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**CAN THE EUROPEAN WELFARE STATE SURVIVE  
GLOBALIZATION?  
SWEDEN, DENMARK, AND THE NETHERLANDS IN  
COMPARATIVE PERSPECTIVE**

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In no area is increased openness to international capital movements and trade seen in more apocalyptic terms than in the case of social welfare. For example, the political theorist John Gray regards the demise of the welfare state as a direct effect of globalization: “To imagine that the social market economies of the past can renew themselves intact under the forces of downwards harmonization is the most dangerous of the many illusions associated with the global market. Instead social market systems are being compelled progressively to dismantle themselves, so that they can compete on more equal terms with economies in which environmental, social and labour costs are lowest.”<sup>1</sup> Many other authors make the same assertion of a race to the bottom, most notably the gloomy German best-seller *The Global Trap* by Hans-Peter Martin and Harald Schuman (1997) or William Greider’s *One World, Ready or Not - The Manic Logic of Global Capitalism* (1997).

There is no doubt that welfare states in the advanced countries are now under a variety of sources of strain that push up both costs and the demand for services: high levels of persistent unemployment in many European countries, aging populations - increasing the costs of pensions and health care, increasing complexity of medical technology, high-rates of family break-up and a decline in informal family-centred welfare, and a growing demand for enhanced welfare and social services generally. In the EU the convergence criteria for monetary union have put a general break on public spending and public borrowing in a

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<sup>1</sup> False Dawn, 1997, p. 92

number of countries, impacting on welfare entitlements and provision. The question, however, is whether there is an added pressure on welfare entitlements and provision that is due to increasing international openness **per se**. If a race to the bottom is taking place, it should show up in a failing economic performance by countries with extensive welfare states. France and Germany are cutting back in order to qualify for EMU, and Germany has the burden of assimilating the former GDR. But both have healthy balance of trade surpluses and their exports continue to grow. France has attracted more inward investment than the UK in the period 1991-5 (\$19 billion pa as against \$17.2 billion) - demonstrating that there are assets other than deregulation and flexible labour markets that attract investors.<sup>2</sup> Both have intrinsic structural problems with their welfare states, high unemployment and relatively low growth, but neither is failing to pay their way in world markets.

This may seem an old fashioned concern, but it is a crude index of competitive performance in international terms. A country, like the UK, that must finance a structural balance of payments deficit is dependent on short-term capital flows as much as a country with a substantial ratio of public debt to GDP is on the bond markets. In a way it might be argued that the real effect of increased international openness to trade and capital movements is to make medium-sized states like France or Germany more like smaller highly internationalized ones like Austria and Switzerland.

In a sense the issue of international exposure is not new and historically a high degree of internationalization has been typical of the smaller advanced countries, and it has induced **higher** rather than lower levels of public and welfare spending. Very open economies are more exposed to external shocks and must develop means to cushion their

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<sup>2</sup> IMF data cited *Observer* 27.4.97

firms and workers against them. Peter Katzenstein in *Small States in World Markets* (1985) showed that small highly-internationalized countries, like Austria, the Netherlands and Sweden, combined corporatist economic policy making and traditions of solidarism and consensus-seeking among the organized social interests, with high levels of welfare and public provision to protect individuals against the effects of externally generated risks. Corporatism enabled states to adapt macro-economically, by restraining wages, co-ordinating economic action by firms, and underwriting public policies of industrial support and labour-market adjustment. Welfare enabled workers to bear the costs of external shocks whilst these adaptive measures were taking effect. By offering security to workers welfare states built political support for consensus policies. Thus a high level of international exposure does not automatically require the responses of cut-throat competition between firms and the slashing of welfare provision. Rodrik (1996) has confirmed these findings of political science by an econometric analysis. This covers government expenditures as a percentage of GDP (excluding interest payments) for 23 OECD countries during 1990-92.<sup>3</sup> It shows a clear connection between the degree of international openness and the level of government expenditure.

In a later work *Has Globalization Gone Too Far?* (1997) Rodrik argues that: “Societies that expose themselves to greater amounts of external risk demand (and receive) a larger governmental role as shelter for the vicissitudes of global markets . . . Hence the conclusion that the social welfare state is the flip side of the open economy!”<sup>4</sup> The issue now is whether such national responses are still possible. Katzenstein’s study relates to a period

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<sup>3</sup> Rodrik, 1996, figure 4.2, p.52

<sup>4</sup> p. 53

in which controls on capital movements were still in force. John Gray, with characteristic emphasis, claims that the “social democratic regime presupposed a closed economy” in which capital movements were controlled within a system of semi-fixed exchange rates.<sup>5</sup> One should be careful here to de-couple welfare systems and Keynesianism in a way Gray does not - many states with high levels of welfare, most notably Germany, did not practice demand management policies. It is certainly true that full-employment during the Great Boom of 1945-73 kept the cost of welfare states down, but high levels of growth and full employment had multiple causes across the advanced world and existed in both Keynesian and non-Keynesian states.<sup>6</sup>

