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The Welfare State in the Global Economy:
The Politics of Social Insurance Retrenchment in Sweden 1990-1998

by

Karen M. Anderson

A dissertation submitted in partial fulfillment
of the requirements for the degree of

Doctor of Philosophy

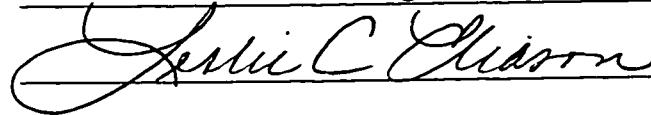
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Abstract

The Welfare State in the Global Economy:
The Politics of Social Insurance Retrenchment in Sweden 1990-1998

by Karen M. Anderson

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This dissertation analyzes the relative success of retrenchment in four cases of social insurance in Sweden: old age pensions, unemployment insurance, work injury insurance, and sickness cash benefits. Retrenchment was most successful in the sickness and work injury cash benefit system and least successful in the unemployment insurance system. Pensions represent a case of moderately successful retrenchment.

In order to explain this pattern of outcomes, I argue that internationalization--the enhanced mobility of both productive and financial capital--influences the policy preferences of domestic political actors. The stronger the link between the financing and operational features of an individual program and the conditions affecting production, the greater the likelihood of retrenchment.

The mobility of financial capital influences the capacity of governments to generate revenues needed to fund social welfare programs. Integrated bond markets tend to punish governments which follow policies resulting in high inflation and large budget deficits. Retrenchment is more likely when program structures permit political actors to identify the extent to which specific welfare programs contribute to budget deficits.

European integration subjects national social insurance schemes to reform pressures arising from the mobility of both capital and labor within the EU. Capital mobility may create limits on the level of taxation needed to finance benefits. The level of program vulnerability to beneficiary mobility depends on the extent to which benefits must be earned by labor force participation or whether benefits are available to all residents.

The effects of internationalization and Europeanization on welfare state politics are mediated by domestic political factors. The structure of individual programs creates different patterns of interest group organization and channels retrenchment strategies in particular ways. The relative strength and policy priorities of social democratic parties shape the extent to which different welfare constituencies bear the burden of budget cutbacks and efforts to enhance competitiveness. In sum, retrenchment is most likely when a policy sector is linked to concerns about competitiveness, when its contribution to budget deficits is clear, and when the labor movement supports reform. All three of these variables are the result of the feedback effects of existing welfare state programs.

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LIST OF ABBREVIATIONS

ATP	Allmänna Tillägspension (Supplementary Pension)
LO	Landsorganisationen i Sverige (Swedish Trade Union Confederation)
SACO	Sveriges Akademikers Centralorganisation (Confederation of Professional Associations)
SAF	Svenska Arbetsgivareföreningen (Swedish Employers' Confederation)
SAP	Sveriges Socialdemokratiska Arbetareparti (Swedish Social Democratic Party)
TCO	Tjänstemännens Centralorganisation (Central Organization of Salaried Employees)

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CHAPTER 1: INTRODUCTION

Two debates dominate current research about the political and economic viability of the welfare state. The first debate emphasizes the relative political durability of the welfare state during the recent era of conservative ascendance and economic austerity. The second debate goes beyond a purely domestic account of welfare state politics by investigating the ways in which the twin processes of international capital mobility and Europeanization influence the capacity and willingness of governments to maintain and/or expand welfare state commitments. Whereas the first debate highlights the *difficulty* of carrying out retrenchment policies, the second debate emphasizes the apparent *necessity* of cutbacks under certain conditions.

This dissertation explores these theoretical issues through a detailed analysis of the recent restructuring of a core area of the Swedish welfare state, the social insurance system. The Swedish case is an especially good test of arguments about the relative importance of domestic and international factors in explaining welfare state restructuring because of the openness of the economy and the strength of interest groups with a stake in welfare state policies, especially organized labor. Sweden also occupies a prominent place in studies of welfare state development because it is commonly considered to be an exceptional case. No matter which criteria are employed, Swedish social insurance policies consistently rank at or near the top in nearly all comparative studies of the welfare state because of the emphasis on universal benefits, relatively high replacement rates, and

the overwhelming dominance of public programs.¹ Esping-Andersen aptly terms this arrangement “the social citizenship state.”²

Between 1990 and 1998, however, both Social Democratic and bourgeois³ governments have carried out significant reforms of the social insurance sector, including cuts in replacement rates, the introduction of waiting days, a shift from employer to employee financing, tightened eligibility rules, and partial privatization. These changes are designed to increase the role of market principles in the operation and financing of the social insurance system, and they have resulted in the imposition of significant losses on current and future social insurance beneficiaries. However, the issue is not the imminent dismantling of the welfare state in Sweden, or even a shift from universal to residual social policies, but rather, the changes adopted since 1990 represent a weakening of what Esping-Andersen calls the “social democratic welfare state regime.”⁴

¹See, for example, John D. Stephens, *The Transition from Capitalism to Socialism* (Urbana: University of Illinois Press, 1979); Gosta Esping-Andersen, *Politics Against Markets. The Social Democratic Road to Power* (Princeton: Princeton University Press, 1985); Gosta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton: Princeton University Press, 1990); and Ramesh Mishra, *The Welfare State in Capitalist Society. Policies of Retrenchment and Maintenance in Europe, North America and Australia* (Toronto: University of Toronto Press, 1990).

²According to Esping-Andersen, the extension of social rights via the welfare state is “a means by which social democracy can surmount obstacles to its own formation” and thereby enhance its power resources and capacity for mobilization. Esping-Andersen, *Politics Against Markets*, chapter five and p. 34.

³According to the Swedish practice, political parties are divided into the bourgeois and socialist blocs. The Left Party (Vänsterpartiet) and the Social Democrats (Socialdemokratiska Arbetarepartiet, SAP) form the socialist bloc, while the Center Party (Centerpartiet, formerly the Agrarian Party), the Liberal Party (Folkpartiet), the Christian Democratic Party (Kristdemokratiska Partiet), and the Conservative Party (Moderata Samlingspartiet) form the bourgeois bloc. The Green Party (Miljöpartiet) was voted into the Riksdag in 1988-1991 and 1994-present, but does not really belong to either bloc. The right wing populist New Democracy Party (Ny Demokrati) was voted into the Riksdag only in the period 1991-1994 and is generally considered a bourgeois party although the party did not serve in the coalition government from 1991-1994.

⁴Esping-Andersen, *The Three Worlds*. Esping-Andersen finds that welfare states cluster into three distinct regimes. The social democratic welfare state regime is characterized by universal benefits and services which provide a high degree of “de-commodification” (independence from the market) for wage-earners. The other two types of welfare state regimes are the liberal regime, characterized by means-testing and the prevalence of

This study investigates the relative success of retrenchment in three cases of social insurance between 1990 and 1998: old age pensions, unemployment insurance, and sickness and work injury insurance. In 1990, these four policy areas accounted for 19.7% of GDP and 55.3% of total government spending.⁵ Retrenchment was most successful in the work injury/sickness cash benefit system and least successful in the unemployment insurance system. Pensions represent a case of moderately successful retrenchment. To explain these outcomes, I advance an argument that draws on two related, but usually separate sets of theoretical literature. First, I show how international economic change affects the preferences of domestic actors concerning welfare state programs. Thus, the dissertation incorporates a "second-image reversed" approach in explaining the pressure for reform and retrenchment in Sweden. Second, I explain the Swedish case with reference to literature focussing on how political institutions and policy legacies mediate the impact of international economic forces. The puzzle that motivates this research is: What accounts for the shift in Social Democratic strategy about the welfare state? In other words, why would a Social Democratic government carry out or cooperate in the adoption of policies inimical to its interests under other circumstances and which appear to threaten its electoral power base in the long run? Once the retrenchment process is set in motion, how do we account for differences in the timing and success of particular retrenchment initiatives?

The arguments advanced in this study challenge two influential explanations of

market mechanisms in the provision of welfare, and the corporatist regime, characterized by the preservation of status and employment based differences in the provision of welfare.

⁵Percentages are calculated from *Statistisk årsbok för Sverige 1994* (Stockholm: SCB, 1995).

welfare state development: the power resources thesis and the policy feedback model. I will examine each in turn. Based on the assumptions of the balance of class power explanation of welfare state development advanced by Korpi, Esping-Andersen, and Stephens, Sweden is a least likely case for welfare state retrenchment.⁶ According to the labor power resources theorists, differences in the balance of class power largely explain variations in welfare state development among the advanced capitalist states. That Sweden possesses a generous and comprehensive social insurance systems is explained by the political influence of the labor movement in Swedish politics. By all indications, however, the Swedish labor movement is still very powerful, yet the process of social insurance retrenchment is well under way. What is more, the labor movement has not always mobilized against welfare state cutbacks and sometimes has even facilitated the process. Implicit in the labor power resources approach is the assumption that the steady expansion of the welfare state is a good unto itself and that retrenchment is not in labor's interest. Thus, the power resources approach fails to consider the conditions under which a social democratic government and a strong union movement may advocate, or grudgingly accept, welfare state retrenchment in order to improve state finances and promote "flexible adjustment" to world markets.⁷

A second weakness of the balance of class power approach is that it fails to disaggregate class actors, especially the labor movement. For example, Pontusson argues

⁶Esping-Andersen, *Politics Against Markets*; Walter Korpi, *The Working Class in Welfare Capitalism. Work, Unions, and Politics in Sweden* (London: Routledge & Kegan Paul, 1978); and Stephens, *The Transition*.

⁷Peter Katzenstein, *Small States in World Markets. Industrial Policy in Europe* (Ithaca: Cornell University Press, 1985).

in a recent study that internal divisions within the Swedish labor movement hampered labor's efforts to implement reforms designed to democratize investment in the 1970s and 1980s.⁸ This criticism of the balance of class power approach suggests that even when labor parties accept the necessity of retrenchment policies, this is likely to spark intense disagreements between the party and unions, within the party, and among the unions themselves. As a result, it will be very difficult even for strong labor movements to agree on and implement specific retrenchment policies. Because retrenchment involves the imposition of losses on large groups of beneficiaries, the emergence of internal divisions within labor movements is likely to be that much more acute. This study addresses this weakness in the power resources literature by demonstrating that the internal divisions within the labor movement have an important effect on the political viability of specific retrenchment initiatives.

A final weakness of the balance of class power approach is that it places insufficient weight on the power of capital. The balance of class power approach depicts Swedish capital as having been tamed by the superior power resources of the labor movement. Swedish capital's acquiescence to the adoption of social democratic social and economic policies is explained by its inferior position vis à vis labor in domestic politics. Thus, the role of capital in Sweden and elsewhere has been under-theorized. Recent studies by Pontusson, Swenson, and Kurzer, however, demonstrate the influence

⁸Jonas Pontusson, *The Limits of Social Democracy. Investment Politics in Sweden* (Ithaca: Cornell University Press, 1992).

of capital in the political economies of the advanced industrial states, including Sweden.⁹ However, there is relatively little research concerning the role of organized capital in welfare state development, especially retrenchment politics. One of the goals of this study is to demonstrate the conditions under which organized capital influences retrenchment processes.

Recent research challenges the balance of class power approach based on a separate set of criticisms. In the foremost articulation of this position, Pierson argues that variations in labor power cannot account for retrenchment outcomes in the United States and Great Britain in the 1980s.¹⁰ If anything, retrenchment should have been much more successful in both cases because of the weakness of labor movements in both countries. Pierson asserts that because retrenchment is not simply the "mirror image" of expansion, the dominant approaches for explaining welfare state development, including the balance of class power approach, will be of little use in the current period. Policy feedback from existing programs, rather than the influence of political parties, social movements, and labor organizations, is the crucial variable in Pierson's analysis of the politics of retrenchment. The expansion of the welfare state has led to the emergence of organized and influential interest groups that derive direct benefits from social programs whose costs are spread across a wide population. When threatened with retrenchment, these groups can organize effective campaigns against benefit cuts. Moreover, groups threatened with

⁹Pontusson, *The Limits of Social Democracy*, Peter Swenson, "Bringing Capital Back In, or Social Democracy Reconsidered: Employer Power, Cross-Class Alliances and Centralization of Industrial Relations in Denmark and Sweden," *World Politics* 43:4 (1991); and Paulette Kurzer, *Business and Banking. Political Change and Economic Integration in Western Europe* (Ithaca: Cornell University Press, 1993).

¹⁰Paul Pierson, *Dismantling the Welfare State? Reagan, Thatcher, and the Politics of Retrenchment* (Cambridge: Cambridge University Press, 1994).

benefit cuts take more political risks in defending their benefits than those who might gain from retrenchment. Thus, governments hoping for reelection face almost insurmountable obstacles in their retrenchment attempts. In this new political landscape transformed by the growth of the welfare state itself, retrenchment is possible only when governments can hide their actions from potential opponents, compensate groups negatively affected by cuts, or divide supporters of social welfare programs.

Pierson's policy feedback model provides a compelling explanation of the difficulty of implementing retrenchment policies in developed welfare states. However, the generalizability of Pierson's argument rests on two implicit assumptions about the relationship between interest group politics and the welfare state. First, Pierson implies that all systems of interest intermediation are broadly similar to the two cases he considers, the USA and Great Britain. As the corporatism literature suggests, however, interest group politics varies widely among the advanced capitalist states.¹¹ Both the US and Britain are dominated by segmented interest groups which largely represent the narrow interests of their members. However, other welfare states might be classified as having a more solidaristic system of interest intermediation in which peak level union organizations are the principal defenders of the interests of welfare state beneficiaries. Under these conditions, the labor movement is likely to play an important role in retrenchment politics. Second, Pierson's analysis implies that pro-welfare interest groups usually emerge separately and autonomously from trade unions. As welfare states mature, these pro-

¹¹See, for example, Philippe Schmitter and Gerhard Lehmbruch, *Patterns of Corporatist Policy-making* (Beverly Hills: Sage, 1982); and John T.S. Keeler, *The Politics of Neo-Corporatism in France. Farmers, the State, and Agricultural Policy-making in the Fifth Republic* (New York: Oxford University Press, 1987).

welfare interest groups supersede labor unions in importance in terms of defending the interests of beneficiaries and mobilizing opposition to retrenchment attempts. As the preceding criticism indicates, however, this is not always the case. Where strong labor movements have influenced the development of social policy such that the emergence and/or influence of more narrowly organized interest groups is limited, the unions are likely to remain the primary defenders of existing social policy arrangements. Moreover, when labor unions are hierarchical, encompassing, and closely linked to powerful political parties, they may be willing to agree to retrenchment under certain conditions. Thus, like the power resources theorists, Pierson does not consider cases in which ordinarily pro-welfare interest groups tacitly accept retrenchment policies.

Pierson's conclusion about the limited role of organized labor is largely the result of case selection. Neither the US nor the UK is a corporatist state, and in neither country has the labor movement dominated the process of welfare state expansion as in Sweden. Moreover, the US and the UK are not small states in world markets, to borrow Katzenstein's phrase.¹² Sweden is a small open economy subject to international economic forces beyond its control, and this fact is crucial for understanding the recent pressure on Swedish welfare state policies and the shift in SAP goals and strategy. I return to this point below.

Pierson argues convincingly that successful retrenchment depends on the ability of politicians to limit the influence of interest groups opposing retrenchment. However, Pierson focuses mainly on the groups representing social policy beneficiaries which can be

¹²Katzenstein, *Small States in World Markets*.

expected to try to block retrenchment. The arguments presented in this study differ from Pierson's by examining not only the preferences of groups which *benefit* from social policies, but also those of groups which *finance* and *administer* welfare state programs.¹³ This study argues that the interest groups representing those who finance social welfare benefits must also be brought into the analysis of retrenchment politics because these groups might actively seek retrenchment, and their influence may exceed that of groups representing beneficiaries. For example, where business is highly organized and dominated by multinational corporations, it may push for retrenchment. In Sweden, employers have traditionally financed the social insurance system through payroll taxes invisible to the employee, and since the 1970s they have pushed for reductions in these charges, arguing that high labor costs hinder competitiveness. Pierson's analysis largely ignores the role of organized business in retrenchment politics.

Similarly, Pierson underplays the question of who administers social welfare programs by merging this issue with that of who benefits. For example, public health care providers would be expected to oppose the privatization of a national health service, as was the case in Great Britain in the 1980s. However, the issue of provision must be distinguished from that of administration. In the former case, the interests of providers are based on their role as employees. Thus, the interest groups representing welfare service providers would be expected to promote the interests of their members as wage-earners. There are other types of administrative arrangements which result in a different set of

¹³Pierson focuses on the role of financing structures in influencing retrenchment agenda-setting, especially the impact of trust-fund financing on program vulnerability. However, Pierson does not explicitly address the issue of *who* finances specific programs. This issue is addressed in chapter three.

political dynamics such as when the administration of a social welfare program by an interest group allows for the provision of selective incentives to members. As Mancur Olson has shown, interest groups rely on the provision of selective incentives to members to increase their membership and thereby their organizational resources.¹⁴ Because of this, the question of who administers may be just as politically important as who benefits. For example, the unions administer the unemployment insurance system in several West European welfare states, including Sweden, and this arrangement provides powerful incentives for wage-earners to become union members. For governments intent on curbing union power, the de-corporatization of such administrative arrangements may be a high priority even though the issue of benefits is not directly at stake. Similarly, we would expect labor parties to jealously guard existing administrative arrangements which enhance the organizational resources of unions.

Pierson also demonstrates the importance of political institutions in the politics of retrenchment. Whether politics are organized in a federal or parliamentary system, for example, influences the viability of different strategies for defusing opposition to retrenchment. The arguments advanced in this study differ from Pierson's by examining the importance of three additional institutional factors: the organization of the party system, the rules of electoral competition, and the system of interest intermediation. These three types of institutions not only provide "the rules of the game" for political struggles, but they can contribute to the relative political power of important societal actors like the labor movement. The organization of the party system structures the way

¹⁴Mancur Olson, *The Logic of Collective Action* (Cambridge: Harvard University Press, 1965).

that cross-party coalitions can be mobilized in favor of retrenchment. Whether the right or left-wing bloc of parties is split into several parties or whether it is dominated by one large party matters in the politics of retrenchment. Electoral rules are important because they influence the number of parties in the legislature and whether governments are likely to be minority, majority, and/or coalitions. Interest group influence on retrenchment outcomes depends on whether interest groups represent narrow or broad interests, whether they are linked to political parties, and how they are incorporated into the policymaking process.

The arguments presented in this study build on the insights of both the balance of class power approach and the policy feedback model. In particular, the study emphasizes the importance of the labor movement in the retrenchment process, but differs from the power resource theorists by identifying the conditions under which labor parties and unions are likely to support social policy retrenchment, by disaggregating the labor movement as a societal actor, and by highlighting the increased influence of organized capital. Following Pierson, this study points to the difficulty of implementing retrenchment politics and emphasizes the powerful feedback effects of previous policy choices as well as the ways in which domestic institutions structure the politics of austerity. However, this study departs from Pierson's policy feedback model by demonstrating the importance of the labor movement in retrenchment politics and by showing the influence of additional formal institutions and aspects of program design neglected in Pierson's analysis. Finally, in contrast to both the balance of class power theorists and the policy feedback model, the arguments advanced here examine the impact of changing external conditions on the political and economic viability of existing welfare

state policies.

The Argument in Brief

I argue that internationalization--the enhanced mobility of both productive and financial capital--influences domestic social policy choices both directly and indirectly. In terms of indirect effects, the mobility of productive capital increases the political importance of export competitiveness. The stronger the link between the financing and operational features of an individual program and the conditions affecting production, the greater the likelihood of retrenchment. Thus, the increased mobility of productive capital influences how politicians perceive their preferences in particular policy sectors. In terms of direct effects, the enhanced mobility of productive capital increases the pressure on governments to facilitate an attractive domestic investment climate.

The increased mobility of financial capital influences domestic social policy choices both indirectly and directly. To the extent that governments need to borrow on capital markets, they are subject to the judgements of investors. Bond markets tend to punish governments which follow policies resulting in high inflation and large budget deficits. This punishment takes the form of high interest rates and declining currency values. In terms of indirect effects, financial capital mobility creates a general constraint on welfare state programs in that bond markets signal their displeasure with overall government policy but not with particular programs. In terms of direct effects, retrenchment is more likely when program structures permit political actors to identify the extent to which specific welfare programs contribute to budget deficits.

