The Finnish Model and the Welfare State in Crisis

The Nordic Welfare State as an Idea and as Reality

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THE FINNISH MODEL AND THE WELFARE STATE IN CRISIS

1. INTRODUCTION
The notion of the welfare state came relatively late into the Finnish discussion and polities, albeit the ideas of equality and Social security have flourished for decades in Finnish Society. From the 1960s to the 1980s, however, welfare systems were institutionalized in Finland, to a great extent along Nordic lines. In the 1990s, this development has come to an end, and all proposals point to cuts and reductions in social transfers and public services.

How are these sudden changes to he explained? I will try here to answer this question, in particular by relating welfare state development to the general characteristics of the Finnish model of economic policy. First, the Finnish model is compared with other Nordic models, and the expansion and peculiarities of the Finnish welfare state are outlined. Then, I ask to which extent the current economic and social crisis is due to the welfare state expansion. Moreover, have the preconditions of the Nordic models fundamentally changed? Finally, given that the Finnish, Norwegian and Swedish welfare states are in serious troubles, I ask how they are prepared to meet the challenge of European integration in the 1990s.

2. THE FINNISH MODEL, AS RELATED TO THE NORDIC MODEL
Recently, various types of welfare models or welfare regimes have been distinguished. The typologies of Korpi, Esping-Andersen, Leibfried etc. have been discussed and criticized, and they have also served as the basis in many comparisons of welfare states (for an evaluation, see Kosonen 1992). My aim here is not to participate in this discussion, but rather to deal with economic and social polities of the Nordic countries, in particular Finland. The notion of the country-specific economic policy model shall be specified in this context.

Country-specific economic policy models have been outlined in an internordic project on economic policies (see Mjøset 1987). The main focus was on the means used in the Nordic countries to control economic and social tensions and transformations. Economic policy models trace the complex interplay between economic structures, economic policy routines and political-institutional frameworks, in turn dependent on class structure and political mobilization.

The postwar growth phase (‘the golden age of capitalism’) enabled policymakers to develop a series of successful economic and social policy routines. These routines, as well as class structures and political coalitions, differed from country to country, but a functioning model of economic and social policy was established in each of them. The international shocks of the 1970s and 1980s put a great strain on the Nordic models, but they persisted albeit with some modifications.

To systematize the analysis of various economic and social policy models, a general framework is provided in Figure 1 (based on Kosonen 1987).

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1 This description of the Finnish model and the Nordic model draws heavily on my collaboration with Jan Otto Andersson and Juhana Vartiainen, as a part of a Nordic research project on economic polities and integration. See Andersson. Kosonen & Vartiainen 1993.
Figure 1. The dynamics of an economic and social policy model

The framework may be outlined as follows. The point of departure is the economic structure of a country, in particular the stage of development and power of the dominant export sector. The division of labour between men and women is another important factor which varies considerably from country to country. On the basis of the socio-economic structure (A), class groups are formed. These groups, in turn, are basis actors in class mobilization (B): through the process of social organization and political struggle, classes and class coalitions are formed. Thus economic and social policy cannot be reduced to economic necessities, but it is essentially mediated by the actions and programmes (which may become hegemonic projects) of social and political groups (C).

In studies of economic and social policy, these kinds of models may be interpreted in a static way, to show the preconditions for economic policy routines only. To avoid this limitation, the dynamics of the model must be discerned. How does the economic and social policy model work, and what kind of results does it produce?

The dynamics of an economic policy model arise from the fact that economic and social policy in turn influences the preconditions of the model. First, policy may enhance or undermine economic growth of the country (D). Second, economic and social policy affects the relative positions and distributive shares of the class groups (E). Third, policy may change the social and political basis of various class coalitions (F), which again may lead to changes in economic and social policy. Thus, the model may reproduce stability or create tensions and conflicts.

On this basis, the Danish, Finnish, Icelandic, Norwegian and Swedish models can be outlined. The rate of industrialization as well as the extent of development of the dominant export sector has varied in these countries. In some countries, notably Sweden, the share of workers in the social structure has been high and a Social Democratic hegemony has prevailed, while in other countries farmers or middle classes have played a more central role. The variation of economic and social policy goals can to a great extent be explained by these structural factors, although various intellectual and political strategies must also be taken into account.

Is it then possible to speak about a “Nordic model” in general terms - as is done in many studies? From my point of departure, a Nordic model must be defined as a summary of the most general features of
various Nordic models. It must include characteristics which are common to most or all country-specific Nordic models. In summarizing these characteristics, based on earlier Studies (see Mjøset 1987; Kosonen 1991), I will depict the main features of the Nordic model while noting that no single country fits it in every regard.

