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Keynesianism and the Scandinavian Models of Economic Policy

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1. INTRODUCTION

The relations between economic theory, economic policy and economic development are complex. The most common perception of this triangle of interactions derives from the conventional Keynesian view best represented by Keynes' famous description of politicians as the slaves of some defunct economist. According to this view, economic policy is capable of moulding economic development quite strongly. But economic policy makers, in turn, are heavily dependent on the advice of economists when choosing policy moves. Consequently, economic theory assumes a key role. This essay takes as its starting point this Keynesian view which, in its strong version, sees a unilateral chain of influence from economic theory through economic policy to the economy. I do not want to deny outright the existence of such a chain of influence, but I shall maintain that it is conditioned by a set of crucial economic-structural, institutional, ideological and political intervening variables which are too often neglected by economists. A study from an economist's point of view of the role of these intervening variables in the diffusion of economic ideas is the main aim of this essay.

These intervening variables are investigated in a limited context, that of the Nordic economies. Contrary to what one might suppose, economic policies in the different Nordic countries display clear and systematic differences which call into question the notion of a common Scandinavian model. But at the same time the Nordic countries are similar enough with respect to economic structures, institutions and ideological and political traditons that the variables which might explain systematic differences in their economic policies can be identified relatively clearly. This paper will also show that the comparison of economic policies in the Nordic countries is enriched by the inclusion of Finland, usually the least known among them. Finland forms an intriguing negative case that to a great extent has resisted Keynesian counter-cyclical policies. I shall deliberately emphasize the contrast between Finland and Sweden, a country which developed Keynesian economic policies relatively early, treating Norway and Denmark as intermediate cases.

2. THE CONCEPTUAL FRAMEWORK

In what follows, I want to emphasize a certain tension, or lack of correspondence, between economic policy debates within an intellectual community of economists on the one hand, and within the broader national policy arena, on the other. These two intellectual communities consist of different types of people. The former is made up of professional economists, while the latter covers a looser group of politicians, civil servants, interest organizations, press, general public (and also some economists in their capacity as members of these groups). These two communities conceive of the scope, targets, constraints, tools and evaluationary criteria of economic policy in different ways. But the relation between them varies among countries and across time; and I am particularly concerned with the determinants of this relationship.

Tension between economic theory and economic policy has been accentuated by the internationalization of economic theory and especially of the neo-classical synthesis in the post-war period. The neoclassical synthesis conceives the central task of macroeconomic policy as the stabilization of aggregate demand, utilizing the tools of fiscal and monetary policy. What will concern us is how this message was received in different Nordic countries where Keynesian economics was to some extent imported from abroad and forced to communicate with national policy issues.

To understand the tension between the neoclassical synthesis and traditional domestic policy concerns we shall need some new concepts. We can start with the observation that from the 1930's onward all industrial societies, in one way or another, have accepted the premise that the national economy has to be managed, i.e. that the formulation and implementation of national economic strategy is one of the central tasks of government. This primise has been particularly marked in small open economies, like the Nordic ones, where the whole existence of a national state is largely based on economic performance. Hence Keynesianism met, in these countries, a relatively established national framework of ideas concerning economic policy. In what follows I shall refer to this inherited framework of ideas as a national policy model. This policy model defines the broad boundaries of the policy agenda in each country: what types of economic problems are to be solved by economic policy intervention and what tools are to be used. It does not necessarily imply any detailed policy scheme, but rather identifies the main orientation of views on economic policy in each country.

The concept of a policy model is made more concrete in the context of specific Scandinavian cases below. Here we need only consider same of its general features and a number of factors that tend to affect the character of each national model.

1. The policy model is tied to the broad economic-structural, cultural, political and institutional setting of each country. It is not the kind of closely-specified conceptual framework that is charecteristically developed by economists. Rather, it consists in a more diffuse set of cultural biases that delimit the agenda of economic policy-making. Professional economists who rely on international economic theories, can meet serious problems of communication with these diffuse, and yet powerful, policy models. If hostile to the policy views implied by an economic theory, the policy model usually does not generate an analytic argument but rather a broad consensus that the economic theory is "unrealistic" or "irrelevant".

2. The policy model is nationally specific. What I mean by this is that no matter how similar the actual economic development of different capitalist countries, the style of argumentation about economic policy and the corresponding balance among policy measures still differ remarkably from one country to another.

3. A national policy model implies some degree of nation-wide coherence: to some extent there is a common framework to all parts of the national economic policyy debate. However, this does not mean that disagreements never arise. As policy measures affect various groups in different ways, conflicts appear. But even so, the boundaries of the economic policy agenda, that is to say, what can and cannot be accomplished by economic policy, and consequently what are seen as legitimate claims on policy, remain relatively fixed. Different groups tend to rationalize their adherence to the policy model in their own specific way, one they find appealing. The national policy model is consequently sustained by several "satellite models" through which it is communicated to groups with diverse interests.

4. The national economic policy model is created out of the broad economic-structural, cultural, social and institutional context of each country. Several faeters in this historical legacy seem especially important:

- Concerning the economic structure of each country, particular attention will be paid to the industrial structure of the economy, to its stage of development and to the structure of foreign trade which places an external constraint on economic policy. I shall argue that small, open economies of the Nordic type generally differ from the kind of economic structure implicitly assumed by an aggregative, demand-oriented Keynesian framework.

- Among the ideological factors, we should pay particular attention to the way the role of the state in the economy is perceived. I shall argue that Keynesianism, as incorporated in the neoclassical synthesis, represents a kind of immanent critique of the laissez faire tradition. However, this tradition has never been particularly strong in the Nordic countries, where the state has traditionally played a more active role on the supply side of the economy.

- The economic structure of each country is reflected in the power structure of classes and interest groups. Many political scientists have recently emphasized the importance of this factor to the explanation of economic policy (c.f. Cameron and Scharpf in Goldthorpe (1984), Gourevitch (1984). They claim that the reception Keynesian ideas, like any national economic strategy, may depend on the relative power of different classes and interest groups. One argument in this vein suggests that a strong working class is necessary for the adoption of Keynesian policies. In this respect the Nordic countries supply an interesting and varied picture: there are countries, like Sweden, where the left has been strong and unified, and countries, like Finland, where it has generally been weaker and, in particular, internally divided by the struggle between Social Democrats and Communists. A more nuanced view argues that Keynesian policies make possible, and in turn depend on, the achievement of a political coalition between working class interests and the agricultural sector. Without totally denying the value of this approach, I shall suggest that the claim that agricultural interest groups have generally contributed positively to the adoption of Keynesian policies appears dubious on the basis of evidence from some Nordic countries.

- Various institutional features also figure in the creation and evolution of the policy model. Theda Skocpol and Margaret Weir (Weir and Skocpol (1984) have argued that the structural features of states affect the ability of a government to innovate, implement and institutionalize different types of economic strategies. In their view Sweden provides an example of a state structure that facilitated the adoptation of a kind of "social Keynesianism" linking macro-economic management to welfare spending and active labour market policies. Particular attention should be given to the status of the government bureaucracy relative to politically representative bodies: a strong bureaucracy may insulate policy from various political pressures, although it may also limit the influence of outside economic theorists over policy. From this point of view, differences in the status of the central bank turn out to be particularly interesting.

- All factors mentioned above condition the influence of economic theory on the policy model. In normal conditions, when these structural factors are changing relatively slowly and the existing course of economic development is not being severely questioned, the policy model is usually relatively stagnant. In particular, it tends to become anchored to its structural determinants and immune to changes in economic theory. This does not imply that that economics profession is without influence on economic policy; but its influence is delimited by the established policy model, i.e. the economists rationalize it and seek for solutions to various technical problems in the implementation of the model.

However, there are episodes when the policy model may change substantially and during which the influence of economic theory on the reorientation of economic policy may be very powerful indeed. This is the case when the policy model finds itself in a crisis, i.e. the lack of correspondence between it and its structural determinants is generally noticed and economic theory has a credible alternative to offer. In fact the breakthrough of Keynesianism in many countries provides an example of this exceptional episode.

Such a crisis of the policy model can ripen gradually, when it is unable to cope with gradual changes in the economic and social environment. More illuminating, however, may be the crisis that occurs when some sudden and profound change in the environment abruptly outdates the policy model. From this point of view, the Great Depression of the 1930s opened the way to Keynesianism, but still more decisive to its breakthrough may have been the Second World War with an aftermath that meant radical economic, social and political change in many countries.[1]

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[1] One may notice in the above account of the change of a policy model a certain analogy to Kuhn's well-known propositions on the development of scientific theories. Indeed, one of Kuhn's main accomplishments was to give more attention to the social determinants of the growth of knowledge. From this his point of view, the concept of a policy model directly comprises the social and economic environment that conditions the application of

In the subsequent sections, I shall compare the policy models of different Nordic countries, relating the similarities and differences among the models to the economic-structural, cultural, political and institutional context each nation. In this way it is possible to acquire some information concerning the relative importance of these different background factors for the evolvement of the policy models. To begin with, however, I shall present a more basic model of a typical Nordic economy in order to contrast it with the kind of economy that Keynesian macroeconomics presupposes. We will see that there is a tension between Keynesian ideas and the Nordic environment. The latter sections will then investigate how this tension played itself out in different Nordic countries, involving either the refinement of Keynesianism or its rejection.

3. THE NORDIC COUNTRIES AS SMALL OPEN ECONOMIES: A SIMPLIFIED PICTURE

Keynes' own ideas, and the neoclassical synthesis they inspired, reflect certain economic, ideological and institutional circumstances that were characteristis of certain "mature" capitalist countries, like the UK and United States. Keynes' emphasis on effective demand can be legitimized by the fact that these counries had already passed through their industrialization process and possessed a settled production structure relatively undisturbet by the war. These countries were also relatively closed in the sense that domestic demand occupied a decisive share of the markets for most branches of production. This gave demand management something to bite on. Ideologically, these countries had a strong laissez faire tradition and a weak Socialist tradition. The modern industrialized economy had come to being on its own without much

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theories to policy. In this way it may make more explicit the external factors that indirectly figure in a Kuhn-type approach. (Naturally there remains the difference that we shall approach the interaction between science and its external environment from the point of view of the practical application of knowledge while the growth of knowledge literature is interested in the development of science itself.)

perceived involvement by the state. Against this background, Keynesian demand management often seemed more immediately acceptable than direct intervention in production.

