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THE CHOICES FOR SCANDINAVIAN SOCIAL DEMOCRACY IN COMPARATIVE PERSPECTIVE

TORBEN IVERSEN
Department of Government, Harvard University[1]

Scandinavian social democracy represents one of the most systematic attempts to shape economic institutions and policies in pursuit of equality and full employment. Increasingly, however, these goals have eluded governments, and their institutional supports have eroded. This paper seeks to understand this shift through a comparative analysis that places particular emphasis on the interaction between macroeconomic policies and wage-bargaining institutions. It is argued that the nature of this interaction, and the associated economic effects, have been changed by new technology, capital market integration, and service-sector expansion. As a result, centralized wage-bargaining institutions and accommodating macroeconomic policy regimes have been undermined, and social democracy increasingly faces a choice between the promotion of equality and employment for all.

I. INTRODUCTION

The purpose of this paper is threefold. First, it seeks to describe the rise, maturation, and eventual decline of two of the most systematic attempts to implement a social democratic economic model: Denmark and Sweden. Focusing on the 1980s and 1990s, I devote particular attention to the breakdown of peak-level coordination of macroeconomic policies and wage bargaining, which in the past had facilitated full employment and exceptional levels of wage equality. Second, through a comparison of the Danish and Swedish experiences with those of other Northern European democracies, I attempt to provide a more general understanding of the interaction between economic policies and macro institutions, and how this interaction is conditioned by internationalization of financial markets, the rise of the service economy, and the introduction of new technology. Third, I try to draw general lessons from the Scandinavian

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experiences by outlining some of the main choices that face social democracy in the 1990s. In particular, I argue that in the present world economy social democracy faces a difficult 'trilemma' where fiscal responsibility in the sense of tight constraints on spending engenders a steeper trade-off between social democracy's traditional goals of equality and full employment.

The rest of the paper is divided into three parts. Section II is a very brief history of the rise of the Scandinavian model, focusing on some of its main institutional characteristics and the role of social democracy. Section III discusses the challenges to the model in the 1980s and 1990s, and how social democratic governments sought to address these, emphasizing changes in the wage bargaining system, in the macroeconomic regime, and in the employment structure. The final section discusses the economic policy trade-offs facing social democracy, and how these may be alleviated.

II. THE RISE OF THE SCANDINAVIAN MODEL

In the decade after the Second World War, Denmark was a relatively stagnant society with low growth, high unemployment, and an underdeveloped industrial base (Hansen, 1983, ch. 18). Unlike in the other Scandinavian countries, there was little state regulation of industrial development in Denmark, and credit markets were comparatively open and left to the oversight of an independent central bank (Mjøset, 1986, p. 137; Uusitalo, 1984). By contrast, the Swedish economy in the 1950s had reached a high level of industrialization (greatly facilitated by a large raw material base), and the state was actively engaged in promoting industrial growth—partly through investment funds and active labour-market policies, and partly through comprehensive credit and currency market controls. The central bank wielded considerable power over credit formation in the economy, and the government used its strong influence over the bank to pursue counter-cyclical monetary policies and to steer investments by means of credit rationing (Mjøset, 1986, p. 131; Scharpf, 1991, p. 205).

During the 1960s, however, the economic and political–institutional infrastructures of the two economies began to converge. Along with a liberalization of manufacturing trade (through the European Free Trade Association (EFTA)), small and medium-sized firms in the Danish industrial sector went through a dynamic phase of expansion (especially in the machine tool industry), causing agriculture to lose its position as the main export sector, and generating high levels of real growth accompanied by virtually full employment. New credit institutions also emerged to provide low-cost capital for the booming industrial sector, and labour-market policies became notably more active.

The industrial relations systems in the two countries also grew more similar during the 1960s. The combination of a building boom and a rapid expansion of public service production prompted the main union confederation (LO) and employer association (DA) in Denmark to assume direct bargaining competence over all general negotiation issues, and since agreements had to be approved by a collective vote, after which a strict peace clause would kick in, the autonomy of individual unions was strictly limited (Due *et al*., 1994). In Sweden the centralization of wage bargaining initiated by the Saltsjöbaden Agreement of 1938 was furthered by yielding greater authority to the LO executive committee over bargaining and the use of strike funds, and at the LO congress in 1951 a decisive step towards centralization was taken with the official adoption of the Rehn–Meidner model of solidaristic wage policies.

The basic idea behind the Rehn–Meidner model was that by demanding 'equal wages for equal work' across industries and sectors, it was possible for LO not only to promote the egalitarian ideals of the union movement, but also to ensure a dynamic modernization of the economy by forcing inefficient companies either to rationalize or close down, while simultaneously assisting the expansion of efficient firms. Profit–wage spirals would be prevented through restrained fiscal policies, while local and industry-specific unemployment was to be alleviated through active labour-market policies (Elvander, 1988, pp. 32–3; Swenson, 1989, pp. 130–3).

By the beginning of the 1960s, both countries were dominated by highly centralized bargaining systems, and with social democratic parties whose electoral support reached all-time highs of 42 per cent in Denmark and 47 per cent in Sweden, the stage was set for a 'golden period' of social democratic welfare capitalism. The government was increasing employment and educational opportunities for everyone (mainly through public services), while wages and prices were successfully held back through consensual wage agreements between peak associations of labour and capital. The public economy in Denmark almost doubled in size during the decade of the 1960s, catching up to Sweden in the mid-1970s when total public spending in both countries reached about half of the GDP. Moreover, rapid economic growth made income redistribution through solidaristic wage policies and increases in the 'social wage' (i.e. transfer payments and social services) both a politically viable strategy, as well as a means to facilitate rapid sectoral transformation and high labour mobility.

A prominent example of the Danish politics of class compromise was the 1963 Danish 'package solution' (*Helhedsløsningen*). One of the first of its kind in Western Europe, this comprehensive agreement between a social democrat-led government and the main labour-market organizations provided for moderate wage increases and low-wage supplements, combined with legislation that increased various social benefits and instituted a new pension scheme (ATP) whose funds were earmarked for investment in Danish industry. The agreement thus contained all the core elements of the corporatist bargain: wage restraint (to be self-administered by LO and DA), wage solidarity (low-wage supplements), an increase in the social wage, and provisions to reassure workers about their future welfare (the ATP fund) (Esping-Andersen, 1990, pp. 171–2).

