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Social Democracy and Full Employment

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Abstract

Full employment was the centrepiece of the economic policy of social democracy in the post-war period. Whilst the role of Keynesianism in policy making may be exaggerated, it offered the prospect of maintaining full employment without any section of society having to pay. Problems with the foreign balance and with the budget deficits, however, may require that some part of society has to pay with reduced consumption for full employment. This will tend to sharpen the distributive conflicts which, as Kalecki argued, are endemic to full employment capitalism and which eventually rendered it unsustainable by undermining profitability and the dynamism of private investment. The demand necessary to sustain full employment can be maintained by a balanced budget expansion provided the political support can be secured for the higher taxation and provided the institutions for containing distributional conflict can be developed.

Zusammenfassung

Vollbeschäftigung war das Hauptziel sozialdemokratischer Wirtschaftspolitik in der Nachkriegsära. Auch wenn die Rolle des Keynesianismus hinsichtlich der praktischen Politik überschätzt werden könnte, so stellte er doch in Aussicht, Vollbeschäftigung zu erhalten, ohne daß dies auf Kosten eines Teils der Gesellschaft ging.

Im Falle einer unausgeglichenen Außenhandelsbilanz und bei Haushaltsdefiziten könnte es natürlich dazu kommen, daß für einige Gruppen in der Gesellschaft Vollbeschäftigung nur um den Preis eines verminderten Konsumniveaus zu haben ist. Dies könnte dann zu einer Verschärfung von Verteilungskonflikten führen, die, so Kalecki, zu einem Vollbeschäftigungskapitalismus gehören und die schließlich ein Stadium erreichen könnten, in dem durch Aushöhlung der Profitabilität und der Investitionsdynamik die Selbsterhaltungskräfte verschwänden.

Die für die Sicherung der Vollbeschäftigung notwendige Nachfrage kann durch eine ausgewogene Budgetausweitung erhalten bleiben, vorausgesetzt, die notwendige politische Unterstützung für eine höhere Besteuerung kann gesichert und institutionelle Regelungen für eine Eindämmung der Verteilungskonflikte können entwickelt werden.

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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).

"We used to think that you could spend your way out of a recession and increase employment by cutting taxes and boosting government spending. I tell you in all candour that that option no longer exists, and that insofar as it did ever exist, it only worked on each occasion by injecting a larger dose of inflation into the economy, followed by a higher level of unemployment as the next step." (Prime Minister James Callaghan speaking at Labour Party Conference, 1976, quoted by Michie 1987 p 131).

In just 20 years the certainty that even the Right would have to maintain full employment and the welfare state had been replaced by acceptance in the Labour Party that Keynesian policies could not work. Labour's travails, operating within one of the least dynamic of the advanced capitalist economies, anticipated the general collapse of confidence within social democracy.

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). The collapse of Keynesianism weakened the defence of social democracy against those who asserted the necessity for divorce on grounds of fundamental incompatibility. As Schmitter and Streek noted "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 Wallerstien 1993 p 222).

This paper attempts to set the disastrous collapse of social democratic aspirations in the context of the decline of the "golden age" of post-war rapid growth. Section I 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. It looks at the sense in which Keynesianism offered a "free lunch" and how the terms on which full employment can be secured may be altered by internationalisation of national economies and by the increasing power of financial markets. The decisive importance of private investment is highlighted. Section II outlines the achievement of full employment and welfare state redistribution during the golden age and evaluates the impact of the investment slowdown and the internationalisation which has characterised the subsequent decades. It also gives an interpretation of two spectacular reverses for social democracy, that of the Mitterrand government and the more recent collapse of full employment in Sweden. The conclusion links the preceding discussion to current discussion of egalitarian policies for full employment.

I The Costs of Full Employment

(a) Wages, Inflation and the Free Lunch

It has been argued (Przeworski 1985 p 37) 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" 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 (alternatively the deficit would rise less than the growth in spending), 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 during 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 (see 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 other than as a by-product of an increase in the progressiveness of the tax system. 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

[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.

profitability has never been in the core of the social democratic programme[3].

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 probed rather deeper[4]. 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' 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 extends beyond wages to include issues of productivity ("discipline in the factories"). Moreover increased "self-assurance and class consciousness of the working class" could bring more fundamental challenges to managerial prerogatives including control over allocation of capital. 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)[5]. 'Full employment capitalism', he noted "will, of course, have to develop new

3 The German trade union movement has espoused this objective on occasions and, as in the 1950s, not only when profits have just risen exceptionally fast (Carlin 1992).

