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**The Finnish
incomes policy as
corporatist political
exchange:
development of
social capital and
the social wage**

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ABSTRACT

The paper is concerned with the history of the Finnish incomes policy, covering the period from the Second World War to the present. It deals with the Finnish incomes policy as a special type of political exchange between the social partners and the Government. In pursuing wage moderation, governments have used welfare reforms as a means of exchange for solving certain externalities arising in wage bargaining.

The continuity of political exchange between the social partners and the Government requires a common ground of values and trust. In the paper, these prerequisites are characterised by the use of the concept of social capital. Social capital can be interpreted as a relationship of horizontal trust between the social partners and the Government. This interpretation is closely related to Bo Rothstein's concept of organised social capital. Accordingly, the paper emphasises the importance of the institutional framework within which incomes policy negotiations have been carried out as an important promoter of social capital between the social partners and the Government.

The paper also emphasises the importance of centrally negotiated incomes policy agreements as an important institutional framework within which the Finnish welfare state has evolved. For example, the earnings-related pension scheme has been developed mostly within the framework.

The paper discusses not only the history but also the present and the future of the Finnish incomes policy. Owing to the traditionally close relationship between centrally negotiated incomes policy agreements and welfare reforms, the end of centrally negotiated incomes policy agreements declared by one of the social partners, the Confederation of Finnish Industries, is likely to affect not only the manner in which wages are negotiated in the future but also the tradition of political exchange between the social partners and the Government. The end of centrally negotiated incomes policy agreements may put an end to political exchange, too. Furthermore, it may give rise to a deterioration of social capital between the social partners.

Key words: incomes policy, political exchange, social capital, social wage

TIIVISTELMÄ

Kirjoituksessa tarkastellaan suomalaisen tulopolitiikan historiaa toisesta maailmansodasta nykypäivään. Suomalaisen tulopolitiikan peruspiirteen voi tiivistää luonnehtimalla tulopolitiikkaa työmarkkinajärjestöjen ja valtiovaltaa edustavan hallituksen väliseksi institutionalisoiduksi kolmikantaiseksi yhteistyöksi. Se on esimerkki poliittisesta vaihdannasta (political exchange). Siten yksi tapa luonnehtia suomalaisen tulopolitiikan historiaa on pitää sitä poliittisen vaihdannan ja tulopolitiikan osapuolten välisen sosiaalisen pääoman historiana.

Perusedellytys poliittisen vaihdannan syntymiselle on, että kaikilla osapuolilla on riittävästi yhteistyökykyä ja -halua, joka perustuu ainakin joihinkin yhteisiksi koettuihin normeihin, tavoitteisiin ja arvoihin. Näitä keskinäisen luottamuksen hallitsemia perusedellytyksiä voi tiivistetysti luonnehtia vaihdannan osapuolten väliseksi sosiaalisesti pääomaksi. Sosiaalinen pääoma voidaan tulkita työmarkkinajärjestöjen ja hallituksen väliseksi horisontaaliseksi luottamukseksi. Kirjoituksessa korostetaan tulopolitiikan institutionaalisten rakenteiden merkitystä niin poliittisen vaihdannan kuin työmarkkinaosapuolten välisen sosiaalisen pääoman ylläpitämisessä.

Kirjoituksessa korostetaan myös tulopoliittisten kokonaisratkaisujen merkitystä suomalaisen hyvinvointivaltion kehityksessä. Esimerkiksi ansiosidonnainen työeläkejärjestelmä on pääosin kehittynyt tulopoliittisten kokonaisratkaisujen luomassa institutionaalisessa kehikossa.

Kirjoituksessa ei tarkastella pelkästään suomalaisen tulopolitiikan historiaa, vaan myös tulopolitiikan tulevaisuutta. Kiinnittämällä huomiota keskitettyjen tulopoliittisten kokonaisratkaisujen ja sosiaaliturvauudistusten väliseen vuorovaikutukseen Elinkeinoelämän keskusliiton päätös olla enää osallistumatta tulopoliittisten kokonaisratkaisujen tekemiseen vaikuttaa luultavasti myös poliittisen vaihdannan perinteeseen työmarkkinajärjestöjen ja hallituksen välillä. Tulopoliittisten kokonaisratkaisujen aikakauden päättymisen saattaa lopettaa myös poliittisen vaihdannan ja siten heikentää työmarkkinajärjestöjen välisen sosiaalisen pääoman määrää.

INTRODUCTION

Finland is one of those countries that have a lengthy history of centrally negotiated incomes policy agreements. This history seems to have come to an end, however. In 2007, before the next round of wage negotiations, the Confederation of Finnish Industries, which is the peak organisation of Finnish employers, declared that it would not take part in negotiations which aimed at achieving a comprehensive incomes policy agreement. Consequently, that kind of agreement was not achieved and negotiations took place at the sectoral level.

Even though the main aim of our paper is not to consider the future of the Finnish incomes policy, our approach enables us also to appraise the consequences of the end of centrally negotiated incomes policy agreements. We argue that the end of making such agreements may have a larger than commonly expected influence on Finnish society.

The main aim of our paper is to present an interpretation of the history of the Finnish incomes policy by paying special attention to the formation of constructive relationships between the social partners and to the importance of the incomes policy in the development of the Finnish welfare state. We emphasise that the Finnish incomes policy agreements were much broader than ordinary wage agreements. For example, they included major changes in earnings-related social security and in transfer payments in general.

The incomes policy has had a decisive influence on the formation and maintenance of *social capital* between the social partners. In this paper, we define social capital simply as trust between the parties of the tripartite co-operation, and especially between trade unions and employers' organisations. The end of centrally negotiated incomes policy agreements may give rise to a deterioration of social capital between the social partners because it may lead to a loosening of their relationships. Furthermore, it may give rise to a profound change in the political and institutional framework within which economic policy and social policy have been conducted in Finland.