It is a testimony to the entrenchment of this 'bridge-building' policy in Denmark that it was continued and even expanded during the centre-right majority government from 1968 to 1971. Although the economy was becoming 'overheated' owing to decidedly expansionary macroeconomic policies (Nannestad, 1991, p. 137), the bourgeois government embarked on an ambitious 'spend-and-tax' programme that dwarfed anything the social democrats had done in the past (taxes increased from 33 to 44 per cent of GNP between 1968 and 1971). This was the background for the (in many ways quite reasonable) claim by Mogens Glistrup—the flamboyant founder of the right-wing Progress Party—that Denmark had four social democratic parties (the Social Democrats, the Conservatives, the Liberals, and the Radical Liberals) and only one liberal one (his own).

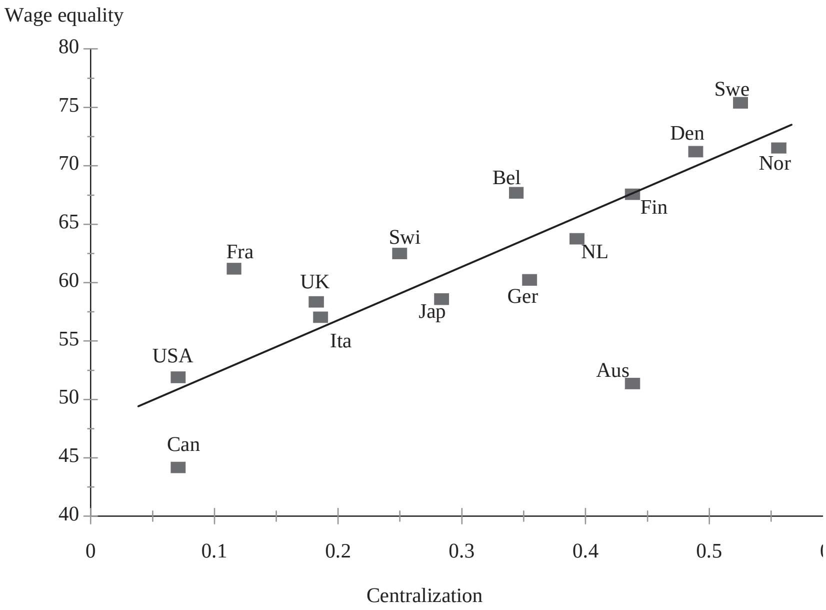
In Sweden the economic policies of the social democratic government also led to a rapid expansion of public consumption, although 'supply-side' policies continued to play a greater role than in Denmark. In particular, the active labour-market policy (administered by the Labor Market Board with representatives from both LO and the employers' federation, SAF) funnelled large resources into training and relocation programmes to re-employ those made redundant by the solidaristic wage policy (Erixon, 1984; Scharpf, 1991, pp. 90–4). The policy had the effect of relieving some of the pressure on fiscal policies because it facilitated job growth in the dynamic sectors of the economy without the need for fiscal expansionism (Rehn, 1985). Although fiscal policies were never restrictive in the sense envisaged by the Rehn–Meidner model, Swedish full employment policies were thus not subject to the same 'overheating' problems as the Danish. Swings in the Swedish business cycle were also counteracted through investment policies that hoarded business surpluses during economic upswings and released them during downturns (Mjøset, 1986, p. 130). Tax and interest-rate policies supported this strategy through a combination of high profit taxes and low interest rates which strongly favoured investments over consumption (Pontusson, 1992*a*).[2]

III. THE SCANDINAVIAN MODEL IN TRANSITION

During the 1970s and 1980s a number of both domestic and international economic developments started to produce cracks in the veneer of the social democratic project. Two of its core components—centralized, solidaristic wage bargaining and the commitment to full employment—came under particular intense pressure. I discuss each in turn.

[2] Although, as mentioned above, it became more difficult during the 1960s to maintain interest rates far below the international level as a result of growing internationalization of capital markets.

Figure 1
Earnings Equality and Centralization of Wage Bargaining



Notes: Wage equality is measured as the ratio of gross earnings (including all employer contributions for pensions, social security etc.) of a worker at the bottom decile of the earnings distribution relative to the worker at the median (d1/d5 ratios). Figures are averages for the period 1977–93 computed from the *OECD Employment Outlook* (1991, 1996). Centralization is an index based on the number of unions and the importance of different bargaining levels (see Iversen, 1998*b*).

(i) Centralized and Solidaristic Bargaining

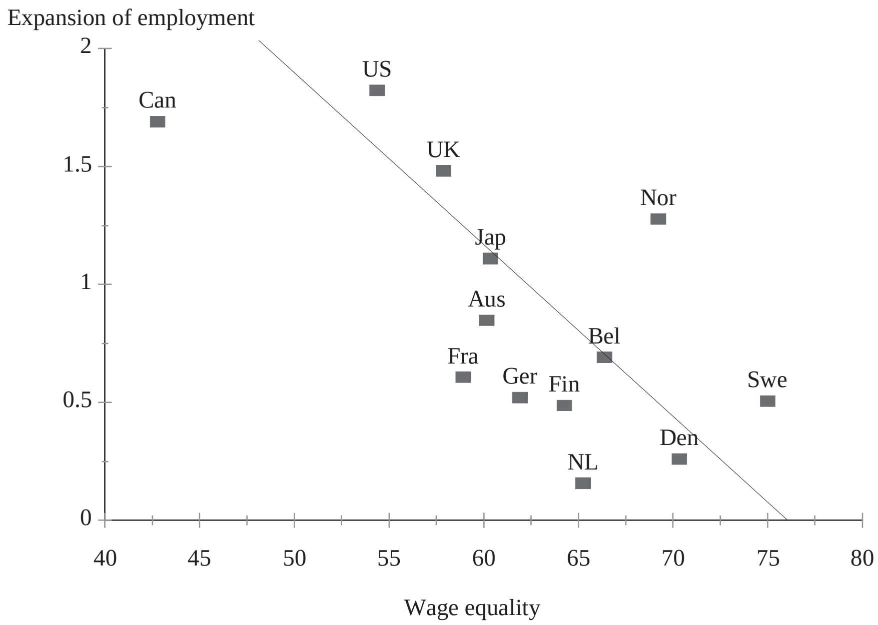
In both countries, centralized bargaining had facilitated negotiated wage restraint, but it had also produced a notable compression of wages by giving low-wage unions considerable organizational influence over the distribution of wages.[3] Using a variety of statistical sources, wage dispersion for Danish manual workers diminished by about 54 per cent between 1963 and 1977, while in the period from 1970 to 1982 the decline for salaried private employees in Denmark was 26 per cent. In Sweden, wage dispersion in the LO–SAF area decreased by about 54 per cent between 1970 and 1980, while the decline for the PTK–SAF area was 26 per cent between 1972 and 1980.[4] As a result, Denmark and Sweden (along with Norway) have some of the most compressed wage structures in the OECD, and compression is closely related to bargaining centralization (see Figure 1). In quantitative terms, a Swedish worker in the lowest decile of the earnings distribution earns about 80 per cent of the earnings of the median worker ('d1/d5 ratios'), while in Canada the comparable figure is 45 per cent.

