

## Abdication from National Policy Autonomy: What's Left to Leave?

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The middle way has reached its end. Unemployment levels in the Nordic social democracies are scaling to post-Depression heights. Concurrently, world financial integration has fundamentally altered the nature of what was once called an international economic "order." This article charts the relationship between these two phenomena, interpreting the social democratic experiment as a test on the constraints of national economic autonomy in an increasingly international marketplace.

It is no longer novel to argue that the decline of social democracy and the increased globalization of capital markets are related. Indeed, the catalyst for my argument—appearing in this journal one year ago—starts from this premise. In "The Abdication from National Policy Autonomy,"<sup>1</sup> Ton Notermans presents a useful descriptive account of the current crisis in two social democracies, Norway and Sweden, against the backdrop of changes in the international economy.<sup>2</sup>

Clearly, the crisis is as Notermans describes it: there has been a move toward a more monetarist policy orientation over the past decade, with price stability surpassing full employment as the main economic objective. Free capital mobility and fixed exchange rates leave precious little room for domestic political maneuvering, and monetary authorities have come to dominate over the trade unions.

Although Notermans' observations are accurate, his hypotheses are not. This article takes issue with two arguments used by Notermans to explain the current

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social democratic dilemma. In doing so it provides the foundation for an alternative explanation, one more consistent with the historical record, and less cynical of the motives of social democratic policymakers.

What follows is divided into four parts and a conclusion. Part one challenges Notermans' basic argument: that the institutions of social democracy were forged in a period of deflationary expectations, and have shown themselves incapable of functioning during inflationary bouts. In itself, this argument is easily tested against the historical evidence, and the bulk of this section does just that. Indeed, the historical record contradicts Notermans' contentions. Social democratic institutions were forged in periods of high-inflation to fight inflation, and were effective instruments in that battle until only recently.

Part two offers a different cut at the material. Open economy social democracies are presented in terms of a struggle over two balances: external and internal. Traditionally, their external balance has been defended with an independent instrument, leaving the internal balance for the undivided attention of fiscal and monetary policy authorities. Changes in the international economic environment have undermined the utility of instruments reserved for balancing the external account, and redirected policy tools from the internal to the external balance.

Part three juxtaposes the Swedish and Norwegian models of social democracy to illustrate how their unique policy mixes were undermined by increased levels of capital mobility. As parts two and three point to the central role played by foreign exchange deregulation, the fourth section takes issue with Notermans' contention that policies for liberalizing capital markets were designed to impose nominal constraints on domestic economic agents.

The result is an argument where social democracy is not in crisis because its institutions or its officials are corrupted. Social democratic institutions were designed for an environment which no longer exists. The conditions no longer exist because of changes that occurred beyond the regulatory reach of social democratic officials. Indeed, in this new international environment it would appear that there is no adequate constellation of policy instruments available to small open economies for securing the economic policy autonomy to which they had grown accustomed.

#### INFLATED EXPECTATIONS

A fundamental assumption of Notermans' argument is that the institutions of social democracy were forged in the fires of deflationary expectations, and that they are ineffective under inflationary bouts.<sup>2</sup> Indeed, Notermans contends that the top priority of inter-war social democrats was the battle against deflation, not the fight for full employment.<sup>3</sup>

Obviously, the Great Depression played an important role in constituting social democratic hegemony and legitimating democratic constraints on capital. Liberal capitalism had shown itself to be bankrupt. A broad political consensus developed

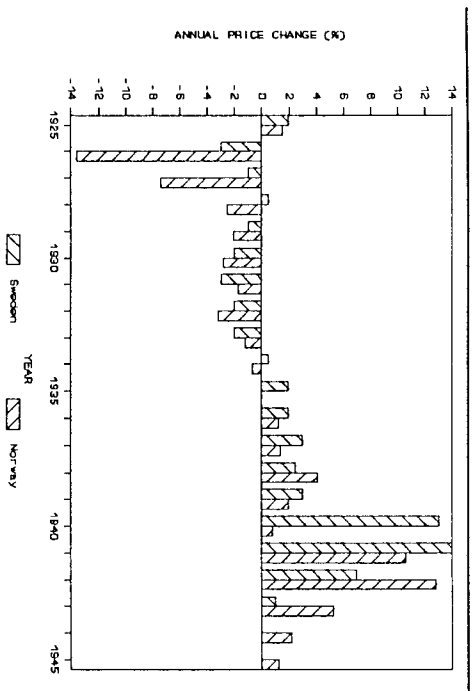


Figure 1. Swedish and Norwegian price changes, 1925-1945.

Sources: Klas Fregert and Lars Jonung, "Svensk arbetsmarknad under deflation. Erfarenheter av lönesänkningar under 1920- och 1930-talet," in *Lönebildning i förändring*, edited by Jan Herin (Stockholm: SÅF, 1992), 137-68; and Kunt Heidar, *Norske politiske fakta 1884-1982* Oslo: Universitetsforlaget, 1983).

for managing the domestic economy, and for insuring that capital flows were used to cover trade in tangible goods, not for short-term speculative gains.<sup>4</sup>

Notermans' argument, however, is not that social democracy was created in response to the failures of liberal capitalism. Instead he maintains that its institutions were forged to combat deflation, and are therefore unequipped to fight inflationary fires. This is an easy point to investigate. The Swedish Saltsjöbaden Agreement was signed in 1938, the Norwegian Main Agreement in 1935. These dates correspond, roughly, with the beginning of social democratic political hegemony, and the development of counter-cyclical stabilization policies in Sweden. In Norway, Labor Party government dominance started with Nygaardsvold's 1935 government,<sup>5</sup> in Sweden it can be said to have started in earnest with the Per Albin Hansson regimes in 1932 and 1936.<sup>6</sup> What, then, did price trends look like when the main institutions of social democracy were being formed?<sup>7</sup>

Figure 1 shows that price movements in both countries tended to reverse in about 1934. Thus, in the latter years of the decade, when one can really begin speaking about the building of the social democratic edifice, both Sweden and Norway were experiencing rising prices. Obviously, gauging the actual expectations of economic actors at the time is difficult. One might, however, assume that expectations would adjust within a year of changes in the actual price trend, and grow with each following year's confirmation.<sup>8</sup>

In the beginning of the decade, of course, prices were steady or falling. However, Notermans himself notes that expectations during this period were of rising prices:

Norway and Sweden, due in part to limited exchange reserves and an inability to obtain foreign loans to support the currency, were forced off gold quite early (September 1931). Yet their first concern after devaluation was that inflation might reemerge. In Sweden, the devaluation was met with an increase in the discount rate and a proclamation by the minister of finance that the Krona would return to gold as soon as possible. . . . In Norway, due to the destructive policies of the twenties the fear of inflation seems to have been less widespread than in Sweden after September 1931. Still it was not until 1935 that the cautious line which had been followed by Norges Bank after the devaluation was abandoned in favor of more expansionary policies.<sup>9</sup>

If (1) expectations in the early part of the 1930s were inflationary while price trends in the latter part of that decade were deflationary; and (2) the founding institutions of social democracy were established during this decade; then (3) it is difficult to argue that the founding institutions of social democracy were forged under deflationary expectations.

If this is not convincing, we might employ the more conventional explanation for the establishment of these institutions (as well as for social democratic electoral support). Since 1932-33, these economies were again expanding in terms of their levels of current exports, growing investments and real income per capita,<sup>10</sup> and yet unemployment levels—as Figures 2 and 3 show—remained high, and responded very slowly to market forces.