(1) The Nordic countries have small open economies, and their dominating export sectors are based on raw materials. National productive systems are thus export oriented, they are based on a high level of national know-how, and they provide the foundation for a well organized body of capitalist interests.

(2) The rate of labour force participation of working-age women is high. Thus, child care and services for the elderly must to a great extent be organized by the public sector. It must be noted, however, that women are mainly concentrated in a restricted number of Tower-paying, less prestigious occupations: there is persistent Sex segregation in the labour market.

(3) Politics are characterized by strong social democratic and agrarian (center) parties. This reflects the high share of workers and farmers in the traditional class structure. Among the policy objectives, full employment and an equal distribution of incomes, as well as the welfare of farmers, are prominent. Since wage-earners, farmers and capital-owners are strongly organized on the national level, the stage is set for broad social agreements and income settlements. This system may be characterized as social corporatism.

(4) The goal of economic policy is to maintain capital accumulation, full employment and an equal distribution of incomes simultaneously. Fiscal policies are moderately Keynesian, and, if need be, backed up by devaluations. There are important elements of selective supply side policies, for instance active labour market policies. Interest rates are kept low through credit rationing and high public saving. In social policy, the responsibility of the State is pronounced. Universal social security rights are in principle guaranteed to all citizens, and incomes are redistributed through transfers and taxation. The role of the public sector is fundamental both in social insurance and in service production. The main distinctive features of the Nordic welfare states may be termed universalism, redistribution and high taxation (for a West European comparison, see Kosonen 1993):

- **Universalism** in social policy denotes that all citizens living in the country are covered by services and social transfers. Universalistic elements such as basic pensions are emphasized in social security arrangements, but this does not exclude additional income-related systems. Moreover, a network of public services is available to every Citizen, and the share of public employment of total employment is high.

- Through **redistribution** of incomes, the public sector affects the final income distribution among various income groups. As a result, income inequality and poverty rates tend to be relatively low.

- In this kind of welfare system, **taxation** is usually high. The financing of social security is to a great extent based on general taxation (in particular personal income taxation) and employer contributions, in contrast to premiums payed by the insured themselves.

The presentation of the Finnish model can be based on the previous characterization of the Nordic model. I try to trace “Nordic features” in the Finnish development as well as the distinctiveness of the Finnish model.

In a Nordic comparison, the distinctiveness of the Finnish model can be seen in the Central status of export competitiveness and the peculiar constellation of interest mediation. These traits, in turn, are based on the industrial structure, in which agriculture and forest industry play crucial roles, and on the political system, in which agrarian and wage earners’ interests are mediated in a corporative and regulated way. The traditional Finnish model may be condensed in the following four points.

(1) Due to late industrialization and the connections between forest owners and forest industry, the agricultural sector has remained large and powerful, and agrarian interests have been well served in all political settlements. Another important element is the effort to guarantee the competitiveness (profitability) of the dominating export sector, i.e. the forest industry, often through devaluations. Since the
world market demand for forest products is subject to powerful cyclical shocks, and Finnish economic policy tends to accentuate these disturbances, business fluctuations have been large.

(2) Agrarian interests and the position of the Center Party have been more powerful in Finland than in the other Nordic countries. Workers have been well organized in labour unions and labour parties, but the fragmentation of the Finnish left has rendered it unable to generate a powerful hegemonic project comparable to that of the Swedish Social Democrats. The leading role of the Center Party in political coalitions (usually with the Social Democrats) explains, on the one hand, why the competitiveness of the export sector has been assigned a high priority in economic policy. This approach has become so dominant that it is usually not challenged at all (see Kosonen 1989). On the other hand, the Finnish model has generated a comprehensive system of interest mediation, in which all important interest groups, as well as the state, are involved: interest mediation is vital for the political coalitions to maintain the support of decisive class groups. As a result, regulation and corporatism characterize Finnish political life.

(3) In economic policy, the State has to guarantee the preconditions of capital accumulation and economic growth. However, the State must respect what are taken as 'economic necessities' and safeguard the performance of the export sector in particular: in this sense the state (and the role of politics) is weaker than in Norway or Sweden. The principal aims of economic policy include economic growth, high investment and a competitive export sector. These priorities imply that it may be necessary to ignore such aims as full employment and the stability of economic development. When the profitability of the export sector weakens, policies react in a contractive fashion. Fiscal and monetary policy are tightened, the currency is devalued and wages are frozen. As a result, unemployment tends to increase. In good years, wages grow again and unemployment rates decline.