Solidaristic wage policies ran into difficulties in the 1980s for a variety of reasons. One problem was that the market position of the high-skilled/well-

[3] In Denmark the central negotiation committee of the LO was composed of the chairpersons of LO and the major national unions—with the Metalworkers' Union (Metal), the General Workers' Union (SID), and later the Union of Commercial and Clerical Employees (HK) in the role of veto-players. Consequently, 'no agreement could be reached without granting rises to low-paid groups', creating a 'vigorous element of solidarity' (Due *et al*., 1994, p. 189). The Swedish LO's solidaristic wage policy had a more articulated intellectual and ideological justification, but the logic of bargaining power being equalized between high- and low-wage workers through centralization was similar. Although the industrial union structure in Sweden is less polarized between high- and low-wage unions than in Denmark, unions with predominantly low-paid members formed a majority in LO's collegiate council which determines the collective bargaining strategy (Swenson, 1989, p. 59).

[4] These figures are my own calculations from various data sources (mostly from national statistical offices, but also from the main employers associations' wage statistics and the data provided in Hibbs and Locking (1991)). It should be noted that because the data are based on different methodologies, the relative sizes of the figures must be taken with a grain of salt.

Figure 2
Wage Equality and Expansion of Private Service-sector Employment, 1970–92



Notes: Equality of earnings is defined as d1/d5 ratios as in Figure 1. Private service-sector expansion is the average annual increase in employment in all private services as a percentage of the working age population. *Sources*: *OECD Employment Outlook* (1991, 1996); OECD, *International Sectoral Data Base* (1997).

educated segment of the labour-force grew out of line with relative wages. While standardized and skill-extensive modes of production in the past had facilitated compression of wages, and made overall wage restraint the most important component of competitiveness, the introduction of more knowledge-intensive and flexible technologies ('diversified quality production') placed greater emphasis on employee qualifications and commitment, and less on the level of their wages (Pontusson and Swenson, 1996; Iversen, 1996). This gave skilled workers opportunities for additional wage increases at the firm level, and simultaneously exposed low-skilled workers to greater risk of unemployment.

For employers, especially in the engineering sector, solidaristic wage policies were seen as an obstacle to achieving greater production flexibility and international competitiveness (see Pontusson and Swenson (1996) for Sweden, and Ibsen and Stamhus (1993, pp. 74–92) for Denmark). As technology became more skill-intensive, and as more decision-making power was delegated to the shop-floor, many employers (especially in the engineering sector) found it imperative to improve the wage and employment conditions for their skilled employees, and to encourage their continued acquisition of firm-specific skills through appropriately designed incentive systems. But the introduction of more flexible remuneration systems created problems in the centralized bargaining structure because non-standard forms of payment broke the upper limits of centrally negotiated wage norms and registered as wage drift (see Ibsen and Stamhus, 1993, pp. 53–8; Pontusson and Swenson, 1996). In turn, such drift triggered payments of compensation to other employees, either directly via formal compensation mechanisms ('earnings-development guarantees' in Sweden, and wage-indexation schemes in Denmark), or indirectly, via solidaristic wage demands in subsequent bargaining rounds.

This type of wage 'contagion' from high to low productivity groups extended across economic sectors through a dense network of formal and informal coordination mechanisms, themselves created to ensure centralized control over wages, and came to pose a particularly acute problem in the context of

Table 1
Public and Private Service-sector Employment in Six OECD Countries, 1970–92 (% of adult population)

	Denmark		Sweden		UK		USA		Germany		Netherlands	
1970–3	14	20	17	19	13	20	10	26	8	17	7	21
1974–7	17	20	20	20	15	22	10	26	9	17	7	21
1978–81	20	20	24	20	15	23	11	29	10	18	8	21
1982–5	22	20	26	20	14	24	10	31	10	18	8	20
1986–9	22	21	26	22	14	28	11	35	10	19	7	22
1990–2	22	21	26	23	14	31	11	36	10	17	7	24
Change	8	1	9	3	0	11	1	11	2	0	0	3

Note: First column is total government employment as a percentage of the adult population; second column is total private service sector employment as a percentage of the adult population (excluding transport and communication).
Source: *OECD International Sectoral Data Base* (1996).

rapidly declining industrial employment.[5] High and increasing wages for the low-paid meant that labour-intensive and low-productivity private services jobs—especially in the retail trade, restaurants and hotels, and social and personal services—would be priced out of the market.[6] The problem was exacerbated by the tendency, evident across all OECD countries, for growth in service-sector productivity significantly to lag that in manufacturing. OECD's estimates of total factor productivity, for example, indicate a persistent gap in productivity growth between private services and manufacturing, averaging about 2.5 per cent on an annual basis between 1970 and 1994.[7] If wages in services relative to wages in manufacturing have to remain stable, therefore, relative prices must rise. Depending on the price elasticity of demand, this dampens the expansion of private service-sector jobs.

Figure 2 illustrates this logic nicely. It shows the relationship between earnings equality—measured again as d1/d5 ratios—and the average annual increase in private services employment as a percentage of the working age population. The association is strong and holds across time for a variety of definitions of the dependent variable, and after control for a number of potentially confounding factors (Glyn, 1997; Iversen and Wren, 1998). Norway is an outlier in Figure 2 primarily because of the rapid growth in gross incomes, which is in turn related to the expansionary macroeconomic effects of the booming oil and petrochemical sectors.