The economic, social and ideological attributes of a typical Nordic economy stand in some contrast with this picture. As far as the economic structure is concerned, the typical Nordic economy is one that may be still in the process of industrialization. The share of investment in GDP is relatively high. Its growth and structural change are typically export-led. The economy is heavily dependent on foreign trade; not only in the sense that the share of exports and imports in GDP is large, but perhaps even more important, exports are heavily concentrated in few branches often consisting of cyclically-sensitive industries like raw-materials processing. The concentration ratio for export industries is also high so that the bulk of its exports come from a small number of firms. As these big firms sell only a small share of their output on the home market, the state of domestic demand does not matter greatly to them. What matters are the domestic costs of production as a factor contributing to the profitability of exports.

This caricature forms a polar case to the picture of a mature capitalist economy described above as a suitable case for Keynesian demand management. Concentrated export industries constitute an effective pressure group emphasizing the cost side rather than the demand side of various policy measures. The cyclical sensitivity of their export industries renders the balance of payments constraint an effective obstacle to stabilization through the management of domestic demand. Managing changes in external economic circumstances more naturally appears as the dominant issue of national economic strategy and draws attention away from the demand side to the supply side.

This economic structure also contributes to the presence of certain ideological and political constellations in the Nordic countries that differ from those often associated with Keynesianism. As noted above, concentrated export industries usually form an active and coherent interest group. Labour is also well organized; union density is high and decision-making in the trade union movement is centralized. Since employer and employee organizations tend to exercise considerable power over policy, neo-corporatist forms of collective decision making often play a central role in economic issues. Furthermore, in the Nordic countries laissez-faire doctrine has not played such a prominent role as in the Anglo-Saxon world. Socialist influence has been relatively strong; and, on the bourgeois side, partly as a reflection of ideas similar to those of the German historical school, the state has been conceived and accepted as a more active force inside the economy rather than a body sitting outside the economy.

Taken together, these characteristics move attention from the demand side of the economy, which forms the focus of Keynesianism, to the supply side. People tend to think of the national economy, in a chanaging international environment, as an entity analogous to an individual firm whose management lies in the hands of the state and the collective organisations of employers and employees that attempt to influence it.

However, this description is only a caricature of the factors that influence Nordic policy models. As we shall see, every Nordic country differs more or less from this simplified picture. Furthermore, the structural characteristics of the Nordic economies have undergone some change. Thus, the description of an undiversified industrializing economy in an export-led growth process applies more to the economic history of the Nordic countries than to the present reality. Finland and Norway may still lie relatively close to it in some respects but Sweden moved away from it in the inter-war period, and it is doubtful whether the description has ever applied to Denmark except in so far as her agricultural sector is concerned. Therefore, each Nordic country has to be investigated separately.

4. THE SWEDISH MODEL

Social Democrats formed the cabinet in Sweden uninterruptedly from the early 1930's until the late 1970's, at times in coalition with the Agrarian party. Although the economic impact of the stabilization measures taken in the 1930's can be questioned, it is generally agreed that the Swedish government was among the first to implement the idea of countercyclical fiscal policy. It is also generally accepted that the Stockholm School, in the early 1930's, invented ideas that later became to be known as Keynesian and was able to influence the reorientation of the economic policy of the Social Democrats.[2] In the post-war period, as well, Sweden has been one of the most consistent appliers of counter-cyclical measures in economic policy. Although policy assesment is not a primary goal of this paper, calculations based on a full employment budget surplus concept show that, for most of the period 1950-1979, Swedish fiscal policy has mainly been in a countercyclical direction. Interpreting the cyclical reactions of monetary policy by means of changes in credit supply is not as straightforward. Yet it seems that credit flows have also had mainly a countercyclical profile.[3]

Sweden's early application and further development of Keynesianism in economic policy is so well-known that it need not be repeated here (c.f. Lindbeck (1975) and from a somewhat different angle Martin in Crouch (1979), Meidner (1976), Higgins-Apple-Wright (1981) and Esping-Andersen (1985)). But certain remarks on the standard description are in order. In particular, we should note

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2 The claim that Keynes's General Theory was nothing new to the young Swedish economists has been put forward by Myrdal and other representatives of the Stockholm School (c.f. Myrdal (1973)). On the other hand Karl-Gustav Landgren (1960) has stressed the role of Keynes's writings in the late 1920's as a source of inspiration of the Swedish Social Democrats. The debate on the relationship between Keynes and the Swedes still continues. For its recent evaluation, see Patinkin (1982).

3 The calculations concerning the reactions of monetary and fiscal policy in Sweden are available from the author.

that the Swedish policy model represents the development of a specific form of Keynesianism. First, the Swedish Social Democrats thought of aggregate demand management as a first-stage reform that would maintain full employment and thus enhance working class political power, building resources for the further development of social welfare in subsequent stages. In Sweden, Keynesian policy prescriptions were braudened early on to tackle problems of <u>industrial structure</u> and <u>inflation</u> as well as those of aggregate demand.

Hence, the post-war development of the model, as originally described by Gösta Rehn (LO (1951)), contained a vision of the supply side. It stressed rapid structural change, flexibility and technical progress in industry as the means to maintain its competitiveness in the world market and combat inflation. Hence, the Rehn plan proposed a 'solidaristic' policy where by all wages would follow the lead of the most successful the export sectors, thereby initiating a profit squeeze that would sweep out inefficient enterprises unable to pay wages comparable to the leading branches of the open sector. Active manpower policy, control of credit flows and taxation were to be used to alleviate employment problems inherent in the profit squeeze and to encourage the creation of new plants to replace the old, inefficient ones.

On the whole, these post-war developments in the Swedish policy model put less emphasis on active demand management; tight fiscal policy was regarded as a means to press industry to rejuvenate. But this emphasis did not exclude the counter-cyclical fiscal measures discussed above. Furthermore, the counter-cyclical character of the fiscal system was made more effective by a system of investment funds and the tax arrangements connected with them. It seems that they have succeeded in stabilizing private investment (c.f. Taylor (1982)).

The supply side measures incorporated in the Swedish model were indirect (and we might even say 'Keynesian') in the sense that they did not involve direct state intervention in production. In fact, state-owned enterprises have not played a significant role in Sweden except for the quite recent past. However, this kind of policy turns on a potentially fatal ambivalence toward income distribution and profits. Is not the profit squeeze a contractive factor which may lead to de-industrialization? It seems that this possibility was not sufficiently considered in the development of the Swedish model, and in the 1970's, the threat of de-industrialization appeared as an obstacle to the further development of the model. In the face of a dramatic slow-down in international trade, the formerly-dynamic Swedish export sector now seemed to consist of many branches in crisis.

Secondly, in contrast to many forms of Keynesianism and some of Keynes' own views, the new economic policy in Sweden was not meant to be an elitist operation over which an enlightened technocracy of civil servants was to preside. From the beginning, it was conceived as a way of broadening economic democracy and of creating a method to control social conflict through economic policy. In addition to the Social Democratic Party, the trade union movement has been actively involved in the development of the Swedish model, suggesting, in fact, the most important revisions concerning anti-inflationary policy and, recently, the workers' investment funds. Thus the Swedish model has been based on a broad political mobilization, and it has left the trade unions relative free to operate in their members' interests. Consequently, incomes policy has not become the contentious issue in Sweden that it has in countries where narrow forms of Keynesianism have been applied. Government control over wage negotiations has not been common, as methods to control wage inflation have been devised by trade unions and employers' organizations.

Finally, the Swedish policy model continues to be dynamic, partly because it has never been free of contradictions or weak points. Today, for instance, it is not clear how the control of imported inflation based on the Scandinavian model (c.f. Edgren-Faxen-Odhner (1969)) will work with a variable rate of world inflation and unstable exchange rates. In this respect, the experience of the

1970's was not very satisfactory. There is also a potential conflict between the solidaristic wage policy and the need for higher profits from which to fund investment. Wage earners' funds have been suggested as a method to deal with this conflict (Meidner (1976)); so far, however, their role has been negligible.

Similarly, the balance of payments is a potential weak spot in the Swedish policy model. Either by accident or as the result of certain structural characteristics of the Swedish economy, Swedish exports and imports have normally been quite closely synchronized so that serious balance of payments problems have been rare. That does not seem to have been attributable to the intrinsic virtues of Swedish economic policy. Indeed, it was during more serious balance of payments crises, at the end of the 1940's or 1960's and at the turn of the last decade, that Swedish model has come under stress. In these conditions the Government has been inclined to adopt traditional stop-go measures to maintain the external balance or beggar-thy-neighbour policies to increase its room for manoeuvre through big devaluations. These have, in turn, strained relations between the Social-Democratic government and the trade unions, a central pillar of the political consensus which is also a key feature of the Swedish model. By and large, recent changes in the external conditions facing the Swedish economy and in the policy orientation of Swedish governments have been so great that the basic parameters of the old Swedish model may now be called into question. This issue will be considered below.

I have argued that a given policy model tends to become a nation-wide frame of reference. It seems that even in Sweden all the participants in the economic policy debate have been more or less anchored to the same national model, although the model was implemented by the Social Democrats and has been particularly strongly associated with their objectives. The last non-socialist government in Sweden was not ready to give up the Swedish model; it simply reduced it to more narrow Keynesian lines. In international terms, it was indeed remarkable that the bourgeois government maintained practically full employment despite structural problems in Swedish industry that were far more serious than in many other countries which readily gave up the full employment goal. It was then left to the present Social Democratic government to launch measures, like a large devaluation and a squeeze on real wage costs, that depart from the old Swedish model.

My final comment on the Swedish model concerns the development of the relation between economic theory land the policy model. Around the time of the Second World War, the policy model and theoretical developments in economics progressed hand in hand. It is an open question which played the more active role. Some have argued that the new policy directios of the 1930's had a strong political appeal, independent of economists' writings (c.f. Myrdal (1973)) and that later on, as further developments of the Swedish model were proposed by the Social Demorats, economists normally opposed them (Bergström (1977)). On the other hand, Swedish economists were closely involved in the economic policy debate of the 1930's and many of the new proposals were formulated by economists close to the labour movement. This fruitful inrteraction between economists and politicians, however, gradually disappeared during the post-war period. Economists turned to foreign influences and the theoretical background of the policy model was left stagnant. In fact, by the 1970's it seemed that a majority of Swedish economists had become higly critical of it. Thus the Swedish case broadly conforms to our thesis concerning the relation between theoretical developments and the policy model. Economic crisis opened the way for the former's influence on the latter, which then become more independent over time until the next crisis arose.