4 Keynes complimented Kalecki "An exceedingly good article and very acute" (Kalecki 1990 p 573).

5 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"

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). This was social democracy's historic challenge.

(b) **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 rise in private sector saving is absorbed by an increased government deficit. Does this cause additional difficulties over and above the fundamental problem of reconciling competing claims at full employment discussed above?

The first issue concerns the duration of the deficit. It may be short-lived, disappearing when private investment expands sufficiently to drive income up to the point where additional tax revenues cover the spending. If the response of private investment is sufficiently dynamic the initial rise in public spending may even be reversed and high employment maintained. Where private investment takes over from increased state spending the initial lack of demand can be seen as a pure co-ordination problem - if there was full employment capitalists would invest enough to keep demand up without any resort to budget deficits. All that is needed to get there is for temporary expansionary policies to "prime the pump" of private sector dynamism. Such a situation, where private investment is "high" at full employment, is most favourable for resolving distributional conflicts. This is because the higher investment the faster will be the growth rate of the capital stock per worker and the faster productivity growth[6]. The faster productivity is growing the more likely that competing claims for real income increase can be contained[7].

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. In which case debt will tend to build up. The extent to which this represents a problem depends on a number of factors. Firstly running any deficit only implies an ever increasing ratio of debt to GDP if there is no growth in the economy. More precisely the long-term impact on the debt ratio of a given persistent deficit (as a percentage of GDP) depends on the growth rate of the economy and the real interest rate on the debt. If the real interest rate

(1991 p 37) by the Keynesians.

[6] Traditionally neoclassical theory played down the impact of capital accumulation on productivity growth; recently "new growth theory" reinstated classical emphasis on the impact of investment, broadly understood, on productivity growth with at least some support in the data (Glyn 1994).

[7] There is a strong difference of opinion in the wage bargaining literature as to whether productivity growth does moderate wage pressure; Layard et al (1991) develop models where it does not, Carlin and Soskice (1990) assume that it does.

is greater than the growth rate any primary deficit (ie excluding interest payments) must lead to a continual increase in the debt ratio[8]. Even if the real interest rate is the smaller, the implied rise in the debt ratio may be regarded (on no very clear criteria it has to be said - see Buiter et al 1993) as unsustainable and "unsound", bringing temptations to monetise and inflate in the future.

A government deficit at full employment thus expresses the weakness of private investment relative to private savings; with a given share of public expenditure in GDP a deficit is required to maintain demand. If such a deficit is "excessive", in the eyes of financial markets at least, then it seems that full employment policies face an extra constraint to add to the distributional conflicts discussed above. This presupposes, however, a given share of government expenditure. Increasing the share of government expenditure, balanced by a corresponding rise in taxation, will raise employment and GDP without increasing the government deficit (the famous balanced budget multiplier -see Peston 1987). The extra taxation redistributes consuming power from taxpayers (those with jobs already) to those finding work. Although total consumption remains unchanged (assuming similar propensities to consume of the two groups) the extra employment now has to be "paid for" by the reduced consumption of taxpayers. They benefit from the improvements in the public services or infrastructure which comprise the rise in GDP, but there is no longer a free lunch in the literal sense of nobody having to pay in reduced consumption for full employment.

The first essential point is that the size of government expenditures/deficits required to secure a full employment level of output depends on the dynamism of private investment relative to savings. With given private sector savings and investment propensities, there is a range of configurations of government expenditure and taxation which yield a full employment level of demand. If private investment is weak (the classic Keynesian presumption), low levels of government expenditure would require very low tax rates and large budget deficits to secure high employment. A higher share of government spending will generate the same overall level of demand with higher tax rates and a lower deficit or even surplus. These two possibilities have very different distributive implications. The benefits of the higher government expenditure will tend to be spread more widely than the costs in terms of reduced consumption by taxpayers. The egalitarian configuration, with a lower deficit, is also better from the point of view of orthodox government financing -unusual bedfellows. The catch of course lies in political acceptability; the more the share of taxation rises as part of a full employment programme the greater the discrepancy between the growth of productivity and the room for increased consumption out of wages and the greater strains on wage and price discipline[9].