European integration intensifies the importance of competitiveness and fiscal

discipline at the same time that it creates a separate set of pressures for welfare state restructuring. EU participation subjects national social insurance schemes to reform pressures arising from the mobility of both capital and labor within the EU. Capital mobility may create limits on the level of taxation required to finance benefits. To the extent that existing tax structures are subject to downward pressure, reform may result. The level of program vulnerability to beneficiary mobility depends on the extent to which benefits must be earned by labor force participation or whether benefits are available to all residents. In sum, EU membership alters the conditions under which social insurance programs operate.

The effects of internationalization and Europeanization on welfare state politics are mediated by domestic political factors. Even when internationalization leads politicians to favor spending cuts or retrenchment in specific programs, they still have choices about how to proceed. And as the welfare state literature demonstrates, retrenchment is difficult, even for the most determined governments. First, the structure of individual programs creates different patterns of interest group organization and channels retrenchment strategies in particular ways. Second, the organization of political decision-making institutions structures the manner and extent to which interest groups influence policy choices. Third, the relative strength and policy priorities of social democratic parties shape the extent to which different welfare constituencies bear the burden of budget cutbacks and efforts to enhance competitiveness. In sum, retrenchment is most likely when a policy sector is linked to concerns about competitiveness, when its contribution to budget deficits is clear, and when labor does not block reform. All three of

these variables are the result of the feedback effects of existing welfare state programs.

Case Selection and Research Methods

As noted, Sweden is a good test of theoretical arguments about the relative importance of both international and domestic sources of social policy reform. As Katzenstein puts it, Sweden is a “small state in world markets” and as such is heavily dependent on foreign trade for its economic livelihood. Two indicators demonstrate this high level of integration in the world economy. First, between the late 1960s and 1985, foreign trade increased from about 20% of GDP to 35.2%. Second, the Swedish economy is arguably the most “multinational” economy among the OECD countries. Sweden has the highest per capita concentration of large multinational enterprises, and the level of activity of these firms has increased dramatically during the past three decades. In 1986, Sweden was home to 17 of the largest non-American industrial corporations.¹⁵ Between 1988 and 1991, Swedish MNCs increased their employment abroad by from 530,000 to 670,000.¹⁶ Thus, if external factors influence domestic policy choices, we should see this rather clearly in Sweden.

Sweden is also home to one of the strongest labor movements in the world. In 1990, union density was 85% and the Social Democratic Party has governed alone or in coalition between 1932 and 1976; between 1982 and 1991; and again since 1994. Thus, the Swedish case is a crucial test of arguments about the influence of labor movements in

¹⁵This figure is quoted in Göran Therborn, “Sweden,” in Alfred Pfaller and Ian Gough, eds., *Can the Welfare State Compete? A Comparative Study of Five Advanced Capitalist Countries* (London: Macmillan, 1991), p. 230.

¹⁶Ronald Fagerfjäll, *Företagandet i Sverige. Modellerna och verkligheten* (Stockholm: Tiden, 1993), p. 143.

retrenchment politics.

The welfare state is typically defined as a network of policies which modify the impact of market forces on the lives of wage-earners. Programs such as public education, health care, and social insurance provide protection to wage-earners against the vagaries of the market in determining life chances. This study focuses on a core area of the welfare state, the social insurance system. As noted, in 1990 programs providing old-age pensions, sickness and work injury insurance, and unemployment insurance in Sweden took up 19.7% of GDP, and they constituted 55.3% of public spending. Social insurance programs should be particularly resistant to retrenchment because they provide cash benefits. Thus, cuts are immediately and directly felt by beneficiaries. Moreover, all three types of benefits are based on universal eligibility, but retrenchment outcomes differed widely. Thus, a comparative analysis of attempts to reform three different types of universal social insurance should provide important insights into the dynamics of retrenchment across policy sectors that are otherwise very similar.

The research presented in this study is based on fieldwork undertaken in Sweden in 1993-94 and 1995. The bulk of the empirical analysis is based on close examination of public documentation, including the policy statements of the peak organizations of labor and capital (LO, TCO, and SAF), the parliamentary record and secondary literature such as newspapers and academic journals. Interviews with policy actors, including members of parliament and representatives of interest groups have been used mainly to obtain background information and to identify important dimensions of the policy debates. Interviews are not cited in the case study chapters except to provide examples of policy

positions already documented by the written record.

This study relies on process tracing methodology in order to reconstruct the retrenchment decision-making process. A process tracing approach permits the researcher to unravel the complex processes that join initial conditions and retrenchment outcomes.¹⁷ In particular, process tracing allows the researcher to ascertain whether the perceptions, actions, and words of political actors correspond to the theory's predictions. In addition, process tracing allows the analyst to ask, "Do the timing and details of other events that comprise the process that translates initial conditions into outcomes match the theory's predictions?"¹⁸ As George and McKeown argue, "if the outcome is consistent with the prediction, then the possibility of a causal relationship is strengthened."¹⁹

This method is especially suited to the theoretical questions which this study addresses. For example, close analysis of the decision-making process provides an important test of arguments about the impact of international economic processes on domestic politics. If capital mobility and Europeanization influence domestic policy preferences in predictable ways, we should see this rather clearly in the actions and statements of political actors in the retrenchment process. Did political actors mention capital mobility and Europeanization in debates about retrenchment in a manner consistent with the arguments advanced in this study? Similarly, a process tracing approach allows

¹⁷Alexander L. George and Timothy J. McKeown, "Case Studies and Theories of Organizational Decisionmaking" *Advances in Information Processing in Organizations* 2 (1985). See also Gary King, Robert O. Keohane, and Sidney Verba, *Designing Social Inquiry. Scientific Inference in Qualitative Research* (Princeton: Princeton University Press, 1994).

¹⁸Stephen Van Evera, *Guide to Methodology for Students of Political Science* (Cambridge: MIT, n.d), p. 33.

¹⁹George and McKeown, "Advances," p. 30.

the investigator to examine the ways in which specific retrenchment strategies were considered, debated, and negotiated by political actors. Did the behavior and statements of political actors about the viability of different retrenchment options conform to the logic outlined the theoretical framework of this study? In sum, the process tracing approach adds to our theoretical understanding of retrenchment by opening the black box of the decision-making process to see whether and to what extent the behavior of political actors actually conforms to the causal logic described by the dominant theories of welfare state development.

Organization of the Dissertation

Chapter two lays out my arguments in the context of the theoretical literature concerning external constraints on welfare state development. I identify the conditions which create pressures for welfare state retrenchment, emphasizing the interaction of external forces, social insurance program structures, and domestic interests. These theoretical arguments are then applied to the Swedish context, identifying the ways in which capital mobility and Europeanization generated pressures for social insurance retrenchment. Thus, the chapter establishes the external context which applies to all four cases of social insurance retrenchment which follow. Chapter three elaborates my arguments concerning the effects of policy feedback and political institutions on the politics of welfare retrenchment. This chapter also describes the specific Swedish political context of retrenchment.

Table 1.1 depicts the predictions generated by the analytical framework presented in chapters two and three. *Vulnerability* refers to the pressure arising from external

constraints on welfare state policy. *Difficulty* refers to the degree of resistance to retrenchment arising from the structure of affected interests in distinct policy areas. Thus, vulnerability is determined largely by external pressures, while difficulty is primarily the result of domestic political variables. As the table shows, the model predicts the greatest degree of retrenchment in sickness and work injury insurance, the least retrenchment in unemployment insurance, and a moderate degree of retrenchment in the pension system. These outcomes are analyzed in chapters four, five, and six.

TABLE 1.1. Vulnerability and Difficulty in Social Insurance Retrenchment

		DIFFICULTY		
		LOW	MEDIUM	HIGH
VULNERABILITY	LOW	sickness & work injury insurance		
	MEDIUM		pensions	
	HIGH			unemployment insurance

Chapters four through six apply the argument to four sectors of the Swedish social insurance system. Chapter four investigates two cases of substantial retrenchment: the sickness and work injury insurance systems. Chapter five examines a case of moderate retrenchment: old-age pensions. Chapter six analyzes the limited success of retrenchment in unemployment insurance policy. Chapter seven concludes the dissertation with a

discussion of the implications of the study for theories of welfare state development and the international political economy literature.

CHAPTER 2:

EXTERNAL CONSTRAINTS ON WELFARE STATE DEVELOPMENT

What accounts for the recent wave of social insurance reform in Sweden? Why did the labor movement begin to revise its strategy concerning the welfare state? Why have recent retrenchment initiatives satisfied many of the concerns of organized capital? Answering these questions requires examining the impact of external influences on domestic politics, the balance of power between labor and capital, the effects of policy legacies, and the institutional context which structures national political decision making processes. This chapter explains the impetus for reform and retrenchment by analyzing the ways in which changes in the international political economy affect welfare states by influencing the relative power and interests of domestic groups in specific policy areas. The next chapter explains the pattern of reform and retrenchment by focusing on the behavior of political coalitions within the structure of domestic institutions and in response to the effects of policy feedback. Thus, my explanation of recent welfare state restructuring and retrenchment in Sweden incorporates three levels of analysis: international economic processes, domestic state-society relations, and the microlevel of program design and policy feedback.

This chapter develops the theoretical arguments summarized in chapter one concerning the external constraints on welfare state development. The first section situates my arguments in the growing literature on globalization and internationalization. The next three sections discuss the ways in which the mobility of financial and productive capital and the process of Europeanization influence domestic social insurance interests.

For each of the three types of external constraint (productive capital mobility, financial capital mobility, and Europeanization), I present an analytical framework for sorting out both the general and specific effects on social insurance program structures. The fourth section draws on the theoretical framework to explain how capital mobility and Europeanization created pressures for social insurance reform in Sweden. The last section is intended to establish the external context which applies to all four cases of retrenchment examined in the case studies which follow.

I. Theoretical Debates on the Nature and Consequences of Internationalization

Until recently, the issue of how international economic factors impinge on social policy choices has been a much neglected aspect in studies of welfare state development. Because the welfare state is usually conceived as a set of *domestic* institutions, policies and programs, most welfare state research relies almost exclusively on domestic level variables to explain welfare state development. Thus, the studies that bring us closest to an understanding of the emergence of distinct regimes of welfare statism are limited in their exclusive focus on domestic level variables. This orientation obscures a set of potentially important variables which may contribute toward a more complete analysis of the welfare state during the 1990s. To be sure, the integration of both international and domestic level variables in analyses of welfare state development is not new,¹ but much of this research is limited in scope because it generally has not focused closely on the *content*

¹David Cameron and Peter Katzenstein incorporate the smallness and openness of the Swedish economy into their analyses but both treat the structure of the international economy as unproblematic. See David R. Cameron, "The Expansion of the Public Economy: A Comparative Analysis," *American Political Science Review* 72 (1978); and Peter J. Katzenstein, *Small States in World Markets. Industrial Policy in Europe* (Ithaca: Cornell University Press, 1985).

of the welfare state and thus can generate only broad predictions about changes in welfare state development.

For scholars concerned about the ways in which comparative and international analyses can be integrated, the Swedish welfare state offers an important case for study. The Swedish case represents one of the most developed welfare states among the advanced capitalist states. Benefits and services are universal, there are (or were) few private or corporate alternatives to state social policies, and the state has (until recently) assumed responsibility for full employment. In terms of economic structure, the Swedish case also stands out. Many observers point out that Swedish firms are increasingly multinational in their operations, and a comparatively small number of large firms account for a very large proportion of export production. Moreover, during the 1980s Swedish firms dramatically increased their investment abroad while investment in Sweden has lagged.² In short, if we want to analyze the impact of international economic integration and internationalization on the full employment welfare state, Sweden is a critical case.

Following Pfaller et al., I define the welfare state as “the use of state power and responsibility towards the end of protecting citizens against economic adversities and ensuring a certain standard of prosperity to all.”³ Conceptualized this way, the welfare state includes programs which provide cash benefits for retirement, unemployment, sickness, disability, housing, child-bearing, and other related programs. Additionally, the

²See, for example, Ronald Fagerfjäll, *Företagandet i Sverige. Modellerna och verkligheten* (Stockholm: Tidens Förlag, 1994).

³Alfred Pfaller, Ian Gough, and Göran Therborn, eds., *Can the Welfare State Compete? A Comparative Study of Five Advanced Capitalist Countries* (London: Macmillan, 1991), p. 2.

welfare state may include a variety of publicly organized services such as education, health care, care for the elderly, day care and the like. This study focuses on one sector of the welfare state, the social insurance system. The decision to focus on social insurance is based on two theoretical considerations. First, the social insurance system provides cash benefits to those both inside and outside the labor market. Thus, the operation and financing of the social insurance sector, for reasons to be elaborated later in this chapter, should have the greatest influence on the ability of firms to compete in world markets. In other words, the programs comprising the social insurance sector influence labor as a factor of production to a greater degree than do social service programs.⁴ Second, to the extent that social insurance programs provide benefits to large numbers of voters, they will be difficult to reorganize and/or roll back. As recent research demonstrates, retrenchment is a difficult undertaking, and the provision of direct and quantifiable benefits to large sectors of the electorate means that social insurance programs should be particularly difficult to roll back.⁵ In sum, the focus on social insurance retrenchment permits two central theoretical debates to be incorporated into a single study: the impact of internationalization on domestic politics and the political dynamics of retrenchment.

Recent research on internationalization and globalization provides little guidance about the ways in which world market integration creates pressures for specific domestic

⁴Arguably social services programs affect the conditions of production in that high levels of public service employment decrease the pool of labor available for the private sector, and because the high tax rates required to finance comprehensive social service programs may shift resources away from the tradable sector of the economy. These issues are not addressed in this study.

⁵Paul Pierson, *Dismantling the Welfare State? Reagan, Thatcher, and the Politics of Retrenchment* (Cambridge: Cambridge University Press, 1994).

policy changes, especially in the welfare state. The current state of the field is characterized by the polarization of viewpoints into two camps. One group of scholars argues that internationalization has very little impact on domestic political processes, while a second group emphasizes the constraints of capital mobility on domestic economic and social policies.⁶ This debate suffers from three central weaknesses. First, neither type of argument adequately specifies the causal mechanisms linking international economic processes to pressures for change in specific policy areas. Second, there is little agreement about whether productive or financial capital mobility (or both) exerts the greatest pressure on domestic politics. Finally, both sets of arguments tend to downplay crucial domestic institutional and economic variables which mediate the impact of internationalization: the structure of welfare state institutions and the structure of the domestic economy. This study specifically addresses all three weaknesses in the current theoretical debate.

The analytical framework elaborated in this chapter is based on the assumption that the effects of world market integration will affect states in different ways. Specifically, domestic institutions and political factors will play an important role in mediating the

⁶For the first group, see Geoffrey Garrett, *Partisan Politics and the Global Economy* (Cambridge: Cambridge University Press, 1998); Linda Weiss, *The Myth of the Powerless State* (Ithaca: Cornell University Press, 1997); and Paul Hirst and Grahame Thompson, *Globalization in Question* (Cambridge: Polity Press, 1996). For the second group, see Fritz W. Scharpf, *Crisis and Choice in European Social Democracy* (Ithaca: Cornell University Press, 1987); Jonathan W. Moses, "The social democratic predicament in the emerging European Union: a capital dilemma," *Journal of European Public Policy* 2:3 (September 1995); Herman Schwartz, "Small States in Big Trouble. State Reorganization in Australia, Denmark, New Zealand, and Sweden in the 1980s" *World Politics* 46:4 (July 1994); and Paulette Kurzer, *Business and Banking. Political Change and Economic Integration in Western Europe* (Ithaca Cornell University Press, 1993).

impact of international economic change.⁷ Thus, international economic processes create pressures for change, but governments have choices about how they respond to these changes. Moreover, states differ markedly in the institutional make-up of their domestic institutions so the same set of external pressures will be filtered differently in different national contexts. This study emphasizes the importance of domestic level variables in channeling the direction of change, but also highlights the restricted set of policy instruments with which governments attempt to cope with change.

The analytical framework presented in this chapter emphasizes the importance of two causal mechanisms linking international economic processes and domestic policy choices. First, I argue that the characteristics of existing welfare state programs are a critical variable through which world market integration processes are channeled into political pressures for reform. As argued below, small, open economies must pursue policies which promote the competitiveness of the export sector in order to maintain economic growth and employment. Depending on their design, specific program structures provide critical information to political actors about the relationship between the welfare state and competitiveness and thereby shape domestic preferences about the desirability of welfare state reform. Two aspects of program structure are likely to determine the extent to which social welfare programs are vulnerable to the forces of internationalization: financing arrangements and labor productivity effects.

Second, domestic economic structure mediates the impact of world market

⁷Suzanne Berger and Ronald Dore, eds., *National Diversity and Global Capitalism* (Ithaca: Cornell University Press, 1996); Helen V. Milner and Robert O. Keohane, *Internationalization and Domestic Politics* (Cambridge: Cambridge University Press, 1996); and Garrett, *Partisan Politics*.

pressures in fairly predictable ways. Simply put, economies characterized by the dominance of large multinational corporations should be far more vulnerable to the effects of internationalization than economies characterized by the preponderance of small firms with close ties to the domestic economy. In other words, the structure of the domestic economy will influence the extent to which capital flight is a credible threat.⁸

The analytical framework presented here also emphasizes the distinction between productive and financial capital in assessing the impact of internationalization on domestic politics. I provide hypotheses about the general and specific effects of both productive and financial capital mobility on the preferences of political actors concerning the welfare state. As argued below, the mobility of productive capital is at least as important in explaining domestic policy change as the mobility of financial capital. This conclusion challenges recent research which argues that financial capital mobility is the primary constraint on domestic policy choices.⁹

II. The Mobility of Productive Capital

This study focuses explicitly on the impact of internationalization--the enhanced mobility of both productive and financial capital--on domestic social policy choices. The following discussion identifies a set of general and specific pressures on the welfare state arising from the integration of both trade and capital markets. In terms of *specific* effects, this study argues that the mobility of *productive capital* increases the political importance of export competitiveness. This effect is much stronger in periods of declining

⁸Christine Ingebritsen, *The Nordic States and European Unity* (Ithaca: Cornell University Press, 1998).

⁹Garrett, *Partisan Politics*.

competitiveness, because political actors are likely to blame the welfare state (among other things) as an important cause of declining market shares. Program structures provide important information to political actors about how the welfare state affects competitiveness. The stronger the perceived negative link between the financing and operational features of an individual program and the conditions affecting production, the greater the likelihood of retrenchment. In other words, when policy makers believe that the workings of a particular welfare program harm the competitiveness of the export sector, the pressure for retrenchment will increase. Thus, the increased mobility of productive capital influences how politicians perceive their interests in particular policy sectors.¹⁰

This study relies on a widely-accepted definition of competitiveness: “the degree to which a nation can, under free and fair conditions, produce goods and services that meet the test of international markets while simultaneously maintaining or expanding the real income of its citizens.”¹¹ Thus, the ability of national firms to sell their products in world markets involves the capacity to “design, produce, and distribute goods and services at costs that are globally competitive.”¹² The cost of traded goods depends on the costs of the factors of production, or capital and labor.¹³ For the purposes of this study, I focus on

¹⁰On the relationship between world market integration and policy preferences, see Peter A. Gourevitch, *Politics in Hard Times. Comparative Responses to International Crises* (Ithaca: Cornell University Press, 1986).

¹¹Jeffrey A. Hart, *Rival Capitalists. International Competitiveness in the United States, Japan, and Western Europe* (Ithaca: Cornell University Press, 1992), p. 5. The definition is similar to that offered by Pfaller et al., *Can the Welfare State Compete?* p. 6.

¹²Hart, *Rival Capitalists*, p. 6.

¹³Hart focuses on the application of the latest technologies in transforming the factors of production into competitive products. As factor costs rise, the application of technologies becomes more crucial.

“cost” or “performing” competitiveness, or the ability of national firms to sell their products on world markets regardless of whether real incomes rise or not.¹⁴

Because they are designed to insulate wage-earners from the effects of the market (at least to some degree), the operational and financing features of social insurance programs will affect labor as a factor of production in several ways. There are three dimensions to labor as a factor of production: cost, use, and supply. First, to the extent that employers rather than wage-earners or the state finance contributions, social insurance programs are a component of non-wage labor costs. If social insurance programs are financed from general revenues or wage-earner contributions, this aspect of program structure should have little impact on labor costs. Thus, the structure of social insurance financing matters greatly for retrenchment dynamics. This aspect of policy design is usually neglected in most studies of retrenchment. Social insurance program structure may influence wage costs in another way. To the extent that unemployed workers receive social insurance benefits close to average wage levels, unemployment levels have little downward pressure on wages. Second, to the extent that employed wage-earners are compensated for absence from work because of sickness, work injury, or parenthood, the operation of social insurance programs influences the ability of firms to use labor efficiently. Thus, if significant numbers of employees “stay home” from work for an insurable reason, firms have less actual labor power at their disposal at the

¹⁴On the distinction between underlying and performing competitiveness, see Pfaller et al., *Can the Welfare State Compete?* The focus on cost competitiveness rather than underlying competitiveness is based on the assumption that when rising export prices result in decreasing market shares and export income, political actors are far more likely to emphasize the costs of production rather than the long term ability to sell exports and increase real incomes at the same time.

production site than actual firm employment levels would indicate. Depending on absence rates, this is likely to reduce labor productivity. Finally, to the extent that wage-earners have opportunities to withdraw from paid employment because of retirement or disability, social insurance programs may contribute to a decline in the supply of labor and unused productive capacity. This may make it difficult for firms to recruit qualified labor, thereby contributing to upward pressure on wages. In sum, social insurance programs influence the cost, use, and supply of labor in different ways depending on specific program designs.