5. THE FINNISH MODEL

A major portion of this paper will be devoted to analysis of the Finnish case which is little known and particularly interesting from this point of view. The Finnish policy model can be considered an extreme non-Keynesian case, marked by a narrow emphasis on cost and supply factors. As a consequence of this approach to policy and the instability of the raw materials intensive foreign sector, the Finnish economy has been one of the most unstable among the OECD-countries. Yet, at the same time, its long-run growth performance has been good.

The Finnish model also provides a good example of a situation in which the interaction between economic theory and the policy model is almost totally absent. The economic science taught and discussed in Finland has, for the most part, closely followed the mainstram of international developments. As early as the 1930s, the new economic theorizing, later labelled the 'Keynesian revolution', was noticed in Finnish economic science. We, must emphasize, however, the Swedish and Scandinavian connections: The Stockholm School was read before Keynes, and only after the war did Keynes' name begin to dominate economists' discussions. By the end of the 1950s, Finnish economic theory was already firmly based on Keynesian lines of thought. The special characteristics of the Finnish economy however, presented obstacles to the implementation of these principles. Thus the policy model was insulated from the theory model.

The Finnish Policy Model

The structural context for Finnish policy - a small and open economy under a process of structural change, and an economic discipline conducted along Stockholmian-Keynesian lines - is not very different from that of the Nordic economies described above. Accordingly, one would expect to find a policy model somewhat similar to that of Sweden or her Scandinavian neighbours, in which Keynesian ideas were prominent but where some attention would also be paid to problems of supply. The traditionally close cultural ties between Sweden and Finland should have made that outcome even more likely. What emerged after the war, however, was a policy model that had little to do with Keynesianism of any sort.

Instead, the Finnish policy model has displayed a rather one-sided emphasis on supply, cost and competitiveness factors, which relies on some pre-Keynesian elements, such as the quantity theory of money, and never abandoned the principle of sound finance. Thus, the Finnish policy model seems to have drawn little from post-war economic science. Indeed, even the model itself has remained somewhat opaque, never clearly spelled-out by economists or policy-makers. Essentially, the model stems from the interwar era and since then it has been part of the national culture showing remarkable continuity even during sharp political upheavals.

The continuity of the Finnish policy model in part reflects the strong position of the bureaucracy in Finnish policy-making. Cabinets have traditionally been very short-lived, and since they have been constituted either by a minority in Parliament or by internally weak coalitions, the role of the bureaucracy has been enhanced. The Finnish policy model has largely been a result of the bureaucracy's daily routines of policy preparation and implementation. Because there are no authoritative documents outlining the Finnish policy model, our interpretation of it has to be built, to a greater extent than would otherwise be desirable, on regularities in actual policy reactions.

Let us look, first, at the historical background of the Finnish model, and then, at its actual substance. Before the Second World War, Finnish economic policy was conservative and orthodox. The depression of the thirties was seen as a natural adjustment process in which economic policy should remain passive. Financial markets were kept tight and fiscal policy was ruled by sound finance. There were no significant political differences over this basic policy line. The new ideas of the Stockholm School had not yet reached economic policy discussion in Finland. Any critics of the deflationary policy concentrated on monetary policy and made no use of the new theoretical tools.

It is useful to remember that during the inter-war period political hegemony in Finland was firmly bourgeois, after the 'white' side had defeated the working class in the 1918 civil war. The labour movement was weak, communist action had been banned and empoyers used repressive measures against trade unions. At the beginning of the thirties, there was even some danger of a right-wing coup, but that was crushed. In 1937, a coalition government of the Social Democratic Party and the Agrarian Centre was formed. By that time the economy was already recovering.

The two decades following the war were a potentially formative period in which there could have been a break in the conservative economic policy tradition. As noted above, many Finnish economists had by that time assimilated the Keynesian ideas of contracyclical policy. There was also a clear shift in political hegemony. The labour movement had gained new strength, although it was bitterly divided into Social Democrats and Communists. The major right-wing party lost most of its influence with the new foreign policy orientation. In the latter half of the 1940's, the Communists, Social Democrats and Agrarian Centre formed a coalition government. After 1948 the Communists' position was weakened, and since then, the Social Democrats and the Centre have been prominent in Finnish politics.

Furthermore, the war had meant in Finland - as in many other countries - more extensive governmental intervention in the economy. Extensive rationing and planning were applied during the war and, after the war, the state played a strategic role in the resettlement of the Carelian refugees and the organization of production to pay for war reparations to the Soviet Union. The development of the productive structure and the fostering of necessary investment were seen as the main economic policy goals at that time. State-owned companies were established, and the metal industry, which has since become an important export industry, was created mainly through state initiatives designed to cover the war reparations. In this new political context, new welfare programmes were also started. All in all, the public sector remained large after the war, and both economic and social policies were interventionist. But, as we shall see, interventionism was not applied to stabilization.

The anti-Keynesian character of the Finnish policy model is most obvious in the trajectory of fiscal policy, the area in which Keynesian initiatives were generally concentrated. Even in the post-way period, Finnish fiscal policy has continuously relied on the principle of sound finance. What is more, the state has been, until recently, a net saver, i.e. the budget surplus has been positive throughout. This results from attempts to balance the budget without loan financing even though the state's own financial investments are counted like current expenditures. In the same spirit, emphasis has been placed on the need to enhance the competitiveness of industry by curtailing its costs through fiscal measures. Loan financing has been avoided, and the crowding-out effects of fiscal policy have been underlined althought the official lines of argumentation have been far from consistent. One can, however, discern a line of argument in accordance with the old British Treasury View: every penny loaned by the state diminishes private economic activity by the same amount. Given the target of a balanced budget, only a few selective measures have been employed to deal with cyclical unemployment. Hence, Finnish fiscal policy has tended to reinforce rather than counterbalance, the underlying cycles of the economy, especially in the 1950's.

The procyclical reaction is well borne out by a full employment surplus calculation outlined in Figure 1. The continuous line shows the hypothetical budget surplus that would have been achieved without cyclical variations in state revenue.[4] It can be

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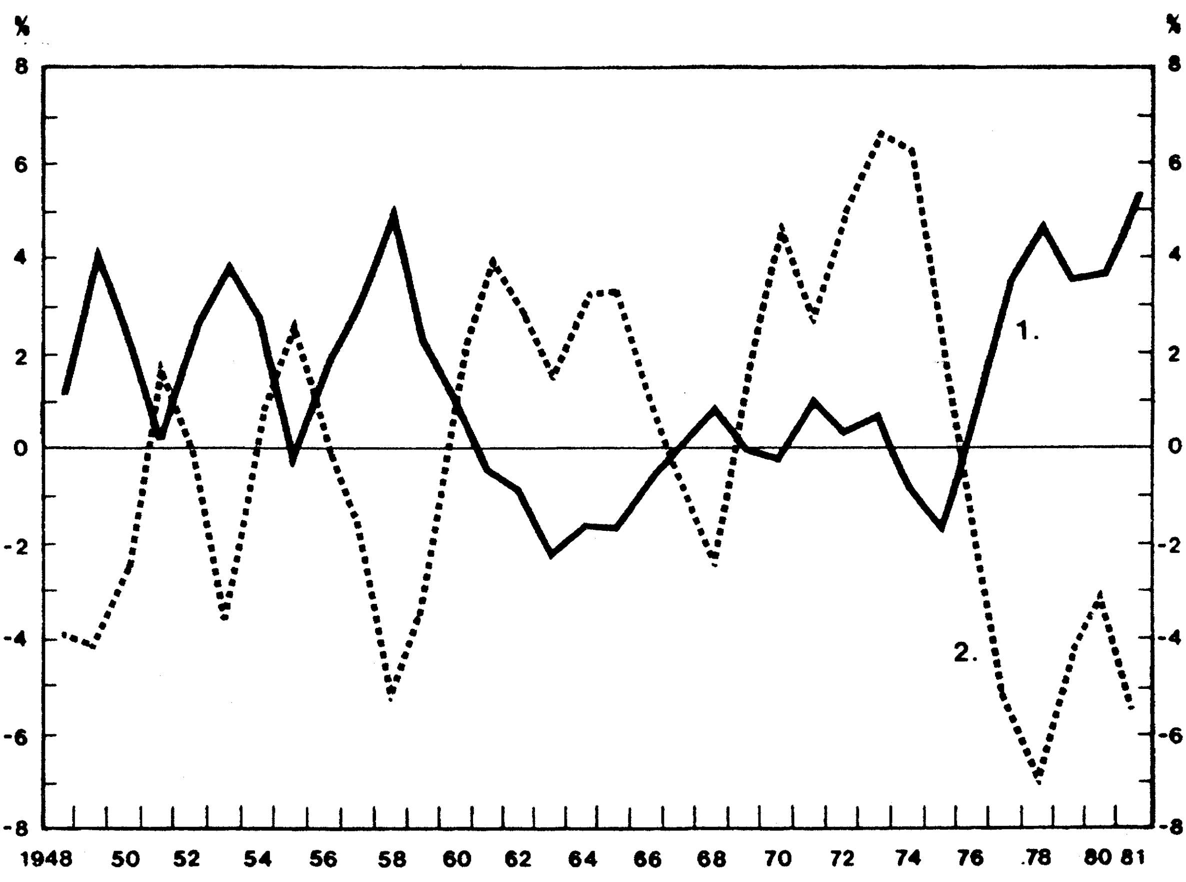
[4] Calculation is made by Juhana Vartiainen. Strictly speaking, the measure is not a full employment surplus, since we have calculated be the hypothetical budget surplus that would at full employment. Essentially, this should yield the same results, since we are interested in the fiscal policy reaction and not in the level of the surpluses. To put it succintly, we have estimated hypothetical state revenues without cyclical fluctuations, taking into account that in that case the income distribution, the share of imports in total supply and the price development would have been different, too. Taxes were disaggregated into direct taxes for consumers, direct taxes for the corporations and indirect taxes and separate functions were estimated for each item. The volume of state expenditures was not altered, but expenditures were of course adjusted to fit the hypothetical price index. The outline of a somewhat similar method can be found in OECD (1977).

interpreted as the discretionary reaction of fiscal policy. The dotted line shows the deviation from trend of the real GDP, thus indicating the cyclical phase. (Both variables as % of GDP.)