Several tools were wielded to combat the high unemployment levels and the role of basic agreements in this regard might be seen as secondary. Governments implemented restrictive tariffs and quotas to secure the external balance, while introducing several new expansionary and redistributive policies on the domestic front. The aim of collective agreements in this policy arsenal was labor market stability, discouraging strikes, and rationalizing production—not fighting deflation.

To suggest that the institutions of social democracy were created to fight deflation is to ignore inter-war price trends and to misunderstand the role for which these institutions were actually designed. But Notermans' trailer, that the institutions of social democracy cannot function in a world of inflationary expectations, is even more suspect. These institutions were not only created during an inflationary period, they have existed *only* in inflationary periods.

In particular, this part of Notermans' argument sidesteps three fundamental characteristics of the post-war social democratic order. First, there were enormous inflationary pressures immediately following World War II when the institutions of social democracy were coming into full blossom. Second, social democrats were well aware of, and hedged against, the inflationary effects of their full-employment policies. Finally, inflation in these countries is most often assumed to be external in origin (i.e., imported). The rest of this section examines these points more thoroughly.

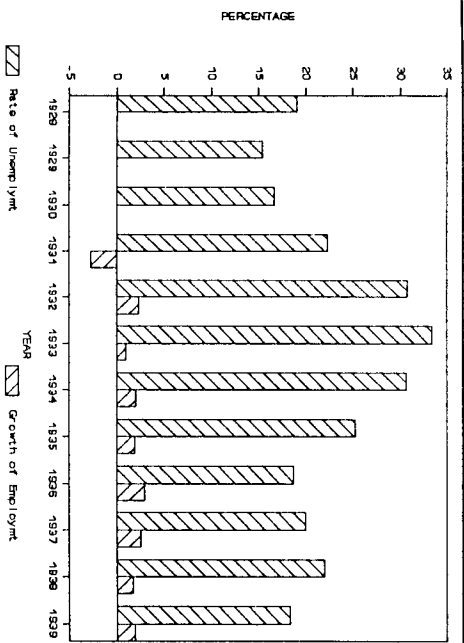


Figure 2. Norwegian indexes for unemployment and growth of employment.<sup>11</sup>  
Source: Henrik Jess Madsen, "Social Democracy in Postwar Scandinavia" (Ph.D. diss., Harvard, 1984), 112.

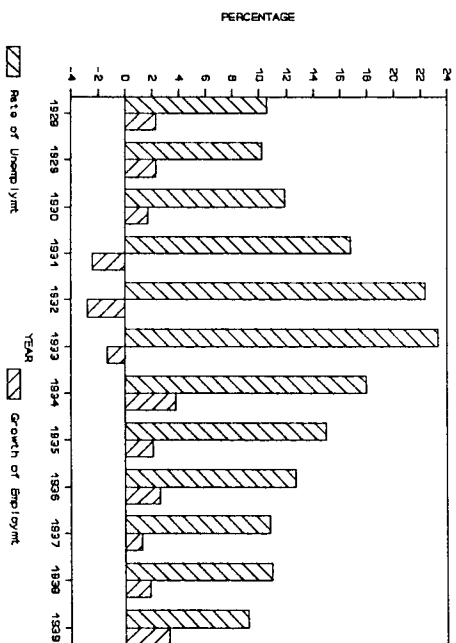


Figure 3. Swedish indexes for unemployment and growth of employment.  
Source: Henrik Jess Madsen, "Social Democracy in Postwar Scandinavia" (Ph.D. diss., Harvard, 1984), 112.

In the immediate post-war years inflation was a serious problem in both of these economies, although possibly for different reasons (see Table 1).<sup>12</sup> Indeed, it was during this heavily inflationary period that the institutions of social de-

Table 1  
Price Developments in Seven Economies

Index of consumer prices	Percentage price increase				
	1938-46	1946-49	1949-52	1952-62	1938-62
West Germany	29	30	3	18	102
United Kingdom	30	11	23	34	139
Denmark	57	6	22	30	165
USA	37	22	11	14	112
Netherlands	91	14	20	28	232
Norway	59	0	33	33	181
Sweden	42	10	27	34	166
Average <sup>a</sup>	39	16	17	27	138

Source: Peter Jakob Bjerve, *Norges økonomi etter krigen* (Oslo: Statistisk Sentralbyrå), 322.

a. Average for the six countries weighted by the sum of exports and imports in their trade with Norway in 1959.

mocracy received their real christening. Governing over full-employment economies, social democrats found themselves in tenuous positions. The full-employment/inflation trade-off took center stage in debates over social democratic institutions. In order to keep Nordic goods competitive, exposed sector wages had to be kept lower (or productivity levels had to be kept higher) than those in competing countries.

It was in an economic environment with fixed exchange rates and foreign exchange controls (i.e., under the Bretton Woods order) that social democratic governments (at first hesitantly) chose solutions which relied heavily on collective bargaining institutions, fortified with transfer programs and investment incentives.<sup>13</sup> In other words, the very institutions which Notermans suggests are incompatible with inflation, were those drafted to fight it!<sup>14</sup>

Despite expectations to the contrary, the post-war period contained tremendous inflationary pressures. Table 1 shows that these pressures were significant in Norway and Sweden, although not outstanding. The first line of defence against inflation in these countries consisted of incomes policies, price controls, wage freezes and/or collective agreement extensions. These initial measures, however, were not to last. Beside the fact that they were temporary in nature (most assumed that they were only for post-war reconstruction), these measures were playing havoc with the solidarity of organized labor. As Andrew Martin recently put it:

To make the most of the political resources provided by unions, then, governing labor movement parties have to have an economic policy strategy that not only makes full employment sustainable by countering its inflationary potential but also does so consistently with the imperatives of organizational cohesion defined by the unions' generic wage bargaining function. Insofar as a strategy that relies primarily on wage restraint is not consistent with those imperatives, labor movement parties clearly have a need for an alternative strategy for maintaining non-inflationary full employment.<sup>15</sup>

In the early post-war era, Sweden's Blue-collar Trade Union (LO) realized that the rate of inflation resulting from inter-war policies (maintenance of a high level of effective demand and a system of regulations for prices, trade, investment, etc.) would not be sustainable over the long run.<sup>16</sup> Leakage was eminent: excess demand would eventually undermine price controls.

From labor's side there was a concern over the potentially undermining influence of wage drift, and a recognition that monetary and fiscal policies should become more restrictive to dampen inflationary pressures. Restrictive economic policies would undoubtedly produce pools of unemployment, which active manpower policies were designed to mop up.

The strategy adopted by the 1951 LO Congress,<sup>17</sup> now referred to as the Rehn<sup>18</sup>-Meidner model, was aimed specifically at these dilemmas. It contained a model designed as an alternative to the sort of union wage restraint called for by the Social Democratic government,<sup>19</sup> and one that addressed the serious problem of inflation in a full-employment economy. The plan visualized a combination of government and union policies designed to produce non-inflationary/full employment by transferring productive resources from inefficient to efficient firms: a so-called active labor market policy.

In Norway, prices increased by 50% during the Second World War. From Norway's liberation up to 1962 prices doubled again so that they were three to three-and-a-half times larger than they were before the beginning of the war. Compared to Sweden, Norway's response was to rely even more heavily on price controls in the early period, and interest rate policies for the remainder of the Golden Age.<sup>20</sup> Indeed, wage laws and indexation regulation, combined with centralized negotiations, remained in force from 1946 to 1966.

As most of Norway's unemployment pressure was regionally distributed, much energy was directed to regional and sectoral stabilization policies. A vast network of state banks and a system of credit allocation were set up to help steer development in different sectors, while capital quotas were used to keep the economy from overexpanding. In short, a different sort of transfer system was used which relied much more on an autonomous monetary policy, and less on so-called active manpower policies.

