECD's output and employment structure (27.4% of

OECD valued added in 1973, 22.2% in 1990). Despite growing international trade in some service sectors (and the importance of business services as inputs into manufacturing) the "sheltered" sector of the economy (notably government and personal services) is probably growing. Such relatively modest increases in import and export shares as have occurred recently could hardly constitute an independent explanation for deflationary bias the world economy. If countries had no reason to hold back from Keynesian policies other than the effects on their payments balances, then it is hard to see why co-ordinated macroeconomic expansion (at the European level for example) would not happen. Domestic resistance to expansion, for the reasons discussed earlier, however makes the failure to engineer co-ordinated expansion entirely explicable.

Increasing internationalisation can be cast in a most convenient role as scapegoat for the failure to maintain high employment. The most important aspect of this process has undoubedly been the expansion of financial flows, bringing instant retribution on governments for policies which are not "credible". This credibility is calibrated by indicators such as government deficits, wage pressure, strikes, profitability and inflation. However, maintaining such credibility only rules out the expansion of employment if there are no means other than unemployment for containing distributional conflict.

The Tale of Two Disasters

Many episodes have contributed to the dominant pessimism about the ability of social democratic governments to secure full employment. But the most influential have been the experience of France in the early 1980s, where the new Socialist government failed to reverse the tide of rising unemployment, and that of Sweden in the early 1990's where a system which had delivered an unparalleled rate of employment and degree of egalitarian redistribution was forced into headlong retreat.

(a) The Mitterrand Expansion

The experience of the French Socialists in having to abort their expansion in the face of balance of payments deficits and exchange crises would seem to contradict the emphasis given above to domestic constraints. One comprehensive assessment concludes : "The external constraint on policy-making in France since 1981 highlights the gulf between the national political structures and the international economic realities of today. At the present time the national framework is no longer a relevant framework for macroeconomic policy-making" (Muet 1985 p. 94).

Yet the argument is not very convincing. It is undeniable that the recession in Europe and the slow growth of markets for French exports offset a substantial part (perhaps one half) of the impact of the government's expansionary policies and contributed (perhaps one third) to the deterioration in the current account. Obviously, therefore, the external cicrcumstances limited what could be achieved; yet unemployment rising by 2% between 1980 and 1983 in France as compared to 4% in the EC and 5% in Germany was an achievement. But the fact that the policies then had to be reversed can hardly be blamed mainly on external circumstances. In 1982 the current account deficit was 2.2% of GDP, the largest of the G7, but 10 other OECD countries had larger deficits and over the whole period 1980-86 four OECD countries ran current account deficits averaging over twice the French deficit in 1982. The budget deficit in 1982 in France

was the lowest of the G7. Where the French economy was seriously out of line in 1982 was inflation -the GDP deflator rose by 11.8% as compared to 7.6% in the UK, where it was falling, and 4.5% in Germany. That this gave rise to expectations of future depreciation is hardly surprising. Sachs and Wyplosz claim "Even without the problems induced by a world recession and a collapse of confidence, Mitterrand had little scope in 1981 to embark on a sustained demand expansion without quickly generating accelerating inflation" (1985 p296).

Even the current rate of inflation was evidently inconsistent with maintenance of the exchange rate, and would have been so quite regardless of the cyclical position of the rest of Europe. An early pre-emptive devaluation was certainly necessary to restore lost competitiveness (see Halimi et al 1994 for a discussion of why that course was not followed). But such a devaluation would have put additional pressure on inflation by reducing real wages. It was precisely the absence of a credible policy for reducing and holding down inflation, that is for containing distributional conflict, that made the turn to deflation inevitable and, given the international circumstances facing France, sooner rather than later.

Perhaps the combination of the domestic economic inheritance (the need to check the inflationary momentum) and the expectations raised by the Socialist victory were inherently impossible to reconcile (not for the first time in the history of Left governments). Obviously faster growth and in particular higher inflation elsewhere would have rendered their task easier. But to conclude that external conditions made the situation more difficult does not imply that national economic policy has been rendered impotent by internationalisation.