Our paper is organised as follows. We first introduce the basic concepts which we utilise extensively in our interpretation. Thereafter, we use these concepts and characterise the history of the Finnish incomes policy at a general level. After the general consideration, we give a more detailed picture about the history and content of the Finnish incomes policy. Thereafter, we put some of the outcomes of the policy into a comparative perspective. Finally, we discuss the current situation and outline alternatives for the future.

THE INCOMES POLICY AND SOCIAL CAPITAL

Currently there exists a vast and rapidly growing literature on social capital. The most commonly used notion of social capital, based on either James S. Coleman's (1988) or Robert D. Putnam's (1993) work, is usually connected to citizen-to-citizen trust that is created as people work in various types of social networks and voluntary associations and that is necessary for a working democracy. However, the literature has widened to comprise social capital between interest groups and organisations, too. In this paper we utilise the concept *organised social capital*, which has been used extensively by Bo Rothstein (2002). The concept characterises trust-related relationships between organisations.

Even though the incomes policy is based on tripartite co-operation between three parties, the social partners and the Government, co-operation between the social partners is its most essential part because they represent continuity in the act of co-operation. This is the reason why we have drawn on the literature on organised social capital.

The link from the incomes policy to social capital is not straightforward and clear. However, it can be argued that a successful incomes policy enhances trust, or social capital, between the social partners. On the other hand, a certain amount of trust is needed if agreements are to be achieved at all. Countries with a history of an incomes policy are typically countries in which the general level of social capital, whether it is defined as citizen-to-citizen trust or trust between organisations, is relatively high. This may have reflected, among others, the homogeneity of the population and high social cohesion.

As regards social cohesion, prerequisites for a sustained and consensual incomes and welfare policy were weaker in Finland than in other Nordic countries. The main reasons for this were the relative backwardness of the country, and especially the civil war, which had a very strong influence on the collective memory of the Finnish people. Therefore the history of the Finnish incomes policy can be regarded as a process which contributed to the accumulation of social cohesion and social capital to the level which was achieved earlier in other Nordic countries.

THE INCOMES POLICY AND POLITICAL EXCHANGE

The Finnish incomes policy can be summarised as *institutionalised* tripartite co-operation between the social partners and the Government. It is an example of *political exchange* between the three parties.

In political exchange, one party (the Government) is operating in the political arena exchanging “commodities” which depend on political decisions. These commodities may be, for example, improvements in social security, changes in taxes, and decisions improving working life.

Political exchange would not exist if the parties did not think that they benefited from it. Irrespective of political coalitions, governments typically aim at stable and employment-enhancing economic development. Its basic prerequisite is the absence of antagonistic social conflicts. Furthermore, wage moderation is normally one of the main objectives that government wants to promote. For the achievement of these objectives, the trade unions’ role has normally been decisive.

Therefore, governments have been interested in political exchange with trade unions. On the other hand, trade unions may have been willing to take part in political exchange with governments if, in exchange for, for example, wage moderation, they have obtained both political influence and

commodities which require decisions made in the political arena. Some of these have been characterised as being examples of the *social wage*, because they directly affect the workers' material living standard.

From the viewpoint of the trade union movement, political exchange and the social wage can be regarded as one solution to the problem which Lancaster (1973, 1095) called workers' dilemma in capitalism: "Should they forego present consumption handing over part of total income to the capitalists? If they do not, they will obtain no higher consumption in the future. If they do, they have no guarantee that the capitalists will actually invest sufficient of this income to bring about the desired level of increase." Because wage moderation is rather in the interests of employers and governments, governments can, within the framework of political exchange, promote wage moderation by using social wage as a means of exchange.

The third party, the employers, may have supported political exchange because it may have advanced both peaceful relationships in the labour market and wage moderation without major concessions on the part of employers. As a part of political exchange, incentives for the increase of investment activity have also been provided. Participating in the finance of social wage has been a typical concession which employers must have made if they have been engaged in political exchange.

The basic prerequisite for the existence of political exchange is that each party has enough ability and will to co-operate. Obviously, the will is based on some common norms, targets and values. It is hard to see that a long-lasting political exchange could be possible without mutual trust. In characterising these prerequisites, we use the concept of social capital.

Accordingly, it can be said that political exchange is impossible without a sufficient amount of social capital between the parties. Social capital is a necessary but, of course, not a sufficient condition for the emergence and existence of political exchange.

TWO VARIANTS OF POLITICAL EXCHANGE

As regards the existence of political exchange, a basic grouping of countries can be made. There are countries where political exchange is a reality, and countries where it is not. Even though this grouping is useful it may be too rough, because, for example, among European countries various traditions of political exchange can be distinguished. In the literature, these traditions have been classified by the use of some specific features of the traditions as criteria. Guido Baglioni (1987) distinguishes between two major variants of political exchange: *pluralistic* political exchange and *corporatistic* political exchange.

In both types of political exchange, an obvious starting-point is that the Government recognises trade unions as legitimate organisations in society. According to Baglioni the important common prerequisites for the existence of political exchange of one or the other type are, for example, the following: class compromise and the recognition of the importance of the trade union movement, the adoption of a non-antagonistic stance on the part of the trade unions, the presence of strong and representative trade unions, a well-established institutional framework within which an economic policy is pursued. Despite the common features, the two variants also have considerable differences.

In pluralistic political exchange, the trade union movement pursues its political targets in co-operation with one or more 'friendly' political parties which act in the political arena. The trade union movement does not operate directly in the political arena. In pluralistic political exchange, the probability of the presence of political exchange increases when there is a pro-labour government.

Corporatist political exchange is based on trilateral co-operation within which trade union organisations (and employers' organisations) are an essential part of the political system, planning and even making decisions on issues which are important for them. Because co-operation is institutionalised, political exchange is possible even if the labour parties are not members of the Government.

Hence, in pluralistic political exchange labour market organisations do not operate in the political arena, while in corporatist political exchange they do. (For a more extensive discussion, see Baglioni 1987.) The differences can be summarised also by the use of the concept of social capital. In pluralistic political exchange, social capital is not so institutionalised as it is in corporatist political exchange.