Thus, it was during the high-inflationary post-war period that the specific character of the Norwegian and Swedish models was developed. Sweden came to rely more heavily on a countercyclical fiscal policy mix; Norway on its control of the credit supply. The institutions of social democracy played different roles in each country, but they were not made ineffective by high levels of inflation. On the contrary—these institutions were seen as necessary tools for balancing both the full-employment and low-inflation objectives.

Finally, to suggest that the domestic price level is a function of, or responsive to, failures in these institutions is to ignore the influential "Scandinavian Inflation Models" of Edgren, Faxén, and Odhner, and Aukrust.<sup>21</sup> Throughout the post-war

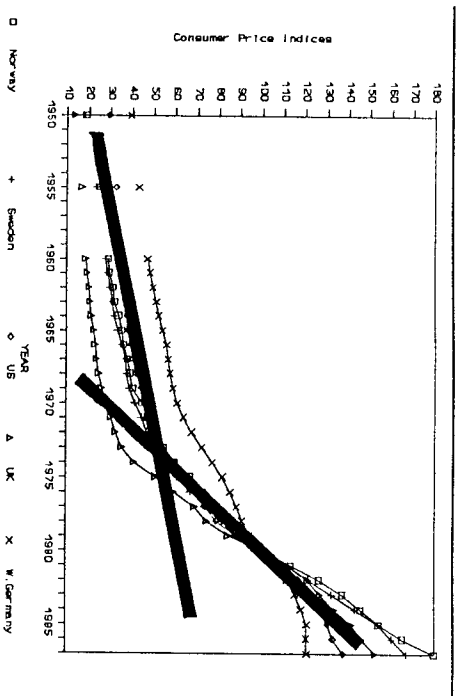


Figure 4. Post-war inflation rates, 1950-1987.

Source: International Monetary Fund, *International Financial Statistics Yearbook* (Washington, DC: IMF, 1988).

era, consensus was built on the assumption that price trends in these economies are set by the world market, and are directly linked—through the very institutions we are discussing—to domestic price and wage trends.

These models require that exchange rates are fixed so that world prices are directly transmitted to the domestic economy.<sup>22</sup> World price trends were seen as creating a “wage corridor,” that is, an upper and lower bound for domestic wages and prices. The parameters of this wage corridor were set by productivity and nominal wage differentials between domestic and world markets.

The very institutions of collective bargaining, and to a large extent an autonomous monetary policy, were seen as necessary components of the Scandinavian inflation models. One of the main justifications for directly transmitting world prices to domestic price levels was the ability to use centralized bargaining agreements and autonomous economic policies to ease and facilitate the adjustment process in both these countries.

To sum up, the institutions of social democracy, collective bargaining and a politically responsive central bank, were actually very effective in a period of extremely high levels of inflation. That they may appear to be the causes of the current problems is, as we shall see below, a function of some other difficulties.

#### SOCIAL DEMOCRACY'S BALANCING ACT

A clue to the explanation may lie in Figure 4, which shows post-war consumer price index movements for Norway, Sweden, Germany, the United States and the United Kingdom. The other three countries are important trading partners for both

Norway and Sweden, and also constitute a fairly broad “institutional” selection. Because the consumer price index (CPI) figures have been indexed for 1980, it is important to look at the slope (i.e., the inflation rate) of the country-line, not their intersection.

Figure 4 shows that inflation rates were fairly similar among these five different economies until sometime in the early 1970s. Afterward, one can find a divergence of inflation trends. The rates of Norway and Sweden are unquestionably above West-Germany's and the United States', but then so is the United Kingdom's. Apparently, something happened in the early to mid-1970s that affected all of these economies, regardless of their institutional make-up.

Another way to look at the problem is to utilize the analytical purchase offered by Notermans in choosing Sweden and Norway as his case studies. Contrary to popular opinion (and as I have hinted at in the previous section), the Swedish and Norwegian models of social democracy varied a great deal: one relied more on a fiscal policy mix which included active manpower policies, the other on an autonomous monetary policy.<sup>23</sup> Because they relied on different strategies for meeting social democratic objectives, and because both strategies have proven ineffective in the new international economic environment, a comparative analysis might suggest that a third, external variable may be responsible for the current crisis.

In short, social democracy could be understood as a complex system of policy instruments created to function in a specific environment: one where control of capital was both possible and desirable. Both conditions were satisfied after the Great Depression. Since the collapse of the Bretton Woods order, and the rapid development of international short-term capital movements, the environment has changed in such a way that traditional social democratic instruments are no longer effective.

Innovations in world financial markets over the past few decades have had an enormous impact on economic policies in all of the industrialized countries, but arguably it is the small open economies that have been impacted the hardest by these changes. Whereas many of the larger economies have allowed their currencies to float on the world market, thus enabling them a degree of autonomy on the domestic monetary front, smaller economies have found it necessary to fix their currencies against some external standard (for example, the European Currency Unit [ECU] or the Deutschmark). In a world with capital mobility, this has required that monetary policy in these countries has generally been aimed at defending the exchange rate, and can no longer be used for internal stabilization. In effect, these changes have created a policy dilemma, limiting the number of policy instruments available to small open economies. Those that do remain appear to be insufficient for maintaining both internal and external balances.

The internal balance is the arena in which national battles for social democratic policies traditionally have been fought. Generally, an internal balance can be

understood as maintaining output at the full employment level. Whereas liberals see this balance being struck naturally without the need for political intervention, social democrats have used a variety of offensive and defensive measures to facilitate that balance.

As small open economies, Sweden and Norway are not self-sufficient—but are extremely dependent on trade with the outside world. This trade requires payment in kind. A country on a fixed exchange rate cannot indefinitely run either a balance of payments deficit nor a surplus. The first imbalance will drain the foreign reserves of the country, the latter leads to a hoarding of foreign reserves which could otherwise be used for foreign consumption purposes. The traditional solution to this two balance act has been to reserve one policy instrument for defending the external balance. A barrage of domestic aggregate demand tools were then used to help clear the internal balance.

Before the Second World War, during the past era with relatively free capital mobility, these countries relied on a variety of controls on the trade of goods. Tariffs, quotas, and the like—usually bilateral in nature—were used to equate the relative value of exports and imports. If a country imported more than it exported in a given year, the government would simply restrict imports (either by quantity or by price) for the following year until a balance was struck.<sup>24</sup>

After the war, an international consensus developed over the lifting of barriers to trade in goods. The Bretton Woods system and the International Monetary Fund, the General Agreement on Tariffs and Trade (GATT), the Organization for Economic Cooperation and Development (OECD) and the European Payments Union were all organized around the principle of free trade in goods, and the establishment of a more liberal international trading regime. However, in the initial stages, the rhetoric of free trade was not allowed to pollute capital pools. The lessons of the Great Depression were still fresh in the minds of the architects of the new liberal hegemony.

Although trade restrictions were the most important tool of small open economies for defending their external balances, their removal did not create undue hardships on the social democratic policy mix in the immediate post-war era. The reason for this is clear. In effect, the move from the inter-war to the post-war economic order was one from free capital mobility with restrictions on trade in goods, to a new regime with free trade in goods and restricted cross-border capital flows. Thus, one policy tool was simply replaced with another.<sup>25</sup>

Not only did international capital controls allow for more autonomy in dealing with the internal balance (monetary, fiscal, and pricing policies could all be aimed at the internal balance, as the external balance was covered), but the control of capital movements at the borders also increased the possibility of politically steering capital at home. The movement from a world economic order which allowed for the free flow of capital (albeit with restrictions on trade) in the inter-war period, to a new order which limited capital's maneuverability, allowed for a degree of

national autonomy within an international capitalist economic order. Because of international constraints on capital mobility, national capital found itself captive to the whims of domestic policymakers.