(b) The Swedish Debacle

The most obvious evidence for the view that the Swedish model has collapsed is the disastrous rise in open unemployment, from 1.5% in 1990 to 8.2% in 1993. The immediate factor behind the recession was the preceding period of excess demand; encouraged by rapid financial deregulation the savings ratio fell by 7 percentage points between 1985 and 1988. This pushed the unemployment to 1.5%. When the rising inflation was met by restrictive monetary policies, there followed a rebound in personal savings ratio (an increase of 12 percentage points between 1989 and 1993). The resulting collapse in consumer demand helped precipitate a 40% fall in business investment and the rising real exchange rate squeezed exports. GDP fell by 5.1% between 1990 and 1993 (as compared to a rise of 2.6% in Europe) and the government deficit rose by 17.1% of GDP. The OECD (1994 pp 16) allocates the blame thus: "The sequencing of changes in the tax system and deregulation of financial markets would appear to be a major factor behind the violent cyclical fluctuations over the last decade." No plausible degree of flexibility of wage bargaining could have prevented a slump. Since financial deregulation, and excess demand, form no part of the Swedish model its seems absolved of responsibility for what occurred. But even if macroeconomic and financial mismanagement generated the recession there were underlying problems within the functioning of the model which helped shape responses. Trends in both inflation and productivity were making it harder to preserve full employment. At first sight the inflation differential as compared to Europe of 1% per year over the 1980s seems modest enough (table 1); until unemployment fell below the NAIRU in 1988 and 1989 (on OECD estimates) the competitive

edge from the 1983 devaluation had been rather successfully maintained. But in 1990 the GDP deflator grew by 8.9% as compared to 6.8% in Europe as a whole and 3% in France and the D.Mark block.

The very high demand for labour undoubtedly contributed; but longer-term problems were involved as well. The system of cordinated wage restraint had been under severe pressure from several sides. Firstly, real take-home pay was almost continuously compressed. The redistributive regime of the golden age continued for a dozen years after 1973, but in the context of productivity growing less than half as fast. Thus over this period consumption out of the average worker's earnings fell by nearly 2% per year (Glyn 1992a). This decline was halted in 1985 and there followed a short period of expansion, but by 1990 consumption out of the average paypacket was still 17% less than in 1973.

Secondly the coherence of wage bargaining was reduced by the growing power of white collar unions, with divergent interests from those of the once dominant manual workers in LO (Kjellberg 1992). There was also increasing pressure from employers, especially in the export sector for less constraints, on their use of wage systems for heightening incentives (Meidner 1993, Pontusson and Swenson 1993). Finally it has been suggested, in somewhat Keynesian vein, that the Swedish bargaining system needed to operate in the context of at least moderate, rather than very low inflation. Only then could aggregate real wage restraint be delivered with both local and central bargainers, in what was in effect a multi-level system, having room for showing their effectiveness to members by achieving non-negligible nominal increases. Only then could relative wage changes be achieved (be it in the direction of greater differentials now pressed by employers or lower differentials demanded earlier by unions) without individual groups of workers having to swallow money wage standstills or even cuts (Calmfors 1993, Vartiainen 1994).

Thus the decision of the Social Democrats in October 1990 to apply join the EC and at the same time accord absolute priority to inflation reduction removed what may have been essential lubrication from the Swedish model. The budget for 1991 stated that "in the long run it is not possible to safeguard employment in an economy which has a higher inflation rate than the surrounding world. In order to protect employment and prosperity economic policies during the next few years...will have to aim for a permanent reduction in inflation. This task must take priority over all other ambitions and demands" (quoted Notermans 1993 p 140).