It seems misleading therefore to see the financing of government deficits as some kind of

[8] Wealth effects on consumption as the debt build will under some assumptions eliminate the primary deficit and generate convergence of the debt ratio in this case as well (see Godley and Rowthorn 1994)

[9] 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).

independent constraint on a full employment policy. The weaker is private investment the greater must be the full employment levels of government expenditure and/or deficits, The choice between government expenditure or deficits to bolster demand is a distributional one; deficits in the short run may be politically the softer option as consumption will be higher. If this is ruled out by financial markets, or because the higher government spending has higher priority, the distributional squeeze is tighter. There is no guarantee that amongst the feasible combinations of private investment/government spending/budget deficits which would generate full employment one or more will be distributionally acceptable.

(c) Open economy effects

(i) Trade

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; the higher the (marginal) propensity to import the greater leakage and the weaker the domestic employment effects of a given increase in demand. A corollary is that the impact of a given increase in government expenditure on the budget deficit is greater, since the offsetting rise in tax revenues is reduced. More immediately the 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 multiplier would be restored with corresponding reduction in the budget deficit.

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. Thus in an open economy maintaining the level of profitability is required for reasons of international competitiveness as well as because of its impact on investment; raiding profits to allow faster real wage increases is even less feasible than in the closed economy case.

The extent of the reduction in real wages required from a programme to expand employment would depend on the propensity to import and on the price elasticities in foreign trade. 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; reduced trade elasticities (sometimes predicted to follow in the short-run at least from cross-country direct investment in manufacturing

subsidiaries) would have the same effect[10]. (ii)

Financial Capital and Direct Investment

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 the level of interest rates. More precisely it is the freedom to determine both interest and exchange rates which is compromised. Interest rates which are lower than the "world" rate are feasible if the exchange rate is expected to appreciate. When the existing exchange rate is overvalued, maintained by higher than average interest rates, then an expansionary policy of reduced interest rates and a lower exchange rate can be put together. This has been precisely the outcome in the UK since the markets ejected sterling from the ERM. In general the best support for an expansion will be lower interest rates combined perhaps with a steady fall in the real exchange rate over the course of an expansion. 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[11]. 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

[10] Import prices may not rise by the full extent of a depreciation if producers absorb part of the costs in lower prices. The apparently mild effect on inflation of the UK's sharp depreciation in the autumn of 1992 led some to play down the terms of trade effects of depreciation and suggest that depreciation is relatively costless. In fact UK import prices appear to have responded almost in proportion to the depreciation. Between 1991 and 1993 the average value of sterling fell 16.3% against the DMark and UK import prices rose by 14.7% more than German import prices; this effect was masked by the downward trend in commodity prices which meant falling German import prices and only relatively slowly growing UK ones.

[11] A fall in the real exchange rate of 20% over 4 years say might be require4 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.

the consequences[12]. Such anticipations reduce real living standards; they can then precipitate the very developments which are feared and make much more likely what was only a possibility.

The upshot is that free movement of capital 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.

The final aspect of internationalisation to be considered is the increase in flows of foreign direct investment. By increasing the range of alternative investments an increased propensity of domestic firms to invest overseas (and vice versa) would tend to sharpen the impact of profitability on investment. This underlines the point made earlier as to the infeasibility of squeezing profits as a route to moderating wage pressure.

(iii) Summary

This section has argued that the problems faced by Keynesian policies aiming to achieve full employment are essentially distributional, as originally analysed by Kalecki. Even the "free lunch" character of the simplest Keynesian, closed-economy models does not rule out unsustainable distributional conflict. Weak private investment, and slow productivity growth, may exacerbate such conflicts. Government deficits at full employment reflect such investment weakness. But the financing problems from such deficits will arise only because the distributional implications of alternative patterns of sustaining demand, with higher levels of government spending and taxation, are even less acceptable. Unsustainable balance of payments effects of expansion reflect the difficulty of achieving sufficient real wage moderation to ensure the required higher level of trade competitiveness. Free movement of financial capital may require real wages to bear whatever pattern of costs is imposed on the economy by exchange rate movements dominated by anticipated future problems. Greater international mobility of fixed investment can tighten the ceiling on the path of real wages consistent with adequate private sector investment. The viability of full employment policies boils down to securing and maintaining support for their distributional implications.

[12] There is a tendency on the Left to treat international financial markets as uniquely disruptive. Even without any international capital flows unregulated national bond markets could cause exactly analogous problems; by anticipating inflationary effects of expansionary programmes nominal interest rates may be forced up with possible adverse effects on the capital accumulation of credit-constrained firms and with distributional effects within the economy. The extra problems posed by international flows of funds are the real cuts in national income via the terms of trade effects of depreciations, surrounded of course by all the national drama of a foreign exchange crisis.