Especially in the fifties, fiscal policy reaction is very clear and systematic: in a period of depression, the discretionary measures have been contractive and vice versa during an upswing. And although unemployment has been identified as a problem, it has been tackled using selective measures, while at the same time general cuts in expenditure have been recommended to balance the budget.

<u>Figure 1</u> Hypothetical discrete budget surplus (1, continuos line) and GDP deviation from trend (2, dotted line) in Finland 1948-1981.



Interestingly enough, this model of fiscal policy has never been systematically articulated, and so the arguments used to defend its elements are often contradictory. Thus, for example, the discussion concerning government borrowing is based a line of thought very similar to the quantity theory of money, while the effects of taxation have often been described in terms of some kind of cost-push inflation theory. Similarly, the endeavour to achieve balanced budgets each year has been justified with widely varying lines of reasoning: in some cases, the crowding-out effects of government expenditure have been emphasized, while others have been based on a political attempt to limit the growth of the public sector. Flying in the face of principles of demand management, it also seems that in the traditional Finnish analysis of fiscal policy, the structure of the budget has been emphasized rather than its overall balance.

A central instutional feature behind the Finnish policy model is a strong and independent monetary authority, the Bank of Finland. Legally it is subject to parliamentary control, but this is largely retrospective in nature, and the Governors of the bank enjoy unlimited tenure in office. In general, legislation stresses the independence of the central bank in its relations to the government.

The Bank of Finland has played a major role in maintaing the continuity of the Finnish policy model at a political and institutional level. It has virtually controlled fiscal policy so as to oppose the growth of state expenditure and hamper attempts to implement more countercyclical budgeting. This has been made possible by the fact that, in Finland, facilities for government borrowing from the public have remained underdeveloped, and the central bank has declined to finance public expenditure directly. As a result, the state has largely been seen as an economic agent comparable to any private one, operating under a budget constraint often even more severe than that of other agents. During the past two decades the prominent role of the Bank of Finland has also been enhanced by the control that it exercises over exchange rate policy.

Monetary policy has not been straightforwardly procyclical in Finland, but even here there has been no effective intervention to even out cyclical fluctuations. Traditionally, the regulation of the terms of commercial banks' central bank debt has been the most important tool of monetary policy. Since Finland has had no important market for short-term financial assets, open market operations have not been used. The role of the deposit banks as mediators of finance has been crucial, and there have been marked cycles in credit expansion due to fluctuations in currency reserves and consequently in deposits. During the 1950's and the 1960's, the central bank tried, to some extent, to offset these swings in reserves by changing the availability of central bank debt to the banks, but this policy instrument was far too weak to bear on the credit cycle in an efficient way.[5] During upswings, as export incomes flooded in, the banks were able to expand loans swiftly without using central bank debt, and when a downswing came, the central bank could not 'push with a rope', i.e. force the banks to expand credit when demand for loans was low. Cash reserve ratio policy would have been a natural addition to the central bank's inadequate tool kit: however, in accordance with the generally anti-interventionist tradition of the Finnish policy model, a proposal to equip the central bank with greater authority to control cash reserves was refused, largely on ideological gounds. Thus, there have been no efficient means to offset the largely procyclical fluctuations in the credit market. In the seventies, monetary policy was quite procyclical and recent statements by the monetary authorities show that external balance has effectively become the major monetary policy objective. In an economy where the business cycle is led by export demand, this results in a procyclical monetary policy.

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5 Even during periods when the availability of central bank credit could have been a binding constraint on banks, the monetary authority was rather shy in using it decisively, partly because it did not want to disrupt depositors' confidence or the profitability of the banks.

Exhange rate policy is a policy area which has also been crucial in Finland and one in which the central bank has also played an active role. The Finnish markka has experienced large devaluations at roughly 10-years intervals, typically towards the end of a deep slump, as in 1957, 1967 and 1977-8. These devaluations have shifted the distribution of income in favour of profits and, by curtailing private consumption, they may have been contractionary in the short run. When exports picked up again on the way to an economic recovery, incomes policies have been used to depress wages, thus laying the foundation for an investment boom. Over time, however, wage inflation again erodes competitiveness and paves the way for a new devaluation. In this way successive devaluations have contributed to the instability of the economy: during periods when exports were depressed big devaluations have further curtailed domestic consumption, and later their expansionary effects have led to excessive investment during export booms.

In the Finnish discussion these developments are known as a devaluation cycle.[6] It is depicted by Figures 2, which shows a rather regular 10-years cycle of the functional distribution of income and of the unemployment relative to the OECD average, an indicator of activity in Finland in international comparison. As shown the figure, devaluations (marked by D) have occured at times of exceptionally low profitability and high unemployment. Demand management can also been interpreted in its context. Typically the slump preceding a devaluation has been characterized by very tight fiscal and monetary policy. On the other hand the policy has been made more expansive during the consequent boom. There is indeed reason to interpret the Finnish devaluation cycle as a 'Kaleckian' political business cycle where periods of deflationary policy have been used to make room for a succesful devaluation to squeeze out the required capital accumulation by shifting the distribution of income in favour of profits. This combination of devaluation policy and procyclical monetary and fiscal policies has helped to render the Finnish economy one of the most unstable in the OECD. But over

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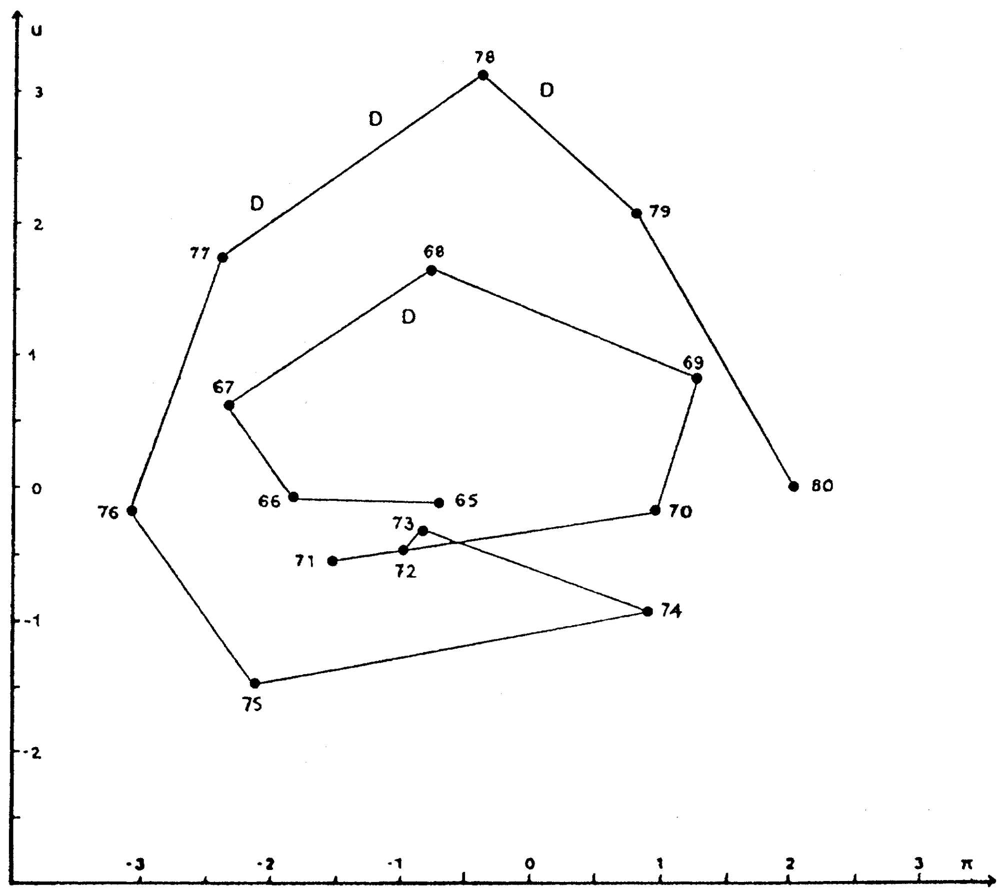
[6] The term is due to Korkman (1978). A short critical analysis of the debate is to be found in Pekkarinen and Sauramo (1985).

Figure 2 **The Finnish devaluation cycle projected on unemployment and profits.**



u^r = relative rate of unemployment (unemployment rate in Finland subtracted with the weighted average of the unemployment rates in USA, UK, Germany and Sweden)

π = gross operating surplus as percentages of disposable national income (deviation from trend)

Source: Korkman (1981)

the cycle, it has striven for high rates of investment and growth. In fact the Finnish economy, while unstable, has grown relatively rapidly and has also underwent very rapid structural change during 1950's and 1960's. This might suggest that there is a trade-off between stability and growth during the process of industrialization.[7]

Furher explanations

To explain the non-Keynesian Finnish policy model, a variety of factors must be taken into account. The structural aspects of the Finnish econmy are discussed below. At the political level, there have been surprisingly few divergences of opinion about the basic policy line. The national policy model seems to posses some degree of hegemony across most lines of political division. In the post-war years the Left did not use its strengthened position to pave the way for a new kind of economic policy, nor did the Left effectively question the authoritative position of the central bank, which institutionalized the bourgeois idea that the economic and political spheres of a capitalist society should remain separate. In this respect, the social theory underlying the Finnish policy model is similar to that implicit in classical economics. On the one hand, it envisions an apolitical monetary authority that safeguards the value of the currency as a basis for the functioning of the system, while, on the other hand, it posit a state that operates within the rules dictated by the economy and is unable to threaten the authority of the central bank. In this way, the political and the economic spheres remain quite separate.