States with low levels of trade to GDP, like Japan or the USA, could get away with vestigial or imperfect welfare states, using other policies to sustain economic performance and, therefore, employment - in Japan industrial policy and in the US demand management and Federal spending on defence and infrastructure. Rodrik argues cautiously that the very factors that increase the need in all the advanced countries for welfare to provide insurance against and adaptation to external shocks may now work against the implementation of such policies. He says, “. . . globalization presents this dilemma: it results in increased demands on the state to provide social insurance while reducing the ability of the state to perform that role effectively.”<sup>7</sup> The danger of a high level of external exposure is that the mixture of extensive welfare and free trade becomes unstuck. Capital becomes mobile and will move if domestic economic policies and tax regimes threaten economic returns available elsewhere. Capital can threaten to defect elsewhere, both to national governments and to workers in

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<sup>5</sup> False Dawn p. 88 see also After Social Democracy (1996)

<sup>6</sup> See Hall (ed.) (1989)

particular firms. How seriously these threats are taken will depend on the conjuncture. Major manufacturing firms with large fixed investments are unlikely to move lock stock and barrel. Financial institutions, however, can move pensions and insurance investments offshore and the markets can refuse to buy government bonds except at an interest premium. Thus in an open economy capital will resist high levels of corporate taxation and payroll taxes paid by employers. It will try to increase its income take from firms by demanding wage restraint without compensating bargains - a form of “post-corporatist” one-sided bargaining typical of the USA. The costs of welfare will, therefore, be forced onto workers’ incomes. At the same time the elite of high-paid and relatively mobile workers will resent high levels of tax. Thus the tax base will erode as incomes from capital and higher salaries are increasingly exempt.

Rodrik’s case depends centrally not merely on the mobility of capital, but on the use of such mobility as a threat in distributional bargaining. It supposes a de-localized and post-corporatist business class. Obviously, the threat is real - very high levels of taxation on investment incomes in an open economy, cutting into pensions and personal saving, will threaten middle class support for the welfare system as well as leading to deflections abroad by major institutional investors. Inevitably welfare and government expenditure generally will have to be funded out of taxes on incomes, sales and targeted services like airline journeys or insurance policies. This means that the public must both want such welfare services and be willing to pay for them. It implies both solidaristic values **and** appropriate political institutions that force decision makers to respond to those values. Hence both attitudes and institutions become central, in the form of distinct national legacies that favour

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<sup>7</sup> Rodrik 1997, p. 53

solidarism and public consumption. Societies without such inheritances or the means to invent them will thus feel the pressure. The degree of international exposure **per se** is not the issue, rather it is the domestic political response to it. Moreover, to attitudes and institutions must be added effective macro economic and welfare policy responses by elites - pressure on public spending can be much worse by poorly conceived or inappropriate policies (as we shall see in the case of Sweden).

This implies that welfare states already funded out of general taxation probably have a head start on those funded from employers' contributions, taxes on capital, and high levels of public borrowing. Pay as-you-go welfare states will be viable, ones that avoid excessive budget deficits and rely on domestic sources of revenue. It also implies that not only is welfare spending a means of insurance against external shocks, it is also a means of macro-economic adjustment. In a severe externally-induced crisis, corporatist bargaining may centre not merely on wage restraint but on the containment or retrenchment of public expenditure. As we shall see, the two are connected - the employed will contain wage demands more readily if tax bills are held down. This means bringing public expenditure and welfare programmes into the domain of bargaining, deciding which programmes must be maintained to help adjust to shocks (training, active labour market measures) and which programmes may involve temporary or long-term cut backs in benefits or entitlements. In an advanced corporatist economy the representatives of the recipients of welfare should be brought into the bargaining, as economic agents with a role in generating consensus and not merely as passive objects of policy.

Ireland, for example, has its corporatist National Economic and Social Council but also the National Economic and Social Forum: the former representing the traditional and

social partners and bargaining primarily over national wage policy; the latter representing other social interests, including the unemployed. So far, the latter interests have not been included directly in national bargaining. However, if effective use is to be made of such extended corporatist representation to achieve consensus on a wide basis and to prevent the Forum turning into a source of special pleading by claimants for more government programmes, in an essentially negative and passive role, then the NESC will have to include them too. Ireland has had a high rate of growth (5.7% 1991-5), but persistent high unemployment.<sup>8</sup>

This is to get ahead of ourselves. If we accept that welfare states do face some added constraints in a period of high capital mobility and international exposure to trade, then the issue is how can these be met. One way is to return to Katzenstein's theme of small states in world markets and look at how very open economies with extended welfare states have fared. The examples chosen are Sweden, because it is always cited as a classic case of retrenchment through international pressures, but also Denmark and Holland because they illustrate the possibilities of successful adaptation and survival both in economic performance and in welfare policy. In both cases the story is not one of simple expansion of welfare, rather welfare has played its part as a variable in macro-economic adjustment, both through strategic cutbacks in difficult conjunctures and long-term shifts in welfare policy and provision. They are also very different institutionally. Denmark has lacked centralized corporatist bargaining over wages, unlike the Netherlands and Sweden. Denmark has been seen as having a 'Scandinavian' welfare state and the Netherlands a 'continental' one. Thus they offer a crucial experiment. Small highly internationalized states facing similar pressures

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<sup>8</sup> See Charles Sabel, 1996



but with different industrial and institutional structures. If the effect of internationalization is to undermine welfare, it should be visible here. If societies can contain these external pressures, then the ability of different complexes of institutions to adapt and respond shows that policy does have an effect and that there are options at the political level.