With the increasingly rapid ebbs and flows of international capital tides, the main bulwark for defending the external balance—foreign exchange restrictions—was gradually eroded. But unlike in the immediate post-war era, it has not yet been replaced with a suitable alternative. Instead, instruments that were traditionally used for managing the internal balance have been diverted away from the internal balance and used to defend the external balance. The result, of course, was less effective control of the internal balance. In effect, the small social democracies are one tool too short for fixing the economy.<sup>26</sup> The responsibility for market clearing has moved off the shoulders of policymakers and onto the backs of labor.

#### SPECIFIC POLICY MIXES

After the Second World War, Norway's participation in the Bretton Woods Agreement—combined with strong recollections of the inter-war period—created the environment for what would eventually become the Norwegian model of social democracy. As the central bank's policies were held responsible for most of the inter-war period's economic problems, its autonomy was greatly restricted,<sup>27</sup> and Norway's set of credit and monetary tools were developed. By design, they were predominantly of a regulatory nature. Severe restrictions were placed on bond markets as well as official and private credit institutions. By the 1960s, Norway's reliance on, and the utility of, credit restrictions was obvious:

A more far-reaching liberalization of these capital movements would make it much more difficult to regulate domestic liquidity development and to affect the credit supply and loan-financed demand with the help of money- and credit-policy instruments.<sup>28</sup>

Because domestic capital was corralled and largely protected from foreign competition, Norwegian authorities intended to efficiently direct it through a network of programs. To secure an economy with full employment, social democrats felt that they needed to steer capital into more socially productive investments.

The result has been aptly described as "credit socialism."<sup>29</sup> As a response to the unstable credit atmosphere of the depressionary era, and the peculiarities of Norway's enclave economies,<sup>30</sup> the Norwegian state took over the responsibility for both the volume of credit and its rate of interest.<sup>31</sup> Direct control was wielded primarily through credit manipulation; indirectly, the authorities had control over the nation's liquidity levels. Norway's private financial sector played a subordinate role.<sup>32</sup>

In contrast to Sweden, the most significant instrument for regulating the economy was credit, not fiscal, policy. These policies were used to stimulate structural changes in the economy (mostly away from agriculture to export—hard

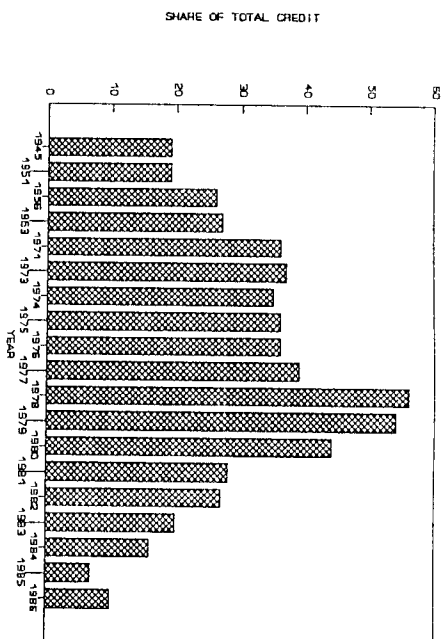


Figure 5. Share of the Norwegian state banks in total credit.

Source: Jan Fagerberg et al., "The Decline of Social-Democratic State Capitalism in Norway," *New Left Review* 181 (May/June 1990): 67.

currency earning—industries) to insure full employment with a high stable investment rate, and to provide the social foundations for democracy (i.e., demodification and an egalitarian income distribution). If demand in the main export industries fell, or if the housing market began to slump, state loans and credits were used to help stimulate production, or finance inventories.

Interest rates were set administratively, and were deliberately low to spark investment and development. Without market pricing as a guide, the economy's credit quantity was controlled by imposing limits on bank lending. In the beginning, credit rationing was mostly administered by private financial institutions—often through their investments in the corporate sector.

Through state controlled credit policies, the Norwegian government was able to stimulate growth and expansion in specific regions, sectors or industries. This helped to control the rate of development, and often served as a regional employment policy. The main tools for this targeted development was a heavy reliance on state banks. The impressive degree of state bank involvement in Norway's credit supply can be seen in Figure 5. Credits for expanding the local public sector, education, housing, agriculture, fisheries, rural areas, and so forth, were granted by state banks,<sup>33</sup> and financed largely through public sector budget surpluses. In addition, the purchase of state-issued bonds was made compulsory for private financial institutions.

Thus, the very nature of the Norwegian full-employment strategy required stringent controls over foreign exchange and credit supplies. To be efficient tools

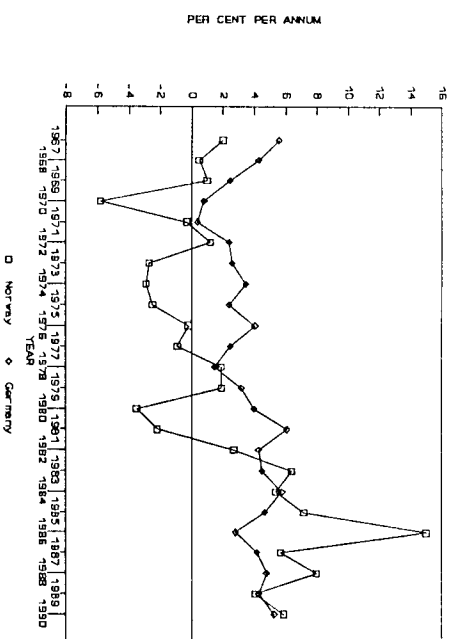


Figure 6. Real long-term interest rates percent per annum.

Source: OECD, *Historical Statistics 1960-1981* (Paris: OECD, 1983); and OECD, *Historical Statistics 1960-1990* (Paris: OECD, 1992).

for building the social democratic edifice, interest rates and credit volumes needed to be in the hands of the public. By placing numerous restraints on capital, the use of fixed exchange rates and autonomous monetary policies were not mutually exclusive. When capital was later liberated, this was no longer the case.

Thus, in Norway, the continued maintenance of a fixed exchange rate<sup>34</sup> regime in a world with capital mobility has had clear consequences for the main weapon in its social democratic arsenal: low real-interest rate policies. No longer can Norwegian interest rates or inflation levels vary from world levels, and the end result has been a transformation to a more *laissez-faire* economic footing. Structural transformations must now take place using unemployment and wages—rather than credit supply and interest rates—as the primary incentive mechanisms.

How capital mobility affected Norwegian monetary policy is clearly seen not only in the unemployment figures, but in a comparison of long-term real interest rates. As Figure 6 shows, until the recent liberalization of its credit markets, Norway was able to maintain lower long-term real interest rates than Germany (for example). Now nominal interest rate and inflation levels are largely influenced by events on the continent. Given current policy objectives, Norwegian interest rates should converge with German rates over the long run; deviation will bring immense pressure on the domestic currency reserves. The recent problems in the fall of 1991 (high unemployment levels, speculative runs on its foreign exchange reserves, a forced float of the krone, etc.) are exemplary of the pressures the Norwegian government can expect under the present circumstances.