It should be clear from the preceding discussion that understanding the relationship between social insurance and competitiveness requires a close examination of program structures.¹⁵ Only when we disaggregate social insurance programs and analyze their specific impact on labor as a factor of production will we see how concerns about competitiveness affect social insurance programs differently. Moreover, the relationship between competitiveness and social insurance programs will be stronger in welfare states dominated by public, rather than private or occupational schemes. Absent publicly mandated requirements for social insurance provision, welfare states characterized by the dominance of occupational and private insurance provide more opportunities for firms to influence these aspects of labor as a factor of production. As a result, it is more likely that social insurance programs conforming to the institutional model should influence competitiveness more than those in residual welfare states.

Looking to the three cases of social insurance examined here, several potential effects on competitiveness can be discerned. First, all three social insurance programs

¹⁵Pierson, *Dismantling the Welfare State?*

(sickness insurance, pensions, and unemployment insurance) are financed almost entirely by employer contributions and therefore contribute to non-wage costs. This program feature is of crucial importance in explaining the Swedish case, because Sweden, alone among the OECD states, relies almost entirely on employer payroll contributions for the financing of social insurance programs. Table 2.1 shows international comparisons of social insurance financing in the OECD countries in 1991.

TABLE 2.1: Distribution of Welfare State Financing Between Employers and Employees, 1991.

	employers	employees
Sweden	34.11	0.00
United Kingdom	10.45	11.00
Japan	12.44	12.00
Italy	47.26	8.19
Germany	18.76	17.40
France	35.90	18.51
Netherlands	12.14	30.94
Belgium	49.68	12.07
Austria	23.80	15.60
USA	11.65	7.65

Source: *Statistical Abstract of the United States 1993* (Washington, D.C.: U.S. Bureau of the Census, 1993), p. 858.

The details of program financing will be discussed in subsequent chapters, but for the present purpose, the essential point is that employers, rather than the state or wage-earners, provide the bulk of financial resources for these programs. Thus, the specific financing structures of social insurance in Sweden contribute to non-wage costs. To the

extent that rising labor costs, including non-wage labor costs, are implicated in debates about declining competitiveness, this aspect of program structure is likely to feature prominently in debates about how the welfare state affects the ability of export firms to maintain and increase market shares. Because the structure of financing is broadly similar for all three programs, the only variation between programs likely to attract attention is the magnitude of employer charges. Thus, even if all three programs are employer-financed and therefore a potential target of criticism, a program with the highest payroll tax rate (and therefore higher contribution to non-wage costs) is likely to attract the most attention from employers and other political actors in terms of demanding specific reductions. Table 2.2 shows the distribution of financing for the sickness insurance, pensions, work injury insurance, and unemployment insurance between the employers, wage-earners and the state in 1990. As indicated, these four programs account for a very large proportion of employer payroll taxes (86.8% of the total) so to the extent that employers demand reductions in these non-wage costs, we should expect political actors to focus on all four programs. The magnitude of employer taxes varies substantially, however, so we would expect the greatest pressure for retrenchment to fall on the programs with the highest payroll tax rates, pensions and sickness insurance, all else equal.

TABLE 2.2: Social Security Payroll Contributions, 1990

	employers*	employees
sickness insurance	10.10%	0
basic pension	7.45%	0
ATP pension	13.00%	0
unemployment insurance	2.16%	0
work injury insurance	0.90%	0
total	33.61%	0
percent of all fees*	86.8%	0

Source: *Skatter, inkomster och avgifter 1992* (Stockholm: SCB, 1992).

*total employer contributions (% of payroll) are 38.7%.

As noted, the operation of unemployment insurance systems may also influence the cost of labor. Because unemployment cash benefits are in effect a “reserve wage” the level of benefits may affect the overall wage level in the economy. To the extent that unemployed wage earners can maintain a standard of living close to that of average economy-wide wages, the cash benefit system will not provide downward pressure on wage levels because the unemployed will not underbid wages. Thus, if the “reserve wage” is high, employed wage-earners need not moderate their wage demands in collective bargaining. Despite the potential importance of this aspect of program structure, it is not included in the analysis for two reasons. First, it would be very difficult to estimate the impact of low levels of unemployment benefit on wage levels. Second, the expected downward pressure on wages would depend at least in part on the level of unemployment, but it is not clear how much time this process would take at a given level of unemployment. Thus, because the relationship between unemployment benefits and wage

levels is difficult to pin down, it is excluded from the study.

The second way that social insurance programs influence labor as a factor of production concerns the ways that firms are able to use the labor they employ. Regarding this aspect of competitiveness, sickness insurance is expected to feature most prominently (relative to pensions and unemployment insurance) in debates about the relationship between social insurance and competitiveness. This proposition is based on the potential impact of the operation of sickness insurance on employee absence rates. High and/or rising sickness absence rates mean that firms utilize less actual labor in the production process at a given rate of employment within the firm. Thus, to maintain production at a given level, firms may turn to hiring extra employees to compensate for an assumed rate of employee absence, thus increasing the costs of production. Another potentially negative impact of high sickness absence rates is declining labor productivity in firms where the production process relies on the use of team work. Thus, both potential effects of high sickness absence rates affect the rate of labor productivity, or the value added per worker per hour, thereby increasing the costs of production.

This potentially negative effect of sickness insurance does not apply to either the pension system or the unemployment system because both provide benefits to persons outside of the regular labor market. Thus, the operation of neither pensions nor unemployment insurance can be said to have any direct bearing on productivity rates. However, both pensions and unemployment insurance, as well as the sickness insurance system, may influence the third aspect of labor as a factor of production: the supply of labor. First, to the extent that high sickness absence rates result in overemployment in

firms, the supply of labor available for other employment decreases. Second, to the extent that pension rules allow wage-earners to withdraw from the labor market to care for children or to increase their education without losing pension rights, the pension system may encourage temporary labor market exit. Additionally, to the extent that the pension system provides for early retirement or disability pensions, wage-earners may leave the labor force before retirement age. In sum, individual program features contribute in different ways to the conditions affecting production and we would expect the programs with the greatest perceived negative impact on competitiveness to be the most vulnerable to retrenchment.

In debates about how the welfare state does or does not contribute to declining competitiveness, political actors are likely to focus more on the first two dimensions of labor as a factor of production (cost and use) and devote less attention to the third (supply). That is, political actors are likely to target the high *costs* of labor represented by employer contributions as well as the potential for firms to *use* labor “efficiently” as contributing to declining competitiveness, but they are less likely to emphasize problems of labor *supply*. This is the case because the non-wage costs and use of labor have a more direct impact on labor costs than does labor supply. Changes in labor supply are likely to affect wages only in the long run whereas changes in non-wage labor costs and the use of labor will have an immediate impact on total labor costs. Thus, I acknowledge the potential importance of labor supply effects on program structures, but I focus mainly on

the non-wage cost and use of labor.¹⁶ Table 2.3 summarizes the relationship between program structure and competitiveness discussed above, relying on two dimensions of labor as a production factor: cost and use. As the table indicates, the operation and financing of the sickness insurance system has the highest hypothesized (potentially negative) impact on competitiveness, with pensions and unemployment insurance influencing competitiveness mainly through the structure of financing.

TABLE 2.3: The Interaction of Program Structures and Competitiveness

	labor costs	labor use	impact on competitiveness
sickness insurance	+++ medium (10.10% of payroll)	++++ high	high
pensions	++++ high (18.5% of payroll)	+ very low	medium
unemployment insurance	++ low (5% of payroll)	+ very low	low
work injury insurance	+ very low (0.9% of payroll)	+++ medium	low/medium

Adjusting to Competitive Decline

Pfaller et al. observe that states experiencing a deterioration of cost competitiveness have four adjustment mechanisms at their disposal to reverse the trend of higher export prices. First, a state may devalue its currency, thereby decreasing export prices (and increasing import prices). Second, states may pursue policies designed to

¹⁶The labor supply effects of social insurance programs will vary with the rate of unemployment. Thus, the relationship between program structure and labor supply is difficult to establish.

reduce the costs of production, especially wage costs. This can be accomplished by a wage freeze, or incomes policies. Third, governments may shift some of the burden of welfare state financing from firms to households or the state, thereby decreasing non-wage labor costs. Fourth, governments may adopt cutbacks in specific welfare programs in order to reduce the costs of production and thereby export prices.¹⁷ As the authors note, all four adjustment mechanisms involve costs to some societal group and the choice among the alternatives requires attention to domestic political processes. I will examine each alternative in turn.

As many observers note, devaluation has been an important policy option for Sweden and the other Nordic states in the past.¹⁸ Especially during the “cost crises” of the 1970s and early 1980s, devaluation was considered a viable option by both social democratic and bourgeois governments. An offensive devaluation of the currency resulted in lower export prices, and governments pursued restrictive monetary and fiscal policies in order to dampen the inflation caused by rising import prices. However, devaluation has two principal disadvantages: it reduces the real income of wage earners and it results in inflation which is difficult to control. What is more important for the present analysis is the fact that increased capital mobility means that devaluation has been effectively ruled out as a policy option. Thus, while devaluation was an option until the early 1980s, it is

¹⁷There are a number of ways this can be achieved. For example, a government might reduce social insurance benefits in order to finance a reduction in employer payroll taxes. See Pfaller et al., *Can the Welfare State Compete?* p. 7.

¹⁸Sweden devalued three times between 1977 and 1982. See, for example, Mats Kinnwall and Peter Norman, *Valutamarknaden* (Stockholm: SNS Förlag, 1991), pp. 94, 97, and 99; and Clas Wihlborg, “Växelkurspolitiken,” in Lars Werin, ed., *Från räntereglering till inflationsnorm. Det finansiella systemet och Riksbankens politik 1945-1990* (Stockholm: SNS Förlag, 1993), pp. 226-241.

no longer possible except as a defensive option. I will return to this point below.

The second adjustment mechanism involves policies aimed at reducing wage costs. For small open economies this has usually meant some sort of centralized wage bargaining in order to keep wage increases in line with competitiveness. The Swedish system of centralized wage bargaining worked well until the mid-1980s and is considered to be one of the most important ingredients in the post-war success of the economy. The recent difficulties of this model have been well-documented.¹⁹ In essence, wage bargaining institutions failed to contain wage costs during the 1980s, seriously undermining this option as an adjustment mechanism. In other words, using this adjustment strategy requires that domestic political and economic institutions can deliver wage restraint.

The third adjustment mechanism involves the transfer of (some of the) costs of the welfare state from firms to either households or the state. If employer social insurance payroll taxes are reduced, for example, non-wage costs decrease, thereby reducing export prices. In the Swedish debate, this is often referred to as an “internal devaluation” because it has the same effect as an external, or currency devaluation. However, reducing employers’ share of welfare state financing means that someone else will have to pay if the same level of welfare provision is to be maintained, and there are generally two options for achieving this: increase individual wage-earner payroll taxes to social programs or

¹⁹On centralized wage bargaining and its demise, see Anders Kjellberg, “Sweden: Can the Model Survive?” in A. Ferner and R. Hyman, eds., *Industrial Relations in the New Europe* (Cambridge: Basil Blackwell, 1992); Jonas Pontusson and Peter Swenson, “Labor Markets, Production Strategies, and Wage Bargaining Institutions. The Swedish Employer Offensive in Comparative Perspective,” *Comparative Political Studies* (April 1996); Andrew Martin, “The Swedish Model: Demise or Reconfiguration?” in Richard Locke, Thomas Kochan, and Michael Piore, eds., *Employment Relations in a Changing World Economy* (Cambridge: MIT Press, 1995); and Kristina Ahlén, “Swedish Collective Bargaining Under Pressure: Inter-union Rivalry and Incomes Policy,” *British Journal of Industrial Relations* 27:3 (November 1989).

maintain the same level of welfare by increasing the share financed by general revenues. In either case, the burden of financing will fall disproportionately on wage-earners in the form of individual payroll taxes, or increased consumption and income taxes.

The last adjustment mechanism is arguably the most unpalatable in political terms because it involves reductions in welfare provision. For governments of both left and right, the choice to pursue retrenchment policies is likely to be a last resort.²⁰ Because social welfare cuts involve the imposition of losses on potentially large sectors of the electorate, governments are likely to pursue this avenue with caution, and only after the first three adjustment strategies have been exhausted. This adjustment strategy is also likely to be more important and thus more difficult in institutional welfare states characterized by the dominance of the public sector in welfare provision. In residual welfare states, a significant proportion of social insurance functions (pensions, sick pay, etc) are provided by the private sector or firms themselves so firms have greater control over these costs. When social insurance functions are dominated by public provision, the decision to reduce costs rests with governments that must balance their desire to improve competitiveness with their desire to be reelected. Thus, in institutional welfare states, we would expect retrenchment only as a last resort regardless of the partisan composition of the government.²¹

²⁰See the discussion in chapter three about the political difficulty of retrenchment.

²¹This discussion of adjustment mechanisms is similar to that found in Michael C. Webb, "International Economic Structures, Government Interests, and International Coordination of Macroeconomic Adjustment Policies," *International Organization* 45 (Summer 1991); and Michael C. Webb, *The Political Economy of Policy Coordination. International Adjustment Since 1945* (Ithaca: Cornell University Press, 1995). Webb identifies three types of adjustment mechanisms for reconciling international constraints with macroeconomic goals (payments imbalances or exchange rate movements): "external policies" include trade and capital controls; "symptom management" policies include borrowing on capital markets or using central bank reserves

Adjustment to declining competitiveness in Sweden has shifted from centralized wage bargaining and devaluation in the 1970s and early 1980s to welfare program cost shifting and direct welfare cuts in the 1990s. As the capital mobility literature demonstrates, financial capital mobility limits the viability of offensive devaluation as an adjustment strategy. In the context of integrated currency markets, devaluation is rendered virtually meaningless because governments must pursue policies which demonstrate to market actors who trade currencies that the value of the currency will remain stable.²² This constraint is greater for small economies whose currencies are not in demand as reserve or vehicle currency.²³ Thus, in the low capital mobility era of Bretton Woods and shortly thereafter, devaluation was a viable option.²⁴ Today, it no longer is. Thus, a government wishing to pursue adjustment strategies must rely on a strategy other than devaluation.

For most of the postwar period, centralized wage bargaining kept wages in Sweden in line with the demands of international competitiveness. For a variety of reasons, however, the centralized system experienced increasing strains beginning in the 1970s. This culminated in the breakdown of centralized bargaining in 1984. Even when

to finance deficits as well as exchange rate intervention; and “internal policies” which include the adjustment of monetary or fiscal policies to get rid of imbalances between savings, investment and consumption.

²²Paul R. Krugman and Maurice Obstfeld, *International Economics. Theory and Policy* (New York: Harper Collins, 1994); and Michael C. Webb, *The Political Economy of Policy Coordination*.

²³Vehicle currencies are those which are traded in sufficient volumes that they function as an intermediate currency in international transactions. The American dollar, German mark, and Japanese yen dominate currency markets because of their role as vehicle currencies. See Krugman and Obstfeld, *International Economics*, p. 341. Among the OECD countries In 1989, only the USA, Japan, and Great Britain allowed their currencies to float. All other countries relied on some sort of fixed exchange rate mechanism. See Kinnwall and Norman, *Valutamarknaden*, pp. 101-102.

²⁴Webb, *The Political Economy of Policy Coordination*.

centralized bargaining resumed in 1986, the existing system proved incapable of containing wage inflation, and Swedish wage costs increased dramatically as the decade wore on. Even though there has recently been a return to centralized bargaining, the Employers Association (SAF) explicitly favors a more decentralized bargaining structure, and it has dismantled its negotiating apparatus. In sum, the failure of existing wage-setting institutions to effectively control wage costs, and the unwillingness of the peak level association of employers to continue to participate in centralized bargaining means that this adjustment strategy is less and less viable.

In sum, devaluation and wage-setting institutions no longer constituted effective adjustment mechanisms by the end of the 1980s. As export costs increased above levels for comparable trading states, policy makers were left with two unpalatable adjustment mechanisms: shifting non-wage welfare costs from firms to the state and workers or cutting welfare benefits and services. As export sales decreased and the economy slipped into recession in 1990, large budget deficits exacerbated the need for these two adjustment mechanisms. To sum up the argument then, Swedish governments relied on wage-setting institutions to maintain price competitiveness until the 1980s. When domestic production costs rendered Swedish exports more expensive than competitor exports, governments resorted to devaluation to restore competitiveness. Devaluation was an attractive option because of the permissive international environment and because capital controls were in place. Moreover, devaluation was a politically more attractive strategy because it involved no direct reductions in welfare benefits. However, devaluation was only an option during the period of relatively low capital mobility and capital controls; it is

virtually impossible in the context of integrated capital markets. Because wage-setting institutions failed to control wage inflation, governments were left with two retrenchment options: cost shifting or benefit reductions. Since 1990 governments have pursued both policies. In sum, changes in the external and internal environment increased incentives for Swedish policymakers to use welfare state retrenchment as an adjustment mechanism. Table 2.4 compares the four adjustment mechanisms discussed above in terms of their viability and political support in the 1945-1985 and post-1985 periods.

TABLE 2.4: Expected Support for/Viability of Competitiveness Adjustment Strategies

adjustment mechanisms	low capital mobility 1945-1985	high capital mobility 1985-
	(support: high = +; low = - / viability: high = +; low = -)	
devaluation	+ / +	- / -
reduction in wage costs	+ / +	+ / -
reduction in non-wage labor costs	- / +	+ / +
cuts in social welfare	- / +	+ / +

Capital Mobility and Business Investment: Specific and General Effects

In terms of *general* effects, the enhanced mobility of productive capital increases the pressure on governments to facilitate an attractive domestic investment climate. Because future economic and employment growth depends on investment, states must pursue policies that ensure sufficient domestic investment. As Pfaller and Gough put it, “For countries it is - with increasing internationalisation of enterprises - more and more a

matter of *where* the firms do all that (invest). Seen in this perspective, productivity is not only the basis of a country's competitiveness, it is also the result of its competitiveness in the international market of industrial locations where countries offer manpower, infrastructure, social and political structures, markets, and the supply of non-tradables. Being competitive in this sense means being attractive to transnational investors."²⁵

Thus, domestic social policies may also be considered one component of the mix of factors affecting firms' decisions to invest. Thus, to the extent that firms are able to move production abroad, the same competition in corporate tax rates that we have seen in the past decade is likely to emerge in terms of employer payroll taxes.²⁶ As the literature on capital mobility argues, whether assets are specific or mobile determines whether this constraint holds.²⁷ In an economy dominated by export sectors based on specific assets (natural resources, for example), this impact is negligible. However, to the extent that policy makers fear that production can and will actually move outside the country, the constraint is likely to be important, and it will increase the pressure on politicians to reduce the employer share of social insurance financing. Thus, in terms of *specific* effects, governments may reduce employer payroll taxes even if there is no immediate concern about cost competitiveness.²⁸ As noted, the Swedish economy stands out for the

²⁵Alfred Pfaller and Ian Gough, "The Competitiveness of Industrialised Welfare States: A Cross-country Survey," in Pfaller et al., eds., *Can the Welfare State Compete?* p. 34.

²⁶Sven Steinmo, *Taxation and Democracy. Swedish, British, and American Approaches to Financing the Modern State* (New Haven: Yale University Press, 1993); and Kjell-Olof Feldt, *Rädda välfärdsstaten!* (Stockholm: Norstedts, 1994).

²⁷Jeffrey Frieden, "Invested Interests: The Politics of National Economic Policies in a World Of Global Finance" *International Organization* 45:4 (Autumn 1991).

²⁸In other words, governments may undertake such a policy in a pre-emptive sense, or before there are any objective indicators of declining competitiveness.

very high concentration of multinational enterprises in the economy. It has been widely reported in the media, and politicians have no doubt been acutely aware of the fact that Swedish MNCs have increased their production abroad, resulting in employment gains outside of Sweden, and employment losses in Sweden.²⁹ In sum, the pressure to improve the investment climate intensifies the effects hypothesized earlier about the relationship between competitiveness and program structure.