### **A Swedish Crisis and a Danish Surprise**

The economic difficulties that Sweden has experienced in the 1990's have been widely cited as evidence that globalization has removed the option for distinctive national economic policies. For example, John Gray claims: "What happened in Sweden has implications for social market economies everywhere" (1998, p.92). In particular Sweden has been forced to retreat from full-employment policies based on the expansion of the public sector and to cut back on entitlements in its extensive and universalist welfare state. Sweden's crisis is taken to be decisive because it was perceived internationally to be the classic embodiment of a social democratic "third way" between state socialism and *laissez-faire* capitalism. If Sweden could not sustain its welfare system, then what hope for other states?

One cannot dispute the severity of the crisis. Over the period 1990-95 growth was virtually stagnant at an average for the five years of 0.4% GDP; in 1991-93 GDP growth was negative.<sup>9</sup> Unemployment rose from 1.6% in 1990 to 7.7% in 1993, and if one includes those in active labour market programmes from 2.1% to 12.5%.<sup>10</sup> Total government expenditure as a percentage of GDP rose from 60% in 1989 to 74.1% in 1993, before falling

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<sup>9</sup> OECD Economic Survey, Denmark 1997, Stat Summary

<sup>10</sup> Stephens p.45

back to 66% in 1995.<sup>11</sup> Sweden suffered a particularly sharp crisis in the early 1990's as a result of three inter-related phenomena that acted together to drive down employment and output: first, the movement of Swedish capital abroad in anticipation of the completion of the European Single Market and before Sweden's own entry into the EU; second, the widespread depression of the early 1990's in Europe; thirdly, the struggle to maintain a fixed parity of the Krona against the Deutschmark after the abandonment of the policy of competitive devaluations of the 1980s.

There are two responses to this crisis. One is to claim it is a typical and inevitable feature of excessive public spending and over-extended welfare entitlements. Sweden is simply an extreme case of a general problem with European welfare states. The other, represented, for example, by Gøsta Esping-Andersen is to see the crisis as primarily conjunctural. Sweden's economy will recover, indeed is recovering, and, with appropriate retrenchment, the welfare state will survive. This view has some merits, but clearly there are structural features that need addressing too. The defect of the first view is that it neither accepts a substantial amount of conjunctural contingency nor it does allow for Swedish specificity. We should not let Sweden's status as an exemplar of welfare capitalism hide the very destructive features of its economy and economic policy that explain why it was so exposed to international constraints in the early 1990s. If that is the case then Sweden's problems may not be intrinsic to welfare states in advanced countries, and such countries may have other more extensive options than Esping-Andersen's expectation of muddling-through and retrenchment.

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<sup>11</sup> Andersen S P Study p.2 Tbl 1 & OECD

Sweden is destructive in the degree of its export orientation in manufacturing and the dominance of the internationally exposed sector by a few highly-concentrated corporations. As a direct consequence of its post-1945 export success Swedish manufacturing has become highly multi-national, with approximately 50% of the output of Swedish firms being produced abroad. Increasingly Swedish large firms have used their internationalization to oppose some of the distinctive features of the Swedish model. The major employers came to reject the corporatist bargaining and governance arrangements that had served them so well until the 1980s: the Swedish Employers Federation (SAF) abandoning centralized wage bargaining in 1990 and withdrawing from tripartism altogether in 1991. The big firms increasingly threatened to defect abroad if governments and unions failed to adopt the employers policy prescriptions.

Swedish society might be said to be paying the price for making firms like L.M. Ericsson and Saab into world companies. In the post-1945 period Swedish economic policy was dominated by the goals of full employment and promoting export performance. Swedish industry was sustained by “forced-draught” macro-economic policies aimed at providing it with a stable domestic environment, internationally competitive wages in the export sector, and low-cost investment. Exchange controls and credit controls served to give governments a high degree of autonomy in managing the domestic economy. From the 1950s to the end of the 1970s wages policy was determined by centralized corporatist bargaining. Industry, labour and the state all pursued policies emphasizing wage restraint and wage solidarity between sectors. Taxation policy restrained domestic demand and thus prevented overheating, and yet ensured full-employment by steadily expanding public sector employment and welfare services. Investment was promoted by low interest rates.

By the 1980s the elements of this policy consensus became unstuck. The unions objected to the excess profits for the major firms created by the wage solidarity policy. The firms themselves chafed at exchange controls limiting their capacity to operate abroad. In the 1980s Swedish governments dismantled the apparatus of exchange and credit controls. They also adopted the policy of using devaluations to restore competitiveness. The effect of the removal of credit controls largely negated the benefits of devaluing the Krona. A credit-fuelled consumer boom led to overheating and inflation, and to the collapse of wage restraint. In responding to this the currency was pegged to the Mark and the public sector expanded to sustain employment, leading to the crises of the early 1990s. Sweden's problems are clearly due to a mixture of economic structure, policy errors and conjunctural factors but the heavy dependence of the economy on large multi-national manufacturing exporters, on the one hand and public employment on the other, severely limited the options available.

However, the idea that all advanced economies would face a crisis deriving from the pressure of their extended welfare states on the international competitiveness of their export sectors is belied by other societies that have had very different experiences in the same period of the late 1980s and early 1990s. One has only to cross the Sound to Denmark. Superficially, Denmark is a typical Scandinavian welfare state with high unemployment and a high percentage of government expenditure to GDP -in 1993 unemployment stood at 10.7% and public expenditure at 63.8% of GDP. Denmark had experienced relatively high unemployment and sluggish growth throughout the 1980s. In the early 1980s Denmark had an early experience of welfare state retrenchment when entitlements and compensation

ratios were cut back. It also provided an early example of populist protest against excessive public expenditure when the taxpayer's Progress Party won 15.9% of the vote in 1973-4.