The identification of the main characteristics of the two types of political exchange enables one to conduct a detailed study of the nature of political exchange in various countries and in various time periods. It should be recognised that, when Baglioni's classification is used, not every country which is normally regarded as a corporatist country is classified as a country with corporatist political exchange. Baglioni takes Sweden, among some other corporatist countries, as an example of a country which has had a period of pluralist political exchange. This is, of course, due to the strong position the Swedish Social Democratic Party has had in Swedish political history.

THE BEGINNINGS OF THE FINNISH INCOMES POLICY

Through the use of the key concepts, social capital, political exchange, and social wage, the history of the Finnish incomes policy becomes not only a history of corporatist political exchange but also a history of the formation, maintenance, and test of the social capital between the parties engaged in political exchange. If one takes into account how many welfare-improving reforms have been implemented as part of incomes policy agreements, the improvement of social security can be regarded as a history of the increase in the social wage in Finland.

When one starts to periodise the history of the Finnish incomes policy, an essential change took place much earlier than 1968, which is commonly regarded as the initial year of the Finnish incomes policy. If one thinks that a necessary condition for the emergence of political exchange is a sufficient amount of mutual understanding and trust, i.e. of social capital, between the parties of the exchange, the history dates back further in Finnish political history.

In the middle of the Winter War, January 1940, the Confederation of Finnish Industries delivered a declaration in which it recognized the Central Organisation of Finnish Trade Unions as a legitimate partner in wage bargaining. That was part of a larger attempt to build up national unity at a critical moment. Before the war, Finnish employers refused to have any collective bargaining with trade unions.

This war-time compromise marked the beginning of collective wage negotiations in Finland. After the Second World War, the declaration was deemed as one of the building blocks on which the formation of social capital between the social partners was based. The shared war-time experiences also helped to build trust between trade unionists and employers.

Continuous negotiations on wages and prices became a central part of economic policy in the post-war years. However, it was not called an incomes policy before the year 1968, when the first centrally negotiated income policy agreement was concluded. It initiated the age of the incomes policy in Finland. The approximately twenty-year period preceding it can, however, be regarded as a preliminary period during which preconditions for an incomes policy were evolved. Conflicts over income distribution were continuous but manageable. Agricultural producers were also involved in the negotiations in addition to the Government and the social partners. Obviously, the negotiations were not yet examples of trilateral corporatist political exchange. Instead, they were a kind of crisis management.

FINNISH CORPORATIST POLITICAL EXCHANGE AND THE SOCIAL WAGE

The golden years of the income policy and social reforms became possible only after certain shifts in the political balance. The first twenty years of the post-war period (1945-1966) in Finland – unlike the other Nordic countries, which had a clear Social Democratic hegemony at that time – were characterized by political instability and growing divisions within the political left and the trade union movement. For the stabilisation of the institutional framework within which the incomes policy was conducted, the end of the disintegration of the Finnish Social Democratic Party and the Finnish trade union movement in the late 1960s was an important prerequisite. The victory of the left-wing parties in the Parliamentary election of 1966 strengthened the preconditions of political exchange. It started a new era of coalition governments, which included the Social Democratic Party and the Centre Party (the former Agrarian Union) as major partners, and reform-minded Communists as junior partners. Corporatist political exchange and, as part of the exchange, decisions about improvements in the social wage became common only after these changes which started the age of the incomes policy.

The golden age of the Finnish incomes policy, which lasted about twenty years following its inauguration, enabled the realisation of an essential share of the targets the Finnish left was pursuing. For the Finnish left and the trade union movement, centrally negotiated incomes policy agreements provided both an essential tool for the development of the Finnish welfare state and an opportunity to co-operate and improve trust-based relations with employers' organisations and also with representatives of non-left parties.

This kind of process was, of course, not unique in Europe. The strong position of the trade union movement was a common feature in many western European countries after the Second World War. The end of the Second World War also led to the strengthening of the political left. Trilateral co-operation and centrally negotiated incomes policy agreements were quite common.

However, Finland differs from the other Nordic countries and many other countries in at least one important respect: the history of the political Left is different. This may be an important reason why the Finnish variant of political exchange became corporatist. In comparison to the Swedish Social Democratic Party, the Finnish Social Democratic Party did not achieve such a powerful position. This was due to the strong support of the Communist Party¹ and other non-social democratic left-wing political forces as well as the exceptionally strong position of the Agrarian Party. Social democratic hegemony, which paved the way to pluralistic political exchange in Sweden, was not a reality in

¹ In the aftermath of the Finnish Civil War (1918) the revolutionaries of the Social Democratic Party established the Finnish Communist Party in Moscow. The Communist Party was legalised in Finland only after the Second World War.

Finland. In Finland the lack of political stability, which was exemplified by the disintegration of the Left and by continuous political conflicts between the Social Democrats and the Agrarian Union, made the development of pluralistic political exchange improbable.

In Finland, the corporatist nature of political exchange is an important reason why the social wage has played a major role in incomes policy agreements. In the collective bargaining process, decisions on the social wage were made simultaneously with decisions on contractual wage increases. It was a common procedure for the social partners to first attempt to achieve a common view about the amount of the room for overall increases in labour costs. Thereafter, they divided the room into various components, each of which could be concluded in negotiations. In addition to contractual wages, components consist, for example, social security contributions, which are an essential part of the social wage, and alterations in working time. These components directly affect firms' labour costs. The main advantage of the simultaneity of the decisions process is that, because of the possibility of political exchange, it can promote wage moderation.

In addition to these components, other elements could also be included in the agreements. Changes in taxes and decisions on the improvements of public services could also be included in incomes policy agreements. Earnings-related social insurance, the shortening of working time and the system of public day-care are examples of reforms which have been attained mainly through corporatist political exchange.