At this point the argument requires qualification on two points. First, this study does not argue that the welfare state harms competitiveness. Recent research concerning this issue is fairly convincing on this issue.³⁰ However, to the extent that export performance deteriorates, concerns about how the welfare state influences competitiveness are almost certain to enter and even dominate public debates about how to cure the problem of declining market shares. Thus, the issue merits attention because it will figure prominently in debates about the causes of competitive decline. Second, this study does not argue that social insurance programs necessarily have the potentially negative effects outlined above. As many analysts have argued, social policy is more often than not a necessary component of a competitive capitalist economy.³¹ Moreover, social program effects which firms consider inefficient are usually considered by wage-earners to be inevitable outgrowths of an unhealthy work environment (high sickness absence rates) or simply a matter of right, such as the ability to maintain an adequate standard of living

²⁹Feldt, *Rädda välfärdsstaten!*

³⁰See Pfaller et al., *Can the Welfare State Compete?* and Garrett, *Partisan Politics*.

³¹Pfaller et al., *Can the Welfare State Compete?* and Claus Offe, *Contradictions of the Welfare State* (Cambridge: MIT Press, 1984).

during unemployment. In short, whether the possible social policy effects are perceived as problems or not is a matter of political debate. However, when objective economic indicators show that national firms are losing world market shares, business leaders and policy makers in search of explanations are likely to blame comprehensive and generous social insurance as part of the problem. Thus, the focus is on debates about the relationship between the welfare state and competitiveness rather than on the assumed causes of an objective economic situation.³²

III. The Mobility of Financial Capital

The increased mobility of *financial* capital influences domestic social policy choices in both general and specific ways. To the extent that governments need to borrow on capital markets, they are subject to the judgements of investors. Bond markets tend to punish borrower governments which follow policies resulting in high inflation and large budget deficits. Recent research suggests that bond market actors use information shortcuts in their investment decisions. The most common information shortcut bond market actors rely on for the developed countries is the Maastricht convergence criteria. Of the four criteria, the inflation rate and budget deficit are most important.³³ When borrower governments exceed the Maastricht targets, they are punished with high real interest rates because market actors demand a risk premium to compensate for expected inflation or the possibility of default. Thus, governments are still able to borrow on capital

³²Fred Block, "Political Choice and the Multiple Logics of Capital," in Sharon Zukin and Paul DiMaggio, eds., *Structures of Capital. The Social Organization of the Economy* (Cambridge: Cambridge University Press, 1990).

³³Layna Moseley, "Getting the Big Numbers Right: Government Policy in an Era of Mobile Capital," Paper presented at the Annual Meeting of the American Political Science Association, September 3-6 1998, Boston.

markets to finance deficits, but the costs of borrowing are higher. To the extent that governments desire to keep borrowing costs low, policymakers will respond to higher real interest rates with policies expected to reduce deficits, inflation, or both. In this context, cuts in welfare expenditures may be one method of several which governments use to reduce deficits and inflation.³⁴

The integration of financial capital markets also means that there is now a 24 hour market for trade in national currencies. Currencies are assets like any other so the price is determined by the interaction of supply and demand. During the Bretton Woods era of controlled capital movements, the basic demand for a currency on foreign exchange markets was determined by foreign demand for the goods, service, and assets that the currency could buy. However, integrated financial markets completely change the way that supply and demand for national currencies are determined, and currency flows associated with the transactions of importers and exports have little influence on currency values. As a result, currency traders use the same kinds of information shortcuts as bond traders when they decide where to place their assets.

Webb argues that increases in the level of both trade and financial market integration create a new set of pressures on national macroeconomic policy. These changes in the structure of the IPE explain why states increasingly rely on the international coordination of monetary and fiscal policies rather than balance of payments coordination. Webb finds that monetary coordination is just as extensive today as it was during the hegemonic Bretton Woods era of fixed exchange rates. The key difference, however, is

³⁴Because welfare benefit cuts reduce the purchasing power of households, they dampen inflation.

that the type of coordination has changed from balance of payments financing toward coordination of monetary and fiscal policies.³⁵ In the low trade volume, low capital mobility Bretton Woods period, international coordination to keep international payments in balance was achieved by external borrowing or exchange rate policies (devaluation). When capital mobility was low, national governments did not face extensive international payments imbalances if their macroeconomic policies diverged from their neighbors' and the imbalances that did occur were small enough to be managed effectively. In the 1980s, however, the volume of trade is much higher and capital is highly mobile. This means that payments imbalances began to be too large to manage with the old formulas. As a result, national economic policy choices are no longer insulated from the effects of payments imbalances, and international coordination has centered on monetary and fiscal policies.³⁶

As the capital mobility literature emphasizes, capital mobility means that governments must choose between exchange rate autonomy and monetary policy autonomy.³⁷ If a government prefers a fixed exchange rate, it must allow the market to determine interest rates. On the other hand, if a government desires monetary policy autonomy, it must let the market decide the value of the currency by pursuing a policy of floating exchange rates. If a government tries to maintain a fixed exchange rate in the context of large and/or rising budget deficits or rising inflation, it must raise interest rates

³⁵Webb focuses on the large capitalist states (USA, Germany, Japan, France, and Great Britain) but the argument applies to the smaller states as well because they are "price takers." Small states have little capacity to influence the bargaining and actions of the larger states, so in effect they must adjust to the environment created by the policies and interactions of the large states. See Webb, *The Political Economy of Policy Coordination*.

³⁶Webb, "International Economic Structures."

³⁷Webb, *The Political Economy of Policy Coordination*; and Frieden, "Invested Interests."

to maintain market confidence in the currency. Market actors are likely to sell high inflation currencies and shift their assets to another “safer” investment, thereby decreasing demand and the market price for the currency. Thus, because inflation erodes the value of money, high inflation countries will experience downward pressure on currency values. Governments intent on maintaining the value of their currency must then raise interest rates in order to keep demand stable. Similarly, large budget deficits expose currencies to the judgements of market actors. Because budget deficits increase the potential for default, investors usually demand higher interest rates to compensate for the risk of default. In either case, high inflation or large budget deficits, governments that prefer to maintain fixed exchange rates face the prospect of rising real interest rates which dampen investment and make macroeconomic adjustment difficult. In sum, we would expect political actors to pay close attention to how market actors react to government attempts to maintain fixed exchange rates. To the extent that governments want to maintain a fixed exchange rate and a reasonable real interest rate, they are likely to try to pursue policies which promote market confidence in the currency.

Stable currency values are especially important for small, trade-dependent economies. Exporters are likely to favor stable currency values so that export pricing is more predictable. Similarly, importers, many of whom are also exporters, should favor stable currency values because depreciation increases the costs of imports as a factor of production. Additionally, rising import prices fuel inflationary pressures in the economy as a whole. That small, open economies favor stable exchange rates is supported by the fact that since the Bretton Woods system collapsed in the 1970s, Sweden maintained a

fixed exchange rate until 1992. Thus, while other, larger countries allowed their currencies to fluctuate with the market, Swedish policymakers actively pursued a policy of fixed rates.

Thus, in terms of *general* effects, financial capital mobility creates a constraint on welfare state programs in that bond and currency markets signal their displeasure with overall deficit-financed and/or high inflation government policy but not with particular programs. Two negative scenarios emerge from the preceding discussion. First, increasing bond interest rates increase the cost of borrowing for a country. Increased rates also mean that domestic interest rates will be high, thus dampening investment. To the extent that governments want to keep interest rates low, they must take measures to increase market confidence in their politics. This is likely to include reducing a budget deficit deemed too high by the market, or taking action to reduce inflation, or both. Thus, to the extent that the social welfare sector is considered to be part of the deficit/inflation problem, rising real interest rates will increase the political influence of retrenchment advocates. Second, downward pressure on the currency may arise when market actors sell their national currency and shift their assets into some other investment. Flight from a currency usually results when market actors doubt the ability of the government to maintain the currency's value. This usually results from inflation rates and budget deficits which exceed that of similarly situated countries. To the extent that politicians want to maintain the value of the currency, they will thus raise interest rates, take measures to cut deficits, or both. Thus, capital flows which create downward pressure on the currency are likely to increase the political influence of retrenchment advocates.

Financial Capital Mobility and Specific Program Effects

In terms of *specific* effects, retrenchment is more likely when program structures permit political actors to identify the extent to which individual welfare programs contribute to budget deficits. Thus, the structure of social insurance financing is the link between capital markets and the political dynamics of retrenchment processes. As noted, social insurance financing can be organized in two main ways. First, general revenues may be used to finance expenditures, as in Denmark. Denmark has very low employer payroll taxes and uses revenues generated by high income and consumption taxes to finance social insurance benefits. In this type of system it is nearly impossible to ascertain whether program expenditures and revenues balance in some way, so it is difficult to identify how the operation of an individual program affects the budget balance. In this type of financing arrangement, it will be difficult for politicians to “blame” the operation of a specific program for increased aggregate spending levels. Thus, if the government is running a budget deficit, it will be difficult to target the operation of a specific program as a significant “cause” of the deficit. Under these conditions, other domestic political factors will influence politicians’ preferences about which programs to scale back if they pursue deficit reduction.

In social insurance systems characterized by ear-marked contributions and trust fund financing, or both, the political logic of assigning blame during periods of budgetary pressure will be very different. For example, ear-marked contributions permit political actors to determine the exact level of revenues destined for a specific program. This tracking process is impossible in systems like Denmark’s which rely on general revenue

financing. In the Danish case, program spending can be tracked easily, but not the source of revenue.

In the case of ear-marked financing, political actors can easily determine whether a social insurance program is “in balance,” that is, whether spending roughly equals revenues. This is the case even when the state contributes a portion of the financing because the state’s portion is usually fixed in advance. In this case, ear-marked contributions are intended to cover a specific proportion of program costs. If they do not, the state is saddled with extra costs and in periods of budgetary pressure, the state may not be able to finance them except at a very high cost. In any case, financing by ear-marked contributions allows political actors to determine whether a social insurance program is functioning according to a prescribed financing formula. This feedback effect of program financing is strengthened when ear-marked contributions are deposited in a trust fund. Trust fund financing is usually motivated by the desire to provide a buffer fund for periods when spending exceeds revenues. Thus, the trust fund mechanism is a way to make a program self-financing in that excess contributions accumulate in a program trust fund and can be used to finance program costs when spending exceeds revenues. This type of arrangement is common in pension systems, for example, but is also found among sickness and unemployment insurance systems. As recent research demonstrates, trust fund crises significantly increase the political space for retrenchment by providing a focusing event which increases the urgency of reform.³⁸ If the state is unwilling or unable to provide extra revenues to correct the trust fund deficit, adjustment will fall on the

³⁸Pierson, *Dismantling the Welfare State?*

program itself.

These program financing features become important when a government is running a large budget deficit and needs to finance it by borrowing on capital markets. Because interest rates converge under conditions of high capital mobility, the judgements of bond market actors in the form of interest rates will determine the costs of borrowing. To the extent that governments want to keep their borrowing costs low, they must take steps to reduce budget deficits. As the capital mobility literature suggests, bond markets signal their displeasure with high deficits but not necessarily with individual programs. However, when choosing among different deficit reduction strategies, domestic political actors are likely to examine the ways that individual programs contribute to deficits. Program financing structures provide important information about how specific programs affect the deficit. In other words, the impact of bond market reactions can be more than a general constraint. Depending on program financing structure, the link between adverse bond market signals and retrenchment policy preferences can be quite direct. Simply put, governments running deficits face the prospect of providing extraordinary injections of revenue from the treasury to a social program running a trust fund deficit. This is not an appealing scenario for governments wishing to reduce their budget deficit since extraordinary financing will increase it. Thus, even if bond market actors provide no information to governments about the specific policies they find displeasing, domestic policy actors will use the information provided by program financing structures in their decisions about which programs to scale back.

Table 2.5 shows the specific financing features of the four social insurance

programs examined in this study. Sickness insurance is designed so that the state pays 15% of costs while ear-marked employer payroll taxes finance the rest. Program balance is tracked in what might be termed a fictitious trust fund. This means that there is no real existing trust fund, but program balance is easily tracked. In other words, political actors have access to clear information about the basic pension affects budget developments. Moreover, to the extent that ear-marked contributions cover less than 85% of costs, the state must pick up the rest, adding to pressure on the budget. The basic pension system operates in a similar way except that there is no explicit tracking mechanism in the form of a fictitious trust fund. Still, program costs and the extent to which the program increases budget deficits is easily tracked. The earnings-related pension (ATP) operates completely according to trust fund principles, and the accumulation of large reserves suggests that even in periods of budgetary pressure, the ATP system is not likely to be blamed as contributing to the deficit. Both the work injury and unemployment insurance system operate according to trust fund principles, so to the extent that the fund is in deficit, the program is likely to come under political pressure for retrenchment in periods of budgetary pressure. To sum up, when the following programs are running a deficit, they will be vulnerable to cutbacks in periods of budgetary pressure: sickness insurance, the basic pension, unemployment insurance, and work injury insurance. The ATP pension system should not be targeted, at least on this criterion. The magnitude of vulnerability should be roughly proportional to the magnitude of the program deficit.

TABLE 2.5: Structure of Financing in Swedish Social Insurance in 1990

	percent of financing provided by			
	employer contributions	individual contributions	state grants	trust funds
sickness insurance	85% (10.1% of payroll)	0	15%	fictitious
basic pension	75% (7.45% of payroll)	0	25%	N/A
ATP pension	100% (13% of payroll)	0	0	buffer
unemployment insurance	100% (5% of payroll)	0*	0	buffer
work injury insurance	100% (0.9% of payroll)	0	0	buffer

Source: RRV, *Social insurance statistics. Facts 1991* (Stockholm: RRV, 1992).

*members of the union funds pay a small membership fee.

IV. Europeanization

Europeanization “refers to the regional integration process, where changes in institutions...(and) policies are occurring between EC states *and* within nation-states.”³⁹

Most research on the impact of EU membership on national welfare states emphasizes the weakness of EU institutions in this policy area.⁴⁰ Pro-active social policy initiatives

³⁹Christine Ingebritsen, “Pulling in Different Directions: The Europeanization of Scandinavian Political Economies,” in Peter J. Katzenstein, ed., *Tamed Power: Germany in Europe* (Ithaca: Cornell University Press, 1997), p. 168.

⁴⁰Debra Johnson, “The Impact of the Nordic Countries on EU Social Policy,” in Lee Miles, ed., *The European Union and the Nordic States* (London: Routledge, 1996); Linda Hantrais, *Social Policy in the European Union* (New York: St. Martin’s Press, 1995); Beverly Springer, *The Social Dimension of 1992. Europe Faces a New EC* (New York: Praeger, 1992); Peter Lange, “The Politics of the Social Dimension,” in Alberta Sbragia, ed., *Euro-politics* (Washington, D.C.: Brookings, 1992); and Ingebritsen, *The Nordic States*.

originating in EU institutions are not likely to have much impact on national social insurance arrangements, at least for the present time. Instead, EU membership will exert pressure on national social insurance systems through the effects of “negative integration,” or the measures taken by the EU to promote market integration within the EU.⁴¹ This section focuses on the pressures created by EU integration on national social insurance systems.

European integration intensifies the importance of competitiveness and fiscal discipline at the same time that it creates a separate set of specific pressures for welfare state restructuring. EU participation subjects national social insurance schemes to reform pressures arising from the mobility of both capital and labor within the EU. Capital mobility may create limits on the level of taxation required to finance benefits. To the extent that existing tax structures are subject to downward pressure, the pressure for reform increases. The level of program vulnerability to beneficiary mobility depends on the extent to which benefits must be earned by labor force participation or whether benefits are available to all residents. The constraints of competitiveness have already been discussed, so the discussion will focus on the effects of the EU convergence criteria and the impact of labor and capital mobility within the EU.

General Effects

In terms of fiscal discipline, the Maastricht convergence criteria create a powerful

⁴¹For a discussion of the concept of “negative integration,” see Fritz W. Scharpf, “Negative and Positive Integration in the Political Economy of European Welfare States,” in Gary Marks, Fritz W. Scharpf, Philippe C. Schmitter, and Wolfgang Streeck, eds., *Governance in the European Union* (London: Sage, 1996).

constraint on national policy choices.⁴² By 1998, 10 of the 15 EU members had announced their intention to join EMU, and Sweden is not among them.⁴³ However, the convergence criteria exert pressure on the policies of all member states whether or not they have decided to join EMU because the criteria provide concrete targets for national economic policy. As previously discussed, market actors use the convergence criteria as a critical information shortcut when they make their investment decisions. As Moseley notes, market actors use the convergence criteria as an information shortcut because governments themselves use them to guide policy. And it is not only EU members that intend to participate in the first stage of EMU in 1999 which rely on the criteria; non-participating states also use the convergence criteria as a benchmark against which to make their own policies.⁴⁴ That future EMU non-participants use the convergence criteria as a guide for their policies is explained by the general preference among all EU members to maintain fixed exchange rates. Because market actors are likely to view EMU participation as an indicator of a government's resolve to pursue policies preferred by the market (price stability and budget deficits below 4%), non-participants will probably be viewed as an investment risk by market actors. Thus, the decision to opt out of EMU increases the pressure on non-participating states to pursue national economic policies

⁴²See, for example, Jonathan W. Moses, "Sweden and EMU," in Erik Jones, Jeffrey Frieden, and Francisco Torres, eds., *Joining Europe's Monetary Club: the Challenges for Smaller Members* (New York: St. Martin's Press, 1998); Paulette Kurzer, "The European Community and the Postwar Settlement: The Effect of Monetary Integration on Corporatist Arrangements," in Dale L. Smith and James Lee Ray, eds., *The 1992 Project and the Future of Integration in Europe* (Armonk, N.Y.: M.E. Sharpe, 1993); and Ingebritsen, *The Nordic States*.

⁴³The other members which have announced their decision to not participate in the first stage are Denmark, Great Britain, Greece, and Portugal.

⁴⁴For example, Swedish political leaders often invoke the convergence criteria as a benchmark even after the Social Democratic government announced that Sweden would not participate in the first stage of EMU.

which do not violate the convergence criteria. In sum, EU membership creates the same kinds of general pressures discussed above in the section on financial capital mobility.

Specific Program Effects

EU membership also creates a separate and more direct set of pressures on national social insurance programs. The first set of pressures concerns the capacity of governments to raise the revenues required to finance public social insurance schemes. As noted, social insurance programs may be financed by ear-marked employer or employee payroll taxes or by general revenues. As discussed above, the ability of firms to move production from one location to another creates downward pressure on the taxes and social security contributions paid by firms. Thus, EU membership intensifies the pressures discussed above concerning productive capital mobility and employer payroll taxes.

EU membership also creates a specific set of pressures which operate through program structures. National social insurance schemes differ in terms of their openness to labor mobility across borders.⁴⁵ Program rules determine whether benefits must be earned by a certain length or kind of labor force participation or if they are available to all residents of a country. In other words, social insurance schemes vary in the extent to which benefits must be earned. The looser the link between earned rights and social insurance benefits, the more open the system is to labor market mobility. On the other hand, the tighter the link between contributions, labor market participation, or length of

⁴⁵The concept of "openness" is borrowed from Hans Tson Söderström, ed., *Tillväxt utan gränser, Konjunkturrådets rapport 1992* (Stockholm: SNS Förlag, 1992), chapter 6. See also, Stephan Leibfried and Paul Pierson, "Semisovereign Welfare States: Social Policy in a Multitiered Europe," in Stephan Leibfried and Paul Pierson, eds., *European Social Policy. Between Fragmentation and Integration* (Washington, D.C.: Brookings, 1995).

residence and the level of benefits, the more closed, or resistant to pressures caused by labor mobility, a program is. Thus, when labor can move freely across borders, persons with a high risk for some insurable condition (sickness, old age, etc) will have increased incentives to move to the EU country providing the most attractive benefits.⁴⁶ The incentive to move depends on the openness of the social insurance program in question. The preceding discussion does not imply that labor mobility will increase dramatically within the EU as households shop around for the best benefits. Certainly there are significant barriers to mobility such as language and family ties. However, given that many EU countries are quite small, including Sweden with a population of 8.5 million, even small labor flows can have significant impacts on the sustainability of national social insurance schemes.⁴⁷ In sum, national social insurance programs with high levels of openness are subject to pressure because of negative selection. As a result, even if domestic political considerations call for maintenance of a particular social insurance program, politicians face pressure to introduce rule changes which reduce the vulnerability of specific programs to labor flows.