Yet since the early 1990s Denmark has experienced a strong economic recovery with above average growth, a reduction in unemployment and a positive balance of payments. It thus seems to be bucking a trend toward welfare states in crisis and, moreover, public support for welfare remains high. If extended welfare states were such a threat to international competitiveness and economic performance then Denmark ought not to work, but it does.

In an article on the history of small scale production in Denmark Peer Hull Kristensen and Charles Sabel (1997) argue that the survival and success of small farmers and firms in that country appears to be an exception, but they contend that a concatenation of circumstances and outcomes, many present in other countries, here produced a distinct variant.<sup>12</sup> In other words Denmark was not so much an exceptional case, as a possible world. It would be too much to see Denmark as a model - whether of successful small scale production or of a modern welfare state. A model implies the experience can be readily copied and applied. Rather it serves as an indication that such variants are possible - that extended welfare and economic performance can go together in a small and highly internationalized economy. As Gosta Esping-Andersen (1990, 1996) argues persuasively welfare states, even if equally extensive and in countries with a common level of development, exhibit distinct structural and institutional features that make them more or less able to respond to the forces of European integration, economic internationalism and social change.

What are the distinctive features of the Danish economy and welfare state that have led it to be able to survive and adapt? The first point to notice is that, unlike Sweden, Denmark has an economy in which numerous small - and medium - sized firms are salient and that these span a number of sectors. The Danish business sector is less homogeneous than Sweden's. It speaks with more voices, and it is less concentrated and less multinational. Firms thus have a long history of adaptation to international markets and the necessity of doing this for themselves without lobbying as privileged insiders in a highly centralized corporatist structure for compensatory policies from government and organized labour. Denmark's exports are now overwhelmingly industrial goods (72% in 1995). Many small firms are dynamic and innovatory, and industrial districts, like those in West Jutland, have been dynamic foci of growth. Denmark has not had centralized national wage bargaining in the private sector.

Unemployment benefit is closely tailored to the features of this small-firm economy. Employment protection measures are among the weakest in Europe, lower than in the UK.<sup>13</sup> Unemployment benefits have been easy to get, with a long period of compensation, and a relatively high level of compensation of lower incomes but a swift taper-off. They are close to flat-rate benefits organized as insurance funds, but where the bulk of financing is provided by the state out of general taxation.<sup>14</sup> Access and availability were tightened up in 1995. The system thus allowed employers to adjust to changing conditions without imposing a severe burden on lower-paid workers. As Jorn Loftayer comments: "... the unemployment benefit system has not only served the interests of the employees. Corresponding to the

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<sup>12</sup> See also Kristensen, 1995

<sup>13</sup> Nickell JEP, p.61, Table 4

generous benefits, the rules for dismissal have been relaxed considerably, thereby becoming more favourable to the employers. And especially in an economy like the Danish characterized by many small firms this has contributed to flexibility and competitiveness.”<sup>15</sup>

The universalism of the benefits system thus has obvious advantages for flexibility. Unemployment benefit and basic pensions are paid out of general taxation (taxes in 1995 were 51.6% of GDP, the highest in the E.U., and primarily composed of income tax and VAT at 25%, corporation taxes were low). Both can thus be varied to suit economic conditions, and, indeed, have been (as in the case of the retrenchment in the early 1980s). Denmark is thus not burdened with unsustainable income-related public pension entitlements, or with a system of welfare as in France that ties benefits closely to one’s existing job. Welfare policy can be adjusted and it does not prevent labour mobility by the inflexible job specific forms that benefits are provided - as in France and Germany where benefits are funded substantially through social insurance paid by employers.

The OECD argues that high taxes depress labour demand and, combined with readily available benefits ensure that wages at the lower end have a high floor.<sup>16</sup> This may be so, but the system has many advantages that outweigh the flexibility provided by very low pay and poor benefits. As Jørgen Goul Andersen remarks: “the Danish welfare system is a universalist system with some resemblance to a citizen’s income system” (RWS p.160). Only a very small proportion of the population is not covered by some automatic citizen’s entitlement to income support - only about 50,000 people or about 1.5% of the population,

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<sup>14</sup> Andersen in RWS, pp.160-61

<sup>15</sup> RWS pp.144-45

<sup>16</sup> OECD Economic Survey Denmark p.51

mostly housewives, have no income of their own.<sup>17</sup> It might therefore be assumed that the disincentives to work mean that the burden of dependents to active citizens will become intolerable.

The evidence does not bear this out. Firstly, demography means that Denmark will be burdened with a below average proportion of people aged 60 and over because of higher than average fertility rates - roughly 4/1 in 2020 in contrast to Germany's 3/1.<sup>18</sup> The OECD calculates that the burden of future transfer commitments places Denmark in the middle range of OECD countries - net present value of social security payments as a percentage of 1994 GDP = 235% in Denmark as against Germany's 348%, France 318% and Italy 401%.<sup>19</sup>

Secondly, a readily accessible universal welfare system does not seem to have reduced labour market participation - the participation ratio in 1993 was 82.6%, above the USA at 75.9% and the EU 15 average of 66.9%. Female participation rates have risen from 43.5% in 1960 to 78.3% in 1993.<sup>20</sup> Most Danish households of working age are one and a half or two incomes. Thus the fact that 20% of those aged 19-66 receive their income from public transfer payments does not mean a large proportion of **households** are excluded from labour market participation and condemned to low incomes.