TRENDS IN THE SOCIAL WAGE AND SOCIAL CAPITAL

An early sign of the social wage and its strengthening was the creation of the Finnish child allowance system in 1948. Originally, the labour market organisations tried to reach an agreement which would guarantee a sufficient level of earnings to the male breadwinner in families with several children. Because such an increase in fathers' wages would have been potentially harmful to family men in the labour market, a system of collective contribution was suggested. In the political process child allowances were fixed to be paid to mothers from the central government budget, even though during the transitional period employers had been obliged to pay their employees an additional sum per child in wages. As the collective contribution was paid by employers and was taken into account in determining the feasible wage increases, the child allowance can be regarded as the social wage.

Several other steps to increase the social wage (e.g. including the annual vacations of employees act, an agreement on the official working time of 40 hours a week, the sickness insurance act and the pension act) were taken at the beginning of the 1960s. These reforms merely formed a sporadic episode of reforms during the period 1945-66 compared with the next decade, which had an

avalanche of such reforms. However, this period was an important prerequisite for the coming era of corporatist political exchange, because it created and strengthened the social capital between social partners.

As part of corporatist political exchange the social wage became an important element of the extension of the welfare state during the era of the Finnish incomes policy from 1968 onwards. In addition to agreements on wages and salaries, comprehensive incomes policy settlements included far-reaching social policy reforms. In particular, during the 1970s, when economic activity was tightly regulated, incomes policy settlements included regulations of agricultural prices and incomes, price control, housing policy and reforms for different social policy issues. (See Incomes Policy Information Commission 1986.)

Such an extension of the social wage would not have been possible without the stop to the dissolution of the trade union movement and the growth of union membership and the electoral victory of leftist parties in 1966. Both the Social Democrats as a major partner and reform-minded Communists² as a junior partner gained growing governmental power in the coalition governments that were formed. The new hegemony of the left and general economic regulation coerced employer organisations to accept a trend which was not in their interests.

The new era of incomes policy settlements also meant a notable increase in the employers' statutory contributions to social security schemes. Such an increase was taken into account in negotiating the level of feasible wage increases which can be considered as an element of political exchange. Financing the higher expenditures required not only increased social security contributions, but also an increasing, overall tax burden. However, the financing of the reforms was made easier by the improving age structure of the population (i.e. improving dependency ratios between 1965 and 1995). Higher taxes also meant increased redistribution of income, which favourably contributed, together with improved benefits, to income distribution. In the mid-1960s income differentials were still large and there was a lot of poverty in Finland. Twenty years later, in the mid-1980s, Finland had achieved a high degree of equality and poverty was largely abolished.

In retrospect, the era of the incomes policy between 1968 and 1988 was a favourable time with regard to the fulfilment of the objects of the trade union movement and the political left, although critical contemporary evaluation did not always find the results good enough. For a start, centralised and comprehensive agreements were in the preferences of the employers' organisations. At first, trade unions and, in particular, communists were suspicious about the incomes policy. However, the results fulfil almost every goal of the trade union movement and the political left.

² The Finnish Communist Party became internally divided between a reformist majority and an uncompromised and revolutionary minority.

This era of the incomes policy meant the inclusion of almost every stratum of society into the national consensus on future progress in society. The compromises that were reached on the basis of the consensus were good enough for most participants. The employers had to give up some of their goals and accept tax increases, a solidaristic wage policy and the growth of the welfare state, but at the same time employers were able to commit employees to the rules of the market economy. Employees were able to fulfil several goals concerning the increase in purchasing power, leisure time and social security. In addition, the political left successfully pursued its demand for equality, lessening the class conflict or juxtaposition in general in society.

PENSION SECURITY REFORMS AND SOCIAL PARTNERS

Perhaps the most central element of the Finnish welfare state is the earnings-related pension scheme. Together with the “first tier” National Pension Scheme it has gradually eliminated poverty among the old-aged population and markedly reduced the overall income inequality. As far as the expenditures incurred by the welfare state are concerned, the earnings-related pension scheme is the most important transfer payment system.

Although the first national pension scheme covering the whole population was established in 1939, it never worked well, mainly owing to the low level of contributions. The earnings-related pension committee was established at the end of 1956 and the general private-sector act, the Employees’ Pension Act (TEL), was enacted in 1961. The labour market parties were actively involved in drawing up the agreement. Pensions security reform, as part of earnings-related social security, was in the interests of the trade unions, while the employers’ organisations took the offensive but participated the inevitable reform. Through their active participation employers’ organisations were also able to affect the outcome, and the resulting earnings-related pension scheme satisfied both parties of the labour market.

The support of employers’ organisations for the act was sought, for example, by the suggestion that the earnings-related pensions be handled by private insurance providers. Labour market parties would have their representatives on the governing bodies of these providers. Furthermore, the employers got the right to borrow the accumulated pension funds at a low regulated interest rate. Thus, accumulated pension funds became an important assistance for investments: in order to benefit from low interest rates a firm had to have investments. During the era of strict economic regulation the main option for investment was the extension of domestic activities. In this way, the Finnish pension system provided a potential solution to the problem which Lancaster (1973, 1095) called the workers’ dilemma in capitalism: employees may be willing to accept wage moderation as the earnings-related pension

scheme is part of the social wage, and employers may have an incentive to make domestic investment because of favourable loan terms.

The aim was to create a sustainable, funded system. However, with a fully funded scheme there was a fear that contributions would increase labour costs too much and therefore unnecessarily reduce investments in the regulated economy. Therefore it was decided that the pension scheme was to enter into force gradually and the financing of the pensions was – and still is – based partially on the pay-as-you-go principle and on pre-funding. The next three decades after the enactment of TEL in 1961 was a period extension of the range and level of the pension benefits through centralised comprehensive income settlements.

ECONOMIC CRISIS AND POLITICAL EXCHANGE

Finland experienced an exceptionally severe economic crisis at the beginning of the 1990s.³ The crisis constituted a major watershed in the modern history of Finnish economy and society. More than two decades of the expansion of the welfare state and the widening of the social wage came suddenly to an end. The recession did not end the incomes policy or political exchange, but the content and the function of political exchange was fundamentally transformed.