The dynamics of employment expansion in the rising service economy turns the Rehn–Meidner model on its head. While solidaristic wage policies were compatible with, and possibly even facilitating, private-sector employment growth when the potential for such growth was concentrated in the most dynamic branches of the industrial economy, such policies served as a brake on employment expansion from the mid-1960s when the greatest potential for job expansion was in low-productivity services. Barring very high levels of wage restraint (which Rehn and Meidner never believed possible) the Rehn–Meidner model therefore cannot ensure full

[5] Some of these linkages were direct since portions of public employees were organized in LO member unions (the large Swedish and Danish municipal workers' unions, SKAF and DKA, are the primary examples). Equally important were more informal coordination efforts between private-sector organizations and governments, where the latter used agreements concluded in the private sector as the norm for reaching public-sector wage settlements. The consequence was that public-sector unions were subjected to private-sector wage discipline.

[6] This argument was first introduced by Baumol and Bowen (1966) and by Baumol (1967). See Gordon (1987) for carefully constructed data on productivity.

[7] This figure is calculated as an average for 14 OECD countries based on data published in the OECD's *International Sectoral Data Base* (1996).

employment in the post-industrializing economy *except* if the government steps in and employs increasingly large numbers of low-skilled workers in public services (Esping-Andersen, 1990; Appelbaum and Schettkat, 1994; Iversen and Wren, 1998).[8]

This was precisely the route followed by social democratic governments in Scandinavia as illustrated by the comparative data in Table 1. For all countries in the table, and indeed across the entire OECD, there has been a marked decline in manufacturing employment, but the magnitudes and composition of service-sector employment growth differ sharply between countries. In the social-democrat-dominated Scandinavian countries, employment in private services has been stagnant or declining throughout the 1970–92 period, whereas public-sector employment rose rapidly during the 1970s and early 1980s. By contrast, in countries such as the USA and Britain, where neo-liberal policies for privatization and deregulation held sway during the 1980s and early 1990s, employment in private services rose very fast, while public-sector employment was stagnant. Not surprisingly, these are also the countries with relatively *in*egalitarian wage structures (refer back to Figure 1), and unlike the other countries in the table, Britain and the USA grew notably more inegalitarian during the 1980s.[9]

But there is clearly an alternative to the social democratic and neo-liberal models as exemplified by Germany and The Netherlands. In these cases services employment has been stagnant in *both* the public sector (as in the neo-liberal countries) *and* in the private sector (as in the social democratic countries). Governments in these countries have been able to maintain a relatively egalitarian wage structure, while successfully controlling public consumption and taxes (before unification, in the case of Germany). This combination is at least partly a results of the strong influence over government policies of Christian democratic parties. In the case of The Netherlands, for example, a 'consociational' political system has accorded equal weight to the Christian democratic concern for keeping the state in a subordinate role and the social democratic concern for class solidarity and equality (Van Kersbergen, 1995, ch. 4). Correspondingly, wage equality in this country is close to Scandinavian levels, but government consumption has remained almost constant at around 10–12 per cent of GDP, whereas in Scandinavia it has more than doubled from a similar starting point in the early 1960s. The 'cost' of these policies has instead come in the form of much lower labour-market participation rates, especially among women and older workers.

The Dutch model has been undergoing significant change over the past decade. Although female participation rates are still considerably lower than in either Scandinavia or North America, the gap has been narrowing somewhat in the 1980s and early 1990s. At the same time, unemployment has been almost halved from its peak in the early 1980s. Both trends are at least partly attributable to reforms aimed at making the labour market more flexible and encouraging the expansion of private-sector employment. But there has been no wholesale attempt at neo-liberal deregulation, as suggested by some observers. Wage dispersion has only increased moderately—partly as a result of the continued role of national unions in collective bargaining—and labour-market participation rates have remained close to the bottom among OECD countries. The Dutch 'employment miracle' is rather due to an effective macroeconomic adjustment (more on this below) combined with a substantial rise in part-time female employment, early retirement, and in the number of people on disability pensions (Schmid, 1997).[10] The Dutch solution to employment problems is thus distinctly Christian democratic. It combines job-sharing and labour-market exit with restrictive macroeconomic policies—*neither* wholesale deregulation as in Britain or the USA, *nor* large-scale public-sector service production, as in Scandinavia.

[8] The alternative to public-sector employment expansion, while pursuing full employment and wage equality, is to discourage labour-market entry (especially of women) and encourage labour-market exit (especially older workers). As discussed below, this is a strategy that has been followed in Austria, Germany, and some other countries dominated by Christian democracy. It is not a strategy that has been pursued by either social democratic governments or liberal governments (although this may be changing).

[9] According to the OECD wage data the d1/d5 ratios went from 60 to 55 in Britain, and from 55 to 48 in the USA across the 1980s (OECD, 1996*a*).

[10] Seventy-five per cent of the increase in service-sector employment between 1985 and 1990 was part-time, and by 1989 an astonishing 13 per cent of the total labour-force was listed as worker-disabled (Jones, 1998).

In one respect, however, The Netherlands has followed a similar path as in Denmark and Sweden. Starting in the early 1980s, authority over wage-setting has shifted from the peak-level to the industry and local levels. Although tripartite bargaining continues to play a coordinating role in The Netherlands, it does not have the same compulsory character as in the 1960s and 1970s, and the solidaristic profile of wage policies has weakened (Visser, 1990). In Denmark, the practice of decentralized bargaining was initiated in 1981 (the first truly decentralized round since the early 1930s), and, as in The Netherlands, it was prompted by pressure from engineering employers and skilled workers. Despite a partial return to centralized bargaining in 1983 and in 1985, the bargaining role of the Danish employers' association has been eclipsed by sectoral associations (especially the powerful Association of Danish Industry) that are opposed to a resumption of peak-level bargaining (Iversen, 1996). In Sweden, the metalworking sector started to conclude separate agreements in 1983 and, although decentralized industry-level bargaining has since then been interspersed with more centralized forms of bargaining (prompted by government pressure), deeper institutional changes suggest an irreversible process. SAF has shut down its central bargaining unit, and has since the mid-1980s been withdrawing from virtually all government bodies, including the previously all-important Labor Market Board (Kjellberg, 1992, p. 100). But this 'making more flexible' of the bargaining system and the wage structure is no more neo-liberal in nature than the labour-market reforms in The Netherlands. Wage dispersion has been on the rise, but it is nowhere near the levels in liberal countries such as the UK or USA, and generous unemployment replacement rates coupled with an egalitarian transfer payment system have guaranteed a continuously high 'social wage'.