(4) In social policy, Finland has adopted many Nordic characteristics, but social policy has been more subordinated to 'economic necessities' than in other Nordic countries. During good times, however, social benefits are developed on the basis of corporatist interest mediation. Due to agrarian interests, universal social rights are developed according to the citizenship principle, but, due to the increasing strength of the trade unions and middle classes, parallel income-related systems have been created. Transfers and services are extended in such a way that all important interest groups (farmers, workers, civil servants, middle classes, people living in towns and in the countryside) get their share. In particular such Nordic characteristics as universalism and redistribution are thus reinforced. In the following section, this development is outlined in more detail.

3. THE MAKING OF THE FINNISH WELFARE STATE

One of the Central axioms of the Finnish model has been that social policy must be subordinated to the “economic necessities” of the policy model. Thus, public expenditures are allowed to increase within the limits of economic growth, but this increase must not endanger the main political goal, i.e. the competitiveness of the export sector. As a result, the share of social expenditure of GDP has remained at a lower level than in the other Nordic countries, and reductions in social expenses are always required during economic recessions.

This way of thinking was particularly strong immediately after the war and in the 1950s, when social reforms were introduced in many European countries. In Finland at the time, workers' accident insurance was almost the only legislative social insurance that fitted into the framework of the model. Child allowances were also introduced. A universal unemployment benefit was rejected on economic and moralistic grounds and the unemployed were instead assigned to badly paid public work projects (the so-called spade line). The old-age insurance legislated in 1937 was not intended to become effective for a long time, and public sickness insurance plans were not adopted until the 1960s. (Alestalo & Uusitalo 1986.)

One peculiarity of the Finnish model was (and partly still is) that sociopolitical goals have been linked to agricultural policy. Thus, agricultural subsidies have played an important role in income
redistribution and Social security. This policy, however, contributed to the delay of modern social legislation in Finland.

The relative backwardness of the Finnish welfare state became clear in the early 1960s. The first wave of European integration, rapid industrialization and changing political constellations put Finland under pressure to introduce universal Social security systems. Thus, the breakthrough of the welfare state finally took place. Occupational pensions and sickness insurance were introduced in the early 1960s, active labour market policy was initiated in the late 1960s, and public health care was extended in the 1970s. The share of Social expenditure in GDP increased, as can be seen from Figure 2.

![Figure 2](image_url)

**Figure 2.** The average share of social expenditure of the GPD according to country groups, 1960-86.

In Figure 2, the Finnish and British share of social expenditure in GDP is compared to the average of three groups, i.e. Continental Europe, Peripheral Europe (Greece, Ireland, Portugal, Spain) and other Nordic countries. During the 1960s and 1970s, the share increased from a low level in Finland, but it increased even faster in other Nordic countries (in particular in Denmark and Sweden). In the mid-1980s, Finland had attained the average West European level.

Even the expansion of the welfare state is based on the working of the Finnish economic policy model. While the growth of the welfare state in the Nordic countries (notably in Sweden) has been strongly influenced by the ‘democratic class struggle’ under Social Democratic leadership (Korpi 1983), the Finnish development can be explained, on the one hand, by the position of the Center Party, and on the other hand by the system of corporatist interest mediation (see Alestalo, Flora & Uusitalo 1985).

The Center Party has favoured universal flat-rate schemes which promote the interests of the agricultural population. The Social Democrats have also been able to promote the interests of their supporters, but this has happened through the system of corporatist concertation, in which employers' interest organizations have also played an important role. Thus, universal social security arrangements in Finland are interwoven with arrangements based on one's labour market position.
The Finnish welfare state model may be illustrated by the implementation of legislated occupational pensions (see Kangas & Palme 1989). In Sweden, the Social Democratic strategy was aimed at a public solution and a fully legislated scheme with pension funds under state control. In Finland this reform was negotiated by the labour market partners, and the employers were willing to accept a decentralized scheme with funds in private insurance companies in charge of the pension funds. The occupational pension system was thus connected to the financing of capital accumulation.

These divergent features notwithstanding, the Finnish welfare state developed in a “Nordic” (or Scandinavian) direction in the 1970s and 1980s. The share of social expenditure in GDP increased from 7 per cent in 1960 to 22-23 per cent in the mid-1980s, i.e. to an average Western European level. In addition, the Finnish welfare state took on “Nordic” characteristics such as universalism and redistribution, in contrast to the more status-preserving Continental welfare states (see Kosonen 1993). This can be seen from the share of public employment and the financing of social security.