During the recession and the subsequent recovery Finnish economic policy was devoted to solving mass unemployment through the incomes policy. During the crisis years Finland had its first centre-right majority government in the post-war period. The Government (led by Prime Minister Esko Aho) tried to build a new “social contract” with the social partners in order to reduce nominal wages. Nominal wages were not reduced (as originally intended), but a historic agreement was reached: in 1991 a centralised wage agreement was settled with wage increases frozen for two years and at the same time a portion of the employers’ social security contributions was passed to the employees’ responsibility. The effect was similar to that in the case of nominal wage reduction. One can argue that the incomes policy response followed the traditional pattern, but this time the price was higher for employees just because the crisis was harder than ever. In that sense, the incomes policy during the recession cannot be considered as a political exchange but, rather, as a test for the social capital previously accumulated and a calculated self-sacrifice of the trade union movement.

The recession changed the Finnish economy and Finnish society in several ways. Finnish enterprises become more and more international, expansion of the welfare state ceased, and income inequality

³ Output fell by 10 per cent and unemployment increased from 3 to 17 per cent in 1991-93. See Jonung et al. (2009).

started to widen sharply. Skyrocketing unemployment remained the main social problem for the next fifteen years. The economic crisis gave rise to criticism of the welfare state, the incomes policy and economic regulation. The incomes policy, however, was not discarded. One reason for this was the political situation.

After the centralised wage settlements for the years 1991-93 the Centre Party, led by Esko Aho, turned against incomes policy settlements. So the Finnish Government was not interested in agreeing to any incomes policy settlement in 1994. In addition, the attitude of the Centre Party was more or less sticky towards the incomes policy and the trade union movement during the Parliamentary election campaigns of 1995 and 1999. During the campaigns the party preferred a rather liberalistic “work reform” programme designed by Esko Aho. Such a liberalisation programme did not have much significance, because during the years 1995-2007 the Social Democratic Party was the leading party in the Government. At that time the Social Democrats, together with other left-wing parties, leaned on the trade union movement and were therefore deeply committed to a comprehensive incomes policy. Thus, the incomes policy and tripartite co-operation in the labour market became the major instrument to bring the unemployment rates down.

The crisis and its legacy (mainly a large deficit in the public finances) changed the role of the incomes policy. Instead of extending the welfare state, the incomes policy became defensive: the current system of social security was defended by cuts in the levels of benefit. The restructuring of the pension system is a good example: together with trade unions and employers’ organisations the Government increased the retirement age, reduced indexation, and introduced a coefficient for life expectancy effects for pensions. Such a weakening of the benefits also reflected the change in the power structures. Previously, the political exchange worked for employees by increasing the social wage. During the 1990s the role of income tax cuts was emphasised in the political exchange for wage moderation.

FINLAND IN A COMPARATIVE PERSPECTIVE

The Finnish tradition of political exchange can be detected from the size and the composition of the public sector. From the comparative perspective a similar development may be found in other countries. Unfortunately, as far as we know, there is no classification of countries according to the degree of political exchange. On the other hand, as Baglioni (1987) notes, the concepts of political exchange and corporatism have been used in parallel. A variety of the orderings of countries by rank has been proposed according to the degree of corporatism.⁴ However, such rankings are typically built on the differences in the bargaining structures, as is the case with the Allen index we use here.⁵

With few exceptions three other Nordic countries (i.e. Denmark, Norway and Sweden) are typically ranked higher than Finland. One obvious reason for such an observation is that corporatist structures are a comparatively recent development in Finland, as is often acknowledged.⁶ Finland is ranked in the Allen index as a country with the third highest degree of centralisation, just after Norway and Austria and just before Sweden and Denmark. According to Baglioni (1987) Sweden and perhaps also Norway and Denmark are the countries with a pluralist variant of political exchange, while Austria is a country with a corporatist variant of political exchange. According to our interpretation, Finland, in contrast to other Nordic countries, belongs to the group of countries with the latter form of political exchange. The dividing line is not the structure of wage bargaining but rather the fact that in pluralist political exchange the social democratic hegemony in the political arena has allowed trade unions to separate their interest in industrial relations and in the political arena of social wage determination, while in corporatist political exchange such a separation does not exist.⁷

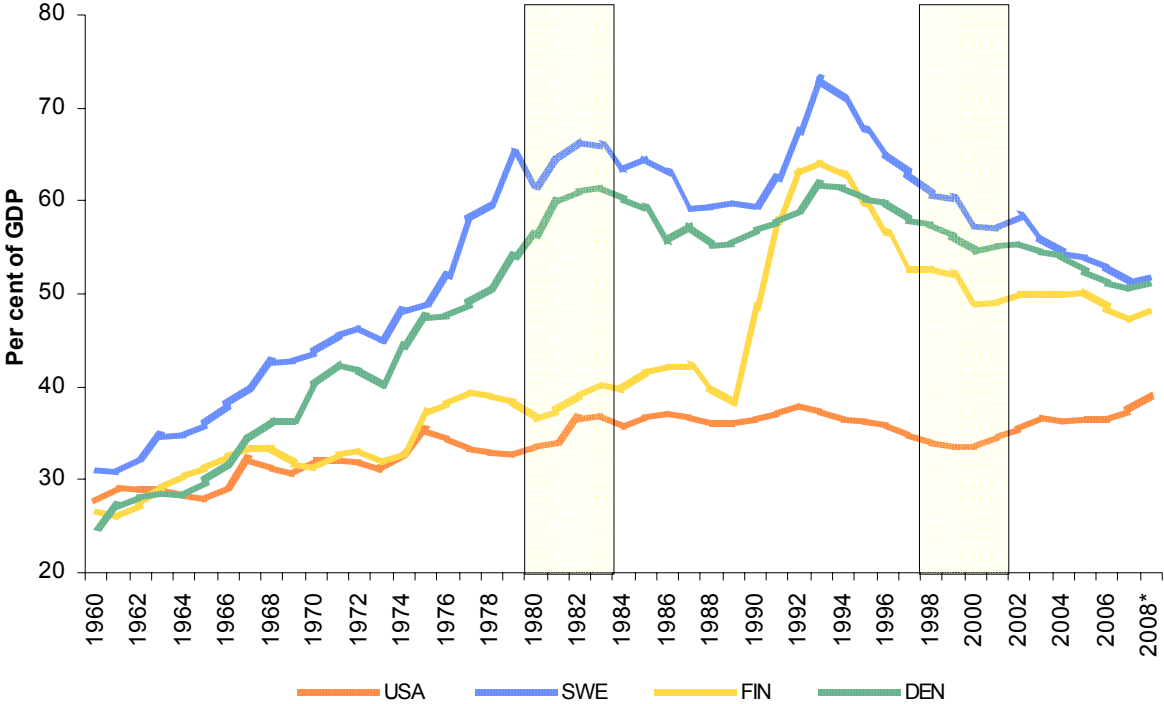
⁴ There is ever growing literature on different concepts used in defining the wage-setting institutions (for a survey see e.g. OECD 2004 or Boeri et al. 2001). For different indices see e.g. (Lijphart and Crepaz 1991 or Mares 2006).