II Advance to, and Retreat from Full Employment

(i) 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 eliminate 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 1988).

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 motivation of the spending was mainly to provide welfare rather than jobs. But the impact of the higher share of government spending on demand and thus jobs probably extended beyond direct balanced budget multiplier effects to include a significant "crowding in" of private investment at least at the beginning of the long boom.

Nor was the impact of the investment on productivity undermined by the redistribution which occurred. 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 hourly productivity by 5-5 1/2 % per year over the period 1965-73, whilst their consumption grew about 1 1/2% per year. A little over one third of the difference was accounted for by sharply declining average hours worked, whilst the rest represented the increased taxation required to fund increases in transfers and employment in the welfare services (table 2)[13].

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 A squeeze on profits (of which more below) was apparently reflected in some reduction in the share of consumption out of property incomes (in both Norway and Sweden for example). However 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. There were some signs in the OECD of productivity growth slackening, possibly in line with Kalecki's predictions about full employment and factory discipline. However, 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. Even without the OPEC "shock" it is hard to imagine that the sharpening distributional conflict could have been resolved in Europe without higher unemployment. If social democracy had been as strong elsewhere as it was in Scandinavia, matters might possibly have turned out differently.

(ii) What changed after 1973

(a) 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

[13] Social democratic governments held no monopoly on the expansion of welfare spending although its structure differed in countries where Christian Democracy dominated (Esping-Andersen, 1990). The voluminous literature on whether social democratic governments altered economic outcomes (employment, welfare state, equality) seems to have broadly concluded that they did (see the comprehensive reviews by Esping-Andersen and van Kersbergen 1992 and Cusack 1994), especially when allied with strong trade union movements. There seems to have been little analysis, however, of the extent to which this impact altered over time and particularly whether it weakened in the 1980s.

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[14].

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[15].

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).

One possibility is that even if conflict is 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

[14] The behaviour of the investment shares 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 (current 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.

[15] 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.

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).

The fact that the obsession of the financial markets with inflation has not faded, along with the inflation rate itself, suggests that those involved believe that governments will feel obliged to intervene to stop inflation rising. An explanation for such government vigilance would be the belief that any substantial lift to inflation would set in train another period of damaging distributional conflict, perhaps reducing profitability as on previous occasions.

(b) The World Economy - Slowdown, Disorder, Integration

Conditions in the world economy have made it much more difficult for individual countries to maintain high investment and full employment since 1973. But it is important not to lump all the 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, or the greater the terms of trade costs of achieving any given growth rate of exports[16]. At the very least this 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). This may be interpreted as reflecting 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 individual economies via demand (where everybody believes interest rates must matter for investment even though econometric confirmation is hard to come by). But also they impose tighter limits on primary government deficits if the debt is not going to rise at (what the markets may regard as) unsustainable rates.

In addition to slower growth, there has been increasing disorder in the world economy. The discussion of the exchange rate implications of expansionary policies in a situation of extreme capital mobility suggested that large swings in exchange rates could occur, perfectly rationally, as expectations about the direction of policy, or their success, altered.

[16] Even the impact of the slower growth of world trade is not quite as straightforward as it appears. Since productivity growth is lower, it requires a slower growth of output to generate a given growth rate of employment and thus the necessary growth rate of exports to pay for import growth will be less. Thus Sweden preserved full employment in the 1980s with export growth of 3.5 % per year as compared to 7.7 % per year for the period 1960-73.

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 is quite consistent with such disruptive impacts on investment plans. Moreover as between countries the extent of the manufacturing investment recovery in the 1980s bore very little relation to the extent of profitability recovery. This may have reflected the close relation between profitability improvement and rise in international competitiveness, with the latter decreasingly predictable in the face of gyrations of real exchange rates (Glyn 1994).

Of the three aspects of internationalisation discussed earlier the huge growth of international financial flows is the most clearcut. 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. As table 3 shows the shares of exports in GDP do not much exceed those of 1913. Taking the OECD as a whole the share has about doubled since 1950, with a particularly sharp rise in the mid-1970s as exports were expanded to pay for oil imports. But since then the rise has been minimal with recent declines in export shares in both Japan and Europe [17]. There has been a sharp increase in international competition *within* manufacturing, as shown by the import penetration data (table 4); this includes substantial growth from non-OECD sources. 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 could hardly constitute an independent explanation for slow growth in 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 coordinated macroeconomic expansion (at the European level for example) would not happen. Domestic resistance to expansion, for the reasons discussed earlier, however,

[17] 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 the case considered above). 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 an inflated measure because it includes the import content of exports.

makes the failure to engineer co-ordinated expansion entirely explicable.