Although Swedish monetary policy paralleled Norway's in its heavy reliance on credit regulation and capital controls, monetary policy was not the tool of choice for Swedish social democrats. This did not make monetary policy irrelevant, but a necessary complement to Sweden's fiscal toolbox. This was made explicit in a Swedish government report of the 1960s, which mentioned that fiscal policy was most important for the maintenance of Swedish economic objectives, but:

At the same time an active credit policy, capable of manipulating the credit volume and liquidity level, has become much more acceptable as—in practice—a necessary complement to fiscal policy.<sup>35</sup>

As the basic tenets of the Swedish model are well known, a brief overview will suffice. The kernel of traditional Swedish economic policy is aptly described by Lindbeck as having three basic features: (1) full-employment policies; (2) economic security via income redistribution (especially transfer programs); and (3) production and administration of government services to households (i.e., public consumption).<sup>36</sup> All three features emphasize fiscal tools for economic control.<sup>37</sup> To the extent that monetary policies were used, they were to be mildly restrictive: used to prevent excess demand in those regions/sectors with the tightest labor and goods' markets. The main aim of Swedish monetary policy was to check inflationary tendencies.

The full-employment part of the Swedish strategy relied heavily on the Rehn-Meidner model. As this model was introduced above, and is well understood, I will provide only a brief description of it, focusing on its fiscal nature. Gösta Rehn conceptualized two paths to full employment. First, one could retain a very high level of aggregate demand ("more jobs than men" à la Beveridge), or—similar to the Norwegian path—more focused demand. Alternatively, one could use general, restrictive economic policies combined with "positive" (i.e., expansionary) selective job-creating measures to remove islands of unemployment in the weaker sectors. Rehn preferred the latter strategy as it was seen to have the potential for decreasing unemployment without (much) increasing the level of aggregate demand in the general economy.<sup>38</sup>

The mechanics of the Rehn-Meidner model rely on reducing the share of gross profits by means of indirect taxation and wage restraint. The profit ceiling was meant to strengthen employer resistance to wage increases, thereby lessening inflationary pressures. Marginal firms and branches were to be supported with subsidies.<sup>39</sup> Wage restraint required the participation of centralized unions and solidaristic wage bargaining. The model's end result, in addition to full employment, included a desirable effect on the functional income distribution, that is, between capital and labor.<sup>40</sup>

These policies required control over capital and credit markets if they were not to be directly transformed into wage inflation.<sup>41</sup> Restrictive monetary policies were necessary to force a ceiling on wage and profit expansion. In return, the end

effect of these policies was an even greater control over capital and credit markets. This is particularly evident in the creation of the rapidly growing government pension funds, financed by rising fees on wage payments.<sup>42</sup>

These funds, in a general environment of credit restrictions and regulation, greatly increased the public role in savings and investments. By the early 1970s, the public sector (including semi-public pension funds, the "AP" system) accounted for 43% of gross savings (66% of net savings) and 40% of the credit supplied in organized credit markets (mainly from pension funds). However, in commercial banking the public sector accounts for only 10% of the stock of assets, and in the total banking sector, about 22%.<sup>43</sup>

The other half of the Swedish strategy relied on public sector growth. Indeed, public sector employment became a central tool for maintaining full employment. Whereas in the 1950s no more than 15% of output was produced in the public sector, this figure rose throughout the post-war period such that it was between 20% and 25% in the early 1970s.<sup>44</sup> The public sector was even more important in the demand side of the economy: public consumption and investment accounted for nearly 20% of gross national product (GNP) in 1950, by the early 1970s it had risen to 30%.

By 1971, total public sector incomes accounted for about 51% of GNP. The difference between the 51% taken in (taxes, fees, etc.) and the 30% used for public consumption and investment, is largely repaid to the private sector in the form of income transfers which in 1970 totaled about 18% of GNP.<sup>45</sup> This represents the third factor in the Swedish strategy. Together, full-employment policies, public sector employment, and income transfers placed an increasingly large burden on Sweden's stock of debt.

The effect of increased capital mobility on Sweden's policy mix runs through this accumulated debt burden. Debt-financed fiscal expansions led to a real appreciation of the Swedish kronor. This, in turn, put pressure on the tradeables' sector—forcing either austerity or devaluation (or both). Sweden's conversion to fixed exchange rates ruled out the latter option, and the only adjustment tool remaining was economic austerity.

Also, in order to fund its debt-financed expansion, Sweden ran up against real "creditworthiness" constraints. On the one hand, with international capital mobility the Swedish authorities have access to a much wider pool of capital from which to borrow.<sup>46</sup> On the other hand, the holders of this capital are likely to impose more stringent requirements on Swedish governments than did captive domestic lenders.

With domestic capital controls, political considerations were fundamental in determining investment needs. With an international capital market, the constituents of investment policies are now less likely to be voters, and more likely to be international investors. With other words, in order to borrow to cover its fiscal policies, Sweden now needs to sell its policies to international investors, leery of public sector growth. In order to be competitive, these policies must be more

efficient, offering a greater return. By moving from social justice to economic efficiency, much of Sweden's social democratic strategy was undermined.

Finally, with capital mobility and a fixed exchange rate, Sweden's inflation rate cannot deviate from that of its main trading partners. The fixed exchange rate sets a limit on the amount of future revenues available to the public sector from seignorage, or the ability to create wealth by excessive money creation.<sup>47</sup> Given an initial stock of debt—in the Swedish case rather high—and a solvency requirement (i.e., the degree to which creditors will be willing to lend to the government)—in Sweden, at present, rather low—a limit on seignorage income puts a lower bound on the present value stream of future primary surpluses in the public sector.<sup>48</sup> If the solvency condition is violated under a fixed exchange rate regime, the authorities will not be able to borrow, and the exchange rate can only be sustained until the currency reserves are depleted.

In other words, with free capital mobility, Sweden's fixed exchange rate requires it to maintain fiscal discipline. Together, these constraints force an internal devaluation on the country. That this constraint is real or perceived is of little relevance; Swedish governments and employers have used it to decrease government spending, employee benefits, and wages. In effect, Swedish fiscal policy's primary aim has become the defense of the external balance.

When problems develop on this front, there may be little or no room left in which fiscal policy can deal with internal problems. As in Norway, adjustment incentives are taken out of the hands of government officials and returned to the marketplace. Like the 1920s, unemployment and flexible wages become the prominent levers for structural adjustment.

Despite the fact that Sweden and Norway can be said to have relied on different strategies for meeting social democratic objectives, both strategies have proved ineffective in the new international economic environment. Fixed exchange rates<sup>49</sup> in a Europe susceptible to international capital flows is a recipe for a bland mix of economic policies suited mostly for German tastes. In such a brew, economic policy autonomy, regardless of its specific ingredients, evaporates. In Norway, interest rates are now directed at defending the exchange rate; in Sweden, fiscal policies have become severely constrained by external imbalances.

#### THE CAPITAL DILEMMA

Seen from this perspective the role played by the liberalization of international capital markets becomes instrumental to the crisis of social democracy. Thus, Noremans' light discussion of this aspect of the crisis does not seem justified given its importance.<sup>50</sup>

Noremans suggests that capital controls were lifted in Norway and Sweden to impose an external restraint on domestic inflationary trends.<sup>51</sup> This is, indeed, the effect that it has had, but to avoid the functionalist trap we need to go even further. At least two questions present themselves. Had they wanted to, could the authori-

ties have maintained the controls? And, was the only motive for liberalization the imposition of an external nominal anchor? In both these counts Noremans' evidence is weak.

The deregulation of domestic and international capital markets is not unique to Norway and Sweden. If the Norwegian and Swedish economies were more inflationary than their main trading partners', requiring the authorities to apply an external brake—as Noremans argues, it is somewhat curious that authorities in all the industrialized countries found it necessary to jettison these controls. Instead, the breadth of consensus on this policy decision suggests that something beyond domestic incentives is driving the liberalization of capital markets.