(ii) Macroeconomic Policies

Until recently, Sweden was one of the small European countries that most persistently defended its macroeconomic policy autonomy. Central to this autonomy was the choice of a 'soft' currency that enabled *ad hoc* 'technical' adjustments to exchange rates, and gave the government the capacity for occasionally large 'surprise' devaluations. The flexible exchange-rate policy undoubtedly facilitated the Swedish full-employment strategy during the 1970s and 1980s, but it clearly depended on the centralized bargaining system because devaluations only worked if followed by across-the-board wage restraint (Martin, 1985; Gylfason, 1990). For example, the social democratic government's 'Third Way' strategy of devaluation-led reflation after the election in 1982 was based on an advance agreement by LO *not* to demand compensation for the cost of living increases expected from higher prices on imports (Elvander, 1988, p. 291; Pontusson, 1992*b*, pp. 116–17).

But the economic success of centralized bargaining also came to depend crucially on monetary policy flexibility. Because collective wage bargains were inevitably followed by some wage drift, and because drift undermined the redistributive terms of the centralized bargain, it was very difficult for low wage unions during periods of low growth to agree to bargained wage increases that were sufficiently small to maintain competitiveness. LO negotiators knew that the higher the level of bargained wage increases, the lower the proportional size of wage drift, and the higher the increase in wage compression and total wage increases. Because the wage demands by LO were the result of a delicate compromise between different groups of wage earners groups, it was therefore difficult for LO to accept wage restraint at a level necessary to maintain competitiveness during the severe recessions in the mid-1970s and early 1980s. Instead, the restoration of Swedish competitiveness was achieved through infrequent but large currency devaluations followed by negotiated wage restraint. This strategy allowed Swedish nominal wage costs to grow at a rate compatible with the LO's solidaristic wage strategy (and generally at a faster rate than in most of its competitor countries),[11] while simultaneously achieving a real wage adjustment sufficient to restore competitiveness.

Of course, this does not tell us what would have happened if centralized bargaining was *not* accompanied by flexible monetary policies, but the Danish

[11] Swedish unit labour costs in manufacturing grew by an average annual rate of 11.3 per cent during 1973–9 compared to 9.4 per cent in Denmark, 5.3 per cent in Austria, 5 per cent in Germany, and 8.8 per cent in the entire OECD.

experience in the mid- to late 1970s can throw some light on this. Denmark had joined the Snake when it was formed in 1973, and it subsequently became a member of the European Monetary System (EMS) in 1979.[12] Participation in these organizations was strongly favoured by the central bank, by the financial community, and by the Radical Party, whose support consecutive social democratic governments depended on for legislative majorities.[13] The main problem with membership in the European exchange-rate mechanisms was that the negotiated devaluations they permitted were too small to accommodate *nominal* wage increases in Denmark. As a result, the Danish real effective exchange rate appreciated by 18 per cent in the first 3 years of membership of the Snake, and even when exchange-rate adjustment policies became more permissive during the 1976–8 period, Danish price competitiveness remained unchanged, while Sweden achieved a significant 12 per cent improvement (Gros and Thygesen, 1992, p. 19).

To make things worse, because Danish inflation was above the German level, Danish interest rates incorporated a substantial 'risk premium' (real long-term interest rates in Denmark in the 1973–82 period were an average of 2.7 per cent above those in Germany). Notwithstanding the political and ideological commitments of the government, Danish economic institutions were therefore not well suited to maintain full employment during a severe recession, and unemployment soared from about 2 per cent in 1974 to over 9 per cent in 1981. At that point, real interest rates were so high that housing construction had come to an almost complete halt, and the public debt (domestic and foreign) was rising exponentially. The impasse came to a pitiful conclusion in 1982 when the social democrats, without calling for an election, handed power over to a centre-right coalition government—a political and moral low point for Danish social democracy.

The Danish experience is also instructive because of what happened to the economy after the new government instituted a fundamental reorientation of economic policies. The anchor for the new low-inflation policy was a pegging of the currency to the German Deutschmark, while credibility was achieved by liberalizing capital markets, eliminating the fiscal budget deficit, and suspending all cost-of-living indexation.[14] The policies enabled a gradual downward convergence of Danish interest rates to German rates with real rates falling from 10.9 to 5.5 per cent.[15] The expansionary effect of this decline, leading to massive wealth gains in securities and one-family houses, was stronger than the contractionary effects of the government's freeze on public consumption and tax increases. Simultaneously, unions' wage policies became much more restrained, and this enabled a substantial improvement in Danish competitiveness.

If the Danish case thus shows that non-accommodation in a sector-based bargaining system is compatible with wage restraint and good economic performance, the Swedish experience in the 1980s shows what happens when accommodating policies are not supported by a centralized wage-setting system. In the absence of effective peak-level control, and in the context of tight labour markets, it proved impossible for the Swedish government to prevent unions in sheltered and booming sectors from exploiting their bargaining power and 'leap-frogging' other unions.[16] The result was a rapid deterioration of Swedish competitiveness.[17] Although this could have been an argument for renewed

[12] Sweden briefly joined the European currency Snake in 1973, but when the soft currency policy came into conflict with the aim of maintaining exchange-rate stability in the system, Sweden resolutely withdrew (in 1977).

[13] Representing farmer interests, the Radicals were anxious to maintain an alignment between the value of the 'Green Krone'—which was used by the European Community to compensate Danish agricultural producers for goods sold under the auspices of the Common Agricultural Policy—and the main exchange rate.

[14] The hard-currency policy was singled out as the centrepiece in the new government's economic strategy: 'The new government is firmly determined to recreate the balance in the Danish economy. The government has no intentions of devaluing the krone. Confidence in the value of the Danish krone at home and abroad is a good start for a new economic policy' (Inauguration speech, 10 September 1982).

[15] Using rates on 10-year government bonds and the GDP deflator.

[16] A perverse example is the 1988 bargaining round, where an agreement was first reached in the baking [*sic*] sector which awarded wage increases that were totally unacceptable to the exposed industries. Another example is the decentralized 1984 bargaining round when public-sector wages broke the proposed 6 per cent pay norm.

[17] Unit labour costs rose much faster than in the rest of OECD, and in 8 of the 10 years since 1980 hourly earnings in manufacturing increased faster in Sweden than in Denmark.