Denmark appears to have very high levels of both passive income support and active labour market programmes, being highest for both in the EU 12 in 1992.<sup>21</sup> The effect of flexible labour markets and strong active measures mean that there is a good deal of

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<sup>17</sup> Loftager, RWS, p.160

<sup>18</sup> Andersen, *Beyond Retrenchment*, p.27

<sup>19</sup> OECD Economic Survey of Denmark 1997, p.59, Table 15

<sup>20</sup> Andersen, SPS p.15 Table 7.

<sup>21</sup> Andersen RWS fig.3 p.163.



conjunctural and frictional unemployment, and a fair bit of “resting,” but much less long-term unemployment than one would anticipate. Indeed: “Denmark had generally had the lowest proportion of long term unemployed in the European Union.”<sup>22</sup>

Thirdly, the effect of this combination of strong passive and active labour market measures ensures that the unemployed are not marginalized. Denmark has among the highest levels of equality in disposable incomes in the OECD and did not experience a major shift toward inequality in the 1980s; unlike many other countries, most notably the UK and New Zealand.<sup>23</sup> Denmark had only 3% of households in which the principal wage earner is unemployed below the poverty line in 1988, compared to close to 50% in the UK.<sup>24</sup> Some 61% of unemployed workers who are married or cohabiting are home owners.<sup>25</sup> Again, among the married, unemployment is concentrated among women (some two thirds) and long term unemployment among the married is even more heavily concentrated among women (75% for those with 4-5 years unemployment).<sup>26</sup> The absence of social exclusion makes the unemployed much like the rest of the population, and therefore more easily employable. However, dual-income families and readily available benefits mean that poverty is not a pressure driving citizens into low paid work. This factor has prompted the recent Danish reforms of 1993-95 which reduced entitlements to unemployment funds - restricting benefit to 5 years of which three will be spent in active labour market measures. This switch in policy does seem to have contributed to a reduction in unemployment - the

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<sup>22</sup> Andersen, RWS, p.163.

<sup>23</sup> Andersen, SPS, table12, p.24.

<sup>24</sup> Andersen, *ibid*, fig.2, p.25.

<sup>25</sup> Andersen, RWS, p.170.

<sup>26</sup> Andersen, RWS, p.171.

“active line” being the factor pushing people to seek work rather than the crude threat of poverty.

Fourthly, private employment in Denmark has been almost flat since 1980 - indeed, the level was only marginally higher in 1997 than in 1948 (1789 vs. 1782 K).<sup>27</sup> Public employment grew from 691,000 in 1980 to 800,000 in 1997. Public employment is heavily concentrated in services. The Danes have a very high level of collective and public service consumption - for example, the widely available public day care that enables dual-income families to function and good public transport. Given a high level of income equality and ready access to good public services and universalist benefits, most citizens irrespective of income or occupation are consumers of public services and benefit from them. Hence the viability of a high-tax high-service regime. There is little evidence that public employment has “crowded-out” the private sector. Public employment has absorbed those who would otherwise have been displaced by “jobless growth”. GDP has grown far faster than employment: GDP at factor cost was some 65% greater in 1990 than in 1970, whereas employment was just over 100% greater.<sup>28</sup>

Moreover, public services (which absorb 30% of the labour force) should not be seen as a pure cost but rather as collective consumption - taxes are “buying” services and enabling them to be available to all. The Danish welfare state is service-intensive rather than benefits-intensive. It is a widespread perverse tendency, reinforced by national income accounting conventions, to treat public expenditure as a deduction from private welfare, as if public services were value destroying. Given a reasonable level of efficiency of service

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<sup>27</sup> Andersen, Beyond Rt, table 3.

<sup>28</sup> Loftager 1996, p.5

provision in both public and private sectors then the choice between private and collective consumption is just that, a political choice in how and why services are provided. Public services have the advantage of promoting equality of access, reducing cost constraints for lower income groups. Thus lower income women are able to work because of publicly provided day care.

Fifthly, the Danish transfer payments system is not, despite popular perceptions, inordinately expensive in comparison with comparable neighbouring countries like Germany or the Netherlands. Danish welfare is overwhelmingly paid out of current taxes - and income taxes and VAT are both highly visible. However, when one aggregates taxes and social insurance payments, then as Jørgen Goul Andersen argues “this composite income tax as a percentage of GDP resembles most other North European countries.”<sup>29</sup> Recalculated after deduction of interest payments and correcting for the taxation of income transfers, public expenditure as a percentage of gross factor income in 1987 was 40.9% for Denmark, 40% approximately for the Netherlands, and 38.1% for Germany.<sup>30</sup>

Lastly, such a level of welfare is not unsustainable, given the political will and political support. Jorgen Goul Andersen has presented extensive survey data on public perceptions of the welfare state - overall some 67% of those surveyed agreed that the welfare state should be maintained rather than reduced. Even among private sector employees with no experience of unemployment some 24% more supported the existing level of welfare provision than thought it had gone too far.<sup>31</sup> This is further evidence that Denmark is not divided into insiders and outsiders - leading to differentiation between the

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<sup>29</sup> Andersen, SPS, p.5

<sup>30</sup> *ibid*, table 2

stably employed, especially in the private sector, regarding those dependent on state benefits as a burden. There is evidence that younger Danes are less solidaristic- particularly students who see the unemployed who enter university given superior terms. Given the high levels of taxation in Denmark, public resistance to welfare is much lower than one would expect. One can surmise that equality, non-marginalization of welfare recipients and a common experience of collective consumption do lead to high levels of solidarity. People contribute but they also benefit. This contrasts with exclusionary welfare states, where exclusion and pauperization lead employed taxpayers to see services and entitlements for the poor and unemployed that they do not use as a pure cost.