In the universal welfare system of the Nordic countries, all citizens are covered by basic services and social transfers, whereas within the Continental European systems, benefits are more tied to one's position in the labour market and one's family status, which means that the Continental systems tend to be status-preserving. Universal welfare states also provide a safety net of public services, and therefore the share of public employment in relation to total employment has increased in the Nordic states. In Finland, this increase has been more rapid than in Continental Europe but somewhat slower than in the other Nordic countries (see Figure 3). Employment in public health care, day care and education expanded in the 1970s and 1980s.

![Figure 3](image)

**Figure 3.** The average proportion of public employment in relation to total employment according to country groups, 1960 and 1966-88.

The Finnish welfare state has also been quite redistributive. A recent comparative cross-national study indicates that the distribution of disposable income around 1980 was more equal in Sweden, Norway and Finland than in Britain, Germany and Switzerland (Gustafsson & Uusitalo 1990). This relatively even
distribution of income in the Nordic welfare states can be explained mainly by the redistributive impact of the public sector. Universal citizenship pensions (‘national pensions’) play an important role in this respect. Poverty problems were not eradicated, but poverty rates decreased substantially in these countries from the mid-1960s to the mid-1980s. In this development, Finland followed the Swedish and Norwegian line.

According to a report based on Nordic surveys from 1986-88, the distribution of the material standard has become more equal in the Nordic countries. The differences in standard between manual workers and salaried employees has decreased in all countries but more so in Norway than in Finland. This trend coincides with a general increase in standard of living in these countries. (Vogel 1991.)

In Table 1, compensation levels of various income transfers in the Nordic countries are compared. For the calculation of the compensation level, typical cases of single male industrial workers have been utilized. In 1990, compensation levels were lower in Finland than in Sweden and Norway, but pensions and illness benefits were somewhat better in Finland than in Denmark. All in all, Finland had nearly reached the Nordic level during the 1980s.

**Table 1. Compensation levels of various income transfers as a per cent of the former average income of a single male industrial worker in 1990 in four Nordic countries.**

<table>
<thead>
<tr>
<th></th>
<th>Denmark</th>
<th>Finland</th>
<th>Norway</th>
<th>Sweden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Old age pension incl. of supplementary pension</td>
<td>56</td>
<td>58</td>
<td>70</td>
<td>70</td>
</tr>
<tr>
<td>Invalidity / anticipatory pension</td>
<td>82</td>
<td>70</td>
<td>71</td>
<td>70</td>
</tr>
<tr>
<td>Illness benefits</td>
<td>75</td>
<td>82</td>
<td>100</td>
<td>91</td>
</tr>
<tr>
<td>Unemployment benefits</td>
<td>75</td>
<td>64</td>
<td>68</td>
<td>85</td>
</tr>
</tbody>
</table>

*Compensation level after taxation.

Source: Social Security in the Nordic Countries 1993, 38, 39, 41.

In the financing of social security, Finland followed Nordic patterns during the 1970s. Social security was financed predominantly by taxes and other revenues collected by the public sector, and employee contributions remained small. This contrasts with Continental and Southern Europe, where social security is financed mainly by employer or employee contributions, since social security is based on individual and collective arrangements.

However, the share of employer contributions became higher in Finland and Sweden than in Denmark and Norway. Denmark is an example of a country where social security is financed almost completely by taxes. In Finland, the financial burden is divided between tax financing and employer contributions.

In the overall level of taxation, Finland departs from the Nordic model. Denmark, Norway and Sweden may be characterized as ‘tax states’ where about half of GDP in collected in taxes and other contributions. Not so in Finland. As can be seen from Figure 4, the share of total taxation has remained substantially lower in Finland than in other Nordic countries and in Continental Europe. Were contributions for legislated occupational pensions (administered by private insurance companies) included, the share would increase somewhat, but basic differences would remain.
With regard to labour market policy, the Swedish model has emphasized active methods to combat unemployment, whereas in Finland unemployment rates have varied according to macroeconomic variation. However, active employment policies were also introduced in Finland during the good times of the 1980s. In particular, the Employment Act of 1987 provided long-term unemployed persons with jobs for six months.

As a result, long-term unemployment was radically reduced and total unemployment decreased slightly (to 3-4 per cent in the late 1980s).

Thus, in the 1980s there seemed to be a converging trend in the Nordic welfare state development as Finland, the late-comer, adopted many - even if not all - characteristics of the Nordic welfare model.

4. THE WELFARE STATE AS THE CAUSE OF ECONOMIC AND SOCIAL CRISIS?

In the early 1990s, the beneficial socioeconomic development in Finland has turned into economic decline and emergency measures. Economic difficulties prevail also in other Nordic countries. In this situation, welfare state development has been denounced as the source of economic and social crises. In particular in Finland, it is argued that the welfare state became too generous compared to economic resources, and cuts are proposed as a cure.