Table 2
Unemployment Rates (%) by Monetary Regime and Centralization of Wage Bargaining in 15 OECD Countries, 1973–93
(number of observations in parenthesis)

		Centralization of wage bargaining			
		Low	Intermediate	High	Low–High
Monetary regime	Accommodation	8.0 (12)	6.9 (12)	3.8 (13)	4.2
	Non-accommodation	7.9 (10)	3.6 (25)	7.1 (3)	0.8
	Row differences	0.1	3.3	–3.3	

Note: Data were grouped into five 4-year intervals for each country. Unemployment refers to standardized rates; the measurement of the independent variables is described in the text. The figures have been corrected for period differences in unemployment.
Sources: For dependent variable, *OECD Economic Outlook* (various years); for independent variables, Iversen (1998*b*).

centralization, the largest Swedish companies were opposed, and the krona was now so vulnerable to international currency speculations that the continuation of accommodating policies proved impractical. Most capital controls had been lifted during the 1980s in response to the expansion of world capital markets and the liberalization of capital controls in most other OECD countries, and this now came to haunt the social democrats (Moses, 1994, pp. 140–2). Without these controls it was difficult for the government to manage a devaluation strategy, and since employers knew this, they had few incentives to agree to centralized coordination.[18]

Like the Danish policy reversal in 1982, the pegging of the value of the krona to the ECU in May 1991 was arguably the most important change in Swedish macroeconomic policies since the 1950s. It signalled a *de facto* abandonment of the social democratic commitment to full employment. Once the government had tied itself to a fixed exchange-rate policy, it had also committed itself to bringing other economic policy goals into line with the pursuit of this strategy, including unemployment. Fiscal policies were tightened, interest rates increased, and EC membership and participation in the EMS became government policy.

But the timing of the hard currency policy was bad. Unlike the Danish situation prior to the 1982 DM-peg, the Swedish currency was considerably overvalued,[19] and it could not withstand the 1992 crisis within the EMS and the subsequent floating of the Finnish markka. The abandonment of the peg has created uncertainty about the commitment of the government to a non-accommodating policy. Although there is no talk by the social democratic government of a return to the full employment policies of the 1960s and 1970s, there are some unanswered questions about Swedish economic

[18] An interesting question is whether the Swedish government could have gone against the tide of international capital market liberalization in the 1980s. Moses (1994) argues that rapidly expanding grey markets would have made this very difficult, but Notermans (1993) stakes out a minority position that new policy instruments would have made it fairly unproblematic. Be this as it may, once liberalization had been implemented it would have been very costly (in political as well as economic terms) for the government to reinstate controls in the 1990s.

[19] It would have made sense to have devalued before instituting the peg, but the government was probably concerned that this would have looked too much like business as usual and thus have undermined the credibility of the new policy. By contrast, in Denmark the centre-right government in 1982 was in the fortunate situation that the devaluation of the currency had occurred under the previous (social democratic) government, and therefore did not signal anything about the current government's policy preferences. I wish to thank one of the anonymous reviewers for suggesting this to me.

policies that have to be addressed. In particular, there is still no fully credible *institutional* commitment to low inflation (although the *de facto* independence of the central bank has been increased), and the close consultation that was re-established between the Carlson government and the unions did nothing to reassure the private sector about a fundamental break with the past. The government's call in the 1997 bargaining round for a return to centralized bargaining, and threats to intervene in the bargaining process with mandated incomes policies, have also not been any help. In some respects, therefore, the current Swedish situation may be more accurately compared to that of Denmark before, rather than after, the 1982 policy-turnaround (including the unprecedented rise in unemployment).

The interaction between monetary regimes, bargaining institutions, and economic performance can be usefully illustrated with some comparative data (see Table 2). The monetary regime is here measured as an average of an institutional variable, central bank independence, and a more policy-sensitive variable based on relative exchange-rate movements.[20] The data are for the same 15 OECD countries as listed in Figure 1, but have been grouped into five 4-year intervals starting in 1973 (for a total of 75 observations). The centralization variable was divided into three classes: a decentralized category where firm and plant-level bargaining dominate; an intermediately centralized category with most bargaining taking place at the industry or sectoral level; and a centralized category with an important role for peak-level bargaining between encompassing organizations of labour and capital (the monetary regime variable was simply divided into two equal categories).

The most interesting part of the table is the bottom row which shows the difference in performance between cases with 'accommodating' and 'non-accommodating' monetary regimes. Note that for highly centralized systems, there appears to be an employment loss from having a restrictive regime, while for intermediately centralized systems the opposite is the case. For decentralized systems—where wage-setters are atomistic and therefore do not interact strategically with the central bank—there are no apparent employment effects from the monetary regime. These patterns resonate well with the Scandinavian experience since, in centralized systems, where monetary authorities have been prepared to facilitate intra-confederal distributive compromises through accommodating policies—Norway and Sweden are exemplary cases until recently—employment performance has been very good. By contrast, the restrictive monetary policy regime in Denmark in the mid- to late 1970s created intense distributional conflicts and high unemployment.

In a similar vein, the table suggests why the breakdown of centralized bargaining in Denmark and Sweden placed governments, left as well as right, under considerable pressure to reform the monetary regime in a non-accommodating direction. With accommodating policies it is difficult to contain wage militancy, and unemployment and inflation are correspondingly high. Conversely, industry- and sector-level bargaining is clearly not incompatible with low unemployment if accompanied by a non-accommodating monetary regime. The reasons, which have been developed in Hall (1994), Hall and Franzese (1998), Iversen (1998*a*,*b*,*c*) and Soskice and Iversen (1998), have to do with the capacity of the monetary authority to *deter* wage militancy. When unions are sufficiently large for their agreements to affect the general price level, and when monetary policy responses are predictable, a non-accommodating monetary policy rule gives bargainers an incentive to moderate demands because they know that such moderation will raise the real money supply, and hence demand and employment. This linkage between wage demands and the real money supply is missing when monetary policies are accommodating or difficult to predict.

The logic may be exemplified by Germany before unification and The Netherlands since the early 1980s. According to Hall (1994), the German central bank is not only committed to a non-accommodating strategy, but its constitution permits it to send credible signals to unions and employers about its policy intentions. Because wage bargaining is con-

[20] The index of central bank independence is an average (after standardization) of three widely used indices by Bade and Parkin (1982), Grilli *et al.* (1991), and Cukierman (1992). The exchange-rate index is based on OECD data for relative growth in nominal effective exchange rates.

ducted at the industry level by well-organized strategic players, it is in the interest of unions and employers to adjust their behaviour to the anticipated non-accommodating reaction of the central bank. And since the central bank is independent, 'pronouncements by the Bundesbank about the kind of monetary stance a projected set of wage settlements might engender are especially credible' (Hall, 1994, p. 12).