In terms of the social insurance programs included in this study, the basic pension is characterized by the highest degree of openness because benefits are payable to all

⁴⁶EU rules state that the location of employment rather than residence determines the national social insurance scheme which applies to a worker. Social insurance benefits are also exportable, and insured persons are guaranteed equal treatment regardless of citizenship. It is important to note that the mobility of firms within the EU creates pressures for retrenchment depending on the openness of individual programs, although these pressures are not likely to be as great as those created by labor mobility. For example, work injury insurance schemes characterized by openness are those with short or non-existent qualifying periods and relatively generous benefits. Thus, firms with high risks for work injuries among their employees have an incentive to relocate production to the EU states with more open systems, all else equal.

⁴⁷Söderström, *Tillväxt utan gränser*, p. 83.

residents above a certain age. Although ear-marked employer payroll taxes (and state grants) finance benefits, there are no formal qualifying rules except for residence and age. Thus, the link between payroll taxes and eventual benefits is very weak. As a result, EU membership creates pressures for rule changes which reduce the degree of openness. Even though actual labor inflows are impossible to predict, the prospect of even a small number moving to Sweden to claim basic pension benefits should create powerful pressure to “close” the system. Assuming that politicians want to maintain the system as close to its current form as possible, the simplest way to close the system would be to introduce residence requirements as a proxy for “earning” benefits.

The ATP pension system can be classified as somewhat open in that the link between qualification rules (length of participation in the labor force) and pension rights is not direct. This issue is addressed in chapter five, but for the present discussion the important point is that wage earners need work only 30 years in order to earn the maximum pension.⁴⁸ ATP’s generous qualification rules mean that the opportunities for wage earners to behave strategically, for example by living and working in another EU country for a significant length of time, in order to take advantage of the program are greater. Again assuming that politicians want to maintain the program close to its present form, the simplest solution would be to tighten the link between earnings and benefits by making the system more actuarial. If wage earners were required to work, for example, 40 years in order to earn a full ATP pension, the risk for exploitation would decrease. Similarly, a more actuarial system would discourage wage-earners from moving to

⁴⁸In comparative terms this is quite low.

Sweden who do not plan to work more than 30 years.

The sickness insurance system can also be classified as moderately open in that there are few qualifying rules and the program pays full benefits from the first day of sickness for an unlimited duration. Thus, we could expect the sickness insurance system to be attractive to persons especially prone to sickness or who prefer to call in sick often.⁴⁹ Assuming domestic political preferences for maintaining the system with few changes, we would expect politicians to propose changes designed to increase the portion of risk borne by the individual, through some combination of tougher qualifying conditions or moderately lower benefits. The work injury insurance system should be subject to the same set of pressures and possible remedies.

In contrast to the other programs, the unemployment insurance system should not be subject to any pressure arising from the free movement of labor because of EU law. According to EU law, unemployed persons receive benefits based on the country where they were employed, so in this sense the unemployed are not mobile. In short, the unemployment insurance system is the only one among the five under consideration here which is completely “closed” to the effects of labor mobility.⁵⁰

Table 2.6 summarizes the argument outlined above. The expected pressure for reform is roughly the same as the degree of openness to EU labor mobility. As noted in the discussion of specific programs, EU membership creates pressures for at least a

⁴⁹Wage earners notify the insurance office and not their employer if they are sick, and a medical certificate is required only after one week. In comparative terms these are generous rules.

⁵⁰It is important to note that the closedness of the unemployment system is the result of EU law and not program structure.

minimum level of change in order to “close” them to labor mobility effects. When domestic political factors favor the maintenance of a specific program, we would expect only the minimal changes necessary to reduce openness. However, the openness of specific programs also strengthens the position of domestic actors supporting retrenchment. Thus to the extent that domestic political factors favor retrenchment, EU membership should add weight to this process.

TABLE 2.6: Openness to Labor Mobility in the EU

program	degree of openness to labor mobility in EU
basic pension	high
ATP pension	medium
sickness insurance	medium
work injury insurance	medium
unemployment insurance	low

V. Competitiveness and Swedish Economic Performance

The previous three sections of this chapter elaborated an analytical framework for determining how the enhanced mobility of productive and financial capital as well as the process of Europeanization affect domestic social insurance policy preferences. The goal of the next section is to show how these external pressures apply to Sweden. The intention is to empirically establish the external context which applies to the case studies of

social insurance retrenchment which follow in chapters three, four, and five. The first section provides several measures of declining competitiveness and the multinationalization of export industry in Sweden and then summarizes Swedish political debates about the relationship between competitiveness and the welfare state. The discussion demonstrates that political actors, especially organized business, began to sharply criticize the welfare state in general and the social insurance system in particular for Sweden's economic troubles in the 1980s and 1990s, including declining competitiveness. The second section briefly discusses the deregulation of Swedish capital and currency markets and their consequences for economic policy management and the social insurance system. I provide a short review of three currency crises in 1990 and 1992 which gave rise to extraordinary policymaking efforts (including social insurance cutbacks) aimed at maintaining the value of the currency. Although I provide several seemingly concrete indicators of competitiveness and market reactions to Swedish domestic policies, I focus on how political actors, especially organized business, interpreted the causes of these economic facts and what should be done to correct them.

Measuring Competitiveness

There are several ways to measure the overall competitiveness of the national economy and of specific sectors. Hart argues that the best overall picture of competitiveness is obtained by using indicators of both types.⁵¹ For the economy as a whole, rising real GDP, relatively stable inflation rates, stable or rising export levels as percent of GDP, trade surpluses, and rising labor productivity demonstrate increasing

⁵¹Hart, *Rival Capitalists*.

competitiveness. At the level of the manufacturing sector, rising (or stable) national shares of world manufacturing production, increasing manufacturing exports in relation to GDP, stable or rising real wages in manufacturing, rising or stable employment of manufacturing workers, and rising revenues and profits of manufacturing firms indicate increasing competitiveness in the manufacturing sector.⁵² For each of these indicators, negative trends indicate declining national or manufacturing competitiveness.

Economy-Wide Indicators

Figures 2.1-2.6 provide data for trends in real GDP, inflation, exports, trade balances, and labor productivity for the past several decades. Taken together, these six sets of indicators appear to provide significant evidence of declining competitiveness in the Swedish economy since the early 1980s. As figure 2.1 demonstrates, real GDP growth has been slower in Sweden than in the OECD as a whole since the early 1970s. Real GDP growth over time is considered the best overall indicator of national economic health because it measures the growth in economic output adjusted for inflation. Relative to its most important competitors, Swedish real GDP growth has been below average. Figure 2.2 provides comparative data on the rate of inflation in Sweden and the OECD since 1970. Since 1981, Swedish inflation has outpaced the OECD average, with large differentials for 1983-1985 and 1990-1992. After the deflationary effects of the 1993-1995 recession, Sweden recorded a lower level of inflation than the OECD in 1996 and 1997. Comparative inflation rates are important for export dependent economies because

⁵²These indicators are based on Hart, *Rival Capitalists*; and Pfaller and Gough, "The Competitiveness of Industrialised Welfare States: A Cross-Country Survey," in Pfaller, et al., *Can the Welfare State Compete?*

domestic inflation must be kept in line with export competitiveness. If domestic inflation outpaces that of competitor states, export prices rise above those of other states competing for the same markets. All else equal, this results in decreasing market share.

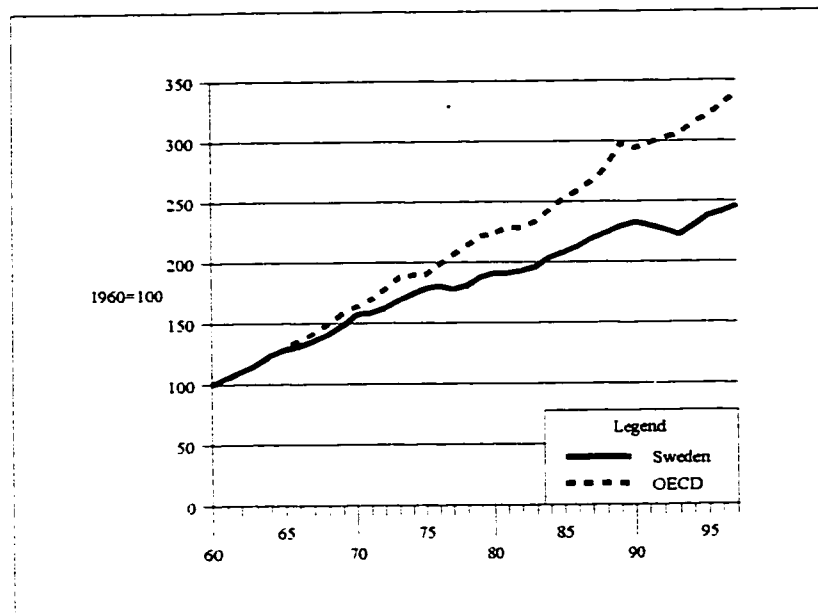


FIGURE 2.1: GDP in Sweden and the OECD, 1960-1997
Source: SAF, *Fakta om Sveriges ekonomi* (Stockholm: SAF, 1998).

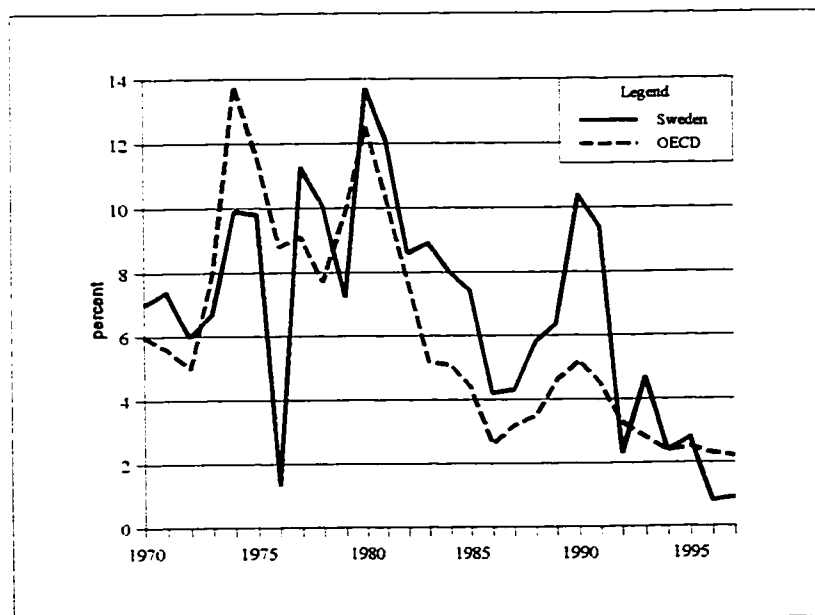


FIGURE 2.2: Inflation in Sweden and the OECD 1970-1995
Source: SAF, *Fakta om Sveriges ekonomi*.

Figures 2.3 and 2.4 present data on Swedish exports as a proportion of GDP.

Figure 2.3 displays average levels of export dependence since 1960 for four export-oriented states: Germany, Sweden, Austria, and the Netherlands. Swedish export dependence is higher than Germany, but lower than Austria and the Netherlands. For all four countries, export dependence has increased, indicating success in maintaining and/or increasing competitiveness. Both Swedish and Dutch average export dependence declined in the 1990-93 period, while that of Austria and Germany increased. The Swedish and Dutch declines may be attributed to the world recession during this period. Figure 2.4 shows Swedish export dependence between 1963 and 1992. Between 1960 and 1984, the trend is one of increasing export dependence, from about 16% of GDP to 31% of GDP. However, since 1985, the trend is one of declining export dependence, indicating a decreased capacity to compete successfully on world markets.

Figure 2.5 shows the Swedish balance of trade between 1970 and 1997. The data indicate significant problems in maintaining a positive trade balance between 1970 and 1982. Since 1983, however, the data show trade balances of varying size until 1990 and then a clear upward trend. This data indicates that exports exceeded imports since 1983. However, the data do not provide unambiguous support for increasing competitiveness, as trade surpluses normally would. First, as already discussed, Swedish exports' share of GDP has fallen in recent years. Second, increasing trade surpluses have been necessary to counteract deficits on the current account. Figure 2.6 shows the balance on current account between 1974 and 1996. The data indicate increasing current account deficits since the mid 1980s. Thus, considering both the trade balance and the balance on current

account reveals that Sweden's payments with the rest of the world have clearly shown a deficit during the past decade. Figure 2.7 displays labor productivity data for Sweden between 1960 and 1995. The data show a clear decline in overall productivity levels, especially in the 1980s. In sum, the indicators of competitiveness discussed above appear to provide a fairly consistent picture of declining competitiveness since the late 1970s.

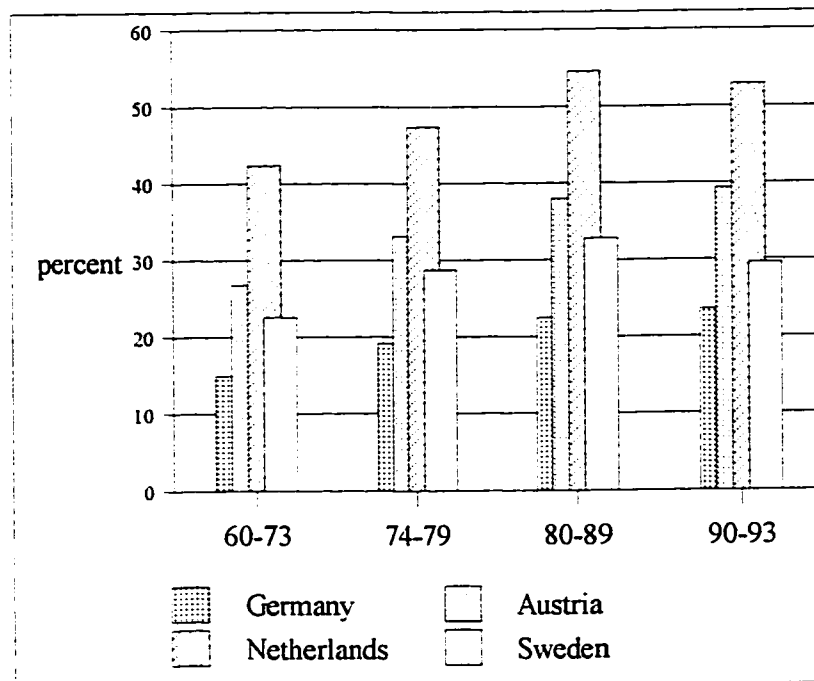


FIGURE 2.3: Exports as Percentage of GDP, averages
 Source: OECD, *Historical Statistics* (Paris: OECD, various years).

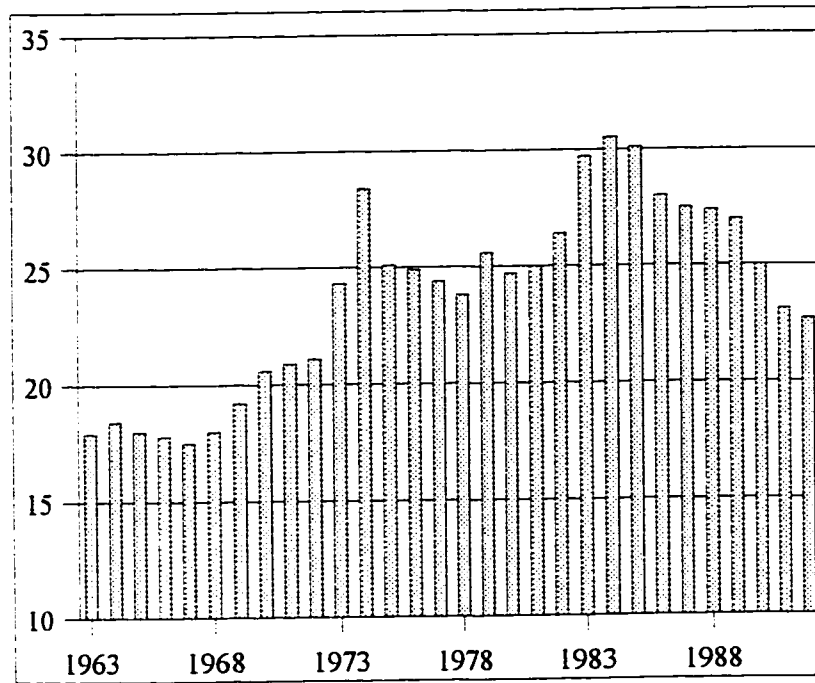


FIGURE 2.4: Swedish Exports as Percent of GDP 1963-1992

Source: *Statistisk årsbok för Sverige* (Stockholm: SCB, various years).

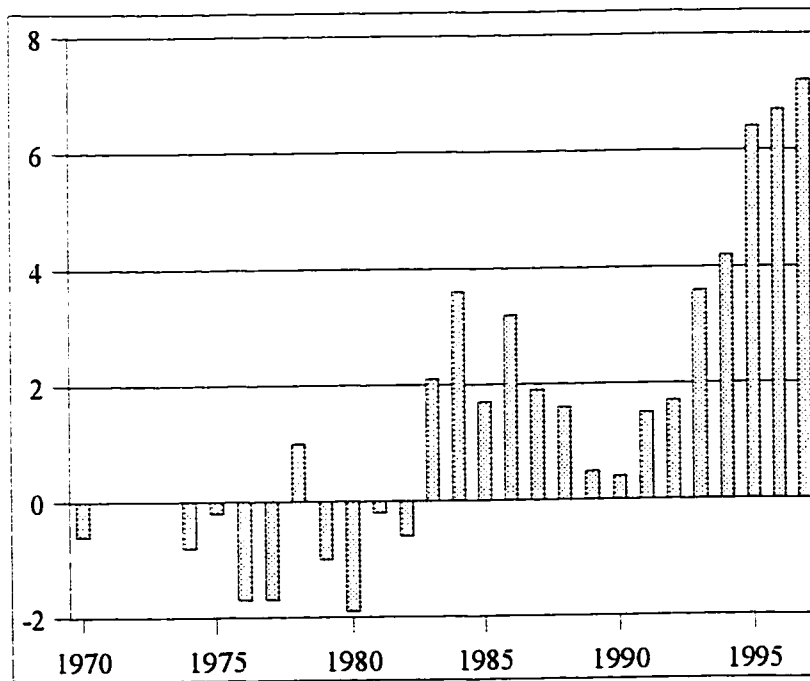


FIGURE 2.5: Balance of Trade as Percent of GDP 1970-1997

Source: SAF, *Fakta om Sveriges ekonomi*; and OECD, *Historical Statistics*.

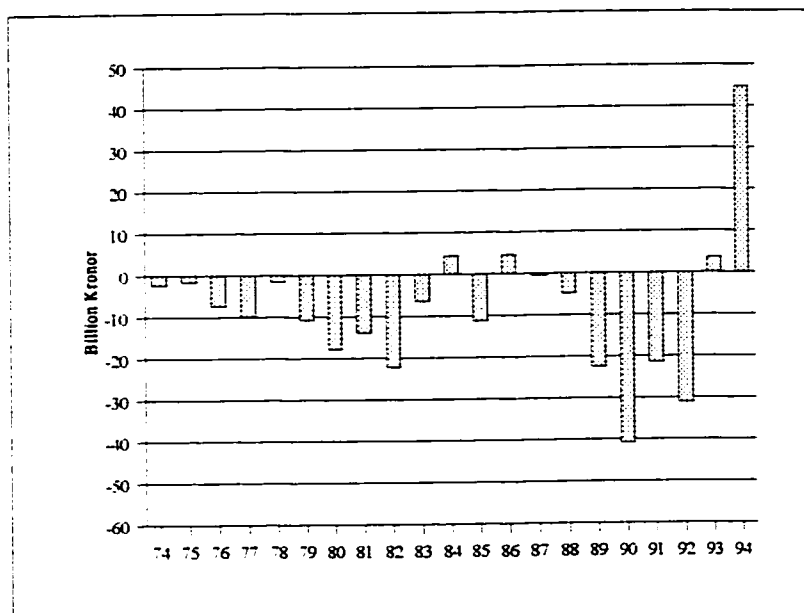


FIGURE 2.6: Balance on Current Account 1974-1994
Source: SAF, *Fakta om Sveriges ekonomi*.