The crucial question is: can these economic and social difficulties be traced back to the expansion of the Nordic welfare states? In this case, one should find inherent contradictions emerging already before the beginning of the recession, i.e. in the 1970s and 1980s.

In a recent comparative study, Ramesh Mishra (1990) outlined policies of retrenchment and maintenance of the welfare state in the 1980s in Western Europe, North America and Australia. According to his
comparisons, the strategy and policy of retrenchment was not strongest in countries with highly
developed welfare systems, but rather in countries with small or medium-sized welfare states. Of all
countries studied, Sweden was alone in its willingness and ability to defend both the commitment to full
employment and to a high level of social welfare. Sweden had weathered the storm in the 1970s and
1980s without sacrificing economics effectiveness and social justice.

There were to some extent divergent reactions in the Nordic countries. According to Marklund's
comparison of Denmark, Finland, Norway and Sweden from the mid-1970s to the late 1980s, it was
Denmark where cuts and alterations had taken place, and these had followed a general pattern towards
increased selectivity of welfare measures. Finland and Norway had some welfare state retrenchment in
the late 1970s, but in the 1980s they experienced rather an expansion. Together with Sweden, they
exemplified welfare state stability (Marklund 1988; see also Kosonen 1991).

Thus, with the exception of Denmark, contradictions between welfare policies and economic-social
development were not very pronounced in the Nordic countries in the 1970s and 1980s. This can be
understood if one examines the dynamics of the economic-political models, based on Figure 1 above.

First, economic and social policy has an influence on the relative position and income distribution of
various class groups (E). Two Nordic peculiarities may be identified: universal entitlements and income
redistribution. Universal entitlements, which are available to all persons living in the country, have ben-
efited all groups and thus helped to maintain support for the welfare state. The case of income
redistribution is somewhat more complicated. Redistribution may enhance the solidarity and
cohesiveness of the population, but it may also cause criticism among the well-to-do. Much depends on
the way in which social transfers and services are financed; reliance on income taxes can be named as
one of the causes of welfare backlash in Denmark.

One of the most important results of economic and social policy, from the viewpoint of political
reactions, is the level of unemployment. With an effective economic policy with respect to the labour
market, in particular Norway and Sweden were able to prevent the increase of unemployment rates in
the 1970s and 1980s. On the other hand, the specific problems of the Danish welfare state seem to be
associated with its high unemployment rates since the mid-1970s. Unemployment is likely to produce
social dualism and worsen the financial and political problems of the welfare state.

It is thus possible to conclude that the favourable results of economic and social policies enhanced
political support for the welfare state in Norway and Sweden. Despite criticism, people in Denmark also
want to maintain the main pillars of the welfare state.

Similarly, support for social reforms remained stable in Finland during the 1980s. The majority of the
population thought that the speed of social reforms was proper or even too slow from 1980 to 1990; only
after the outbreak of the crisis did critical opinion strengthen somewhat (Allardt, Sihto & Usitalo
1992). In spite of the enactment of a tax ceiling in the late 1970s in response to the 'revolt of the
affluent' and a reduction of marginal income taxes in the late 1980s, the financial and political basis of
the welfare state has not fundamentally altered.

Secondly, economic and social policies have had an impact on the economic performance of the Nordic
countries (D), particularly on the financing of social security and on the competitiveness of the export
sector.

The financial burden of the welfare state depends on the share of social expenditure in GDP. Figure 2
above shows that from 1960 to 1986 Finland attained the average West European level but remained
below the level of other Nordic countries. Changes of social security expenditure as per cent of GDP
from 1978 to 1990, based on Nordic social statistics, are presented in Table 2.
From 1987 to 1990, the share of Social expenditure in GDP remained at a high level in Sweden, also by international standards. In Denmark and Norway, the share rose quite rapidly. By contrast, in Finland the share remained practically at its previous level, since the expansion of social expenditure coincided with rapid economic growth. Thus, at the beginning of the 1990s the financial burden of the welfare State was smallest in Finland, and it did not exceed the Western European average. It is therefore difficult to confirm the claim that rising social expenditure was one of the primary causes of the current Finnish economic crisis since 1990. From 1991 onwards, the share of social expenditure in GDP has reached a level well over 30 percent, but this is mainly an effect of recession and not one of its causes.

Has the competitiveness of the Nordic export sectors been impaired by welfare State development? It is a popular assumption that welfare states are in contradiction with competitiveness (see Pfaller et al. 1991). First, price competitiveness is reduced due to the high Social costs which must be borne by enterprises. In addition, it is fashionable to claim that the welfare State has become an even greater an obstacle to innovation and higher productivity, factors which are important in modern production and marketing.