In the case of The Netherlands, there are interesting parallels to the Danish experience. As in Denmark, Dutch wage-setting underwent a transition away from a highly centralized incomes-policy-based system in the 1970s and early 1980s to a system dominated by industry-level bargaining, and this transition was followed by a shift to a more non-accommodating monetary regime anchored to a Deutschmark currency peg. As in Denmark, this macroeconomic shift was initiated by a centre-right government, and it appears to have assisted in the restoration of Dutch competitiveness. Unit wage costs declined substantially, and unemployment rates were eventually cut in half.

In terms of the coupling of monetary policies and wage-bargaining institutions, The Netherlands thus seems to have joined Denmark and Sweden in a movement towards a German-type system. Indeed, as a result of new technology, internationalization of capital markets, and the rise of services, it may no longer be feasible for countries to combine centralized bargaining with an accommodating monetary regime (the upper right-hand corner in Table 2). If correct, this poses a severe challenge to a very influential line of scholarship during the 1970s and 1980s, neo-corporatism, which argued that centralized wage bargaining combined with flexible neo-Keynesian economic policy was an attractive, even economically superior, political–institutional alternative (see, for example, Cameron, 1984; and Lange and Garrett, 1985).

It is still possible to point to cases, Austria and Norway in particular, which seem to conform to a neo-corporatist pattern (e.g. Wallerstein *et al.*, 1997). But I do not think these lend strong support to the neo-corporatist thesis. In Austria, the corporatist Parity Commission, the Federal Economic Chamber (representing employers), and the ÖGB (the union confederation) certainly continue to form a highly centralized setting for the bargaining of wages (not unlike tripartism in The Netherlands). However, the wage-setting process in Austria differs in one important respect from that which used to characterize Scandinavia: the distribution of wage increases has never been subject to centralized bargaining. Instead, adjustment of relative wages in response to changes in labour demand and supply is achieved through a complex system of plant- and sector-level negotiations, where wage increases for particular groups of employees are approved by the Parity Commission if they can be justified in terms of changes in relative labour scarcities (note that Austria is an outlier in Figure 1).

This is a crucial point because it helps us to understand why Austria has been able to combine a non-accommodating policy regime with a relatively centralized bargaining system. Thus, without solidaristic wage policies, it is possible in a centralized system to negotiate downward real wage adjustments without currency devaluations during recessions and without rises in unemployment. To my knowledge Austria is the *only* OECD country that satisfies these conditions, and they may be very difficult to replicate elsewhere. Unlike the Scandinavian labour confederations, individual unions have little democratic influence over the formulation of ÖGB wage strategies (Katzenstein, 1984, pp. 47, 61; Visser, 1990), and Austrian social democracy has a very different history and character than Scandinavian (see Katzenstein, 1984, pp. 181–90; Scharpf, 1991, pp. 178–80, 188–90, 193–4). The commitment to wage equality, in particular, is much weaker. To cite just one piece of evidence, when Austrian socialist party voters were asked whether they thought it was fair or unfair for two secretaries with similar jobs to be paid differently based on productivity, only 5 per cent thought that it was unfair, while in Scandinavia between 30 per cent (in Denmark) and 60 per cent (in Norway) of social democratic supporters thought it was unfair.[21]

Norway, which retained a relatively centralized bargaining system with an accommodating macroeconomic regime well into the 1990s, also turns out to be a rather exceptional case because of the role

[21] The data are taken from the 1990/1 World Values Survey.

of oil. The oil boom from the early to mid-1970s generated huge capital investments, drove up demand for labour, and permitted governments to pursue very expansionist fiscal policies (including a 40 per cent increase in public employment between 1973 and 1989) (Calmfors, 1990, pp. 26–8; Dølvik and Stokland, 1992, p. 155). When oil prices suddenly dropped in 1986, the cushion effect of oil revenues on the Norwegian economy was removed, and the long decline in the competitiveness of Norwegian industry was manifested in a rapid deterioration of the external current account. Against this background, the social democratic government (which came to power in 1986) declared 1987 a year of 'emergency incomes policies' and agreed with LO and NAF that centrally negotiated limits on wage increases were absolutely essential for restoring the competitiveness of Norwegian industry (Mjøset, 1989, p. 334; Calmfors, 1990, p. 33).

The re-centralization of Norwegian bargaining institutions was a natural consequence of the rapid growth of the oil industry, expansionary fiscal and monetary policies, and the wage-push inflation that this economic expansion generated. The relative success of centralization in the late 1980s and early 1990s should therefore not blind us to underlying pressures for decentralization. As in Denmark and Sweden, credit market liberalization during the 1980s has reduced the degrees of freedom in economic policies (Dølvik and Stokland, 1992; Moses, 1994). Likewise, the making more flexible of production and work organization has created pressures for greater wage dispersion (reflected in the introduction of new pay systems) that run up against the solidaristic wage policy (Dølvik and Stokland, 1992, p. 161). In fact, the bargaining system has exhibited subtle signs of decentralization throughout the early 1990s, with an increasing portion of total increases (between 55 and 85 per cent) coming in the form of wage drift, and bargaining returned to the sectoral level in the 1997 bargaining round for the first time in more than a decade.

IV. THE SOCIAL DEMOCRATIC TRILEMMA

Decentralization of wage bargaining and the linking of economic policies to a non-accommodating monetary policy rule remove two of the most important pillars of social democratic corporatism: solidaristic wage policies and full employment. Without these supports, other elements of the system, in particular the universalistic welfare state, come under strain. Since much of the political–economic rationale behind the Scandinavian welfare state in the centralized-flexible institutional context was to support income solidarity and to 'socialize' the threat of unemployment, these elements lose their *raison d'être* and even work at cross-purposes in a decentralized system that is premised on greater wage dispersion and 'privatization' of the risk of unemployment. Moreover, along with the internationalization and the making more flexible of the private-sector economy, and given the tighter fiscal constraints on government spending, the class solidarity that served as a seal for public–private-sector collaboration starts to fall apart. No longer are solidaristic wages and public-sector expansion likely to be viewed by either employers or better-paid, better-educated groups (especially in the private sector) as a necessary *quid pro quo* for 'well-behaved' low-wage unions (especially in the public sector). Rather, decentralization of wage bargaining removes the rationale underpinning redistributive welfare policies, and points to a potential break-up of, or at least a redefinition of the terms of, the electoral coalition supporting a continuation of the social democratic welfare state and full employment policies.