The key element of the post-1970s international economic environment is capital market integration. Breakthroughs in communication and computer technologies, the breakup of Bretton Woods, the development of Euro-dollar off-shore markets, increasingly multinational enterprises, et cetera, all contributed to the building of a new world market for capital.<sup>52</sup> For some, this was seen as a natural continuation of a process of freeing international trade flows which had taken place especially under the auspices of GATT and the OECD. Whether natural or not, this new world market for capital resulted in an explosion of short-term capital flows around the globe, making capital restrictions more difficult for each of the industrialized countries to maintain.

In Scandinavia, capital market deregulation occurred for many reasons beside the desire of authorities to constrain domestic wage demands. In particular one can speak of at least four other motives for liberalization: inefficiencies, ineffectiveness, potential EC membership, and possibly even "liberalization fever."

In both Norway and Sweden, concern about investment efficiencies prompted much of the liberalization drive. Questions were raised throughout the region about the productivity return on their investments. Nordic real rates of interest have been consistently very low, often even negative, despite high levels of inflation. As a result, their investment levels have been relatively high throughout the post-war period. In the beginning of the 1980s, however, policymakers began to question the efficiency of these investments. At the time, liberating investment constraints and interest rates seemed to be a way of increasing the productive potential of investment capital.

Second, traditional capital controls were becoming ineffective. The growing distance between central bank targets and actual credit supply signaled the development of an enormous grey market in capital. As global capital markets grew, the costs of restricting access to them also grew, until the costs came to outweigh the benefits.<sup>53</sup> Indeed, because of risk premiums, currency regulation may have already lost most of its effectiveness by the early 1980s.<sup>54</sup>

Even when technically feasible, however, foreign exchange constraints proved morally problematic. Because Norwegian and Swedish controls cannot affect the international market, firms with access to international capital will be privileged

vis-à-vis domestic firms. This is not only a messy moral issue, but it most likely brings with it leakage through arbitrage. International firms have found (and will continue to find) ways to import capital from abroad and sell it to the domestic, regulated markets; in effect undermining the domestic controls.

Third, both Sweden and Norway are preparing EC-membership applications. With an eye towards negotiations, both countries underwent tremendous liberalization campaigns in many different markets, including capital's. In fact, as European Free Trade Agreement (EFTA) member-states, both countries were required to adjust their economic policies after 1985 to the "four freedoms" of the Single European Act: this adjustment included foreign exchange deregulation.

Finally, the liberalization process occurred during the 1980s. Although very difficult to substantiate, few who have survived the 1980s can doubt the influence of the neo-classical tide-shift which filled both intellectual and economic pools. Liberalization and deregulation were, after all, the catchwords of the decade. That these small economies could fall susceptible to popular rhetoric and fashion is not out of the question.<sup>55</sup>

Capital market liberalization in these countries should not be explained by its use as an enforcement mechanism against domestic actors to stay within rigid price norms. The effect was undeniably so, only the cause is suspect. Instead, the liberalization of these markets should be placed in their international context, and in the explanation of actors themselves.<sup>56</sup> Traditional capital controls (both internal and external) were shown to be ineffective and inefficient in a new, more competitive, mostly unregulated world capital market. In addition, Swedish and Norwegian designs on future EC membership have played a not insignificant role.

#### CONCLUDING REMARKS

In defiance of Notermans' argument, the current crisis of social democracy is not the result of a "shift in priorities" on the part of the authorities, nor their reliance on faulty instruments. The current crisis of social democracy is a reaction to changes in the international economy. A new international economic regime, characterized by increased levels of capital mobility, has made traditional tools for government steering ineffective.

In this new economic environment, domestic policy autonomy—of any variant—is costly. Social democracy—a long time outlier, following its own, middle-way—is perhaps the most obvious victim. But in a world with free capital mobility and fixed exchange rates all participants are subject to an iron law of policy.

One key element of this new economic environment is the role played by international capital flows. To explain their liberalization, Notermans' argument emphasizes domestic policy objectives, discounting the opinions of most policy-makers and their advisors. I have tried to show the opposite side of the coin. I argue that traditional controls had shown themselves to be ineffective, inefficient, and in the way of European ambitions. An honest appraisal of the situation might

find that the jury is still out with regards to reimposing international capital controls, at least at the domestic level. There has been a great deal of discussion about this at an informal level, but surprisingly little has been done beyond the speculative realm.<sup>57</sup>

Notermans' argument is correct in arguing that technological sophistication should be just as useful for monitoring capital movements as it is for evading them. The problem is that the people whose job it is to do such things seem either unwilling to take up the responsibility, or—as they themselves say—no longer can. More hope, I believe, lies in an international agreement which might limit such flows. Such a solution, however, lays beyond the singular reach of social democratic policymakers and their perceptions.

The reasons for engaging Notermans' argument are only partly based on its historical inaccuracies. More troublesome are the potential policy implications which might be built atop these confused hypotheses. The institutions of social democracy are not inherently inflationary, nor were their authorities inherently devious. The world has simply changed such that traditional methods for democratically controlling the economy are no longer sufficient. Rather than blame the old institutions or their sponsors, social democrats must look for new solutions (e.g., worker ownership?) capable of surviving in this new environment. An alternative solution is to try and recreate the old environment in which those institutions were so effective.

Finally, on a more normative note: social democracy, and much of the socialist movement, was originally premised on the need to control private property, defined in Marx and Engels' *Communist Manifesto* as private ownership of the means of production (i.e., capital). For social democracy to return in anything more than its name alone, it must again take up the issue of controlling capital and social investment.

Therefore, on both pragmatic and ideological grounds it would seem a mistake for social democratic regimes to address the current dilemma with an attempt at controlling public perceptions and/or changing the institutions from which they have benefited so much in the past. Controlling social investments defines the social democratic project, it is here—and not policy and institutional failures—that the first lines of battle should be anticipated.

#### NOTES

1. Ton Notermans, "The Abdication from National Policy Autonomy: Why the Macroeconomic Policy Regime Has Become so Unfavorable to Labor," *Politics & Society* 21, no. 2 (June 1993): 133-67.

2. The following three references should suffice as support: "As the institutional setup of the old regime found its roots in the effort to halt a falling price level during the Great Depression, it was unable to deal effectively with the inflationary pressures of the last decades," Notermans, "The Abdication from National Policy Autonomy," 134.

And, "This article will argue that the demise of full-employment policies reflects the institutional inability of present day market economies to contain inflationary pressures." *Ibid.*, 136.

Finally, and more specifically, "the demise of the Norwegian and Swedish model was based on an incompatibility between their institutional capacity for moderating inflation and their preference for full employment." *Ibid.*, 159.

3. *Ibid.*, 156.

4. In this I agree with Notermans. The inter-war period has a lot to teach the contemporary observer. But the lessons of the inter-war period can be divided in two: pre- and post-Depression. In the absence of another Great Depression, I contend that the 1930s have less than the 1920s to offer us in terms of relevant lessons.

Parallels between the 1920s and the 1980s are manifold. Both periods were colored by a dogmatic adherence to fixed currency regimes and price stability, despite a tumultuous international economy. In addition, both decades witnessed a slew of bank bankruptcies, enormous speculative ebbs and flows, and crippling unemployment levels.

In the 1920s, social democrats in both Sweden and Norway agreed with bourgeois politicians about the need for a rigidly fixed external price system, even at the cost of increased unemployment. Both decades witnessed a peculiar alliance between capital and labor on issues related to external trade and monetary matters.

Like the 1980s, in the 1920s the goal for Sweden's fiscal policy was balanced budgets. In a report from the Brysselkonferensen, assembled in 1920 (i.e., during a Social Democratic coalition government), but reporting on the 1921 fiscal plan:

The country which accepts budget deficits in its fiscal policy is travelling down a slippery slope, in the bottom of which lies destruction. In order to avoid this danger *no sacrifice is too large*. (Finansplan, Exhibit 1 of *K.Maj:s proposition Nr.7*, [1921]. Translation mine, emphasis added)

It is wrong to argue, as Notermans does, that these countries were (or are) less concerned with price stability in the 1930s (1940s-70s) than in the 1920s (1980s-90s?). The 1930s were a Great Depression away from the 1920s. Price stability remained a goal in *both* periods, by bourgeois and socialist governments alike; but the tools available for addressing price stability had changed.