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7 After all the above story is not meant to describe the Finnish policy model, while un-Keynesian, as wholly unsuccesful. The pay-offs of the stability-growth trade-off should be assessed in order to make such a judgment. Furthermore, in an open export dependent economy which is curtailed by the balance of payments constraint, the room for Keynesian policies is in any case restricted. We shall come back to this below.

The narrowness of the Left's scope for interventionist action can be further explained by a general 'tightness' in the political climate after the war. The Right was afraid of the Soviet Union and distrusted all major reforms. On the other side, the parties of the Left did not develop a comprehensive and consistent economic strategy. As already mentioned, they were internally divided into Social Democrats on the one and Communists and allies on the other roughly of equal strength. What is particularly important is that the Finnish Social Democratic movement never integrated Keynesian stabilization policy into its strategic goals. Starting from a traditional Marxist perspective, the Communists combined some of these ideas into an underconsumption thesis; but this then simply made the Social Democrats even more suspicious of them. Nor did Keynesian ideas find fertile ground in the other main governing party, the Agrarian Centre, both because of the general discrepancy between the agrarian ideology that praises thriftiness and Keynesianism which was seen as spendthrift and because many Centre Party supporters shared the cost-oriented interests of the export forest industry. Thus, political criticism of the policy model has been rare and unsystematic, coming mainly from the trade unions and some leftist or populist circles.

The deep rift between academically-accepted economic theory, which became Keynesian in the post-war era, and the policy model in Finland remains, to some extent, a mystery. There has been very little dialoque between advocates of the policy model, relying on pre-Keynesian modes of thought and economic theorists working along Keynesian lines. In the fifties and again during the seventies, there was some academic criticism of economic policy but to little effect.

In general, advocates of the policy model have been able to gather from theoretical discussions the elements they need to legitimize it. This has become even easier in the current state of economic science. The crisis of Keynesianism has created in the international macrotheoretic discussion new tools for conceptualization and analysis which apologists for the Finnish policy model have been able to utilize for its reproduction and elaboration. The critics of Keynesianism have stressed supply side factors related to growth and competitiveness which resonate with traditional aspects of the Finnish policy model.

The Finnish policy model becomes more understandable when seen within the general intellectual tradition of Finland. The influence of the German Historical School and the openness of the economy created an intellectual climate in which economic growth through good export performance was identified as the preeminent national problem. Hence, economic development has been regarded as being something that is exogenously determined and economic policy as something that must adapt itself to external 'realities', dictated primarily by the competitiveness and profitability of export industry.

Swedish and Finnish policy models: preliminary comparisons

In their relation to Keynesianism, the Swedish and Finnish policy models contrast sharply. The former adopted Keynesianism early and later developed it further while the latter has quite consistently resisted it. This contrast has to be explained. In what follows I shall not provide a conclusive explanation but ratherr suggest some ideas for further investigation. The sharp contrast between Swedish and Finnish policy is all the more perplexing, as both countries to begin with had a Nordic type of an open economy in which the economic role of the state was relatively strong from the start. Consequently, the broad ideological background has been similar us and intervention did not become such a contention issue as in countries with a stronger liberal tradition.

What kind of differences are, then, to be found in the background factors? Closer inspection suggests several:

1) Despite broad similarities, there are important differences in the <u>economic structure</u> of the two countries that may have had a

bearing on the reception of Keynesian ideas. Thus the industrial structure, and particularly the export structure, of the Swedish economy has been more diversified than that of Finland. In Sweden, forest and metal industries have long been the two main export sectors, while in Finland the latter has gained importance only in the last two decades. Since the export cycles of these two industries tend to be timed differently, they cancel out each other's fluctuations. Furthermore, the direct import content of the metal industries is large enough that swings in its exports are reflected with a short lag in imports. On the other hand forest exports, which utilize domestic inputs, have only an indirect effect on imports after a considerable time-lag, through the income and capacity effects they generate. Perhaps for this reason, the external account has been much more balanced in Sweden than in Finland where an export-led boom usually leads to an upswing in imports after a year or two. The export boom has then passed so that the increase in imports leads to a large deficit on the current account. This has contributed to stop and go policies in Finnish demand management. In Sweden the external constraint has been more stable and given counter cyclical policies more flexibility. All in all, this suggests that a soft external constraint is a crucial precondition for adopting Keynesian policies. This conclusion will be strengthened by further Nordic country cases below.[8]

2) Differences in the influence of the power structures in Sweden and Finland give rise to two comments. First, Sweden has often been cited as a good case for the claim that farmers, along with workers, are generally "the least committed to economic orthodoxy

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8 But one has to take caution of the possibility of a reverse causation: tightness of the external constraint is not a purely exogenous factor but is partly detemined by economic policy itself. Thus e.g. in Finland unstable domestic demand, destabilized by economic policy, has led to unstable imports and consequently to recurrent balance of payments crises, while in Sweden stable domestic demand has contributed to steady external balance. It is likely that both the exogenous and the endogenous factors of the external constraint have contributed to its different behaviour in Swedish and Finnish cases.

and the most willing to experiment in times of stress" (Gourevitch (1984), 116) and hence form a crucial partner in the alliance that adopted Keynesian ideas. Reference is usually made to the "cow trade" of 1932. The Finnish case, however, inspires some doubts about the general validity of this claim. In Finland, the Agrarian party played a central role in governments both in the inter-war and the post-war period, but its overall approach to economic policy has been quite orthodox, notwithstanding its support for broad welfare measures, particularly those reaching the inactive population. During the Great Slump, the Agrarian party defended the orthodox policy then being pursued. In 1937, it formed a cabinet with Social Democrats, but this cabinet did not change the general principles of economic policy. In the post-war period, too, a coalition of Agrarians and Social Democrats has been the most common form of cabinet, and the former have firmly defended the kind of procyclical fiscal policy we described in the Finnish case above.

What might explain this Agrarian stand? Without claiming for any definitive answer, following suggestions can be made. First, the traditional doctrines of Agrarian parties generally favour values like thriftiness that Keynesianism attacked. Second, in Finland revenues from forestry form an important share of farmers' income. This has tied their interests closely to the main export sector, i.e. the forest industry. And as we have seen, the profitability requirements of this sector have played a key role in the Finnish devaluation cycle and the instability connected with it. It may be the case that in Sweden the representation of interests has been more diversified: on the one hand, foresters have not occupied such a dominant position among farmers, on the other hand neither the claims of the export industries have been equivocal as the interests of the forest industries and metal industries may have differed. Consequently the conditions for the alliance between farmers and the main export sector may have been more favourable in Finland than in Sweden. Third, in the Finnish Center-Left coalition cabinets the Agrarian Party has traditionally occupied the role of the main representative of the interests of industry in general against claims of the Left. This may also have strenghtened its emphasis on costs and competitiveness at the cost of domestic demand.

The economic policy approach of the Finnish coalition cabinets has, of course, not been determined by the Agrarian Party alone. The main coalition partner, the Social Democrats, have had their own influence on it. In fact, it is even more surprising that he Finnish Social Democrats, in contrast to their Swedish comrades, were so deaf to the temptations of Keynesianism. There may be several possible explanatiaons for this difference. First, the Finnish <u>trade unions</u> have been much weaker than those in Sweden, where their role in the design of economic policy stratgegy has often been decisive. Second, one might point to the internal divisions and weakness of the Finnish Left. In Finland, Communists and Social Democrats have been roughly equal and often bitter competitors for long periods of time. It seems that the Communists, starting from a Marxist underconsumption thesis, had a more positive attitude towards Keynesian prescriptions and this rendered the "responsible" Social Democrats even more suspicious of them. Conversely, the cautious attitude of the Finnish Social Democrats may originate in an ideological inheritance that leaned towards Kautskyism. In its Finnish variant, this doctrine inclined the Social Democrats toward a policy of passive waiting until the time was ripe for Socialism. This was not a good starting point for active reformism, the perspective from which the Swedish Social Democrats, for instance, pursued Keynesianism. It seems that the same inheritance paralyzed Social demcrats in the inter-war period in other countries as well, such as Germany.

Third, several pertinent differences in the <u>institutional features</u> of the Swedish and Finnish states have already been mentioned. After the Second World War, Sweden had a long, uninterrupted period of Social Democratic cabinets, while the Finnish cabinets, in general, consisted of weak coalitions and were very short-lived. Combined with the provision in the Finnish constitution that allows even a minority of 1/6 of the Parliament to postpone some types of new legislation, this tradition of weak cabinets inhibited purposeful economic strategy.

In comparison to the political authorities, the central bank is unusually powerful in Finland,[9] and it has enforced a degree of continuity on Finnish economic policy. Although the Bank has not had a particularly 'monetarist' orientation, its approach to monetary policy has generally been cautious, giving heavy weight to the state of foreign exchange resaerves, while its exchange rate policy has been remarkably growth-oriented and often destabilizing. The Bank's influence over economic policy has been broadly conservative in nature in the sense that it has contributed to a kind of "depolitisization of economic policy" that emphasizes the division between economic and political speheres in a society. No doubt this has inhibited the renewal of economic strategy. At the same time, we should remember that the status of the central bank is by no means an exogenous factor; it reflects as much as it conditions the persistence of a certain orthodoxy in Finnish economic policy.

The powerful central bank is but one aspect of the influential and independent status of the bureaucracy in Finnish politics in general. That results partly from the internal weakness of Finnish cabinets, but it also has roots in the 19th century when Finland was under Russian rule and relied heavily on her domestic bureaucracy. It seems that the continuity of the Finnish policy model has depended crucially on her bureaucracy. However, one would not want to argue that, compared with other Nordic countries, the Finnish bureaucracy has been completely incapable of adopting new ideas and procedures in economic policy. Immediately after the war, for instance, the civil service took the initiative to the heavy war reparations,[10] and it later initiated many supply side measures designed to modernize the

9 The status of the Bank of Finland is compared with other Nordic central banks in Uusitalo (1984).

10 Cf. Charles Kindleberger (1986).

economy. Some other factors are needed to explain why the bureaucracy was so reluctant to adopt counter-cyclical measures in demand management.

This finally brings us, as the fourth type of explanation, to the role of professional economists in accounting for differences between Sweden and Finland in the reception of Keynesianism. Sweden provides an example of a country where economists were striving on their own towards Keynesian ideas. The young economists of the Stockholm School also soon realized the policy relevance of their new ideas and began, like Keynes, to look for political forces able and willing to implement their new ideas. Gunnar Myrdal, for instance, turned to the Social Democrats and another group of economists subsequently played a prominent role in the new proposals of the trade union movement. Bertil Ohlin had influence over the Liberals, and so on.