Finally, the 1980s saw a sharp increase in foreign direct investment; practically doubling as a ratio of world GDP. Table 5 shows inflows and outflows expressed as a percentage of domestic investment for the 1980s. They give an indication of the proportions of the domestic capital stock which would be owned overseas, and how large ownership of overseas capital stock would be relative to the domestic stock, if flows continued at the 1980s rates. Generally the rates are quite modest. Even the large figures for outward investment for Sweden and the UK may exaggerate the real internationalisation of production (much of the FDI from the UK was "portfolio" purchases of existing assets by conglomerates). Certainly real investment "lost" to the domestic economy cannot be read off from them since there is no guarantee that the enterprises concerned would otherwise purchase new fixed assets at home.

(iii) The Tale of Two Disasters

(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 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 the external circumstances 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" (p296). But regardless of future acceleration, and the position of the NAIRU beyond which acceleration takes place is notoriously hard to determine, 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.

A credible policy for reducing the inflation rate which Mitterrand had inherited, possibly after a pre-emptive devaluation, would have obviated the need for deflation. To point to domestic problems does not provide the political solution. 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 is hardly the same as writing off national economic policy as impotent.

(b) The Swedish Debacle

Almost continuous social democratic rule in Sweden reduced economic inequality to an unprecedented extent for an advanced capitalist country. At the beginning of the 1980s Sweden was top of the equality league in terms of:

* Employment (per head of population)
* Female as compared to male wages
* Progressiveness of tax system
* Generosity of public pensions
* Public provision of health, education £ welfare services
* Relative absence of Poverty
* Overall Income Equality

Sweden also had the best record on unemployment during the 1980s if Switzerland's lower average rate is discounted as having been manipulated by expelling foreign workers and one of the most egalitarian wage structures[18]. Whilst the indicators overlap, their coverage is incomplete, and their measurement often contentious, the consistency of Sweden's position is remarkable. Although the individual indicators do not show the Swedish position as qualitatively more egalitarian than the countries immediately below (usually Scandinavian), the overall effect made Sweden's premier position difficult to dispute.

The most obvious evidence for the view that the Swedish model has buckled under the accumulated stresses and strains is the disastrous rise in open unemployment, from 1.5% in 1990 to 8.2% in 1993. Indeed when Sweden joined the EC at the beginning of 1995 its unemployment rate would have been close to the rest of the EC but for the substantial extension of its famed active labour market programmes. This section first of all

[18] OECD *Labour Force Statistics;* ILO *Yearbook of Labour Statistics-,* OECD *The Income Tax Base;* Esping Andersen (1990) Cusack et al (1989); O'Higgins and Jenkins (1990) and Buhmann et al (1988); OECD *Employment Outlook,* 1993.

examines the role of macro-economic mismanagement. Was this disastrous recession really anything to do with fundamental problems within the Swedish model at all as against ill-advised policy decisions? Concluding that the latter was very important, but not the whole story, the unsatisfactory trends in inflation and productivity growth are discussed. Finally an interpretation is suggested for the attempt by the employers to comprehensively dismantle the whole Swedish model.

It must be emphasised that there was no spectacular disintegration of the model, in the form, for instance, of a massive pay explosion. 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 the very low level of 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 p 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 (by offsetting the demand effects set off by rising saving). 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, Germany and the D.Mark block.

The very high demand for labour undoubtedly contributed; but longer-term problems were involved as well. The system of coordinated wage restraint had been under severe pressure from several sides. Firstly, and insufficiently emphasised, 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 or some 20% all told (table 2). This decline was halted in 1985 and there followed a short period of expansion according to the Social Democrats' Third Way (neither Thatcher nor Mitterrand). Consumption grew faster with the credit expansion of 1985-88, but this was shortlived. Transfers continued to rise, productivity growth fell further and by 1990 consumption out of the average paypacket was still 17% less than in 1973. Many households benefitted from receiving higher transfers, and some from a second family member working finding work. Nevertheless acceptance of such extensive and prolonged post-tax wage restraint without greater wage pressure was

remarkable enough, but obviously the strains involved were formidable.