There is a good deal of academic and elite criticism of Danish government institutions and of public expenditure in particular. Danish political science has a strong Public Choice Theory strand and neo-classical economics is influential. Denmark thus does not lack the elite voices that have been so successful in transforming countries like the UK and then New Zealand in an anti-welfare direction. What has been missing is the political capacity. Most Danish governments have been coalitions without large majorities. Confronted with strong public support for welfare, political parties have hesitated to follow arguments for radical reform. Political power is also highly diffused in Denmark. Local government is very decentralized and has a high degree of autonomy. Corporatism may be weak at national level, but is strongly entrenched within the different branches of the public sector. It is thus difficult to drive through change against the resistance of local authorities and welfare professionals. It is significant that both the UK and New Zealand are highly centralized Westminster systems, characterized by winner-take-all exclusive party

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<sup>31</sup> RWS p.179

government. In both countries the first past the post system meant that governments could enjoy effective majorities whilst appealing to narrow and exclusive electoral constituencies. Thus in the UK the public continued to support higher public spending on health and education, yet since the 1970's successive governments have been able to ignore these mass attitudes.

According to Public Choice Theory Denmark should have experienced institutional deadlock and ever-escalating public expenditures as entrenched interests fought budget cuts and sought to expand their own programmes. Yet Danish governments have been able to restrain budget growth and cut back on entitlements. The reason argue Albaeck et. al. is that organized interests within the state and public sector trade-off short-term budgetary gains for preserving long-term institutional autonomy.<sup>32</sup> Danish citizens and organized interests seem to have been willing to adapt to crises, making sacrifices in periods of economic difficulty. Undoubtedly, equality and inclusion help to promote such solidaristic and public-minded behaviour, citizens and organized interests have a high degree of influence in the political process and a reasonable expectation of fairness in the behaviour of governments and other political actors. Unlike polarized societies in which the losers can expect to be penalized in distributional conflict, solidaristic behaviour in this situation is a rational choice.

### **A Dutch Miracle**

Jelle Visser and Anton Hemerijck's *'A Dutch Miracle': Job Growth, Welfare Reform and Corporatism in the Netherlands*<sup>33</sup> is an extremely valuable study of the institutional

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<sup>32</sup> Erick Albaeck et. al. (eds.) 'Introduction' Managing the Danish Welfare State Under Pressure MSS

<sup>33</sup> Amsterdam University Press: Amsterdam, 1997

conditions and policy measures under which a small and highly internationalized advanced economy can adapt to the intensified competitive pressures of the 1990s and in doing so preserve an extensive system of social welfare. They show how the Netherlands is an exception to Gøsta Esping-Andersen's (1990, 1996) analysis that welfare states, once institutionalized, are very difficult to change. It is widely accepted that extensive welfare states create powerful political constituencies, vested interests, and organized groups with veto powers that obstruct change in either structures or entitlements, however real and necessary may be the economic pressures for adaptation. Such rigidities are a block to effective macro-economic adjustment to the pressures of the world economy. At the same time Esping-Andersen argues that welfare states come in distinct institutional complexes, some of which (like the continental European model) have more serious effects on the level of unemployment and the capacity to control public expenditure and welfare entitlements than others. It would be an exaggeration to say he believes that the institutional structure chosen at the beginning of welfare reform is fate, but the analysis claims a high degree of path dependency and a high tendency to adaptive sclerosis.

The Netherlands is close to being a crucial experiment for the effects of globalization on the welfare state, since it is one of the most highly internationalized economies in the world and has been so for some time. Its ratio of commodity exports and imports to GDP puts it in a league as with Singapore at 89.2% in 1994 (although still lower than it was in 1913).

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**Ratio of commodity exports plus imports to GDP at current market prices (%)<sup>34</sup>**

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<sup>34</sup> Financial Times 18.09.95 p.24 Martin Wolf 'A Liberal World Restored'

|                    | <u>1913</u> | <u>1950</u> | <u>1973</u> | <u>1994</u> |
|--------------------|-------------|-------------|-------------|-------------|
| France             | 30.9        | 21.4        | 29.2        | 34.2        |
| Germany            | 36.1        | 20.1        | 35.3        | 39.3        |
| Japan              | 30.1        | 16.4        | 18.2        | 14.6        |
| Netherlands        | 100.0       | 70.9        | 74.8        | 89.2        |
| UK                 | 47.2        | 37.1        | 37.6        | 41.8        |
| US                 | 11.2        | 6.9         | 10.8        | 17.8        |
| Arithmetic Average | 42.6        | 28.8        | 34.3        | 39.5        |

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The Dutch invest substantially abroad, some 17% of the financial assets of household being held overseas in 1995, comparable to the UK, Canada, Denmark, Germany, Italy, Norway and Sweden were all under 10 and France, Japan and Spain under 5.<sup>35</sup>

Until the late 1980s the Netherlands appeared to be a classic example of the defects of a continental welfare model. The Dutch system like the French and German concentrated on benefits for full-time working breadwinners, with high social insurance costs per employee. Firms adapted to competitive pressures by productivity growth and by shedding labour onto the social security system. Together the employers and unions, who controlled, through the consociational governance system, access to the employment and sickness insurance funds, accepted large-scale early retirements and a huge increase in disability benefits.