⁵ Tuovi Allen (1997) updated and extended the Calmfors-Driffill index (see Appendix). The Calmfors-Driffill measure of the degree of centralisation of wage bargaining has been constructed as the sum of two indices: (i) the level of co-ordination within the bargaining structure and (ii) the number of existing central union and employer organisations.

⁶ For example Tarantelli (1986, 11) notes that his ranking does not count “a higher degree of neocorporatism in Finland since the early eighties”. Similarly, in his classification of welfare state regimes Esping-Andersen (1990, 53) points out Finland’s postwar rise in the de-commodification score.

⁷ In particular, Baglioni (1987) emphasises the importance of the functions performed in political exchange rather than the structure of the political exchange.

Figure 1. General government total outlays in Finland, Denmark, Sweden and the USA between 1960 and 2005.



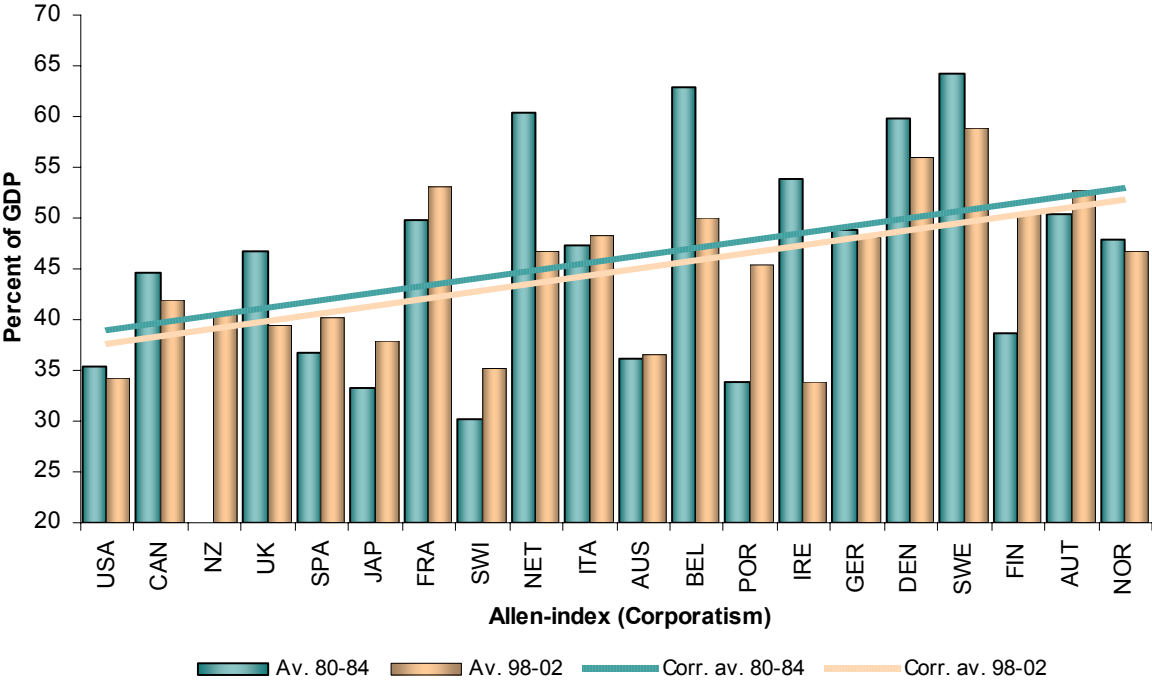
Note: For sources of data, see Data appendix.

To illustrate the differences in the expansion of the public sector, we show the growth of government expenditure in Finland, Denmark, Sweden and the USA since 1960 in Figure 1. Until the mid-1970s the size of the public sector in Finland seemed to follow a similar trend to that of the USA, which is typically considered as a country with no political exchange at all, rather than a trend in two other Nordic countries with social democratic hegemony. There was a dramatic increase at the beginning of the 1990s followed by a reduction in the size of the government expenditure in Sweden and in Finland. The huge jump merely illustrates the severity of the recession in the early 1990s. At the beginning of the 21st century the size of the public sector is still smaller in Finland compared with Sweden and Denmark. One possible explanation is the lack of social democratic hegemony and therefore the nature of corporatist political exchange suggested by Baglioni (1987).

A more general interpretation of Figure 1 could be that the welfare state expansion had already ended by the beginning of the 1980s. To illustrate this, further individual country experiences are shown in Figure 2 for the early 1980s and the turn of the century (i.e. dashed time periods in Figure 1). The relative size of the public sector has decreased markedly in six countries and increased in seven countries. Of those countries with a reduced size of the public sector the United Kingdom and Belgium are the countries in which Baglioni (1987) identified the end of political exchange and the Netherlands was identified as a country with some strain in political exchange. Given our static classification of countries we are not able to follow such a hypothesis in depth. Of the Nordic

countries only in Finland have government total outlays a higher share of GDP at the turn of the century than in the early 1980s. Given our structural measure of corporatism, the positive relationship between the Allen index and the government total outlays has not changed much between the two periods.