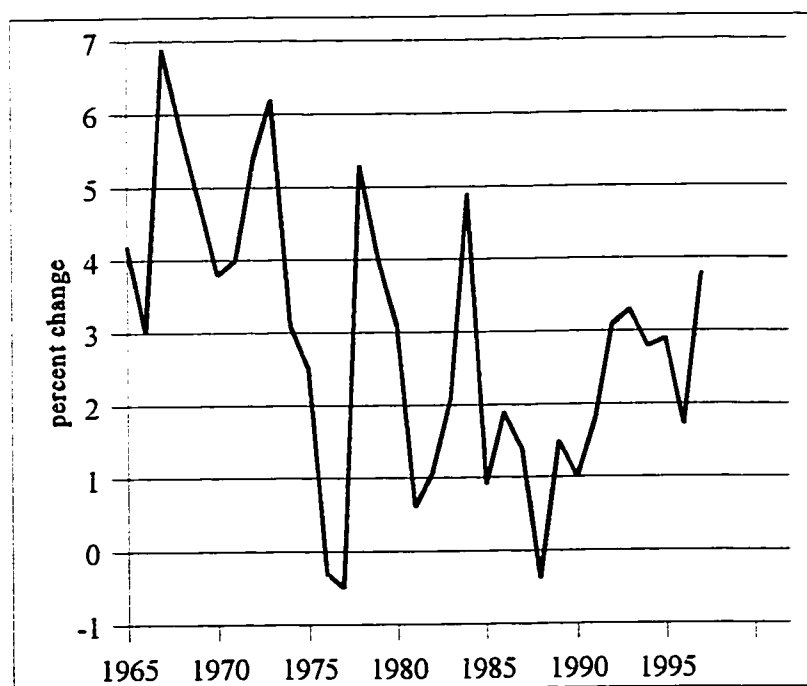


FIGURE 2.7: Labor Productivity in Sweden 1965-1997
Source: SAF, *Fakta om Sveriges ekonomi*.

Indicators for the Manufacturing Sector

Figures 2.8-2.12 provide competitiveness indicators for the manufacturing sector in Sweden. Because manufactured goods dominate Swedish exports, it is this sector of the economy which is most exposed to foreign competition. Data on the manufacturing sector should thus provide more specific indicators of competitiveness than economy wide data. Figure 2.8 shows Swedish exporters' share of the total volume of manufactured goods of 14 OECD countries. The overall trend between 1970 and 1992 is clearly negative, indicating a relative decline in competitiveness for this period. Figure 2.9 displays comparative data on the rate of manufacturing productivity growth in Sweden and Sweden's 11 most important competitors between 1970 and 1996. The data show that Swedish manufacturing productivity has been noticeably lower than its competitors' since 1980. Figure 2.10 presents data on annual changes in real wages in manufacturing between 1970 and 1995 for Sweden and six other small export oriented states. Rising real wage rates indicate increasing competitiveness. The data show that changes in real wages vary significantly over time, but only Swedish manufacturing workers experienced the greatest decreases in real wages, in 1977, 1980, and 1992.

Figure 2.11 provides data on manufacturing employment levels since 1970. Increasing or slowly decreasing employment levels indicate increasing competitiveness. The trend in Sweden is clearly negative, indicating declining competitiveness. Figure 2.12 shows the rate of return on working capital in manufacturing⁵³ between 1970 and 1996.

⁵³The term working capital refers to total capital minus financial capital (cash on hand, bank deposits, securities, and loans).

The rate of return varies significantly over time, and there are two troughs in the graph, in 1978 and 1993, when the rate of return was 2 and 3 percent respectively. The periods 1975-1978 show a steep decrease in the rate of return, from about 11 percent to 2 percent, and again between 1984 and 1992 when the rate of return dropped from just over 10 percent to about 3 percent. In sum, figures 2.8-2.12 appear to indicate a marked decline in the competitiveness of the manufacturing sector between the 1970s and early 1990s.

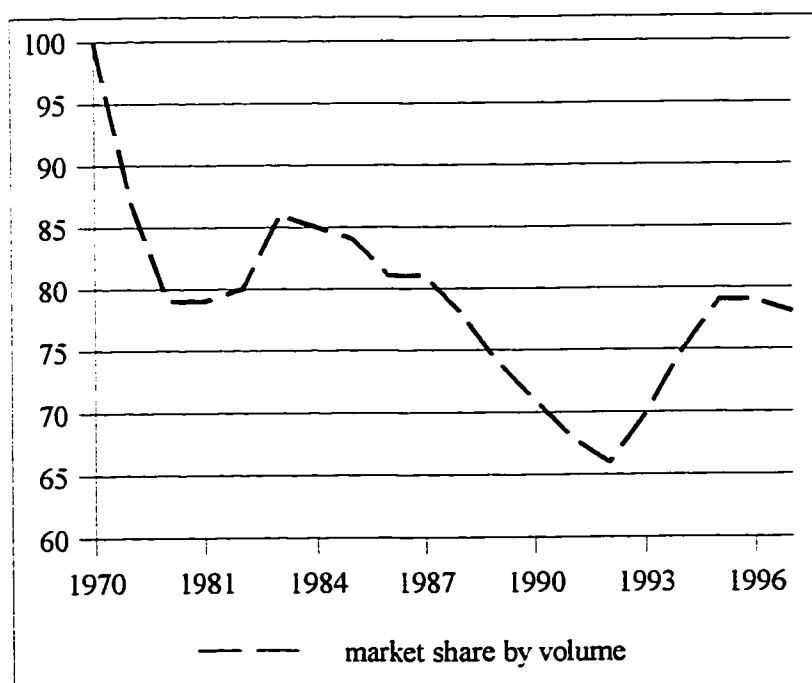


FIGURE 2.8: Market Share in Manufactured Exports, by volume, 1970=100

Source: SAF, *Fakta om Sveriges ekonomi*.

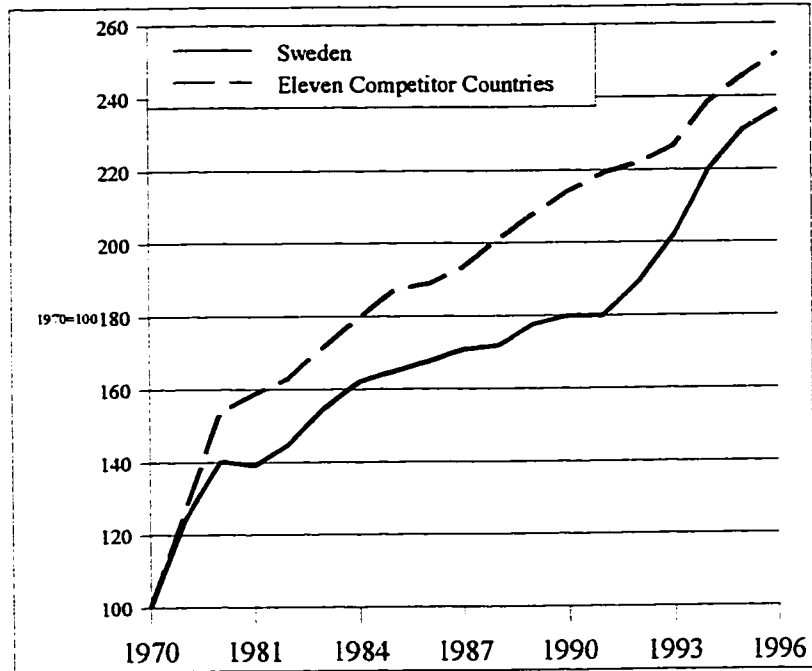


FIGURE 2.9: Manufacturing Productivity 1965-1996
Source: SAF, *Fakta om Sveriges ekonomi*.

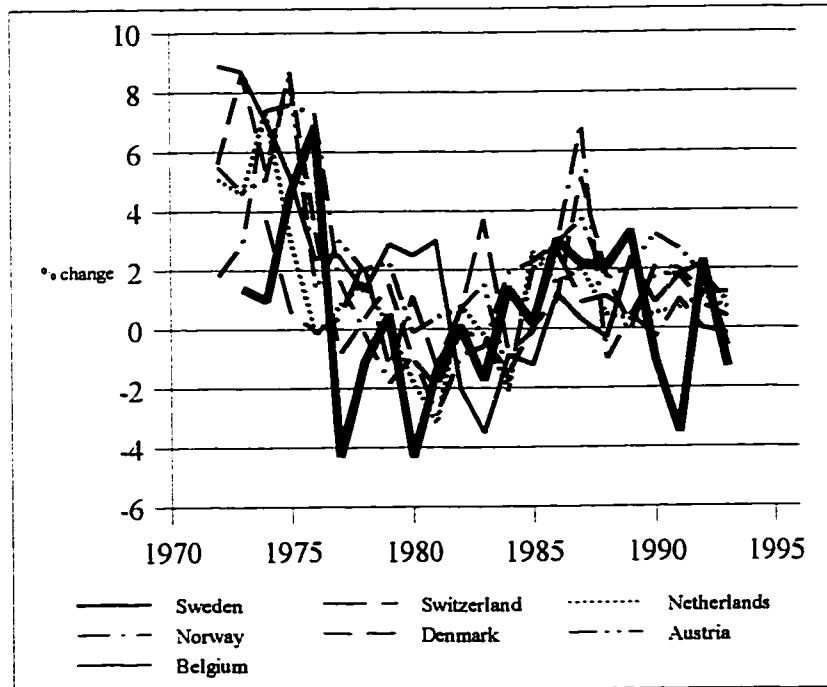


FIGURE 2.10: Real Hourly Earnings in Manufacturing 1970-1996
Source: OECD, *Historical Statistics*.

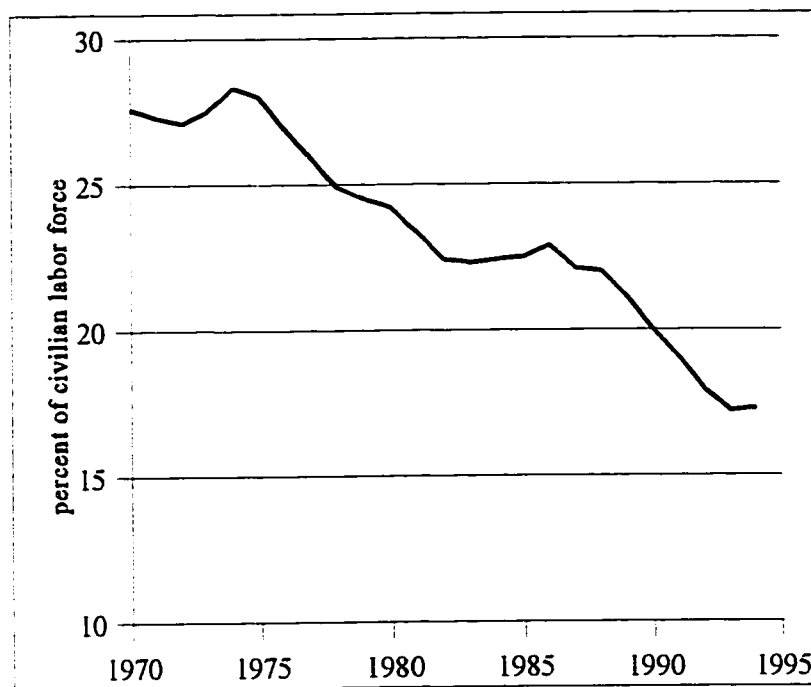


FIGURE 2.11: Manufacturing Employment 1970-1995
Source: OECD, *Historical Statistics*.

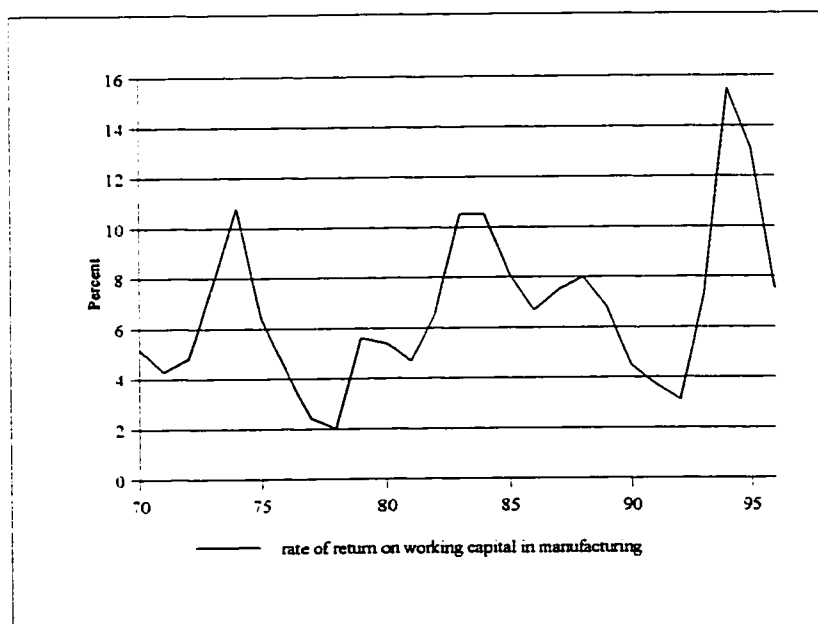


FIGURE 2.12: Rate of Return in Industry, 1970-1996
Source: SAF, *Fakta om Sveriges ekonomi*.

The Multinationalization of the Swedish Export Sector

As noted, Sweden is home to a very high number of multinational corporations. Measured on a per capita basis, Sweden was home to the highest number of MNCs in the world in 1986, with 17 of the largest non-US MNCs industrial corporations. This ratio, about two MNCs per one million inhabitants, was higher than that for Switzerland, the UK, and Germany, the other three economies with the highest degree of multinationalization.⁵⁴ The high level of multinationalization of Swedish industry means that the effects of productive capital mobility should be relatively greater in Sweden than in the rest of the OECD. Statistics on MNC employment provide support for this assertion. In 1988, Swedish MNCs employed 400,000 persons in domestic production and 530,000 in foreign subsidiaries. In 1991, Swedish MNCs employed 300,000 in domestic industry and 670,000 abroad.⁵⁵ Whatever the cause, Swedish MNCs expanded abroad and not in Sweden. Another indicator of employment trends is that the proportion of total employees of MNCs working in Sweden decreased from 60 percent in 1974 to 39 percent in 1990 (table 2.7).⁵⁶ Jagrén reports that industrial employment in Sweden decreased by about 85,000 persons between 1975 and 1990, while the number of

⁵⁴Cited in Göran Therborn, "Sweden," in Pfaller et al., eds., *Can the Welfare State Compete?* p. 230. Another way of measuring the multinationalization of Swedish industry is to calculate the number of MNCs in the world's top 500 in relation to GDP. This indicator is used in Lars Jagrén, "De dominerande storföretagen," in Thomas Andersson, et al., *Den långa vägen - den ekonomiska politikens begränsningar och möjligheter att föra Sverige ur 1900-talets kris* (Stockholm: Industriens Utredningsinstitut, 1993), p. 78. Jagrén's results for 1991 confirm those reported by Therborn. See also Feldt, *Rädda välfärdsstaten!* p. 33.

⁵⁵Fagerfjäll, *Företagandet i Sverige*, p. 143.

⁵⁶Thomas Andersson, "Den svenska industrins expansion i utlandet," in Andersson et al., *Den långa vägen*, p. 59.

employees of MNCs abroad increased during the same period by 330,000.⁵⁷

TABLE 2.7: Percentage Distribution of 100 Swedish MNCs' Employment in Sweden and Abroad, 1974-1990⁵⁸

	1974	1978	1986	1990
employees in Sweden (%)	60	58	51	39
employees abroad (%)	40	42	49	61
total (%)	100	100	100	100

Source: Andersson, "Den svenska industrins expansion i utlandet," p. 60.

According to Andersson, Swedish MNC production abroad increased by 180% between 1974 and 1990. During the same period, industrial production in Sweden increased by 16%, 26% in OECD-Europe, and 44% for the entire OECD. These MNCs produce 50-60 percent of Swedish exports. These trends have been strongest in the last half of the 1980s.⁵⁹

Trends in foreign direct investment also illustrate the centrality of MNCs in the Swedish economy. As figure 2.13 shows, foreign direct investment from Sweden increased dramatically during the second half of the 1980s. During the period 1984-1991, the EC was the destination for 172 billion kronor in Swedish FDI, while the USA attracted 39 billion kronor of Swedish FDI.⁶⁰ As table 2.8 shows, Sweden's share of outgoing FDI

⁵⁷Jagrén, "De dominerande storföretagen," p. 79.

⁵⁸Andersson uses a different number of MNCs in his calculations than Fagerfjäll so the results are different.

⁵⁹Andersson, "Den svenska industrins expansion i utlandet," in Andersson, et al., eds., *Den långa vägen*, pp. 56-57.

⁶⁰*ibid.*, p. 60.

among OECD countries reached a high of 7.3 percent, almost seven times the size of Sweden's GDP.

TABLE 2.8: OECD Countries' Outgoing Direct Investments

	1980	1988	1989	1990	1991
OECD total (USD billion)	49.0	147.0	185.0	194.0	154.0
Sweden's share (%)	1.2	5.0	5.2	7.3	6.2
Sweden's share (%) of OECD GDP	1.2	1.1	1.1	1.1	1.1

Source: Jagrén, "De dominerande storföretagen," p. 79.

In sum, at the same time that Swedish domestic industry experienced a decline in competitiveness, Swedish MNCS were stepping up their operations abroad and reducing them at home. The causes for this foreign expansion are complex and are not addressed here. The effect of this expansion abroad is dramatic: Swedish MNCs exercised their option to move production abroad. The important point for the present analysis is that this expansion made the specter of future capital flight a credible threat, regardless of the causes. Moreover, the expansion of MNC operations abroad strengthened organized business vis à vis organized labor. As a result, the preferences of Swedish business weigh more heavily in domestic policy debates.

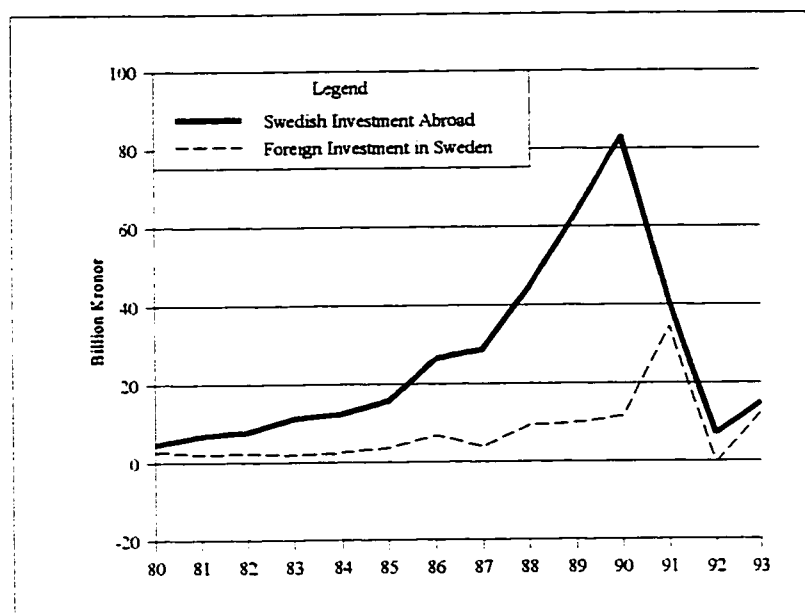


FIGURE 2.13: Swedish Foreign Direct Investment 1980-1993

Source: SAF, *Fakta om Sveriges ekonomi*.

Debating the Determinants of Competitiveness in Sweden

In a small open economy policy-makers must balance domestic policy goals against the constraints and opportunities presented by the international political economy.⁶¹ In Sweden, economic and social policy choices have always been based on the ideal of distributing the fruits of a successful capitalist economy, and the importance of export industries can hardly be overemphasized. For policy-makers, the challenge has been to adapt welfare state institutions so that they are compatible with a competitive and growing economy, led by the export sector.

⁶¹Katzenstein, *Small States in World Markets*.

For much of the postwar period, Sweden's ability to combine a generous and comprehensive welfare state with a successful capitalist economy has been held up as proof that welfare statism was compatible with economic efficiency and growth. As recently as 1991, Therborn described the Swedish welfare state as the "confluence of welfare and international competitiveness."⁶² However, Therborn's analysis stops in the late 1980s, and therefore does not include the recession of 1991-1993 or the recent cuts in social welfare benefits. In his examination of publications by the major organizations representing business interests Therborn finds little evidence that business leaders believed welfare programs hindered competitiveness. At least this view was not professed in the policy documents of organized business. The next section provides a brief survey of business opinions concerning the welfare state and competitiveness using three of the same document sources used by Therborn: statements from the Employers Federation (SAF), reports by the Research Institute of Industry (IUI), and the annual reports of the Business Study Association (SNS). In contrast to Therborn's findings, the analysis shows a marked shift in opinion on the part of organized business from grudging acceptance of the welfare state to outright hostility.