However, increasing welfare costs did not prevent economic development in the Nordic countries. When measured by growth, employment and income distribution, economic performance of the Nordic countries during the 1970s and 1980s was quite satisfactory (Pekkarinen, Pohjola & Rowthorn 1992). Industrial growth was not very rapid, but the overall picture was brighter than in many other European countries. One possible interpretation is that contrary to fashionable arguments, productivity and innovation benefit from the welfare State, or at least from some parts of it. High-productivity and high quality production requires systems of training and education, and co-operation between business and labour may be beneficial as well (Pfaller et al. 1991). Thus, economic performance is not necessarily in contradiction with the welfare State. A welfare system may or may not enhance economic and Social development in a country, depending on the distribution of spending and on the relationship of Social policy to economic productivity and innovation.

It is true that structural economic problems appeared in many Nordic countries in the 1970s and 1980s, including the limited size of the Danish export industry, the one-sidedness of the Finnish export sector, and the dominance of oil production in relation to mainland industrial production in Norway. These structural problems could be examined in a separate study. However, with the possible exception of Denmark, these problems seem not to be caused by Social policies or by the level of Social expenditure.

The structural problems of the Finnish economy, in particular, can hardly be explained by welfare state development. Rather, the one-sidedness and the low processing level of exports have been constant features of the Finnish economic structure, and they have been preserved through devaluations and interest rate policies. Due to long-standing policy decisions, particularly with regard to subsidies, agriculture has suffered from insufficient structural adaptation. It must be noticed, however, that specialization in engineering and related products increased rapidly from the early 1960s to the end of the 1980s, i.e. during the period of welfare State expansion. Thus, in the 1970s and 1980s the Finnish

5. TENSIONS AND CHANGES IN THE FINNISH MODEL AFTER THE MID-1980s

As emphasized above, the Finnish model as such is crisis-prone. In the postwar period, phases of economic growth and recession have alternated. Since the world market demand for Finnish export products (forest products) is subject to powerful cyclical shocks, and the procyclical tendencies of Finnish monetary and fiscal policies have accentuated these disturbances, business fluctuations have been large. These characteristics of the Finnish model may, in turn, be traced back to the industrial and political structure and to the lack of distinctive political strategies.

Thus, the recession and the economic-political reactions of the early 1990s are nothing entirely new in Finland. What is new, however, is that the international preconditions of the Finnish model have changed considerably. This change is caused by globalization, Europeanization - and by the collapse of the Soviet economy.

The collapse of the Soviet economy is of Special concern to Finland, since trade with the Soviet Union was substantial (nearly one fifth of total trade) and beneficial for Finland. This trade fell rapidly at the beginning of the 1990s, and its share has collapsed to 2-3 per cent of total exports. The decline of export income is, in turn, one factor behind the current crisis.

At the same time, changes are occurring in the capitalist world economy that are related to the process of globalization. In a globalized international economy, individual national economies are subsumed and rearticulated into the system by essentially international processes and transactions. The international system becomes autonomized as markets and production become truly global. (Hirst & Thompson 1992.) This kind of globalized economy does not yet exist, however many of its features have become more pronounced. The shift from standardized mass production to more flexible systems has intensified the international division of labour, which often is organized within a corporation.

Moreover, monetary and currency markets are being influenced more and more by international capital movements. There are several reasons for these processes: imbalances between rich and poor countries, loose money floating from a country to another, and general trends towards deregulation of monetary markets.

Changes in financial markets are of particular concern to all Nordic countries. They all made decisions to deregulate their capital markets in the 1980s, thus relinquishing a large part of their economic-political sovereignty. Denmark was in the lead in the deregulation process: in 1982-83 it embarked on a hard currency option, and deregulation was completed already in 1987. Norway came next in 1984 with the lifting of direct regulations on banks and insurance company lending. In Norway, as well as in Sweden, deregulation was practically completed in 1990.