Secondly the coherence of wage bargaining was reduced by the growing power of white collar and public sector 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, Ramaswamy 1994). 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, Vartianen 1994). If Swedish inflation was to fall to European levels essential lubrication would be removed from the system. To preserve the flexibility of average wages, and increase the flexibility of relative wages, a radical decentralisation of bargaining might do the trick or (more likely) unemployment would have to be allowed to rise substantially[19].

In October 1990 the Social Democrats announced their intention to join the EC and at the same time accorded absolute priority to inflation reduction, with the budget for 1991 stating 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 p 140). The Swedish employers had come out against accommodating future cost pressures by devaluation in a 1986 report which noted that Sweden's competitiveness was "currently very good indeed" (Therborn 1991 p 263). But with the subsequent deterioration in competitiveness, rising unemployment was the inevitable result of Sweden's businessmen having "suddenly got what they wanted from the country's left-wing government" in terms of "making the fight against inflation its top priority, above that of full employment" *(The Economist* November 17, 1990).

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 (table 5) acted to starve domestic

[19] Calmfors (1993) seems to suggest that decentralisation was an alternative to unemployment for restraining wage drift. Certainly the disinflation achieved between 1990 and 1992 occurred under the auspices of a government appointed commission with negotiations described as "the most centralised ever held" (Aberg 1994 p 88). Subsequently the struggle over decentralisation has continued in the new context of high unemployment.

investment. But it also puts the poor performance of labour productivity in an even worse light; Lindbeck et al (1993) point to studies suggesting that "total factor productivity in manufacturing has grown more slowly than in any other OECD country for which statistics are available" (p 221). A government appointed group of economists blamed, amongst other factors, the successive devaluations, which released the pressure on business to rationalise (Johansson and Ekdahl 1992)[20]. Thus the decision to fight inflation with a fixed exchange rate would also force the rationalisation of firms (indeed manufacturing productivity rose 7% in 1992 after output had slumped). If policies (such as devaluation) which preserved full employment also relaxed the pressures on productivity growth, then abandoning full employment could contribute to productivity revival, by putting greater competitive pressure in product markets and giving firms greater latitude in relation to their labour force (as in Thatcher's Britain).

Thus whilst macroeconomic mismanagement definitely contributed to both the problems flowing from the extent of the boom and the depth of the recession it is not the whole story. A further devaluation (such as was eventually forced on Sweden after the most strenuous attempts to preserve the exchange rate) and less restrictive monetary policy could have limited the damage to employment at least for a time. Lindbeck at el (1993 p 22) point to the deliberate element to macroeconomic policies in terms of "a collision between domestic inflation and a fixed exchange rate". Calmfors elaborates on the reasons for the policy stance suggesting 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 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, encouraged by the employers it "has taken up earlier social-democratic proposals and has extended them into what might be characterised as a general labour law offensive aimed at circumscribing union power, especially through the regulation of industrial conflict at the workplace" (Kjallberg 1993 p 137).

[20] Also mentioned are disincentive effects of high taxation. In fact the international data are far from confirming that economic equality generally reduces productivity growth. Alesina and Rodrick (1992) conclude that "countries where income is more equally distributed also grow faster" (p 34); Persson and Tabellini (1992) reach the same conclusion and the World Bank found that "If anything inequality is associated with lower growth" (1991 p 137). But this does not, of course, absolve individual egalitarian policies, in Sweden or anywhere else, from adverse effects on productivity.

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-earner 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 impinged on the authority and freedom of action of business which was supposed to be guaranteed in return for full employment and the welfare state. This seems to at the root of the employers' repudiation of the Swedish model, of which full employment was a central part, exploiting both internal discontents and external circumstances (the general adoption of disinflationary policies for example). Deregulation of international financial transactions was an important contribution to stoking up the pressure for a change of priorities

Pehaps a fundamental, Kaleckian contradiction of social democratic full employment policy can be distilled from this experience. Its maintenance for an extended period generated demands which violated the prerogatives of capital. This provoked a backlash which forced social democracy to abandon not only its radical, and system-reforming proposals, but also full employment itself.

Summary

This section has tried to situate the current retreat from full employment policies in historical perspective. The dynamism of private investment in the golden age was crucial in that it (a) allowed high employment without deficit spending and (b) generated the rapid productivity growth which allowed substantial redistribution to be combined with rising consumption out of earnings. High and rising tax-financed government spending also bolstered demand. The problematic element was the distributive struggles 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 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.