Figure 2. General government total outlays on the average in the early 1980s and at the turn of the century.



Note: For sources of data, see Data appendix.

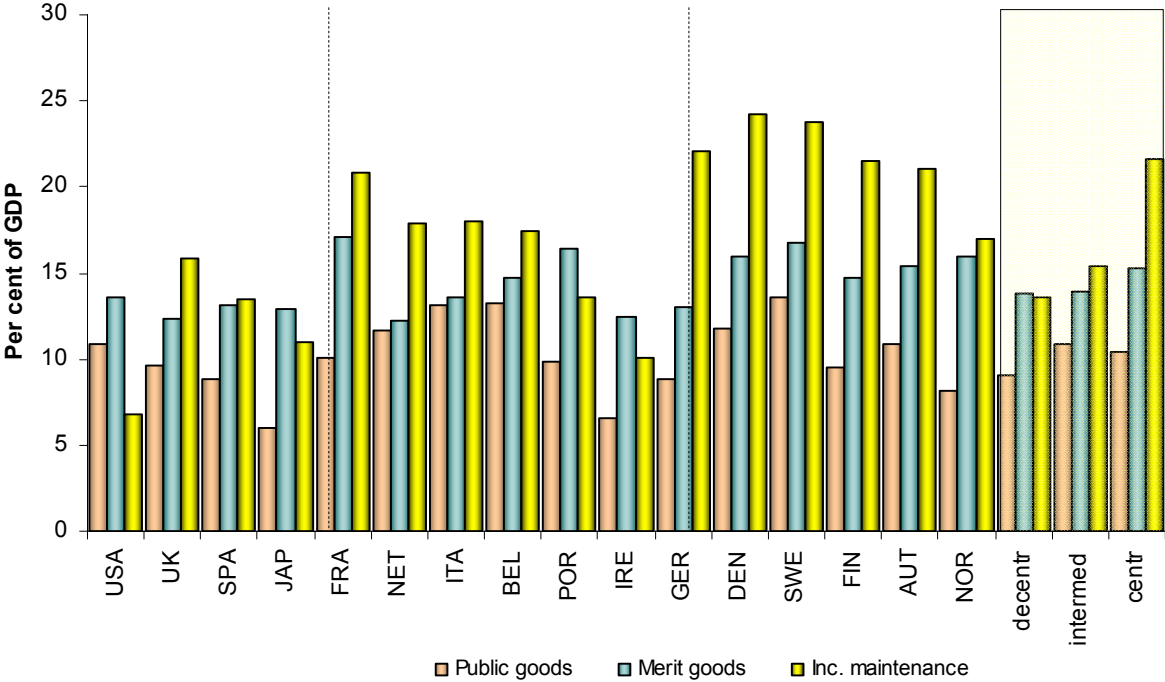
Next, we consider the structure of the public sector from the point of view of the classical Musgravean objectives of government policy: allocation, redistribution, and stabilisation. The general government expenditure can be grouped according to the main classic economic functions as follows: (i) the provision of public goods; (ii) the provision of merit goods; (iii) expenditure on income maintenance; and (iv) the provision of social infrastructure through expenditure on economic services (see e.g. Saunders and Klau 1985).⁸ This breakdown of general government expenditure by function at the turn of the century is shown in Figure 3.⁹ It appears that in countries with a high degree of

⁸ According to the Musgravean classification the provision of merit goods can be regarded as contributing to the allocation, although with a strong element of redistribution. Government expenditure on income maintenance i.e. social security serves the redistribution function. The provision of public goods contains a strong element of allocation. One can roughly characterise merit goods and income maintenance as welfare state expenditures.

⁹ We can find statistically significant differences in the level and the composition of government expenditure. In particular, total government outlays are positively related to the degree of corporatism. When government expenditure is decomposed into our three categories, both the provision of merit goods and income maintenance

corporatism provision on both merit goods and income maintenance is at a high level of GDP.¹⁰ Neither Finland nor Austria differs from the other corporatist countries. Thus, we can argue that countries with a tradition of political exchange are committed to a high level of total welfare spending.

Figure 3. General government expenditure by three main functions at the turn of the century.



Note: For sources of data, see Data appendix.

We have emphasised above that political exchange is about wage moderation and the social wage. Rueda and Pontunson (2000) argue that the politics of wage moderation and the politics of wage distribution are the opposite sides of the same coin. Thus, the argument of political exchange may be applied to the question of curtailing wage or income distribution. In their study Bradley et al. (2003) follow a particular line of argument: union strength reduces factor income inequality while leftist government redistributes income by increasing the size of taxes and transfers as well as the profile of taxes and transfers. In their empirical analysis for fourteen countries Bradley et al. (2003) found that both union density (and/or corporatism) and a generous welfare state increased the amount of redistribution in society. On the other hand, Moene and Wellerstein (2003) argue that the effect of

expenditure are positively and statistically significantly related to the degree of corporatism at the turn of the century.

¹⁰ According to the ranking order of countries in the Allen-index, we have divided countries as centralised (i.e. Norway, Austria, Finland, Sweden and Denmark), intermediate (i.e. Germany, Ireland, Portugal, Belgium, Australia, Italy, the Netherlands, Switzerland and France) and decentralised (i.e. Japan, Spain, the UK, New Zealand, Canada and the USA). The division of countries is, of course, more or less arbitrary.

unionisation and wage bargaining institutions on welfare expenditures is indirect: unions and wage bargaining institutions affect the distribution of income, which, in turn, affects the political support for social insurance (Moene and Wallerstein 2003, 500).