Although Finland followed this Nordic line in the 1980s, some Finnish peculiarities may be noticed. In 1986 a gradual deregulation of financial markets occurred, and the first steps were taken to terminate the regulation of interests rates when the Bank of Finland stopped controlling interest rates. One year later enterprises were given free access to international long-term loans. By 1991, all restrictions on international capital movements had been lifted. It is interesting to note that all decisions were made by civil servants of the Bank of Finland. Deregulation never became part of the political agenda overtly discussed by the political parties and the government; nor were the political parties especially interested in it. Moreover, commercial banks acquired extensive options to take and transmit foreign loans, but no corresponding public control measures were enacted.
What are the effects of this kind of deregulation? The answer may be based on the so-called “impossibility theorem” (Grahl & Teague 1990). According to this theorem, fixed exchange rates, independent monetary policies, and full mobility of capital are incompatible because fully mobile capital will always flow from a country with lower interest rates to one with higher rates - unless there is a risk of exchange rate movements. This makes independent monetary policies or fixed exchange rates impossible. Thus, independent monetary policies of the postwar period were based on restrictions of capital movements. Now, with the present liberalization of private capital movements, it can be expected that either interest rates or exchange rates will become more unstable, as in fact is happening in many West European countries today.

Finnish events confirm the impossibility theorem. During the latter part of the 1980s, free capital movements led to an overheating of the financial sector and to competition between the banks. The deregulation of credit unleashed the repressed demand for loans, and a buoyant loan expansion coincided with an overall boom in the economy. The banks, free from the tutelage of the Bank of Finland and unaccustomed to operating in a market-oriented environment, increased their loans in a rather Cavalier way and thus generated a boom of speculation and investment of dubious long-term quality. As there were generous rules for tax-deductions, housing investments expanded as did the prices of apartments. A consumption and investment boom followed. When the economic recession began in 1989-90, interest rates went up, resulting in reduced domestic demand and investments; foreign debt expanded, and the policy of fixed exchange rates and hard currency failed completely. As a result, GDP collapsed by 10 per cent in two years and unemployment soared from 3 per cent in 1990 to 15 per cent by the end of 1992.

The success story of financial liberalization was replaced by banking crisis and bank support. The first measure was the takeover by the Bank of Finland of Skopbank in 1991 following an acute liquidity crisis. In 1992, the government decided to provide the banks with a capital injection totalling 8 billion markka in order to ensure the continued supply of bank credit to customers. The third measure was the creation of the Government Guarantee Fund, which seems to need tens of billions of markka. (Nyberg 1992.)

Thus, the Finnish version of the impossibility theorem was that deregulation of capital movements made both fixed exchange rates and independent monetary policies impossible. Moreover, it made bank support necessary. In sum, a radical change in the preconditions of the Finnish and other Nordic welfare models has occurred. In a globalized economy, national economic-political autonomy is challenged to a great extent. This implies, first, that the room for maneuvering in national employment policies is restricted, and high unemployment figures will persist for a long time to come. Second, because of budget deficits and problems in the banking sector, it is difficult to maintain current levels of social security and public services.

6. ECONOMIC AND SOCIAL POLICY DURING RECESSION

A crucial element of the Finnish economic policy model has been to preserve international competitiveness. When competitiveness of the export sector weakens, policies react in a contractive fashion. This response can be very clearly seen during the recession in the early 1990s. Despite the grave consequences for domestic demand, the government has made a very serious attempt to cut wages and social expenditure. Competitiveness has been enhanced through devaluations and bank support. On the other hand, no effective measures to combat mass unemployment have been utilized.

These traditional economic policies, however, are carried out in the new environment described above. Free international capital movements and the deep crisis of the financial sector are reinforcing the contractive effects of domestic policies. As a result, economic decline is deeper and the rise of unemployment is faster than during previous recessions.
Finnish currency policy provides a good example of the old and new traits in recent economic policy decisions. When the steady markka policy proved unsustainable in face of speculative attacks, the markka was devalued by 14 percent in November 1991. Even that parity was abandoned and the markka was floated in September 1992. Excellent price competitiveness, which is a result of devaluations, has made it possible to increase exports. However, export companies are using their earnings to pay back their foreign debts. The contraction of domestic demand and the weakening of the markka are hurting the home-market companies. Export growth is thus not able to being unemployment down from its current high levels. The growth in unemployment and tax increases are further restraining consumption, and the recession is being prolonged.

Interest rates remained high until December 1992 despite the fact that the markka had depreciated by about 25 percent with respect to the Deutschmark. This worsened the situation of indebted enterprises and households. In 1993, interest rates have fallen close to European averages.

Thus, the volume of total output contracted by 10 percent from 1990 to 1992. As a consequence, unemployment increased rapidly. In 1993, the unemployment rate is estimated to have risen to 17 or even to 20 percent. According to the Ministry of Labour statistics this corresponds to 500,000 unemployed.

According to the government, the Employment Act, which was meant to combat long-term unemployment, costs too much. An active labour market policy cannot be maintained, and long-term unemployment has been increasing rapidly.