In the context of the transition towards a service economy, and in the absence of labour-market institutions which facilitate wage restraint and equality, the government will find it both politically and economically harder to combine egalitarian wage policies with full employment. It is not that the promotion of pay equality through public policies is impossible. Equal pay and minimum wage legislation, cost-of-living indexation, mandatory extension laws, as well as a whole range of welfare and regulatory provisions (including unemployment compensation and competition policy) can significantly influence the relative pay and bargaining power of low-wage unions. But because the government cannot depend on centralized bargaining institutions to sponsor and 'subsidize' such policies through wage restraint among the better paid, it has to rely more heavily on expansion of public-sector employment to accomplish its full employment goal. And such an expansion runs counter not only to a non-accommodating macroeconomic strategy which uses the threat of unemployment to deter militant union behaviour, it may also be politically infeasible.

During the 1970s and 1980s, soaring levels of taxation met with increasing opposition from business and private-sector unions, and the electoral success of the Danish Progress Party and the Swedish Conservatives in the 1970s—both running on a neo-liberal, anti-tax political platform—sent a clear message to politicians that there can be electoral costs associated with public-sector expansion.[22] Indeed, both left and right governments have found it imperative to bring public consumption under control by taking tougher stands against the demands of public-sector unions, and by reforming the budgetary process. As a result, the relative wages of public-sector workers have been declining, and a series of budgetary and administrative reforms have been undertaken with the aim of bringing public expenditures under control (see Elvander, 1988, pp. 314–16; Due and Madsen, 1988; Kjellberg, 1992; Pontusson, 1992*b*, p. 119; Schwartz, 1994). As is evident from the data presented in Table 1, public-sector employment also seems to have reached a maximum in the early to mid-1980s. Perhaps most tellingly, public-sector employment has remained unchanged from the early 1980s and has even started to decline in recent years.

As Anne Wren and I have argued elsewhere (Iversen and Wren, 1998), the choices facing social democracy in the 1990s and beyond may be characterized (borrowing a term from Peter Swenson) as a 'trilemma' where the pursuit of the traditional goals of social democracy—earnings equality and employment for all—is prone to run into an upper budgetary ceiling. Conversely, if social democracy wants to exercise budgetary restraint it cannot simultaneously achieve its employment and equality goals. Instead, it faces a hard choice between a more 'neo-liberal' strategy where private service-sector employment is promoted through deregulation and a more flexible (inegalitarian) wage structure, and a more 'Christian democratic' strategy, where employment is sacrificed for equality and fiscal responsibility. Judging from the experience over the past decade, Danish and Swedish social democrats appear to have chosen to sacrifice employment. Unemployment in both countries is above the OECD average, and early retirement schemes have been introduced in both countries to encourage exit from the labour market.[23] The result is that the number of people in employment as a percentage of the working age population has dropped from its peak of over 76 per cent in 1986 to about 70 per cent in 1994 in the case of Denmark, and from over 82 per cent in 1989 to less than 72 per cent in 1994 in the case of Sweden.[24] These figures are still much higher than in Germany and The Netherlands, but nevertheless constitute a clear departure from the past.

Some changes *have* been made to loosen the egalitarian effects of the welfare state, most notably in the area of unemployment compensation. Denmark and, later, Sweden have implemented a marked reduction in the average replacement rate, and although this reduction was initiated under centre-right governments—in Denmark in the early 1980s, in Sweden in the early 1990s—it has not been reversed by succeeding social democratic governments. Likewise, the progressivity of the tax systems has been notably reduced. Still, the reforms in the unemployment benefit system have only marginally affected replacement rates for the lowest paid, and since low-paid workers tend to be semi-skilled with the highest incidence of unemployment, the wage-disciplining effects of a less generous benefit system have been the weakest where they are most 'needed.'

It is difficult to see how social democracy can transcend the trilemma in the future in the way that the Rehn–Meidner model did in the past. A return to the centralized coordination of wages and macroeconomic policies is probably impractical in the foreseeable future, and monetarism (in the sense of

[22] For an analysis of the growing polarization of public- and private-sector interests in Sweden, see Swenson (1991, pp. 379–99).

[23] Of course, unemployment in Sweden is also a result of short-term forces that are outside the immediate control of the government. Only time will provide clearer indicators of policy choices. In Denmark, however, where unemployment among low-skilled workers has been very high for decades, it seems appropriate to talk about a conscious political choice.

[24] The magnitudes of the figures are slightly reduced by subtracting cyclical unemployment, defined as the difference between the actual unemployment rate and OECD's estimate of the NAIRU (non-accelerating inflation rate of unemployment) (OECD, 1996*b*).

non-accommodating macroeconomic policy regimes) seems to have become a necessary evil for social democracy. Although this does not rule out full employment—as perhaps the Austrian and Dutch experiences show—it does seem to preclude highly egalitarian wage policies unless there is a radical break with the social democratic commitment to employment for all. To put it in the starkest terms possible, the question for Scandinavian social democracy is whether it wants to deepen class divisions by accepting greater inequalities, or whether it wants to create a marginalized group of people, excluded from full participation in the economy.

If the first option is chosen there are clearly policies that can cushion the unequalizing effects of a more market-conforming wage structure, such as negative income taxes and the conversion of universal benefits into need-tested ones. As exemplified by the Danish social democratic government's policy of the right to sabbaticals, more emphasis can also be placed on ensuring that people have access to further education, and thus to participation in the stream of wealth creation in the post-Fordist economy. In an institutional and technological environment where production of goods and services is becoming more knowledge-intensive and more decentralized, it may prove very costly for social democratic governments to try to ensure equality of outcomes, but they can greatly facilitate educational opportunities while simultaneously promoting economic growth. The negative effects of the second option can also be lessened by emphasizing voluntary early retirement schemes, and by encouraging work-sharing through part-time employment and fixed-term contracts. This will not please unions—traditionally opposed to non-standard and part-time employment—and it challenges social democratic notions of equality between the sexes (since it is mainly women who end up in part-time employment). However, in the post-industrial economy, and constrained by a monetarist international monetary system, social democracy appears compelled to make hard choices between different forms of labour-market inequalities.

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