The recent political activism of the Employers Association has been well-documented.⁶³ In the 1980s, SAF stepped up its criticism of the social insurance system, arguing that high employer payroll taxes increased the costs of production and added to an already high tax wedge. In a series of publications beginning in 1990, SAF made specific

⁶²Göran Therborn, "Sweden," p. 269

⁶³Hans DeGeer, *I vänstervind och högerväg. SAF under 1970-talet* (Stockholm: Publica, 1989); and Pontusson and Swenson, "Labor Markets."

demands about how the social insurance should be reformed. SAF did not advocate a wholesale privatization of the social insurance sector, but it emphasized three issues: social insurance should be more actuarial; it should provide incentives to work rather than receive cash benefits (by increasing the level of self-risk in the system and lowering benefit levels); and employees should pay a substantial portion of the payroll taxes currently paid by employers. In other words, SAF blamed the social insurance for contributing to sagging labor productivity, labor shortages in tight labor markets, and high non-wage costs.

In a booklet published in 1990 designed to contribute to discussions about the relationship between the public sector and the labor market, the SAF leadership argued that labor productivity was too low in Sweden relative to Sweden's competitors. SAF also complained specifically about high sickness absence rates relative to other countries and recommended the introduction of an employer period. In terms of unemployment insurance, SAF recommended a reduction from 90% to 75% of qualifying income in order to increase the difference between wages and unemployment insurance benefits. In other words "it must pay to take a regular job." SAF also recommended lower tax rates in order to increase work incentives, and the introduction of a variable retirement age to provide incentives for people to work longer.⁶⁴

SAF adopted a new policy program in September 1990, called "Markets and Multiplicity." SAF called for tax decreases, including employer payroll charges, to average European levels, the nationalization of unemployment insurance, the introduction

⁶⁴SAF, *The Dynamic 90s. Work and the labour market in Sweden* (Stockholm: SAF, n.d.).

of waiting days and decreased levels of compensation in sickness insurance, the abolition of work injury insurance, and other social insurance reforms aimed at stimulating work incentives.⁶⁵

These two 1990 documents reflected employers' concerns about how they claimed social insurance programs contributed to high non-wage labor costs, low productivity, and labor shortages. In 1990, unemployment had been very low for some time and employers complained about the difficulties of recruiting qualified labor. Between 1991 and 1994, however, unemployment rose dramatically (see below) alleviating labor supply problems. As a result, subsequent policy statements emphasized non-wage costs and labor productivity.

In a booklet published in March 1992, SAF presented its view of the causes of the emerging economic crisis and offered concrete suggestions for changes in government policy. SAF argued that the crisis was due to the policy mistakes of the 1970s and 1980s, specifically the expansion of the public sector and frequent devaluations. SAF claimed that these policies led to weak productivity growth and labor shortages in the private sector. SAF also argued that social insurance programs provided incentives for wage earners to receive benefits rather than work, exacerbating weak productivity and labor shortages. SAF also blamed the centralized bargaining system for not holding wages in line with competitiveness, arguing that Swedish wage costs had increased twice as much as in competitor states in the end of the 1980s. SAF blamed the economic and social policy choices of the 1980s for causing the dramatic increase in outward foreign

⁶⁵SAF, *Marknad och mångfald-SAFs program för 90-talet* (Stockholm: SAF, September 1990).

investment, and thereby deficits on the current account and high interest rates. SAF also complained that one half of employer payroll charges were a pure wage tax because they had no relationship to employee benefits. SAF cited figures from the EC and OECD on employer fees to bolster its case for reductions. At the time, average employer payroll tax rates were 25% in the EC and 17% in the OECD. This would have required a cut in payroll taxes of about 10%. SAF asserted that benefits cuts should finance an immediate reduction to the EC average. As SAF put it, “a successive decrease in employer payroll taxes, combined with a corresponding reduction of the public sector, is the most effective structural-political measure which can be taken in order to give Swedish industry new push.”⁶⁶ SAF also specifically called for reform of the social insurance system. SAF repeated its demand that social insurance programs be designed so that it should always pay more to work than to receive benefits. SAF specifically called for reductions to 80 percent of income and the introduction of individual fees so that employers and employees pay about half. For the pension system, SAF called for the immediate introduction of a premium reserve system so that the system would be stable long in to the future.⁶⁷

Subsequent publications have emphasized these same problems.⁶⁸

⁶⁶SAF, *Bättre tider med rätt åtgärder* (Stockholm: SAF, 1992), p. 13.

⁶⁷ibid.

⁶⁸See, for example, SAF, *Väg till tillväxt* (Stockholm: SAF, March 17, 1994). SAF also publishes two annual reports which provide evidence of its view about the relationship between the welfare state and competitiveness. The first, *Facts on the Swedish Economy*, has been published since the 1970s. By 1994, the report included 60 figures reporting various indicators of economic performance, including export trends, labor productivity statistics, comparative tax rates, etc. The report is overwhelmingly negative about the size of the public sector, Swedish tax rates, and declining labor productivity. The second publication is the *Structural Report*, first published in 1994, which provides SAF's analysis of how the Swedish economy is functioning. The reports for 1994, 1995 and 1996 are sharply critical of the public sector in general and the social insurance system in particular. See, for example, SAF, *Välsändets grunder. Strukturrapport 95* (Stockholm: SAF, 1994).

Publications issued by the Business Study Association (SNS) and the Research Institute of Industry (IUI) echo the concerns voiced by SAF. The annual reports issued by SNS began to sharply criticize the social insurance system in 1989. Reports issued between 1989 and 1996 advocate fundamental reforms of the social insurance along the lines argued by SAF: the social insurance system should be made more actuarial, employer contributions should be decreased and individual employee payroll taxes introduced, and the level of self-risk should be increased. The overall direction of suggested reforms emphasizes a shift toward a more market-oriented system, with lower state spending, and much lower levels of publicly provided benefits.⁶⁹

The IUI has also been vociferous in its attacks on the welfare state, especially the social insurance system. A research report published in 1993 called for a radical reform of the social insurance system. According to the report's authors, the large size of the public sector and the negative effects of the social insurance system were a major cause of the 1991 recession: "The size and organization of the public sector as well as the negative influences on incentives represent (therefore) the basic problem in the Swedish economy." The public sector is a "crisis sector which in large part must be privatized or abolished."⁷⁰

In sum, beginning in about 1990, representatives of the business community have been vocal and united in their criticism of the social insurance system and its apparently

⁶⁹See the following reports issued by SNS: Hans Tson Söderström, ed., *I samtidens bakvatten? Konjunkturrådets rapport 1990* (Stockholm: SNS Förlag, 1990); Hans Tson Söderström, ed., *Sverige vid vändpunkten. Konjunkturrådets rapport 1991* (Stockholm: SNS Förlag, 1991); Hans Tson Söderström, ed., *Tillväxt utan gränser. Konjunkturrådets rapport 1992* (Stockholm: SNS Förlag, 1992); Hans Tson Söderström, ed., *Fast kurs med flytande krona. Konjunkturrådets rapport 1993* (Stockholm: SNS Förlag, 1993); and Hans Tson Söderström, *Välfärdsland i ofärdstid. Konjunkturrådets rapport 1994* (Stockholm: SNS Förlag, 1994).

⁷⁰Andersson, et al., *Den långa vägen*, p. 25.

negative impact on competitiveness. Organized business has also been very specific about its preferences about how the social insurance system should be reformed. According to organized business, a reformed system should contribute to lower payroll tax rates for employers, greater work incentives for employees, partial or wholesale privatization, and a direct link between social insurance payroll taxes and expected benefits. This change in opinion on the part of business leaders and those who represent business interests is remarkable. As noted, Therborn found little evidence of business criticism of the welfare state during the 1980s. What happened to cause this radical shift in opinion?

Economic Crisis and Financial Capital Mobility

The root cause of social insurance retrenchment is the deep recession which began in 1990 as a result of a delayed and drastic adjustment to economic conditions prevailing throughout Western Europe. Between 1991 and 1993, Sweden experienced its worst economic downturn since the Great Depression. 1990 marked the culmination of the transition from an economic policy regime that promoted domestic intervention in the economy and insulation from world market forces, to a new regime based on unregulated capital flows and price stability. Sweden resisted this shift longer than most other OECD countries because economic growth and full employment could be maintained throughout the 1980s as a result of the combined effects of the 1982 devaluation, the international economic upswing of the 1980s, and a high inflation rate that pushed up tax revenues. Capital controls remained in place until 1990, adding further protection from world economic influences. By 1990, however, the economic crisis was widely acknowledged.

The roots of the current crisis date from the 1970s when the oil shocks and

spiraling inflation eroded the competitiveness of Sweden's export firms. A series of devaluations implemented between 1978 and 1982 restored competitiveness, but existing institutions failed to control inflation. Since 1982, Swedish governments have ruled out devaluation as a cure for declining competitiveness. Between 1982 and 1991, the krona was pegged to a basket of currencies, and from 1991, it was pegged to the ECU. The peg to the ECU was tantamount to outlawing devaluation. Policymakers hoped to use the hard currency policy as a brake on inflation. Despite the commitment to price stability, Swedish inflation significantly outpaced that of its competitors throughout the 1980s, but there was not much of a penalty in terms of currency outflows and high interest rates because several capital controls were still in place. However, by 1990, the last of Swedish foreign exchange controls had been removed, the domestic credit market had been deregulated, and the integration of capital markets was virtually complete.

Slow or negative growth rates accompanied by high levels of unemployment strained the resource base of the social insurance system and contributed to huge budget deficits (figures 2.14 and 2.15). The twin shocks of negative growth and high unemployment created stresses which the social insurance system was not designed to handle. High replacement rates and generous eligibility rules were established in the 1960s and 1970s with stable growth rates of 3-4 percent and full employment as prerequisites. When these two preconditions disappeared in 1990, Swedish governments faced rapidly rising budget deficits. Because fewer wage-earners paid into the social security system, tax revenues fell, and the state began to cover an increasing share of social insurance expenditures. Financial markets reacted skeptically to government attempts to maintain

the fixed exchange rate in the context of skyrocketing budget deficits, sharply falling production, and rapidly rising unemployment. It was only a matter of time before financial markets would force the hand of the government, and with tax rates the highest in the OECD, action was bound to focus on the expenditure side of the system. In sum, the severe recession exposed and magnified the perceived weaknesses in the public social insurance system. Financial market actors expecting devaluation or inflation reacted to government policy by fleeing assets dominated in Swedish currency. In response, the central bank raised interest rates to record highs and the major political parties adopted sharp cuts in welfare spending in order to gain the confidence of market actors. Increasingly aggressive business interests capitalized on the crisis by blaming the welfare state for Sweden's economic woes.

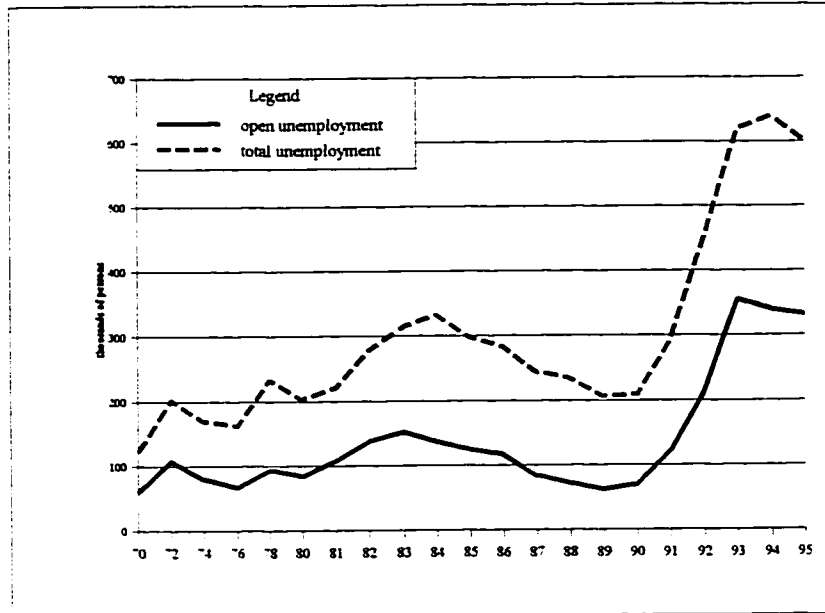


FIGURE 2.14: Unemployment 1970-1995
Source: SAF, *Fakta om Sveriges ekonomi*.

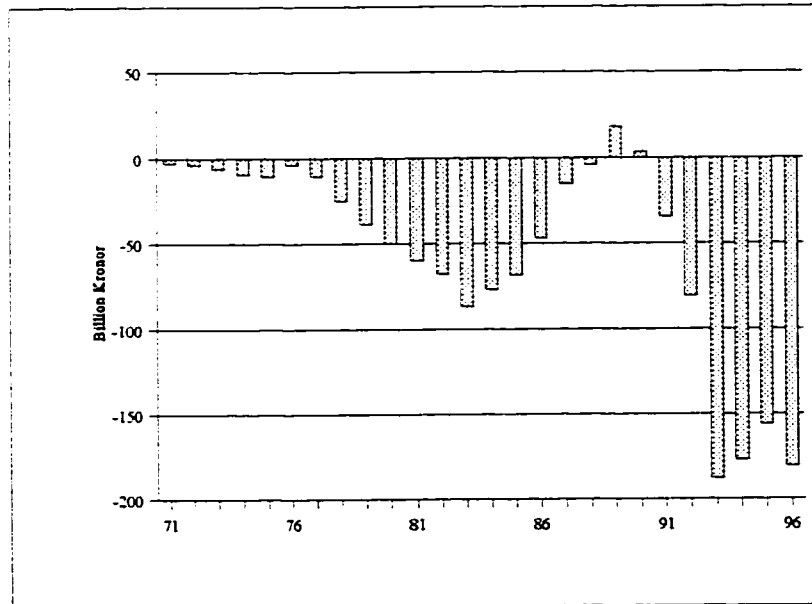


FIGURE 2.15: Central Government Budget Balance 1971-1996
Source: SAF, *Fakta om Sveriges ekonomi*.

The first cuts in social insurance occurred in the midst of acute short term economic crises which involved substantial outflows of capital and rising interest rates. Cuts were motivated by the desire to reduce budget deficits and restore the confidence of financial markets in the currency. In the context of capital mobility, politicians hoped that taking painful austerity measures such as social insurance cuts would signal to international financial markets that Swedish governments could indeed exercise fiscal discipline even if this meant imposing losses on voters.

As the budget situation grew worse and unemployment persisted at high levels, policymakers capitalized on the momentum of these initial cuts and began the process of structural reform. The election of the bourgeois coalition government in 1991 headed by Carl Bildt (conservative)⁷¹ added further momentum to the retrenchment process, even if results were unimpressive at first. Whereas the initial cuts aimed at immediate savings, more recent reforms focus on the structural features of the entire social insurance system. Although the political parties disagree on important details, all agree that structural reform is essential in order to stabilize interest rates and the value of the currency, and to reduce the budget deficit. Moreover, all parties agree that the re-designed social insurance system should be resistant to future economic shocks. Even in the case of structural reform, integrated capital markets provide a powerful constraint on public policy-making. Politicians have paid close attention to the reactions of financial markets to structural social insurance reform. In particular, politicians have watched short-term capital flows in

⁷¹The bourgeois minority coalition consisted of the Conservatives, Liberals, Center Party, and Christian Democratic Party. Unlike the bourgeois coalitions that governed Sweden 1976-1982, the Conservatives dominated the Bildt government.

domestic currency (flow of foreign exchange) and relative interest rates as the main indicators of financial market confidence in their policies.

Garrett argues that "the expected reaction of financial markets is likely to be the primary restraint on government policy in a world of mobile capital."⁷² In terms of fiscal policy, capital market integration increases the availability of funds for borrowing, but it also exposes governments to the judgements of investors. Sweden's history of devaluation and high inflation, as well as the emerging budget crisis resulted in persistently high interest rates as investors demanded an interest rate premium as a safeguard against possible devaluation and high inflation (Figures 2.16 and 2.17). When the economic crisis hit in 1990 with rising unemployment and budget deficits, politicians faced the full force of integrated capital markets which severely constrained their options. The traditional Swedish method of fighting recession would have been to pursue an expansionary fiscal policy by expanding public employment and to step up active labor market measures. Although governments have pursued the latter option since the recession hit, the magnitude of the crisis demonstrates the limits of the traditional policy mix.⁷³

⁷²Geoffrey Garrett, "Economic Integration and the Politics of Monetary Policy in the United States," in Robert O. Keohane and Helen V. Milner, eds., *The Internationalization of Domestic Politics* (Cambridge: Cambridge University Press, 1996), p. 88.

⁷³Active labor market policies are expensive. With open unemployment reaching previously unthinkable levels of 7-8 percent, this type of policy could hardly absorb all of those without jobs.

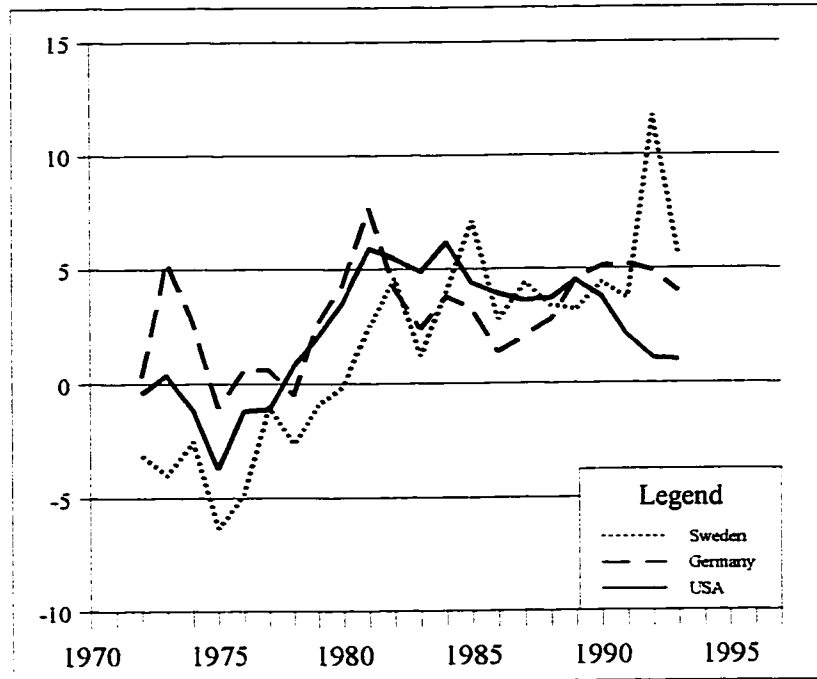


FIGURE 2.16: Real Short-term Interest Rates 1972-1996
 Source: OECD, *Historical Statistics*.

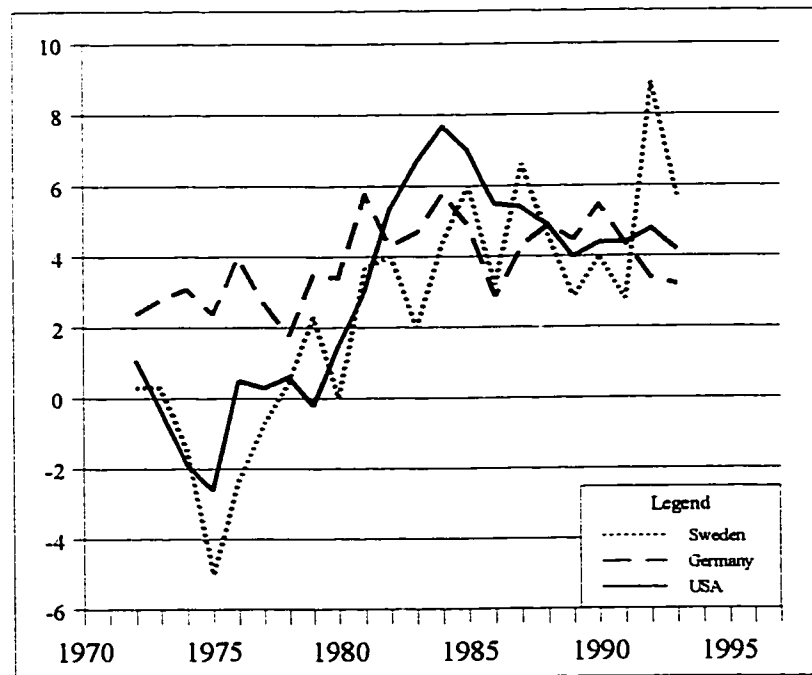


FIGURE 2.17: Real Long-term Interest Rates, 1972-1996
 Source: OECD, *Historical Statistics*.