Despite the fact that certain Finnish economists had easy access to decision makers - in the inter-war period one professor of economics was Prime Minister - and that Keynesian ideas were accepted in principle, at least, by the 1950's in Finnish economics, professional economists did not do much to introduce Keynesian ideas into Finnish economic policy. Even criticism of the obvious un-Keynesian features of actual policies was scarce, if not at times non-existent. It may be that those professional economists with the closest contacts to decision makers took a critical or cautious attitude to Keynesianism. Alternatively, given the structural factors discussed above, they may simple have believed that the assumptions of the theory did not apply to Finnish circmustances.[11] For whatever reason, it seems that, in contrast to the Swedish case, the inability or willingness of professional economists to argue in Keynesian terms in a way

11 This emphasis can already been discerned in the first reactions of influential Finnish economists to the new ideas of the Stockholm School in the 1930's. The writings of Professor Bruno Suviranta, for instance, offer ample evidence for this.

relevant to Finnish circumstances was a potentially crucial barrier to the adoption of Keynesian policies there.

On the basis of this Swedish-Finnish comparison I have isolated certain factors which may have contributed to differences in the evolution of the economic policy models of these two countries since the 1930's. To gather more information on the relative importance of the factors behind these policy models we should also consider certain features of the Norwegian and Danish policy models. It appears that the Norwegian case may sharpen certain observations we have made about Sweden, while Denmark may replicate some of the factors associated with reception on Keynesianism in Finland.

6. THE NORWEGIAN MODEL

My discussion of the Norwegian case will be organized as follows. First, there will be a brief review of the economic, ideological and intellectual factors behind economic policy. Thereafter some salient characteristics of Norwegian economic policy and economic development are taken up. Finally, I will discuss some issues concerning the relation between economic theory and the policy model in the Norwegian case.

The economic structure of Norway represents a fairly strong version of the Nordic type of open economy described above. First, exports of goods and services have represented for more than 40 % of total output throughout the post-war period - the highest proportion in Scandinavia. Second, Norway, like Finland, has a relatively undiversified set of exports. The bulk of her exports consist of freight services or shipping and exports of processed raw materials, like aluminium, steel and, recently, oil, the processing of which is very capital (and energy) intensive. In imports, too, raw materials figure highly, together with various kinds of semimanufactured goods and some capital goods.

Consequently, the foreign sector in Norway is cyclically highly sensitive: export prices as well as volumes are volatile; the income elasticity of imports is relatively high, and many import prices are subject to great cyclical changes. These similarities with the Finnish economic structure will raise some intriquing questions of comparison in what follows.

As in Finland, Norwegian industrialization lagged considerably behind that of Sweden until just after the Second World War. Since then, the process of industrialization and structural change has been very rapid. As in Finland, this, together with a high capital-labour ratio in the leading export industries, has led to a high investment ratio.[12] Furthermore, state-owned companies have played a great role in certain capital-intensive industries, partly because Norway, like Finland, was considerably damaged by the war and faced the task of reconstruction.

While Norway bears at least some resemblance with Finland as far as her economic structure is concerned, her ideological and intellectual background is more closely comparable to that Sweden. Bourgeois hegemony in the inter-war period was not as substantial as in Finland. The Social Democrats enhanced their position among the Left in the 1920's, in 1935 they formed the cabinet. Collective wage agreements were also launched in the 1930's. After the war the Social Democrats formed the cabinet uninterruptedly until 1965; since then there has been an alternation between Labour and bourgeois cabinets.

Nevertheless there have been some crucial differences between the policy orientations of the Swedish and Norwegian Social Democrats. The Norwegian Social Democrats focused on the organisation of production while the Swedes were more interested in redistribution and the conditions for securing peaceful labour markets (Björgum et al. (1974)). This is connected to the role the trade union

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12 The average figure for the ratio of gross investment to GDP for the 1950-1979 period is 29.6 in Norway and 27.8 in Finland.

movement has played in the strategy of the Left in these two countries. As we have seen, it played a crucial role in the Swedish model, but in Norway, the trade unions have not been so central compared to the parties, the bureaucrats or the intellectuals (economists included).

The state of economic science in Norway at the threshold of the Keynesian era was much like that in Sweden. Norwegian economics was renewed by Ragnar Frisch (1895-1973). Like the economists of the Stockholm School, he can claim to have invented in the early 1930's certain central ideas of what later came to be known as Keynesian macroeconomics (cf. Berg&Hanisch (1984), 176-183).[13] The 1934 crisis programme of the Norwegian Labour Party was strongly influenced by his ideas, and as a teacher and supervisor, Frisch created the 'Oslo School' whose influence has persisted to the present. This school is very policy-oriented; it emphasizes economic planning and the interaction between economists and decision makers in the planning process.

As we shall see, this combination of economic, ideological and intellectual factors brought in some special features to the Norwegian policy model and its interaction with economic theory in Norway.

The situation after the Second World War offers a natural starting point for any discussion of the economic policy model in Norway. The War had damaged much of Norway's economic infrastructure and institutions. Politically, the position of the Left was enhanced. Since the Social Democrats had taken a reformist stand even before the War, they were ideologically prepared to step into the breach. Furthermore, they had established quite close contacts with the Norwegian economists who were developing new tools for economic management.

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13 Like Gunnar Myrdal and some other Stockholm School economists, Frisch was also of the oppinion that there was nothing essentially new in the General Theory.

Building on the work of Frisch and his students, the Norwegian administration was able to deliver the first National Budget as early as 1945, a rudimentary version of the full-blown yearly National Budgets which started in 1947. Gradually they were enlarged in scope to include even credit flows in a comprehensive survey of the economic outlook and economic policy.

In working out these first National Budgets, the Norwegian economists had to confront many new problems connected with national income accounting which Firsch's earlier work helped resolve and the Norwegian system of national accounts was soon highly developed by international standards. Later on, the Norwegians also became pioneers in developing new tools for economic planning. By the end of 1950's, Statistical Central Office had produced a quite disaggregated macroeconomic model called MODIS, which then went through several new versions. This model of the real side of the economy was complemented in 1966 by another model (PRIM), which incorporated costs and prices utilizing the famous Scandinavian model of inflation. In his doctoral dissertation Leif Johansen developed another model calles MSG (A Multisectoral Study of Economic Growth) for long-term forecasting. Norwegian economic policy-makers have made quite extensive use of all of these models.

Let us turn to the most safient features of Norwegian economic policy in comparison with Sweden and Finland, our two polar cases. As in Sweden, the Social Democrats played a key role in the breakthrough to economic policy activism which has been high by Western European standards. The contents of Norwegian intervention differ, in some respects from Sweden's. Norway has made greater use of direct intervention in production trough state-owned enterprises and the like, while the Swedes have relied on more indirect means like redistribution and wage policy. As noted above, this difference originates in the early views of Swedish and Norwegian Social Democrats and was amplified by the emphasis Norwegian economists gave to the direct planning of production in their work. It may also reflect the fact that, compared to Sweden, the manufacturing sectors of Norway and Finland (where intervention is also often direct) have been undiversified and hence likely to inspire state initiatives to promote investment and restructuring.[14]

That brings us to the intriguing comparison between Norway and Finland. I have already noted that the external sectors are highly unstable in both Norway and Finland and both have been subject to recurrent cyclical shocks emitted by the foreign sector. Yet the cyclical development of the Finnish economy in the post-war period has been very unstable while Norway has succeeded in being one of the most stable OECD economies, largely because domestic demand has dampened down the effects of changes in exports. Therefore, we must ask: what explains this difference?

Two possible explanations offer themselves. First, it may be that the foreign sectors of the Norwegian and Finnish economies are not as similar as we imagine so that the structure of each economy transmits foreign cyclical impulses in different ways. For instance, certain 'automatic stabilizers' seem to cushion the effecgs of foreign shocks on the Norwegian economy (c.f. Andersen & Åkerholm (1982), 614). Changes in Norwegian exports originate to a large extent from the shipping sector, and it has a rather small influence on the domestic economy because it is a capital-intensive branch that relies on foreign sources of credit. Similarly,

14 The fact that the contents of intervention are different in the Swedish and the Norwegian models is also reflected in differences in the public sector. The growth of the public sector has been rapid in both countries. In 1955, the share of taxes of GDP was 26 % in Sweden and 28 % in Norway against the OECD-average 24 %, while in 1980 the figures were 50 %, 47 % and 36 % respectively. Traditionally, however, public consumption has been much higher in Sweden than in Norway. In 1980, its share of GDP was 18.8 % in Norway against 28.9 % in Sweden. In Norway, on the other hand, transfers and subsidies have been much more important in Norway than in Sweden. In 1974-1976, the average share of GDP of transfers to producers was 6.3 % in Norway, 2.3 % in Sweden; since then, during the econmic crisis, this difference has been blurred by the fact that the growth of transfers and subsidies has been particularly rapid in Sweden.

fluctuations in exports of raw-materials and semi-manufactured goods are often cushioned by corresponding changes in inventories; and the import content of Norwegian exports is relatively high so that changes in exports are reflected in corresponding changes in imports. In general, the Norwegian economy (at least before the discovery of the North Sea oil) can be said to have an export enclave: the domestic sector is protected by various means from fluctuations in exports.

By contrast, the import content of the traditional export sector in Finland, i.e. forestry, is relatively low, and the cushioning role of inventories has been virtually absent. This has resulted in a close correlation between changes in exports and changes in domestic income. Moreover, as we have seen, the Finnish credit mechanism has been higly sensitive to changes in foreign reserves. Hence, any change in the level of exports has produced corresponding changes in domestic demand. These, in turn, have led to intensified fluctuations in imports so that the balance of payments typically begins to deteriorate rather badly following an export-led boom.

The second possible explanation is that economic policy has off-set the cyclical effects of the foreign sector in Norway in a Keynesian fashion while Finnish economic policy has not done so. This may be because the credit system seems to operate differently in the two countries. However, the evidence also suggests that the reactions of fiscal and monetary policy have been rather countercyclical in Norway, whereas they turned out to have been highly procyclical in the Finnish case. The above two explanations do not exclude one another. But we cannot fully evaluate their relative importance here.