PROSPECTS FOR THE FUTURE

For decades, corporatist political exchange has contributed to the formation and maintenance of social capital between the parties of the exchange. This has been an essential part of the process during which Finnish society has developed towards a consensus society. Now the Confederation of Finnish Industries is dismantling this tradition by using the need to adjust to globalisation as the most important reason for its decision.

Neither has the internationalisation of Finnish enterprises been not without harm for the Finnish trade union movement. Outward foreign direct investment has reduced investment activity in Finland, because it has decreased the financial resources that are available for domestic investment (Sauramo 2008). Therefore wage moderation may not increase domestic investment and employment any more. In a world dominated by multinational enterprises, the previously mentioned workers' dilemma in Lancaster (1973) is much more difficult to solve for the trade union movement.

Therefore the vitality of the institutional framework within which the incomes policy has been conducted is higher in a world in which internationalised firms are not multinational enterprises but pure exporters located in the home country. This does not imply, however, that demolishing the institutional framework would be the best way of reacting – at least not for the trade union movement. Nonetheless, globalisation also affects the willingness of the trade union movement to maintain the social capital which has been accumulated during the age of the incomes policy.

The decision by the Confederation of Finnish Industries can be interpreted in such a way that employers think that they cannot benefit from comprehensive incomes policy agreements any more. However, they have not stated explicitly in which direction they would like to move after the era of the incomes policy.

Within our conceptual framework, the rejection of the incomes policy can be interpreted as a desire to end corporatist political exchange, too. This desire has not been put forward explicitly, however. On the other hand, the representatives of the Confederation of Finnish Industries have mentioned that they are willing to continue tripartite co-operation on issues like social insurance. Yet, if wage negotiations are separated from negotiations over social insurance, the possibilities for corporatist political exchange are lost. This will certainly change the institutional framework within which the Finnish welfare state has been developed.

Even though the intentions of the employers' side have not been explicitly stated, within our conceptual framework two basic directions are left: towards an era of pluralistic political exchange or towards an era without political exchange. If we think that one of the basic features of pluralistic political exchange is a powerful left-wing (social democratic) party which operates in the political arena, we know that currently this feature is absent. In fact, the political left is weaker today than during the period when corporatist political exchange was developing.

Therefore, the most likely alternative might be the direction towards the era without political exchange. For employers, this may not be a problem, because it can be thought that, because of globalisation, wage moderation can be achieved without political exchange. This kind of appraisal may turn out to be wrong, but it is highly likely that globalisation has strengthened the employers' position at the cost of the trade unions.

It is obvious that in the era when the most important Finnish companies are multinational enterprises whose link to Finland and to Finnish society is weakening, the maintenance of social cohesion may not be so important for employers as it was earlier. This is one reason why the end of political exchange may not be a problem for employers.

In this paper, we have emphasised one important feature of corporatist political exchange, i.e. the institutionalisation of social capital. Therefore the end of the age of the incomes policy and corporatist political exchange may cause a deinstitutionalisation of social capital between the social partners. This may lead to a deterioration of trust between the social partners.

Furthermore, the end of corporatist political exchange is bound to transform the institutional framework within which the Finnish welfare state has evolved.

DATA APPENDIX

Income maintenance (per cent of GDP) consists of general government expenditure on social protection, source: OECD National Accounts, Volume IV, General Government Accounts - Detailed tables.

Merit goods (per cent of GDP) consist of general government expenditure on education, health, housing, environment, and recreation, source: OECD National Accounts, Volume IV, General Government Accounts - Detailed tables.

Public goods (per cent of GDP) consist of general government expenditure on general public services, defence, and public order and safety, source: OECD National Accounts, Volume IV, General Government Accounts - Detailed tables.

Total outlays (per cent of GDP), source: OECD Economic Outlook, various issues.

Corporatism measure; Indexation for the 1990s by Allén (1997).

	prop. 1	prop. 2	prop. 3	prop. 4	prop 5	prop. 6	Sum:	Rank
USA	1.00	1.00	1.00	1.00	1.00	1.00	6.00	1
CAN	1.00	1.00	1.25	1.00	1.00	1.00	6.25	2
NZ	1.25	1.25	1.25	1.00	1.00	1.00	6.75	3
UK	1.00	1.00	2.00	1.00	1.75	1.00	7.75	4
SPA	2.00	1.75	1.00	1.00	2.25	1.25	9.25	5
FRA	2.00	2.00	1.00	1.00	3.00	1.00	10.00	6
JAP	1.00	2.00	1.00	2.00	2.00	2.00	10.00	7
SWI	2.00	2.00	1.00	2.75	1.25	1.25	10.25	8
NET	2.00	2.00	1.50	2.00	2.00	1.75	11.25	9
AUS	1.75	2.00	2.00	2.00	2.00	1.75	11.50	10
ITA	2.00	2.00	2.25	2.00	2.00	1.25	11.50	11
BEL	2.00	1.75	2.75	2.00	2.00	1.25	11.75	12
POR	2.25	2.00	1.75	2.00	3.00	1.00	12.00	13
IRE	2.75	2.00	2.75	2.00	1.75	1.75	13.00	14
GER	2.25	2.25	1.75	3.00	3.00	1.75	14.00	15
DEN	2.00	2.00	3.00	2.75	3.00	2.00	14.75	16
SWE	2.25	2.00	3.00	2.75	2.75	2.25	15.00	17
FIN	2.75	2.25	3.00	2.25	3.00	2.00	15.25	18
AUT	2.25	2.25	2.50	2.75	3.00	3.00	15.75	19
NOR	3.00	2.25	2.75	2.75	3.00	3.00	16.75	20

Prop. 1: Predominant bargaining level (national, industry, firm)

Prop. 2: Number of existing negotiation parties at given bargaining level (1, 2–5, no co-ordination)

Prop. 3: Union density (high, medium, low)

Prop. 4: Employer's organization rate (high, medium, low)

Prop. 5: Collective bargaining coverage (high, medium, low)

Prop. 6: Horizontal co-ordination (high, medium, low)

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