In this situation, social security arrangements were needed more than ever. However, the government is convinced that public expenditure must be reduced and that the welfare state must be cut back. At a time when tax receipts are decreasing and expenditures for unemployment and bank support are increasing, central government finances remain in substantial deficit. To solve these problems, the government has proposed cuts in unemployment benefits, child allowances and other benefits. In addition, many services are to be privatized. All in all, limitation of the public sector has become one of the central economic policy objectives. The amounts of benefits must be cut back and/or the number of these entitled to receive services and transfers must be decreased; the production of services must be rendered increasingly effective; and price mechanisms must be introduced to affect the supply of and the demand for services (The Finnish Economy to 1996).

In 1991-92 cutbacks and saving plans do not seem to have reduced social transfers or services substantially (see Heikkilä & Lehto 1992). However, the Finnish municipalities will face a financial crisis in the future, since their incomes are decreasing at a time when more and more people will need social support.

As a consequence, the welfare state model towards which Finland moved in the 1970s and 1980s is under pressure. The compensation levels of pensions, unemployment benefits and illness benefits will be reduced. Public services such as health care and day care will be curtailed. Income inequalities are very likely to widen again. Despite cutbacks and reductions, however, the share of social expenditure in GDP will remain high, since there will be more and more people who need employment benefits, social assistance and social services.

What is the theoretical or ideological rationale behind this turn? One could assume that these economic and social policy measures are based on neo-liberal thinking and research. This, however, is not the case. The justification of these measures may simply be denoted Finnish pragmatism: decisions must be made because of prevailing `economic necessities.' Libertarian, neo-liberal or some other theoretical foundations are not needed: common sense is enough.
7. THE FINNISH WELFARE STATE FACING EUROPEAN INTEGRATION

The current changes form a major turning point in the development of the Finnish and other Nordic welfare models. In the process of globalization and deregulation of capital movements, the stability of these models is lost, and the room for manoeuvring in national economic and social policies has been considerably diminished. As a result, the national welfare models of the Nordic type are being seriously challenged.

From a Finnish point of view, the present situation is nothing entirely new. According to the traditional Finnish model, the State must respect “economic necessities” and in particular the success of the export sector. Social policy is subordinated to these “economic necessities”, and reductions in social expenses are often required during economic recessions. However, in the new international environment the results of this economic policy model are more drastic than during previous recessions.

In this situation, Finland - together with Austria, Norway and Sweden - have applied for EC membership. These countries have been participating in European integration since the early 1960s when West European countries outside the EC formed EFTA. Moreover, EFTA countries signed free trade agreements with the EC in the early 1970s. In the 1990s, however, the EC is entering into a new phase with its internal market programme and plans for economic and monetary union. It may be asked how EC integration will change the Finnish model and other Nordic models.

Firstly, EC membership will have various economic consequences for Finland (Hjerppe 1992). It is often hoped that EC membership will create a more favourable investment environment both for domestic and foreign investors, as well as a higher efficiency due to greater competition. On the other hand, economic adjustment problems will appear, particularly in agriculture and in remote parts of the country. Since the Finnish economy has become vulnerable in the 1990s, it is possible that these adjustment problems will become more difficult and will concern more areas of the economy than could be predicted only a few years ago.

Secondly, the role of autonomous national economic policy will be further diminished. As was mentioned above, this autonomy has already been reduced due to globalization and the liberalization of capital movements. Member states of the EC and in particular of the economic and monetary union (EMU) will transfer a great deal of their economic decision-making into EC institutions. On the benefit side one can note the gains derived from lower inflation, stable exchange rates and a smaller interest rate differential vis-à-vis other European countries (Hjerppe 1992). On the cost side, however, one can notice fewer prospects for combating unemployment and stabilizing the economy through national measures. The scope for such measures would be small already during the transition period: EMU criteria would require a tight fiscal policy since government debt (which has rapidly increased in Finland) must be diminished.

Thirdly, the Nordic welfare systems will be affected by EC membership. This will not be a result of EC social legislation, which is a minor area in EC integration. For instance, the Danish welfare state has preserved many of its 'Nordic' characteristics as far. However, in the 1990s EC membership implies pressures on financing in the Nordic welfare states. It is likely that, in particular, high tax countries like Denmark and Sweden will be affected by the proposed tax harmonization. The greater the share of taxation on goods and services, and the higher the existing levels of taxation, the more adjustments may be expected (Petersen 1991). In the early 1990s, the share of public expenditure in GDP has exceeded 50 percent in Finland as well, due to the contraction of GDP. All in all, tax harmonization will mean a substantial loss of public revenues in the Nordic countries, and a good deal of innovative thinking will be needed to find ways to compensate for their loss if the Nordic welfare model is to be maintained.
REFERENCES