The productivity problems facing Swedish industry were arguably of no less importance than inflation (to which indeed they contributed). Since 1973 labour productivity growth in manufacturing (crucial for trade) was around 1% per year slower than in Europe on average (table 1). After 1984 manufacturing productivity grew only about 1% per year. This was despite an investment recovery which saw the manufacturing capital stock growing at 3.5% per year in 1989, faster than in Europe as a whole and contradicting the notion that the very large direct investment outflows starved domestic investment. The decision to fight inflation with a fixed exchange rate was also aimed at forcing rationalisation of firms which had been cushioned by earlier devaluations. Calmfors concluded that the "non-accommodative policies pursued in 1990-2 as part of the determined effort to converge on the lower inflation rates of the EMS

countries also seem to be the main explanations of the dramatic rise of Swedish unemployment" (1993 p 57/8).

Running the economy at a somewhat higher level of unemployment and permitting somewhat greater local flexibility in wage bargaining in an attempt to match EC productivity and inflation trends would have been an important adjustment to the model, but hardly a wholesale rejection. However the pressure from the employers went far further than this. Their strategy was described by the *Financial Times* (November 8 1990) under the headline "Business plans five-year campaign to end Swedish economic model" as being a plan "to transform social democratic Sweden into a robust free market economy", aiming "to destroy the vestiges of the famed Swedish economic model, with its collectivist values of equality and solidarity" and involving radical cuts in public spending and taxation, privatisation, introduction of market forces into the welfare state, abolition of publicly-run wage earner funds as well as an end to national wage agreements with emphasis on linking pay to productivity. When the Right gained power it launched "a general labour law offensive aimed at circumscribing union power, especially through the regulation of industrial conflict at the workplace (Kjallberg 1992 p 137).

The increased strength of organised labour, underpinned by prolonged full employment, had thrown up a range of demands which directly threatened the prerogatives of capitalist ownership and management -demands for industrial democracy, interventionist industrial policy and perhaps above all the highly polarising issue of wage-warner funds (Pontusson 1992). Lundberg's essay on "The Rise and Fall of the Swedish Model", published in 1985, argued that "The fall of the Swedish Model is, at bottom, a political development. The present *political crisis* (his emphasis), which has involved an intense confrontation between the socialist and non-socialist parties, since the middle seventies, has created a stage of uncertainty and bewilderment" and he blamed the Social Democrats for abandoning their pragmatism -"At the present time the socialist goals are more serious" (1985 p 31). The policies which the Social Democrats were proposing violated what the employers took to be the workers' side of the implict full employment/welfare state bargain. These demands derived from the organisational strength which full employment brought and the economic problems which developed alongside it. No wonder the employers turned decisively against full employment, exploiting both internal discontents and external circumstances (the general adoption of disinflationary policies for example).

Perhaps a fundamental, Kaleckian contradiction of social democratic full employment policy can be distilled from this experience in Sweden, and from the challenges to capital which were a widespread phenomenon from the late 1960s until the early 1980s (demands for industrial democracy, planning agreements, industrial policies, nationalisations). The maintenance of full employment for an extended period generated demands which violated the prerogatives of capital and provoked a backlash which forced social democracy to abandon not only its radical, and system-reforming proposals, but also full employment itself.

Conclusions

It is doubtful that "free lunch Keynesianism" -deficit financed expansion in which the unemployed, wage earners and capitalists all gained-was ever very important in accounting for post-war full employment. As soon

as international economic relations are taken into account, and constraints on borrowing are accepted, then policies of demand expansion have their costs which must be met by those already employed. The dynamism of private investment in the golden age was crucial in that it facilitated high employment without deficit spending and it generated the rapid productivity growth which allowed substantial redistribution to be combined with rising consumption for workers. High and rising tax-financed government spending also bolstered demand. The problematic element was the distributive conflict, and broader struggles which challenged capital's prerogatives, which emerged from the period of full employment.