In 1986 some 27% of those of working age were on disability benefits, unemployment benefits, early retirement, social assistance or special employment measures.<sup>36</sup> The labour force participation rate for males aged 60-65 fell from 70% in 1973 to 22% in 1991.<sup>37</sup> In 1973 women's participation in the labour force was a mere 29% and in

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<sup>35</sup> David Miles Independent 27.12.97, pg.19

<sup>36</sup> Visser p. 9

<sup>37</sup> Visser p. 17

1983 just 34.7% - well below the European average.<sup>38</sup> In 1983 the employment/population ratio was 52% - the lowest of all OECD countries.<sup>39</sup> In 1989 the number of people receiving disability benefits approached one million in a population of just over 15 million. In 1983 unemployment was 9.7%.<sup>40</sup>

Whatever one's stance in economic theory, the Netherlands was faced with a potentially unsustainable burden of dependants to active participants in the labour force. The tendency to adapt by shedding labour onto the social welfare budget drove up both the costs of employees for firms and the tax take on worker's incomes. The result was a cycle of maladaptive responses. Workers became unwilling to continue the wage moderation policies that had enabled the strongly externally-orientated Dutch economy to compete in world markets. Employers were reluctant to hire labour and sought to drive up productivity - since 1960 productivity has risen from 54% of US levels to 92% in 1987 and 99% in 1995.<sup>41</sup> Only this high rate of growth in productivity could sustain the welfare system, but it had the inevitable consequence of 'jobless' economic growth. Moreover, as it was approaching US levels by the mid 1990s, there were distinct limits to improving competitiveness further by this route.

Consider then the following facts. The labour force has increased by 25% between 1982 and 1996.<sup>42</sup> Unemployment fell to 6.5% in 1996 by standardized measures, comparable with the US.<sup>43</sup> Employment growth averaged 1.8% pa between 1983-1993 -

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<sup>38</sup> Visser p. 33 and p. 25 Table 4

<sup>39</sup> Visser p. 24

<sup>40</sup> Visser p. 25 Table 3

<sup>41</sup> OECD Denmark 1997 p. 94 Table 24

<sup>42</sup> Visser p. 23

<sup>43</sup> Visser p. 24



compared to a mere 0.4 EU average.<sup>44</sup> In 1994 employment growth was 0.8%, in 1995 2.4%, in 1996 1.9% and projected for 1997 2.0%.<sup>45</sup> Between 1991-96 GDP growth was 2.2% compared to an EU average of 1.5%.<sup>46</sup> Inflation remains low at 2.5%. The budget deficit was 2.2% of GDP in 1996 - in 1980 it was 7.2%.<sup>47</sup> Thus the Netherlands seems to have somehow achieved a remarkable turnaround - boosting employment, reducing the costs of welfare without fundamentally undermining the welfare state, and achieving modest but non-inflationary growth. The Netherlands have broken out of the path apparently ordained by its institutional structure.

How was this possible? Firstly, let us look at where most of the new jobs have come from and who has filled them. The labour force has grown by 1.4% per year 1982-1995 - compared with a 0.5% EU average.<sup>48</sup> This is a result of above average population growth and the entry of females into the labour force. The Netherlands has switched from a single breadwinner family-centred employment pattern to a 1.5 jobs per family pattern. Women's employment increased from 34.7% of the labour force in 1983 to 55% in 1996, above the EU average and comparable to France and Germany.<sup>49</sup> Most of the new jobs are temporary, part-time or less than 35 hours. Since 1987 60% of all new jobs were part-time. Part-time jobs have grown rapidly to 36.5% of employment in 1996.<sup>50</sup> Part-time jobs are mainly held by women - some 75%.

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<sup>44</sup> Visser p. 24 Table 2

<sup>45</sup> Visser p. 24 Table 2

<sup>46</sup> Visser p. 11 Table 1

<sup>47</sup> Visser p. 10

<sup>48</sup> Visser p. 24

<sup>49</sup> Visser p. 25 Table 4

<sup>50</sup> Visser p. 30 *ibid*

Most new jobs can be attributed to the effects of the policy to wage moderation. Job growth was restored in 1983 as the Netherlands emerged from recession and the Wassenaar Accord of 1982 on wages began to take effect. Unit labour costs in manufacturing in 1994 were lower than in Western Europe or Scandinavia, and lower than in the US.<sup>51</sup> The Central Planning Bureau claims institutionalized wage restraint has been ‘Holland’s single most important weapon in international competition’ and attributes two thirds of employment growth in the latter half of the 1980s to the effect of wage restraint.<sup>52</sup>

If wage moderation contributed to the competitiveness of the manufacturing sector, most of the new jobs created are in services. Manufacturing represents just 18.2% of total employment in 1996; commercial services grew from 20 to 27% of total employment between 1960 and 1996.<sup>53</sup> Non-marketed services have grown much less rapidly - thus job growth in Holland has not been by the expansion in public employment, unlike Scandinavia.