To conclude this discussion of the Norwegian case I shall make some points concerning the relation between economic theory and the policy model.

It has often been pointed out that the Second World War was important for the breakthrough to Keynesian types of interventionism. When theoretical ideas that had been developed in the 1930's were applied to the management of the war econmoy, their usefulness was demonstrated, and the task of reconstruction that many countries faced after the war gave renewed impetus to Keynesians and planners. Hovewer, the Scandinavian countries we have examined might lead us to quality this view slightly. It seems that the war alone was not sufficient to change longstanding habits of thought. The Finnish economy and society were greatly changed by the war, yet the principles fiscal and monetary policy remained unchanged. Keynesian policies were more often pursued after the war in countries that had developed an indigenous strain of proto-Keynesian economic thought in the 1930's. In Norway, the task of reconstruction gave added impetus to such policies, while Sweden continued to purssue such policies despite a less-devastating war-time experience. The Second World War may have only accelerated underlying changes that were taking place independently of it.

We have noticed that the interaction between economic theory and the policy model in Finland has been virtually non-existent. On the other hand, Swedish economists had a powerful influence on the reorientation of the economic policy in the 1930's, even if their positive influence has gradually deteriorated since then, as a majority of the Swedish economists known for their scientific work have become highly ciritical of the Swedish model. By comparison, it is in Norway that economic theory has been most influential and closely linked to the policy model. One may refer to the sequence of models that Norwegian economists have built for policy purposes and like Sweden, Norway has an extensive system of governmental committees working which utilize the expert knowledge of economists. Compared with their Swedish colleagues, hovewer, the Norwegian economists have preserved a positive attitude toward the domestic policy model to the present day. If anything, the Norwegian economists have occasionally been dissatisfied with the seemingly half-hearted way in which the policy model has been implemented. In their view, the decision-makers can be distracted by spurious 'political necessities' from making full use of the powerful means the policy model offers. Indeed, Norwegian economists have consistently defended the autonomy of specialists in economic policy making.[15]

In summary, the discussion of the Norwegian policy model in comparison to the Swedish and Finnish models points to the importance of the following three factors to the reception of Keynesianism:

(i) The structure of foreign trade, particularly as reflected in the synchronization of changes in exports and imports and the consequent balance of payments constraint seems to have had some impact on the degree to which a national policy model was open to Keynesian ideas and a considerable effect on its ability to implement Keynesian policies successfully.

(ii) Innovative domestic economists who were discovering Keynesian-type ideas on their own and capable of communicating their new ideas to decision-makers.

(iii) The political strength and ideological stance of the Social Democratic Party. A strong Labour Party with a settled reformist stance was favourable to the diffusion of Keynesianism, as was the readiness of economists to cooperate with the labour movement.

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[15] Ragnar Frisch, for instance, became in 1950's critical of the cautious attitude decision makers had to economic policy. Indeed it has been said that in the conditions of post-war reconstruction it was the Norwegian Labour Party which put itself to economists' service, not the other way round (Berg&Hanisch (1984), 127). When it later appeared that decision makers were not willing to go as far in intervention as especially Frisch wanted, frustration was a natural outcome. Later on economists in Norway seem to have been worried by the threat the 'bargaining economy' with its pressure groups means for the autonomy of authorities. In a way this is reflected in Leif Johansen's work on game theory. As a further example, one may refer to the long struggle many of the Norwegian economists, Ragnar Frisch and Leif Johansen among them, have led against the process of economic integration. They have maintained that integration is highly detrimental to the autonomy of domestic economic policy.

In general the Norwegian model corroborates the importance of background factors which already appeared salient in the Swedish case. In particular, it is precisely these factors which differentiate Norway from Finland, two countries which otherwise seem to have a quite similar economic and social structure.

7. THE DANISH MODEL

Denmark's industrialization has been slow but it began earlier than the other Scandinavian countries. As strong commercial farmers prospered, Danish industrialization took place without major proletariazation (Esping-Andersen (1985), ch. 2). Agriculture was export-oriented from a very early stage and it provided the backbone of Danish exports throughout the period from the first half ot the 19th century until the mid-1950's. Between 1955 and 1965, output and investment in manufacturing industry grew rapidly, while agriculture declined. However, this growth was very capital-intensive so that employment in industry and manufacturing increased at a considerably slower pace. Industrial development since this period has been heavily export-oriented, matching the decline in agricultural exports so that the share of exports in GDP has remained around 30 % throughout the post-war period. In contrast to the other countries, then Denmark's exports have leaned heavily towards foodstuffs and the products of small or medium-sized, highly specialized firms so that the income elasticity of export demand has been lower than in Finland or Sweden. This has provided a partial shelter from international fluctuations (Åkerholm - Andersen, 1982). However, Denmark has still suffered from terms of trade changes and current account disturbances since it has traditionally been totally dependent on imports for many price-sensitive raw materials and the elasticity of imports with respect to domestic demand has been rather high.

Political mobilization in Denmark has been marked by perennial conflict between strong liberal-bourgeois forces and the Social Democratic Party. In Sweden and Norway, the Social Democrats were able to build a large wage-earners' coalition, but the Danish Social Democrats' attempts to implement their ideas have offen been thwarted by the bourgeois parties. Thus Danish politics displays a kind of Liberal hegemony, in which the farmers and industrialists have been able to form an effective counterblock to Social Democratic aspirations.

Although the Social Democrats were interested in more comprehensive economic planning and industrial democracy even before the German occupation, their political weakness compelled them, at an early stage, to adopt a rather pragmatic attitude toward day-to-day economic management. The Danish trade union movement has also been organized in a way that has made it more difficult to build a united alliance representing wage-earners' interest. Although the rate of unionization has been high, many Danish unions have been organized on a professional basis that perpetuates a marked distinction between skilled and unskilled workers. Hence, real wages have often been more rigid downwards than employment, and the Social Democrats have been confronted with a left-wing opposition both at the political level and among the trade union movement.

The state of economic science in Denmark was originally not very different from that in Sweden and Norway. Although many Danish economists seemed to think that little in Keynes' writing was genuinely new compared to the ideas of the Stockholm School, these ideas gained widespread attention in the Danish press during the thirties, and the new line of thought became a major influence on Danish economists. There were even some interesting Danish contributions to Keynesian theory - mostly associated with the name Jörgen Pedersen.

At the political level, Keynesian ideas were received most favourably by the Social Democrats, who adopted Keynesian principles even before the occupation and reexpressed them in their influential 1945 program 'Fremtidens Danmark' (Denmark in the Future). According to Grnbaum (1983), the thinking of many influential policymakers was solidly Keynesian during the 1950's and the 1960's. The overall political attitude to Keynesianism in Denmark hovewer, has not been free of reservations. While the major liberal party, the Venstre, also adopted Keynesianism in principle after the war, at the same time it also endorsed some older lines of policy stressing the need to balance the budget and ensure firms' competitiveness. As in Finland, officials often emphasized various economic constraints on activist fiscal policies (see Topp, 1983). Compared to the Swedish Social Democrats, even the Danish Social Democrats' attitude towards activist fiscal policy was a little half-hearted. For instance, they did not conceive of active fiscal policy as the first stage in a grander strategy to change the balance of forces in society to the advantage of wage-earners; and the legacy of the 1920's and 1930's, when Social Democrats 'hovered between a Marxian underconsumptionist analysis and an odd loyalty to orthodox liberal principles of balanced budgets' (Esping-Andersen (1984), 192), was not completely without influence during the post-war period either. This is very smilar the Finnish case.

Turning to the actual course of economic policy, we find that policy during the Great Depression was predominantly conservative and orthodox. Although Keynesian ideas of activist fiscal policy were acknowledged, the crisis was - rightly, to some extent - seen as an export downswing which would be cured by wage-price adjustments. The main elements of the 1933 crisis package were a devaluation and a wage freeze.

Since the war-time occupation, there have been periodic attempts to utilize countercyclical policies, but balance of payments constraints and fear of inflation have been major obstacles to the successful pursuit of such a strategy. Thus, especially during the 1950's, the outcome was rather a series of stop-and-go-measures. Expansionist policies were attempted in 1949, 1954-55 and 1957-60, but they were usually reversed, as the external constraint and the fear of inflation became binding obstacles. Given the nature of the labour market organization, wage restraint has not been easy to implement, and governments have often had to intervent there. Troughout the 1950's, the opposition between the Social Democrats the Venstre continued to provide the basic political setting for policy compromises. Although employment was made a goal of policy and Keynesian ideas were accepted in principle, there was no dramatic change in actual policies. Denmark's dependence on agricultural exports was almost complete during the fifties, and farmers' organizations blocked more active Keynesian full employment plans. Public expenditure growth was usually not permitted to exceed GDP growth and Danish Keynesianism did not loose its 'Myrdalian' overtones with the result that the principle of balanced budgets was not abandoned even if it was not implemented on as strict a basis as in the 1930's.

On the monetary side the discount rate was lowered several times to boost construction, but this policy also ran into balance of payments-problems. As Thygesen (1983) observes, prior to 1957-58 the task of defending the country's international reserves was dominant; and this policy objective was even explicitly incorporated intoa written agreement between the government and the central bank, which allowed any external deficit or surplus to be reflected fully in the monetary base. Thus, on the whole, austerity policies prevailed and unemployment was often high.

Basically the same tensions determined the course of economic policy in the 1960's, although there was some expansion during 1957-62, due to a strengthening of the Social Democrats' position and the weakening of the farmers' political base. This rapid expansion induced a wage-price spiral, and a deterioration in the balance of payments, which again led to a more restrictive policy stance. More liberal monetary policies were attempted, but for external reasons again interest rates remained high most of the time. Thus, like Finland but in contrast to Sweden and Norway, the Danish economy has been cyclically rather volatile. It has suffered from a chronic balance-of-payments deficit and the external constraint has been the major obstacle to stabilization policy.