III Conclusions

Unemployment is a major source of rising inequality and insecurity the OECD economies and as such constitutes the acid test of the capacity of social democracy for regeneration. There are two hurdles to surmount. First, the Keynesian problem of generating the jobs (not necessarily by Keynesian means) and then the Kaleckian problem of resolving the distributional and other conflicts accompanying full employment.

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 even orthodox policies of demand expansion have their costs which must be met by those already employed (whilst bringing them other benefits). Moreover during the golden age the dynamism of private investment (for which workers paid in a variety of wages in respect of pay and conditions at work) was the fundamental explanation for full employment. It was supported by tax-financed public expenditure which in the main redistributed welfare within the mass of wage and salary earners.

Prolonged full employment brought the distributional problems foreseen by Kalecki which form the backdrop to the decline in investment growth. By making demand less dynamic, and by much reducing the productivity growth out of which redistribution can be financed, this weakness of investment is at the heart of social democracy's problems.

Increasing international economic integration has been most important in terms of hugely expanded flows of financial capital. These have further weakened private investment through the economic disorder they have generated (and the high real interest rates they have spread); anticipatory financial flows may also threaten otherwise viable programmes to raise employment. The increase in trade flows between advanced countries has been limited and its modest impact on the costs of expansion could be largely offset by international co-ordination in the absence of domestic inhibitions.

It seems quite wrong to interpret the problems of the Mitterrand expansion as showing that national macroeconomic policies are irrelevant; rather it demonstrates the decisive importance of credible policies to contain distributional conflict. The crisis in Sweden has been overlain by disastrous macroeconomic (and financial) policies; but it also exemplifies the longer-term strains, on productivity and inflation, of a prolonged period of very high employment and extensive redistribution. Most fundamentally the implicit compromise between capital and labour was threatened as labour's aspirations, bolstered by high employment, encroached on the employers' right to control the allocation of work and capital.

The context for implementing policies to expand employment would be much improved if the power of international financial flows was curbed. The fact that the speculators can on occasion force an improvement in damaging macroeconomic policies (the UK and Sweden in 1992 being excellent examples) cannot justify the overall destructive effects of these flows which must vastly outweigh their (highly debatable) microeconomic benefits. Passivity cannot be justified by bogus arguments about the speed of electronic transfers

of funds. Proposals to limit foreign exchange speculation have included taxes on the value of the transactions (Tobin 1982) and deposit requirements on foreign exchange business (Eichengreen and Wyplosz 1993). Perhaps most relevant to the problem in hand -avoiding the disruptive effects of anticipatory depreciations - are systems of dual exchange rates where the rate for current transactions is pegged by government intervention leaving the market rate on capital transactions free to float without impact on the terms of trade and real incomes (Dornbusch 1986).

Curbing speculative capital movements would improve the context for full employment policies, but the fundamental questions concern their domestic distributional implications.

There are a range of policies which offer the possibility of regaining high employment on reasonably egalitarian terms. Broadly speaking, to any right wing proposal there is a more egalitarian shadow. Space permits no more than a list. "An egalitarian supply-side approach to full employment would aim at enabling marginal workers to earn high wages....by helping them increase their productivity" (Streek 1992 p 29). This implies heavy emphasis on training, especially for the least educated group of workers whose labour market position in many countries is catastrophic (in the UK at the moment one third of men in this category are not in work - Schmidt and Wadsworth 1994). To the idea that labour markets should be deregulated to force workers into low-paid private service jobs can be added some form of subsidy or income support for these workers (or most radically a basic income - van Parys 1992) to allow them to live tolerably . Reduction in the working week could be seen as an egalitarian alternative to forcing sections of the population, more or less openly, out of the labour force (immigrants, women workers).

In diametric opposition to the right's policies is tax-financed government spending, whose long-term rise has already featured prominently in this paper. Its impact on jobs is much quicker and predictable than supply side measures to boost training or promote private services. By redistributing consumption to the unemployed no extra pressure is put on the tradeables sector and the direct import content of such spending is low (Glyn and Rowthorn, 1994); there is little problem of shortage of capacity on which to employ people in government services or supplying sectors such as construction; programmes can be geared towards providing jobs, with reasonable conditions and pay, for the less qualified and targeting on particular groups such as the long-term unemployed is simpler than within the market sector. Expansion of public spending highlights the case for additional work of social value to be done (contrary to what might be suggested by proposing cuts in the working week). Programmes can be geared towards bolstering the supply side, including infrastructure.