Job growth has not come primarily from a reduction of the working week of full-time employees; full-time hours have not been reduced as in Germany. Certainly, the new jobs have not been filled by the long-term unemployed. Since 1984 50% or more of the unemployed have been out of work for one year or more.<sup>54</sup> Only one seventh of the new jobs created between 1984 and 1990 went to the unemployed. This means that most new jobs were taken by new entrants to the labour market, by young people or women leaving the home for work. Older workers have certainly not returned - only 41% of men aged 55-64 were in work in 1996.<sup>55</sup>

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<sup>51</sup> Visser p. 27 Table 5

<sup>52</sup> Visser p. 26

<sup>53</sup> Visser pp. 28-9

<sup>54</sup> Visser p. 36

<sup>55</sup> Visser p. 38

The shift toward new entrants, part-timers and women has not led to a marked growth in earnings inequality. The effect of the new policies has not been a reduction in the real wages of unskilled workers as in the US - the Netherlands has a lower incidence of low pay and earning inequality than the Anglo-Saxon economies, Japan, France and Germany.<sup>56</sup> Visser and Hemerijck cite a Dutch econometric study by Roorda and Vogels that shows there is no robust relationship between earnings inequality and employment growth. They point out that wage restraint and job growth have been consensual policies supported by the unions, and that wage moderation has affected higher earnings too. Undoubtedly, without a commitment to equality and fairness these policies would have been unsustainable. Holland has avoided the mixture of 'winner takes all' for the top 20% and widespread working poverty that characterize the impressive American employment growth since the early 1980s, and render it improbable as a route for the reform of advanced European economies.

Visser and Hemerijck's study is especially valuable in analysing the possibilities and limitations of corporatism under modern conditions. The identification of corporatism with highly centralized bargaining, with large-scale standardized mass production, and with Keynesian policies conducted within the constraints of exchange and credit controls is to mistake a member of the class for the class. Holland exhibits a network of dense corporatist institutions, and, in particular, strong aspects of consociational governance. It ought to generate the vested interests and veto groups that inhibit change and lead to the accumulating inefficiencies that add up to maladaptation, but it has not. Why?

This is not because there were not periods of immobilism and crisis, when the corporatist partners were deadlocked, nor because there were not strong pressures against

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<sup>56</sup> Visser p. 40 OECD data

consensus from below. The unions persisted in the policy of wage restraint in the 1980s despite continuing job losses and falling membership, and despite the policy being unpopular. Likewise, the coalition partners the Christian Democrats and Social Democrats lost heavily in the 1994 general election in protest at their cuts in benefit levels and tightening up on access to disability benefits.

The answer seems to be that the Netherlands adapted through a mixture of inescapable economic pressures that forced a response, decisive action by governments and a willingness to persist in dialogue while seeking to find new policy options by the social partners. In theory hierarchies, for example, Westminster style governments with exclusive control of executive and legislative power, ought to be the most effective institutional forms for breaking with previous arrangements, the least path dependent. The experience of the UK shows that this leads to adventurism in macro-economic policy, radical and excessive deviations from the previous course of policy, and a neglect of seeking the co-operation of the social interests. Holland seems to have had the lucky combination of enough hierarchy to break the deadlock between the organized interests on the part of government, but not so much as to destroy negotiated social governance in all policy areas.

In the case of the policy of wage moderation the Wassenaar Accord of 1982 was negotiated in the “shadow of hierarchy”<sup>57</sup> and in the face of an accelerating economic crisis - during the 1981-83 recession one in 25 firms in manufacturing went bankrupt and 300,000 jobs were lost.<sup>58</sup> The government threatened to impose a wage freeze and the employers and

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<sup>57</sup> p. 110

<sup>58</sup> Visser p. 13

the unions struck an accord rather than lose all autonomy in wage determination. The deadlock of 1976-82 was broken by the unions recognising the need to restore competitiveness through wage moderation. Equally, the employers recognized the need for a deal, because they feared that in the context of a wages freeze the government would enforce job sharing and job subsidy programmes that would undermine their autonomy too. The New Course deal of 1993 was again negotiated in the depression of the early 1990s and the social partners faced again with the threat of a government imposed wage freeze. The role of the government in pushing the partners toward an agreement is central, as is the commitment of the partners to a form of negotiated governance characterized by realism and accommodation.

In the case of disability benefits the government chose to act independently of the social partners, as in claiming to represent the general interest it regarded the system of negotiated social governance of social welfare as beyond repair. That the unions despite this remained in other spheres of bargaining, and accepted the new active labour market policies and also the development of part-time work, is evidence of their political maturity and ability to judge policies by their effects. Visser and Hemerijck's emphasis on the combination of power and social learning in this process is well judged. Without a measure of objectivity in analysing outcomes and a commitment to stay in the process neither the employers nor the unions could have continued with the system of corporatist governance. Had the state gone beyond the shadow of hierarchy and relied on its substance as the main means of achieving policy, then the delicate balances on which depended compliance for its policies - aided by judiciously timed threats - would have broken down. The lesson is that enough corporatism to win the commitment of the social partners in certain policy spheres and

enough hierarchy to remove blockages and to unravel serious policy failures are both necessary. Something similar can be seen in Denmark. To dispense with governance by negotiation, to rely on hierarchy and the market alone, has been the aim of most economic liberals. Yet the example of the Netherlands shows how a form of negotiated social governance in a post-Keynesian context can work and can deliver the goods better than strong states enforcing free markets.

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