5. This is, of course, discounting the famous eighteen-day reign of the Hornsrud Det Norske Arbeiderparti-The Norwegian Labor Party (DNA), government from 28 January to 15 February, 1928.

6. There were brief social democratic regimes in the 1920s (Branting: 1920, 1924-25; Sandhaer 1925-26); and Per Albin Hansson's first regime (1932-36) was briefly replaced by a Center Party government (Axel Pettersson-Bramstorp) before the long stretch of uninterrupted social democratic rule took root in 1936.

7. The careful reader will note that Notermans' argument in both sections is based on actor perceptions, not "objective" economic conditions. Perceptions are impossible to substantiate, and are often contradictory. Therefore, a substantial discussion of these matters must be grounded in observable phenomena, not hearsay.

8. Obviously, there is something of an endogeneity problem built into arguments about deflationary expectations in the 1930s. Inasmuch as deflation led to pressure for reflation, there could have been both perceptions of deflation *and* expectations that it would be reversed (accompanied by pressure for its reversal).

9. Notermans, "The Abdication from National Policy Autonomy," 155-6. Emphasis added.

10. See Henrik Jess Madsen "Social Democracy in Postwar Scandinavia: Macro-economic Management, Electoral Support and the Fading Legacy of Prosperity" (Ph.D. diss., Harvard, 1984), 111.

11. Inter-war Scandinavian unemployment figures are very unreliable and cross-national comparisons should be avoided. The unemployment figures here represent the percentage of trade union members unemployed in Norway and Sweden. For national trending purposes, however, these statistics are satisfactory.

12. Generally, immediate post-war inflation in Sweden is said to have been driven by excess world demand for Swedish goods (after all, its economy had not been destroyed in the war). Norwegian inflation is said to have been influenced by an over-liquidity legacy of a Germany printing-frenzy, and insurance payments to its war-damaged shipping fleet. As inflation rates were high throughout Europe after the war, much inflation was probably also imported.

If we compare Norwegian import and export prices for the immediate post-war period, this seems like a reasonable conclusion. Import price percentage increases usually exceeded those of the export prices:

	Percentage increase of import and export prices for Norway (based on national accounts)			
	1946-49	1949-52	1952-62	1938-62
Price of imports	28	43	-7	312
Price of exports	4	49	-15	266

Source: Peter Jakob Bjerre, *Norges økonomi etter krigen* (Oslo: Statistisk Sentralbyrå, 1965), 322.

Either way, the high post-war inflation rates cannot be attributed to the institutions of social democracy.

13. The post-war Social Democratic coalition government in Sweden foresaw political difficulties in the need for higher taxes (needed to finance the new labor market policy) and the maintenance of budget surpluses in order to prevent excess demand in the economy. The Agrarian (later Center) Party, a coalition partner from 1951-58, was particularly insistent on an easy-money policy. All around, there was not much political support for a less expansionary monetary policy.

14. It seems peculiar to argue that the institutions of collective bargaining are incompatible with inflation. Historically, they have not only thrived in inflationary periods but have been frequently offered as the most obtainable social solution to post-war economic inflation.

The most famous early expression of this is probably William H. Beveridge's *Full Employment in a Free Society* (New York: Norton, 1945): pressure for increased wages at a time when industrial and labor capacity is fully utilized (e.g., the post-war reconstruction era) may cause inflationary tendencies that will eventually jeopardize that very full employment. Beveridge, along with several other economists, emphasized the desirability of a centralized wage policy which is sufficiently encompassing to reflect the interests of the community in general.

See also Robert J. Flanagan, David W. Soskice, and Lloyd Ulman, *Unionism, Economic Stabilization, and Income Policies* (Washington, DC: Brookings Institution, 1983) for a more contemporary, general discussion on this issue.

15. Andrew Martin, *Wage Bargaining and Swedish Politics: The Political Implications of the End of Central Negotiations* (Stockholm: FIEF, 1992), 26-7.

16. For a general description of Sweden's post-war economic policy, see Leif Lewin, *Planhushållnings debatten* (Stockholm: Almqvist and Wiksell, 1967).