To conclude, the Danish model can be located rather nearer to the Finnish model than to the Swedish one. One may call attention to the following background factors as possible explanations for this:

(i) As far as economic structure is concerned, it seems that the Danish case underlines the importance of the elasticities of foreign trade. These determine how the trade balance reacts to foreign shocks and to domestic demand changes. Unsynchronized changes in exports and imports make the balance of payments constraint more severe and attempts at Keynesian policy therefore tend to degenerate into a series of stop and go measures. It seems that Denmark is among the Scandinavian countries the clearest example of a case where the idea of stabilization through management of domestic demand was in principle widely accepted, especially among the Social Democrats, but the success of policies was frequently frustrated by the external constraint. In Finland, there has been more principal opposition towards Keynesian ideas. But this difference between Denmark and Finland is a matter of degree as the balance of payments constraint has played a crucial role also in Finland.

(ii) Both in Finland and Denmark, Social Democrats have had only limited success in working out and implementing a coherent strategy. They have frequently found themselves in outright opposition or as minority partners in governmental coalitions dominated by bourgeous parties. Their trade union movements have also been rather-weak by Scandinavian standards. But again there is the difference that in Denmark the Social Democrats have accepted the Keynesian ideas in principle but they have been to weak or inhibited by the extgernal constraint to implement them in practice, whereas the Finnish Social Democrats have shied with Keynesianism even in principle.

(iii) The Danish agricultural sector (and the main export sector until the 1950's) is comparable to forestry in Finland. It formed a strong political pressure group whose interests have been closely associated with the cost competitiveness of exports. It seems that in both Finland and Denmark the farmers' interest groups have often allied with the main export industry to oppose Keynesian measures. This has preserved principal objection to Keynesianism in both countries. Thus Denmark after all to some extent shares with

Finland the dissociation from Keynesianism also at the level of principles.

(iv) Finally, Denmark forms an intermediate case as for as the role fo economics profession in the diffusion of Keynesianism is concerned. Danish economists accepted Keynesianism rather early and they propagated it more eagerly than economics profession in Finland, but, on the other hand, they did not provide an indigenous school as in Oslo or Stockholm of a sort that could exercise special influence over policy-makers.

8. CONCLUSIONS

In this examination of Keynesianism in the Nordic countries, I have attempted to develop a framework which can be used to study the interaction between economic theory and economic policy. I have argued that, while economic theory is quite universal and has become increasingly so in the course of time, actual economic policy-makers still conceive of the targets, constraints and instruments of economic policy in different ways in different countries. I used the term 'policy model' to refer to the specific ways in which the economic policy agenda is conceived in each country. Thus our task was to analyze the role of various intervening factors in the transmission of Keynesian ideas to the policy models of different Nordic countries.

My choice of factors on which to concentrate was based partly on the previous literature, which offers a rich menu of factors to explain the differences in the economic strategies of different countries. But I have also given more consideration than is usual to the specific economic-structural conditions of the Nordic countries, in particular, the structure of foreign trade in these countries and the degree of diversification in their production structure. I argued that these factors formed specific Nordic conditions Keynesianism had to overcome.

It has turned out that, seen in a comparative perspective, the Nordic countries display an interesting variety of experiences whose analysis may contribute to our understanding of the diffusion of economic ideas more generally. First, the reception given to Keynesianism clearly varied from one Nordic country to another. At one extreme, Keynesian ideas were widely accepted in Sweden even before the Second World War and were later developed there into a more comprehensive economic strategy attacking problems of supply and inflation as well as those of aggregate demand stabilization. At the other extreme there is Finland, which has consistently resisted Keynesian ideas right up to the present time. This negative case, which is often neglected in the Nordic context, has been very helpful for analyzing the factors that affect the diffusion of Keynesian ideas. Finally, the Nordic countries include two intermediatae cases. Norway comes rather near to the Swedish case, while Denmark has displayed a much more hesitant adherence to Keynesianism and thus bears some resemblance to Finland.

Table 1 Keynesianism and the Nordic Economies: An Overview

Independent Variables of Potential Importance	Adherence to Keynesianism (incr. to the right)			
	Finland	Denmark	Norway	Sweden
Economic structure				
- early industrialization (in Nordic comparisons)	--	+	-	++
- diversified export sector	--	+	-	+
- steady external equalibrium	--	-	+	+
Power structure				
- strong and unified left and trade unions	--	-	+	++
- "cow deal" (workers-farmers coalition) in the inter-war period	+	+	+	+
Institutional features of the states				
- strong (one party) government	--	-	+	++
- dependent central bank	--	-	+	+
- bureaucracy under political control	-	+	+	+
Economics profession				
- strong domestic tradition of economics, especially	-	+	+	+
- domestic origins of Keynesian ideas	-	+	++	++

How are these differences to be explained? It turns out that, despite strong similarities in the broad outlines of policy and economic development, there are some interesting differences between these nations that may have a bearing on the reception of Keynesianism. My argument is summarized, in a highly simplified form, in Table 1. Horizontally, it ranks the Nordic countries in relation to their adherence to Keynesian economic policies. Vertically, various characteristics which may constitute possible explanations for these differences are arrayed. Positive and negative signs suggest, with due allowance for the simplied nature of this presentation, the degree to which these characteristics are, or are not, to be found in different Nordic countries.

The investigations made in the paper have indicated that the "independnent variables" of Table 1 may in fact interact with one another in each country. Furthermore, they need be exogenous in the sense that they are totally independent of the actual economic policies followed. It can also be maintained that some of the factors are necessary for any consistent policy strategy to be followed without necessarily implying that it should be Keynesian in its contents. With these reservatons, the following comments on Table 1 are in order:

1. I have stressed the role of the trade balance which has been subject to violent changes in Finland and Denmark where attempts at Keynesian policies have degenerated into a kind of stop-and-go cycle. In Sweden and Norway, a healthy external balance over long periods of time has left room for stabilizationary measures. Notwithstanding the fact that it remains open to what extent the balance itself is a result of determined stabilization, it seems that the chronic tendency to trade deficit is a major single explanation for the fact that Denmark has not succeeded in the application of Keynesian measures which she in fact often has attempted at.

Unstable external balance has played an important inhibitive role in Finland as well. But besides this, the rejection of Keynesianism has been more fundamental there. I have suggested as an economic-structural explanation for this the fact that in the post-war period the Finnish economy has found herself under the process of industrialization and rapid structural change. Shortage of saving has been the main motivation behind economic policies in Finland. The cyclical volatility of the economy may in fact have served a function in the sense that it has helped to make room for profits, saving and investment. There may have existed a trade-off between instability and growth. But the Norwegian case on the other hand clearly demonstrates that high levels of investment and rapid structural change can be attained without casting away Keynesian ideas. Some further explanations have to be found.

2. The Nordic comparisons clearly indicate that the strength and unity of the political left have been important to the adoption of Keynesian economic policy. The relevance of this factor seems striking when one contrasts Sweden with Finland. On the other hand it does not appear that the formation of an alliance between the Agricultural Party and the Social Democrats in a coalition cabinet during the 1930's was, by itself, the most crucial factor paving the way for Keynesianism. Farmer-worker alliances were agreed upon in all Nordic countries during the inter-war period, yet some of them firmly resisted Keynesianism. Indeed the Finnish and Danish cases suggest that the nature of the agrricultural sector itself may be important. Where the farmers' interests closely coincide with the main export industry, as in the cases of forestry in Finland or foodstuffs in Denmark, agricultural interest groups may remain hostile to Keynesian ideas, which also conflict in many ways with traditional rural ideology.

3. Comparing Finland on the one hand and Sweden and Norway on the other, we see that Keynesian ideas were received more readily in the latter countries where the official bureaucracy, including the central bank, were structured so as to be generally responsive to political initiatives and outside advice. In the implementation of economic policy, Sweden and Norway exemplify governments with small and open-minded bureaucracies, powerful legislatures with detailed

committees and much use of commissions and outside testimony. In these countries, the initiative over the adoptation of Keynesianism was placed at the political level, where it was open to outside pressures. In Finland, on the other hand, the maintanance of a non-Keynesian model seems related to the existence of a strong and independent central bureaucracy (and central bank) in relation to which governments have normally been weak. The implementation of economic policy was kept in the hands of closed bureaucracy averting Keynesian ideas. The role of these institutional differences forms an interesting subject for further study. Let it only be noted that it is not the general administrative creativity and efficiency of the bureaucracy which is at stake here, but rather its sensivity to Keynesian-type approaches in a specific historical context. Thus the attitudes of the bureaucracy may in turn reflect some deeper structural features of the society.

4. On the basis of this Nordic comparison, we cannot escape the conclusion that the quality of the domestic economics profession and its attitude to Keynesianism have been important to the passage of Keynesian ideas into economic policy. Sweden and Norway are countries in which domestic economists developed their own version of Keynesian ideas in the 1930's and were eager to persuade political parties to adopt them. Finland on the other hand exemplies the case of peripheral economics profession which passively accepted Keynesian ideas from abroad and was unable to communicate them to politicians. Hence, the gap between the policy model and academic economics persisted for an unusally long time.

The Finnish case indicates that a national policy model often stubbornly resists change. It can survive relatively intact over great economic, political and cultural upheavals. But, sooner or later, fundamental changes in the economic, social and cultural factors behind the policy models begin to alter it. I have argued that economic theory is most likely to influence the policy model when the latter finds itself in crisis, that is to say when its results are generally regarded as unsatisfactory and the economics profession has a promising new approach to offer. Such a crisis can ripen as a result of a growing dissonance between the policy model and its environment or when some dramatic change in the latter suddenly overwhelms the model. It has often been suggested that the Second World War and its aftermath provided the dramatic change which legitimated Keynesian policies. But our Nordic comparisons qualify this theme. Norway seems to conform such an interpretation. However, Sweden and Finland deviate from it. In the former case, the reorientation of economic policy was largely accomplished before the War which did not generally initiate such a sharp social and economic reordering in Sweden as in many other countries. In Finland, on the other hand, the War changed the economic and political constellations abruptly, yet the policy model remained largely unchanged.

To conclude, it seems that the economic, political, institutional and cultural factors we have singled out, may account relatively well for differences in the Nordic countries' response to Keynesianism. However, this is a preliminary analysis. It does not exclude the possibility that some other factors may be relevant as well, nor does it imply that exactly the same factors have been central in other countries. We have made considerable progress, but in this area of comparative research, much work remains to be done.

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