The slowdown after 1973, above all of investment, was the response to rising inflation and profit squeeze compounded by the eventual generalised turn to deflationary policies. In such a context of weak private demand and slow productivity growth, maintaining full employment required severe restraint on workers' pay and consumption to keep exports competitive, investment profitable and the budget under control. Where social democracy was capable of mobilising such support and self-discipline full employment and an extension of other egalitarian policies was sustainable. But there also, prolonged full employment also brought demands for extension of workers' rights over the organisation of work and collective influence over the deployment of capital. This added to pressure from the employers to sharpen market-based incentives and reduce inflation which more or less inevitably meant the abandonment of full employment.

It is a central argument of this paper that conditions in the world economy and their influence on national economies do not constitute the fundamental block to full employment policies. The increased power of financial markets may have rendered unviable "free lunch Keynesianism" where employment can be pushed up by deficit spending and no section of society need apparently bear any costs. It has also further constrained the (always very limited) extent to which resources could be raised by taxation of capital. Finally, it has made it increasingly difficult to continue with policies which accommodate a persistently higher inflation rate than elsewhere. But international economic integration has <u>not</u> ruled out policies for expanding employment where the costs for the rest of society are explicitly counted and willingly shouldered by the mass of wage and salary earners. But until social democracy can formulate and gain support for such an alternative, mass unemployment is liable to continue as the mechanism by which distributional conflict and other challenges to capital are contained.

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Table 1 **Economic Performance and Conflict 1950-94**

Output Growth (GDP average annual % changes)	1951-68	1968-73	1973-79	1979-90	1990-94
Europe	4.7	4.9	2.9	2.0	1.2
Sweden	4.1	3.7	1.8	1.9	-0.7
Labour Productivity (manufacturing, % pa)	1950-60	1960-73	1973-79	1979-89	1989-92
Europe	4.9	6.5	3.8	2.9	2.5
Sweden	3.4	6.4	2.6	2.2	3.3
Inflation (consumer prices, average % pa)					1990-94
Europe	3.3	6.1	11.7	7.1	4.1
Sweden	3.1	6.0	9.8	8.1	5.5
Unemployment (average % rate)	1960-67				
Europe	2.8	3.4	5.1	9.0	10.1
Sweden	1.6	2.2	1.9	2.4	6.1
Profitability (net profit share, manufacturing)	1952-66	1968	1973	1979	1989
Europe	26.0	21.8	20.9	17.4	23.7
Sweden		19.0	15.8	8.5	18.4
Strikes (average days per year per 100 industrial & transport workers	1953-66	1967-73	1974-79	1980-90	1990-93
Europe	40	130	52	28	12
Sweden	4	5	2	29	5
Budget balances (general government, % GDP)	1960-67	1968-73	1974-79	1980-90	1990-94
Europe	0.0	-0.3	-3.3	-4.1	-5.5
Sweden	3.3	4.4	1.3	-1.1	-8.3
Real interest rates (long-term, %)	1960-67	1968-73	1974-79	1980-90	1990-94
Europe	1.6	1.2	-0.4	3.8	4.4
Sweden	1.2	1.7	-1.1	3.7	8.0

Sources: OECD *Historical Statistics, Economic Outlook, National Accounts*; plus for profits Armstrong, Glyn & Harrison op cit, for strikes UK Department of Employment *Employment Gazette*, , for productivity *US* Bureau of Labor Statistics *Monthly Labor Review*.

Europe is OECD Europe where possible, otherwise unweighted averages of countries for which data is available(For productivity 8 countries, strikes big 4, profits 9,real interest rates 7 countries).

Table 2 Indicators of Internationalisation

Exports as % of GDP, current prices	1913	1950	1960-73	1974-79	1980-90	1991-2
Europe	(25)	19.5	19.3	25.8	28.7	26.4
Sweden	(25)	22.1	22.6	28.8	32.7	27.9
Imports as % of domestic market for manufactures	1913	1950	Early 1970s		1985-90	
France, Germany, Italy, UK,	(18)	(7)	16		25.7	
Sweden			30		40.9	
Foreign direct investment as % of Domestic Investment					Inward 1981-92	Outward 1981-92
Europe					4.2	6.3
Sweden					3.2	13.1

Sources: Exports OECD *Historical Statistics, National Accounts;* 1913 crudely linked from Maddison 1991.
Imports calculated from Martins 1993 ; 1950 and 1913 crudely linked from Maizels 1963.
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Notes

[1] The issue is not whether a fall in real wages will generate extra jobs but whether employment increases as a result of a government-led demand expansion *must* involve a reduction in the real wage in order to render additional market sector employment profitable.