17. LO *Fackföreningsrörelsen och den fulla sysselsättningen* (Stockholm: LO, 1951). An English translation came out in 1953 as LO, *Trade Unions and Full Employment* (Stockholm: LO).
18. Actually, Gösta Rehn has dedicated his professional life to the problem of inflation in full-employment economies. A collection of his writings was published in 1988 under the title "Full Employment without Inflation." See Gösta Rehn, *Full sysselsättning utan inflation* (Stockholm: Fritens, 1988).
19. The LO policy statement presenting the model makes this explicit. See LO, *Fackföreningsrörelsen*.
20. For a description of Norwegian post-war economic policy and strategy, see Bjerve, *Norges økonomi etter krigen*; Peter Jakob Bjerve, *Planning in Norway 1947-56* (Amsterdam: North-Holland, 1959); and Alice Boumeuf, *Norway: The Planned Revival* (Cambridge: Harvard, 1958).
21. Gösta Edgren, Karl-Olof Faxén, and Clas-Erik Odhner, *Wage Formation and the Economy* (London: Allen & Unwin, 1973); and Odd Aukrust, "Inflation in the Open Economy: A Norwegian Model," in *Worldwide Inflation: Theory and Recent Experience*, edited by Lawrence B. Krause and Walter S. Salant (Washington, DC: Brookings Institution, 1977), 107-66.
22. With floating exchange rates, Aukrust claims that the Norwegian inflation model is useless. See Aukrust, "Inflation in the Open Economy," 114.
23. This is, of course, not a novel distinction. Several authors have previously documented the character of different Nordic "models." See, for example, Lars Mjset, *Nordens dagen derpå* (Oslo: Norwegian University Press, 1986); Lars Mjset, "Nordic Economic Policies in the 1970s and 1980s," *International Organization* 41, no. 3 (1987): 403-56; *Nordisk tidsskrift for politisk økonomi* no. 15/16 (1984); and Gösta Esping-Andersen, *Politics against Markets* (Princeton, NJ: Princeton University Press, 1985).
24. For a useful description of inter-war policies in the Nordic countries, see Hans Chr. Johansen, "Hovedlinier i den økonomiske utvikling i de nordiske lande i mellomkrigssteden," in *Kriser og krispolitikk i Norden under mellomkrigssteden*, edited by Nordiska historikernämnet (Stockholm: Almqvist and Wiksell, 1974), 13-26; and Svante Beckman, "Ekonomisk politik och teori i Norden under mellankrigstiden," *Kriser och krispolitikk i Norden under mellankrigstiden*, 27-70.
25. Already in the debate over Bretton Woods, the need to maintain capital controls was very obvious to its participants. This was, after all, one of the fundamental differences between the two contesting original plans (Keynes' vs. White's). In the Government Finance Committee's recommendation to the Norwegian parliament, this concern was voiced as follows:
- One of the Fund's objectives is the lifting of prevailing currency controls. Although this will be beneficial in many ways for Norway's foreign trade, one cannot ignore the fact that such controls often provide the necessary conditions for our domestic economy and for the social policy which Norway desires to conduct. In order that a system with more liberal currency and trade policies can be introduced without such costs, the larger countries would at least need to conduct similar policies with regard to employment, prices, wages, social policy and monetary policy." (Finans- og tolldepartementet, "Ihnhentelse av Stortingets samtykke til at Norge tiltrer avtale om Det Internasjonale Valutafond og Den Internasjonale Bank for gjennoppygging og utvikling av det økonomiske live, undertegnet i Bretton Woods 22 juli 1944." *St. prp. nr. 6* (Oslo, 1945:46):9. Translation mine).
26. One solution to this policy dilemma may be the reintroduction of income policies. Well-designed income policies have the capacity to deliver some wage flexibility without turning wage determination directly over to the market.
27. This was most clearly articulated in a Penge- og bankkomiteens rapport (established March 24, 1950), which recommended political control over the central bank, and projected the anticipated path for credit development and regulation in the post-war era.
28. Finans- og tolldepartementet, *Innsilting fra den penge- og kredittpolitiske komité: oppnevnt ved kongelig resolusjon 11. november 1960* (Bergen: Reklametrykk A.S., 1964). Translation mine.
29. Jan Fjegerberg et al., "The Decline of Social-Democratic State Capitalism in Norway," *New Left Review* 181 (May/June 1990): 60-94.
30. The Norwegian export industry was initially focused in industries which were very capital intensive (e.g., shipping and ship building, energy-intensive products, etc.).
31. There is much written on Norwegian credit and monetary policy. See for example: Arne Jon Isachsen, *Penger, kreditt og valuta* (Oslo: Universitetsforlaget, 1984); Wilhelm Kellhu, *Den norske pengehistorie* (Oslo: H. Aschehoug and Co., 1951); NOD, *Rentepolitikk* (Oslo: Universitetsforlaget, 1980); Bjerve, *Norges økonomi etter krigen*; Bjørn Tjønn "Norsk penge- og kredittpolitikk i etterkrigssteden," *Bedriftsøkonomiske Instituttets Arbeidsnotat* 15 (Sandvika: Bedriftsøkonomiske Institutt, Norway, 1990); and Bent Solfus Tranøy, "Fra styring, via selvregulering til selvstabilisering: staten og kredittpolitikken 1950-1990" (Hovedoppgave at the Department of Political Science, University of Oslo, 1992).
32. This is not surprising in that the Norwegian private financial sector was both late and slow in developing. See Fritz Hodne, *Norges økonomiske historie 1815-1917* (Oslo: J.W. Cappelens Forlag A.S., 1981).
33. State banks were developed specifically, but not exclusively, for housing (1947), agriculture (1948), education (1947), and regional industrial development (1960).
34. Although the Norwegian kroner is currently floating, for all intents and purposes it is linked to the ECU as part of a long-term confidence strategy.
35. Statens Offentlige Utredningar (SOU), *Bankkvalitet og kredittprioritering* no. 16 (Stockholm: 1960). Translation mine.
36. Assar Lindbeck, "The Swedish Experience," Seminar paper no. 482 (Stockholm: Institute for International Economic Studies, December 1990), 3.
37. Lindbeck does note that devaluations have become an important part of the full-employment tool bag in the 1970s. But it would be wrong to characterize the "Golden Age" Swedish model by the use of devaluations, as this is a relatively new phenomenon.
38. Assar Lindbeck, *Swedish Economic Policy* (Berkeley: University of California Press, 1974), 39.
39. Government support for subsidies and retrenching came when the Rehn model was largely incorporated in government policy with the (1961) report by a public committee on stabilization policy. See SOU, *Mål och medel i stabiliseringspolitikken* no. 42 (Stockholm 1961).
40. See Erik Lundberg, "The Rise and Fall of the Swedish Model," *Journal of Economic Literature* 23, no. 1 (March 1985): 17.
41. For a more detailed review of how these controls were applied, see SOU, *Valutarregulering och økonomisk politik* no. 51 (Stockholm 1980); SOU, *Kredittpolitikken, Fakta, teorier och erfaringer* no. 53 (Stockholm, 1982); SOU, *Översyn av valutaregleringen* no. 52 (Stockholm, 1985); and Lars Hörngren and Ann Westman-Mårtensson, "Swedish Monetary Policy: Institutions, Targets and Instruments," *Sveriges Riksbank Arbetsrapport* no. 2 (Stockholm, May 1991).
42. In the 1970s these pension funds totaled about 50% of Swedish GNP.
43. Lindbeck, *Swedish Economic Policy*, 9.

44. Permanent public sector employment—excluding public sector corporations and public utilities—increased from 21% in 1970 to 30% in 1980, measured in the number of employees. See Lindbeck, "The Swedish Experience," 9.

45. Lindbeck, *Swedish Economic Policy*, 8.

46. Indeed, Englund argues that Sweden's emerging money market opened new possibilities for funding government deficits, which in turn set the stage for even more credit market deregulation. Peter Englund, "Financial deregulation in Sweden," *European Economic Review* 34 (1990): 386.

47. The underlying rate of growth of domestic credit cannot exceed an upper bound determined by the rate of growth of the demand for money, which depends on the world rate of inflation, the rate of growth of real income, and the income elasticity of demand for money. This upper bound may be relaxed to the extent that the central bank borrows abroad to support its reserves, but this cannot continue indefinitely.

48. This was exacerbated by a 1984 rule (since rescinded) which restricts governments from borrowing in foreign currencies. This acts as an enormous constraint on monetary and budget policies. See Höjningren and Westman-Mårtensson, "Swedish Monetary Policy," 9.

49. Obviously, here is the other potential instrument for leveraging more policy autonomy for the social democracies. Thus far, however, devaluations have remained largely outside the policy circle for fear of inflation and in anticipation of Economic Community (EC) membership.

50. "Three arguments for the impossibility of exchange controls can be discarded right away," Notermans, "The Abdication from National Policy Autonomy," 151.

51. "It is my contention that the policies of exchange deregulation and (de facto) EMS membership must be understood as an effort to find a nominal anchor for the price system. . . . [T]he Swedish and Norwegian governments chose to import price stability by imposing the external constraint of the EMS on their domestic economies." Notermans, "The Abdication from National Policy Autonomy," 152.

52. The most recent description of this process is John B. Goodman and Louis W. Pauly, "The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets," *World Politics* 46, no. 1 (October 1993): 50-82. For other examples, see Jeffrey A. Frieden, "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," *International Organization* 45, no. 4 (Autumn 1991): 425-52; and Arne Jon Isachsen and Ivar Strømpeid, *Produktutvikling i finansmarkedene: Finansielle innovasjoner i USA og Norge* (Oslo: TANO, 1988).

53. For some specifics on Swedish deregulation, see Englund, "Financial deregulation in Sweden," and Clas Wiborg, "Valutapolitiken," in *Frida värnerglerng til inflationsnorm*, edited by Lars Merin (Stockholm: SNS, 1993), 196-287. For Norway, see Jarle O. Thaberg and Olaf Johan Thomsgaard, "Dereguleringen av det norske kreditmarkedet" (Diplomoppgave at the Norwegian School of Management 1992).

54. See L. Oxelheim, *Finansiell integrasjon* (Stockholm: UII, 1988).

55. For an interesting description of the Norwegian process along these lines, see Tranøy, "Fra styring, via selvregulering til selsosialisering." Tend to see these ideological tide changes as reflections of deeper structural movements, but recognize that the direction of this causal arrow (between structure and ideas) is extremely difficult to substantiate.

56. Using such a method will avoid a slippery argument which relies on actors working under "false necessities." See Notermans, "The Abdication from National Policy Autonomy," 160.

57. See, for example, Eichengreen, Barry, and Charles Wyplosz, "The Unstable EMS" paper presented to the Brookings Panel on Economic Activity, 1-2 April, 1993.