The crucial question with all these proposals is not only their effectiveness in generating work but also the distribution of costs and benefits. The net costs of extra public expenditure (training, subsidies, infrastructure, welfare services and so forth) are only a proportion (as low as half perhaps) of the gross cost as higher employment reduces benefit and increases tax revenue. But the net cost still has to be met. The fundamental problem of achieving high employment is the political problem of persuading people to bear the costs. It seems a less daunting task in the UK (where public spending is around 45 % of GDP and the long-term costs to the rest of society of prolonged high

unemployment and of soaring social divisions are increasingly evident) than in Sweden (with higher shares of spending and taxation and only very recent experience of rising inequality).

Once high employment is regained, and the benefits from restraint become less obvious, there is the possibly even greater obstacle of devising the means of avoiding a renewed upsurge of distributional conflict[21]. It is also hard to believe that prolonged full employment would not again bring more challenges to capital's prerogatives and resultant political conflicts. Reassessing the experience of the first period of full employment capitalism is essential for more lasting success.

[21] See Dore et al 1994 for valuable discussion about incomes policies..

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	1990-92
Europe	40	130	52	28	9
Sweden	4	5	2	29	
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	
Europe	1.6	1.2	-0.4	3.8	
Sweden	1.2	1.7	-1.1	3.7	

Sources: OECD Historical Statistics, Economic Outlook, National Accounts, and Maddison 1991. plus
Strikes Department of Employment Gazette
Profit Shares Armstrong et al, and OECD National Accounts
Manufacturing Productivity: Bureau of Labour Statistics
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 Sweden Patterns of Redistribution 1965-90

average annual % changes	1965-73	1973-85	1985-90
(1) Productivity (hourly, market sector)	5.4	2.3	1.1
(2) Workers' Consumption (out of wages)	1.5	-1.7	0.6
(3) State employment	1.1	0.8	-0.1
(4) Av hours worked (includes part-time)	-1.6	-0.7	0.4
(5) Market output per person employed (whole economy) = (l)-(3)+(4)	2.7	0.8	1.4
Shares of market output (changes, % points pa)			
Net Exports	0.5	0.4	-0.8
Fixed investment in market sector	0	-0.1	0.6
Consumption from property incomes	-0.1	0.1	-0.1
Consumption from transfers	0.5	0.6	0.7
Workers consumption (out of wages)	-0.5	-1.0	-0.3
Memo item: employment/population of working age	0.2	0.5	0.4

Notes: definitions and sources, see Glyn (1992a)

average hours worked includes effect of part-time working after 1973 (about half the total effect)

changes in shares of market output do not add to 1 because stocks and government purchases omitted (latter changes very small).

Source: OECD National Accounts diskette.

Table 3 Exports as % of GDP 1913-92

Current prices	1913	1950	1960-73	1974-9	1980-90	1991-92
USA	(6)	4.4	5.2	8.4	8.5	10.6
Europe	(25)	19.5	19.3	25.8	28.7	26.4
Japan	(20)	12.6	9.8	12.6	12.7	10.3
OECD	(16)	9.9	12.4	17.3	18.4	17.9

Source: OECD Historical Statistics and National Accounts: figures for 1913 are (crudely) linked from Maddison Dynamic Forces 1991.

Table 4 Import Penetration of Domestic Markets for Manufactures 1913-90

percentage	1913	1950	Early 1970s	Non-OECD Sources	1985-90	Non-OECD Sources
USA	3	2	5.0	1.0	13.3	4.3
Japan	48	3	3.2	2.1	5.4	2.6
4 Large European	18	7	15.8	2.0	25.6	3.1
4 Small European			28.7	3.3	37.7	3.3

Note: imports as % of apparent consumption (production plus imports less exports)
Source: 1985-90 Martins, 1993; early 70s calculated from Martins; figures for 1950 and 1913 are (crudely) linked from Maizels 1980.

Table 5 Foreign Direct Investment, 1981-92

% of Gross Domestic Investment	OECD	USA	JAPAN	EUROPE	Germany	UK	Sweden
Inward	3.3	4.7	0.1	4.2	1.4	9.8	3.2
Outward	4.2	2.6	2.9	6.3	5.9	15.5	13.1

Source: UNCTAD World Investment Report 1994 Annex Tables 1,2,6 and OECD Review on Foreign

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