[2] Friedman's model had the bizarre result that not only would those already employed suffer from high employment policies as their real wage declined with the marginal productivity of the extra workers, but once the natural rate was breached, even those who took the new jobs would have been better off without them since what they actually receive as real wages, after unanticipated inflation, fails to compensate them for the disutility of working.

[3] A bold enough statement for the staid *Review of Economics and Statistics* but also a self-conscious example of Scharpf's complaint that the institutional preconditions for incomes policies "were not specified with the necessary theoretical clarity and were not politically supported with the necessary sense of urgency" (1991 p 37) by the Keynesians.

[4] There is a strong difference of opinion in the wage bargaining literature as to whether productivity growth does moderate wage pressure; see Rowthorn (1995) for arguments that it does and discussion of the consequent importance of investment in durably increasing employment.

[5] Compare Kalecki "income tax-financed expenditure -which has the advantage not only of securing more employment but also of reducing the inequality in the distribution of incomes , after taxation. -should be pushed as far as politically possible, and, if this is not enough to secure full employment, expenditure should be expanded as much as is necessary by means of borrowing" (1990 [1944] p 376).

[6] A fall in the real exchange rate of 20% over 4 years say might be required to sustain the balance of payments position; interest rates at 2.5% below the world level persisting for the same period would require an immediate further depreciation of 10% to bring the rate down so that sufficient real appreciation was anticipated to make the currency worth holding. If the markets expected that the inflationary impact of the programme would amount to 2.5% per year an additional decline of 10% would be required to offset the resulting nominal depreciation. It is easy, therefore, to see how large immediate falls in the exchange rate could result from expansionary packages even without politically motivated speculation.

[7] There is often a tendency on the Left to treat international financial markets as uniquely disruptive, but as discussed earlier unregulated national bond markets can cause analogous problems by anticipating inflationary effects from expansionary programmes. The extra dimension posed by international flows of funds is the real cut in national income via the terms of trade effects of depreciations, surrounded of course by all the national drama of a foreign exchange crisis.

[8] The behaviour of the investment share of GDP (typically current prices) is misleading as an indicator of the growth of investment; even a constant share implies a proportionately lower growth if output growth declines. It is extremely misleading as an indicator of the growth of the capital stock since the , cuurent price. output capital ratio may be falling because of underlying technology, because of growing excess capacity or because the relative price of capital goods is rising. Thus the fall in the non-residential investment share of GDP from 16.5% in 1960-73 to 15.5% in 1980-90 in Europe conveys no idea of the slowdown in capital stock growth reported in the text.

[9] Budget deficits were the exception, rising by as much in the recession of the early 1990s as they had fallen during the previous upswing. Understandably unemployment had much less effect in weakening commitment to the welfare state and taxpayers' resistance to tax rises, than it did on shop-floor bargaining.

[10] But how can this rather slow increase in the export share square with the data frequently quoted showing exports typically growing twice as fast as GDP , for the OECD during 1979-90 the figures were 5.0% pa and 2.7% pa respectively.? The explanation is the relatively slow growth of export prices , 3.6% per year as compared to 5.2% per year for GDP in this instance). This differential reflects the relatively rapid growth of productivity in manufacturing, the main export sector (2.9% per year as compared to productivity growth of 1.5% in the economy as a whole). The current price share is the appropriate measure of the importance of exports in terms of the resources (notably labour. involved, although it is still inflated by including the import content of exports.