Chronology of Main Economic Events

Capital outflows and high interest rates began to plague the Swedish economy in early 1990. The first signs of crisis-motivated cuts came in the Spring of 1990 under the Social Democratic government. After failing to control wage inflation and deal with the overheated economy, the government proposed an austerity package containing a general wage and rent freeze as well as a ban on strikes. In the wake of sharp criticism, the government fell in a vote of confidence but returned two weeks later with a new finance minister, Allan Larsson. In a crisis agreement worked out with the Liberal party, the government gained support for a program that focused on fighting inflation. Employers assumed responsibility for the first fourteen days of sickness insurance and were compensated with a reduction in the payroll tax for sickness insurance. Benefits were also reduced. For the first time, a Social Democratic government reduced benefit levels in an income maintenance program. The background to these crisis cuts was large capital outflows requiring intervention by the central bank to stabilize the value of the currency.

In October of 1990, another crisis hit the Swedish economy. In the midst of capital flight and fears of devaluation, the government announced its intention to apply for membership in the European Community. This decision was a remarkable turnaround for the Social Democrats since they had consistently maintained that EC membership was not compatible with Sweden's longstanding policy of neutrality.⁷⁴ Financial markets calmed, but interest rates remained high. In the (final) Social Democratic budget presented in early

⁷⁴On the Swedish EU decisions, see Leslie C. Eliason and Emily O. Goldman, "The High Stakes of Low Politics: The Nordic Neutrals and the European Community," Working Paper 93-4 in Public Policy Analysis and Management, Graduate School of Public Affairs, University of Washington.

1991, two aspects attracted much attention. In terms of economic policy goals, fighting inflation was moved up to number three after full employment and economic growth. Elsewhere in the budget, the fight against inflation was emphasized to such a degree that many observers speculated that a Social Democratic government was prepared to allow unemployment to increase in a recession.⁷⁵ That the government would emphasize the fight against inflation was an important signal to both financial and labor markets. The government declared that it would not assist in wage negotiations if the agreement was too high, and the clear signal to foreign exchange markets was that the government had no intention of devaluing to accommodate a high wage agreement. In May of 1991, the krona was pegged to the ECU, and in July Sweden formally applied for EC membership.

The state of the economy worsened in the summer of 1991 as a result of the overvalued krona and high interest rates. Unemployment rose from 1.5% in 1990 to 2.7% in 1991, and GDP growth completely stopped. In the wake of these difficulties, it is not surprising that a bourgeois coalition formed the government after the 1991 national election. The inability of the Social Democratic government to manage the economy, and their repudiation of election promises alienated many traditional Social Democratic voters.

The new bourgeois government headed by Prime Minister Carl Bildt promised to restore Sweden as an industrial nation and to undertake far-reaching reforms of the welfare state. Financial markets calmed and interest rates fell, but in 1992 the economic situation rapidly deteriorated. In 1992, increasing uncertainty about whether the bourgeois government would exercise fiscal discipline resulted in another round of rising

⁷⁵Dag Rolander and Carl Hamilton, *Att leda Sverige in i krisen* (Stockholm: Norstedts, 1993)

interest rates and capital outflows. In March 1992, interest rates rose because of the growing budget deficit, the weak economy, and the banking crisis.⁷⁶ Expectations of a Finnish devaluation also increased pressure on the krona. On April 3, 1992, SEK 22 billion left the country, and the Riksbank raised marginal rates from 11 to 13 percent. The Danish rejection of the Maastricht Treaty also fed uncertainty about Sweden's relationship to the EC, adding upward pressure on interest rates.⁷⁷ In June and July, SEK 5.6 billion left the country. In August, pressure was more intense as doubts surfaced about the ability of the Bildt government to deal with the growing deficit. In the third week of August, the currency outflow was SEK 10 billion. In the last week of August, the outflow was SEK 22 billion.⁷⁸

In September 1992, Sweden was dragged into the currency turmoil that hit Western Europe and resulted in the devaluation of the British pound, the Italian lira, and the Finnish markka. Downward pressure on the krona resulted from the sharp fall in industrial production and the dramatic deterioration of public finances. The Finnish devaluation on September 8 increased capital outflows from Sweden. As currency left the country, the Riksbank emptied its exchange reserves, raised interest rates, and resorted to foreign currency borrowing.

⁷⁶In the wake of speculation and deregulation, the banking system fell into a crisis between 1992 and 1993. Government assistance to bail out failed banks totaled 3.5 percent of GDP in 1993. See, for example, *Proposition 1994/95:100, bilaga 1.1*, p. 25. For an analysis of the banking crisis and its causes, see Karl-Henrik Petersson, *Bankkrisen inifrån* (Stockholm: SNS Förlag, 1993).

⁷⁷See Leslie C. Eliason, "Reading the Cards on the Table: Danish Politics in the Era of European Integration," *Scandinavian Studies* 64:4 (Fall 1992).

⁷⁸"Monetary and Foreign Exchange Policy in 1992," *Quarterly Review of Sveriges Riksbank* 1 (1993), pp. 5-14.

The Riksbank drastically increased marginal (overnight) interest rates to dampen the currency outflow. On September 10 the marginal rate was raised to 75%. On September 16, rates went up to 500% to stem the outflow. It was against this backdrop that the Bildt government and the Social Democratic opposition agreed on two hastily constructed crisis packages, on September 20 and 30. The two crisis packages contained reductions in employer payroll taxes and cuts in sickness insurance, pensions, and unemployment insurance. These measures were aimed at reducing the deficit, and they were negotiated by party leaders without public debate. Sharp cuts in social spending were designed to influence financial markets and reduce capital outflows. Moreover, the package of cuts was aimed at reducing the costs of export firms.

These crisis measures calmed financial markets for a while, but in late October, currency outflows continued on a larger scale as traders sold Swedish kronor in large amounts. This developed into a wave of speculation. Between November 12 and 19, the equivalent of SEK 158 billion in foreign currency left the country. Finally, on November 19, the Riksbank abandoned its defense of the currency, and a devaluation was forced. Figure 2.18 shows the flow of foreign exchange⁷⁹ between 1989 and early 1995.

In sum, Swedish governments faced the full impact of capital market integration at the worst possible moment. The failure of economic policy in the 1980s resulted in high inflation and falling industrial production. Unable to control inflation via existing institutions, Swedish policymakers tied themselves to the mast of EU discipline. Since

⁷⁹The flow of foreign exchange is the sum of the capital balance and the balance on current account. It is also equal to the change in foreign currency reserves minus other central bank cross-border transactions minus government foreign current borrowing.

1990 Swedish governments have responded to capital outflows with a series of crisis

packages designed to cut expenditure in order to gain the confidence of financial markets.

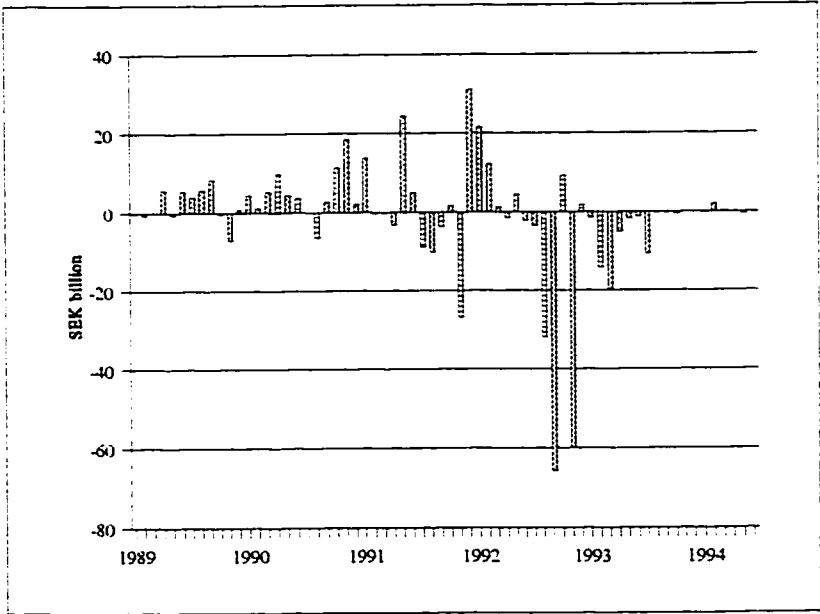


FIGURE 2.18: Flow of Foreign Exchange, 1989-1995
Source: Sveriges Riksbank, *The Quarterly Review*, various issues.

Forced to act on the conditions set by the market, government attempts to deal with rising budget deficits were met with skepticism on the part of financial asset holders. Only in the wake of massive capital outflows and intense downward pressure on the currency could politicians muster the political will to impose significant losses on social insurance beneficiaries. Financial market reactions continue to constrain government policy even after the currency crisis of Autumn 1992. Throughout the process of structural reform, politicians have watched market reactions to proposed reforms very closely, and regaining the confidence of financial markets has been a significant factor driving the retrenchment process.

It was only in this context of acute economic crisis that the SAP changed its position about social insurance reform and the bourgeois parties could dare to challenge social democratic hegemony in social insurance policy. Severe economic crisis can lead to political crisis that create the "political space" or "policy window" necessary for political entrepreneurs to reshape domestic politics.⁸⁰ The influence of the world economy is most visible during currency crises; downward pressure on a currency communicates to governments that financial asset holders have lost confidence in their policies. As Keohane and Milner put it, "when countries adopt policies that generate large and persistent budget deficits or inflation, relative price changes in international markets may wreak havoc on the country's currency."⁸¹

⁸⁰On the concept of the policy window, see John T.S. Keeler, "Opening the Window for Reform: Mandates, Crises, and Extraordinary Policy-Making," *Comparative Political Studies* 25:4 (January 1993).

⁸¹Keohane and Milner, *Internationalization and Domestic Politics*, p. 246.

Conclusion

This chapter argues that there is a discernable logic to the political dynamics of retrenchment when it occurs as adjustment to competitive decline in the context of capital mobility. The analytical framework laid out in this chapter emphasizes two ways that internationalization affects domestic social politics. First, capital mobility influences the relative strength of domestic actors. Second, capital mobility influences the interests of domestic actors.

The multinationalization of Swedish industry increased its political influence vis à vis organized labor. The ineffectiveness of previous labor strategies of promoting competitiveness, devaluation and centralized wage bargaining, contributed to labor's weakness relative to business. The mobility of productive capital increased Swedish firms' exit options, and the investment of Swedish MNCs abroad gave credibility to that threat. The mobility of financial capital reduced the attractiveness of devaluation as an adjustment mechanism. When market actors (Swedish MNCs and financial markets) signaled their displeasure with government policy, political actors responded with reforms which satisfied many of the professed demands of organized business dominated by multinational export firms. Organized business did not get everything it wanted in terms of social insurance reform, but the similarity between business demands and actual cutbacks is striking. This conclusion challenges the capital mobility literature which argues that the mobility of financial rather than productive capital is the primary constraint on domestic policy choices,⁸² and it is consistent with arguments advanced by Schwartz and Huber and

⁸²Garrett, *Partisan Politics*.

Stephens about the significance of the multinationalization of Swedish export industry for understanding the recent pressures on welfare state institutions.⁸³

The literature which asserts that financial rather than productive capital mobility is the primary constraint on domestic policy choices also ignores the ways in which financial and productive capital mobility interact.⁸⁴ For one thing, the distinction between productive and financial capital is not always clear. Multinational corporations may hold *both* productive and financial assets and thus may be important actors in both markets for traded goods and markets for financial assets. An important aspect of the Swedish currency crises of 1990 and 1992 demonstrates this. Swedish MNCS were among the financial asset-holders which fled assets denominated in Swedish currency, contributing to the pressure on the currency.⁸⁵

Productive and financial capital mobility interact in a second way as well. When the actions of financial market actors create pressure on currency values, governments intent on maintaining a fixed exchange rate must adopt policies designed to restore confidence in the currency. If market actors demand budget discipline and price stability, governments have a wide range of options from which to choose. But how do governments choose among options almost certain to involve unpopular cuts? This

⁸³Herman Schwartz, "Social Democracy Going Down or Down Under: Institutions, Internationalized Capital, and Indebted States," *Comparative Politics* 30:3 (April 1998); and Evelyne Huber and John D. Stephens, "Internationalization and the Social Democratic Model. Crisis and Future Prospects," *Comparative Political Studies* 31:3 (June 1998).

⁸⁴Huber and Stephens, "Internationalization;" Duane Swank, "Social Democratic Welfare States in a Global Economy: Scandinavia in Comparative Perspective," in Robert Geyer, Christine Ingebritsen, and Jonathan Moses, eds., *Globalization, Europeanization, and the End of Scandinavian Social Democracy* (London: Macmillan, in press); and Garrett, *Partisan Politics*.

⁸⁵Feldt, *Rädda välfärdsstaten!*

chapter argues that the preferences of productive capital, as well as the mechanics of policy design, are important influences on government choices about which programs to cut. This effect of the mobility of productive capital on specific welfare state policy preferences is not examined in most arguments about internationalization. The brief review of the 1990-1993 economic crisis in Sweden reveals that two specific employer demands, EC/EU membership and the partial privatization of sickness insurance, were the first policy reversals carried out by the SAP and the non-socialist parties. I argue that these two policy choices were not simply the avenue of least political resistance, but rather, these policy changes were also intended to satisfy business concerns about declining competitiveness. The policy reversals were aimed not only at calming financial markets, but they were also designed to improve the performance of the export sector (sickness insurance) and stem the flow of productive capital flight from Sweden (EC/EU membership). Besides these two policy changes, the crisis packages contained significant reductions in employer payroll taxes, another specific demand of SAF. These issues are explored in greater detail in the case study chapters.

CHAPTER 3: THE DOMESTIC SOURCES OF WELFARE STATE RETRENCHMENT

The previous chapter elaborated a theoretical framework for analyzing the impact of internationalization on domestic social policy choices. This chapter focuses on the domestic political factors that shape political struggles about retrenchment. The arguments developed here draw explicitly on elements from both Esping-Andersen's class coalition/labor power model and Pierson's policy feedback model. I attempt to combine the insights of both approaches by emphasizing the political institutions, the role of the labor movement and the impact of program structures on retrenchment in specific social insurance programs. My analysis differs from that of power resources theorists by focusing on the institutional bases of labor power and splits within the labor movement. I sketch the conditions under which labor power matters in the retrenchment process and provide an explanation for why labor might not try to block retrenchment efforts. Following Pierson, this chapter emphasizes the role of program structures and formal institutions in influencing the difficulty of retrenchment initiatives. However, I extend the analysis of program structure beyond a simple examination of who benefits from existing social insurance arrangements. I examine two additional features of program operation that may channel retrenchment politics in important ways: the issue of financing and the issue of administration. These two aspects of program structure are largely ignored in both Esping-Andersen's and Pierson's analyses.¹ Finally, the framework developed in this

¹Paul Pierson, *Dismantling the Welfare State? Reagan, Thatcher, and the Politics of Retrenchment* (Cambridge: Cambridge University Press, 1994); and Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton: Princeton University Press, 1990).

chapter highlights the political importance of organized capital in retrenchment politics.

Analysis of the role of organized labor is a central aspect of this analytical framework. When Left parties and unions are still strong, the nature of retrenchment will reflect the interests of labor, and a government of the Left will attempt to manage the retrenchment process so that it least jeopardizes labor's power resources in the long run. When welfare reform occupies a prominent place on the national political agenda regardless of which party is in office, this will lead to "competitive retrenchment" in which Left governments attempt to reform welfare programs in line with their own priorities lest the parties of the Right win the next election and initiate reforms which may be anathema to the labor movement. When welfare reform is perceived as inevitable, then the retrenchment process becomes one of setting priorities, or deciding which programs will be cut and restructured, and in what order. In this type of process, the power resources of class actors definitely matter.

Retrenchment is an especially tricky and painful process for a social democratic government committed to fiscal discipline because high unemployment and large budget deficits may require "re-commodification" in income maintenance programs. Once it has accepted the necessity of cutbacks, a social democratic party will confront internal divisions and union opposition. Above all, a social democratic party advocating cutbacks must convince its constituents of the need for reform. The internal cohesion of the labor movement influences whether this is possible. Alternatively, a social democratic party and union movement united in opposition to cuts renders retrenchment nearly impossible. In other words, labor can either facilitate or oppose retrenchment. In either case, labor is the

dominant actor.

The chapter begins with a discussion of Esping-Andersen's influential study of capitalist welfare state regimes and evaluates the utility of the labor power/class coalitions approach for predicting retrenchment outcomes. Esping-Andersen's class mobilization/coalition approach is then compared to the policy feedback model recently elaborated by Pierson. I argue that Esping-Andersen's approach provides more theoretical insight into the dynamics of retrenchment than Pierson claims. In fact, both the Esping-Andersen and the Pierson models are compatible, and my analysis incorporates elements from both. The chapter concludes with a discussion of the problem of measuring retrenchment.

The Power Resources/Class Coalitions Model

In order to establish the potential importance of organized labor in the retrenchment process, it would be helpful to return to some of the arguments advanced by the power resource theorists. Of relevance here are the role of labor in influencing the structure of welfare state programs, and the impact of regime institutionalization in welfare state regimes dominated by labor.

According to the labor power resources theorists, differences in the balance of class power largely explain variations in welfare state development in the advanced capitalist states. Stephens, for example, argues that comprehensive, redistributive welfare states emerge because of the strength of organized labor and the political influence of

labor/social democratic parties.² Labor power means that “welfare state policies can be used both to counteract the dominance of capital that market relationships entail and to reinforce the effective solidarity of organised labour.”³ Korpi makes a similar argument about the impact of labor power on social policy. According to Korpi, “the power resources of the wage earners are channeled through unions and political parties.” Thus, the unions represent the interests of wage earners in the economic arena, and the social democratic party represents the interests of wage earners in the political arena. As Korpi argues, “close ties between the organizations in these spheres--the two wings of the labour movement--have helped to bridge the gap between the roles as citizen and as a wage earner.”⁴

Esping-Andersen modifies the power resources approach to include class coalitions. Esping-Andersen argues that social democratic power in Scandinavia has been predicated on the construction of class coalitions. Social democratic welfare policy plays a critical role in this process. In Sweden, labor joined forces with the farmer's party in the famous Cow Trade of 1933, exchanging agricultural price supports for political acceptance of Social Democratic employment policies. By the 1950s, class structural changes had reduced the number of farmers and increased the size of the white-collar workforce. As the worker-farmer alliance lost its political appeal, the Social Democratic

²John D. Stephens, *The Transition from Capitalism to Socialism* (Urbana: University of Illinois Press, 1979).

³Christopher Pierson, *Beyond the Welfare State? The New Political Economy of Welfare* (University Park, PA: Pennsylvania State Press, 1991), p. 30.

⁴Walter Korpi, *The Working Class in Welfare Capitalism. Work, Unions and Politics in Sweden* (London: Routledge and Kegan Paul, 1978), p. 318.

Party entered into a new class coalition, with the burgeoning middle classes. This coalition was based on the introduction and/or modification of social programs designed to appeal to both blue and white-collar groups. Thus, the 1933 Cow Trade ushered in 44 years of uninterrupted Social Democratic rule in Sweden, and paved the way for the construction of a welfare state deeply imbued with Social Democratic values and strategic goals. Social Democratic governments adopted legislation that transformed Sweden into what Esping-Andersen calls the "social citizenship state." Benefits and services are available to all citizens as a matter of right, and they are tailored to middle class needs and expectations. As a result, the public economy grew exponentially in the postwar period as the state extended its reach into nearly all aspects of welfare, effectively precluding the emergence of a market for private welfare, both in services and in social insurance. In other words, the structure of the welfare state generated cross-class support for the welfare state.

In a later study, Esping-Andersen extends this argument and uses it to explain welfare state variations in 18 capitalist countries. In Esping-Andersen's modified approach, three variables explain social policy outcomes: "the nature of class mobilization (especially the working class), class political coalition structures, and the historical legacy of regime institutionalization."⁵ Based on this analysis, Esping-Andersen finds that welfare states cluster into three distinct regimes: liberal, corporatist, and social democratic. Liberal welfare states such as the USA and Great Britain, means-tested benefits, modest social insurance, and private and occupational alternatives to state welfare predominate. In

⁵Esping-Andersen, *The Three Worlds*, p. 29.

corporatist/conservative welfare states such as Germany, publicly provided social insurance programs reinforce status and income differentials. Finally, the social democratic welfare regime is characterized by the dominance of universal, state-financed benefits and services and a minimal role for private or market alternatives to state welfare.

Esping-Andersen arrives at this typology by examining three main dimensions of welfare state regimes: the quality of social rights (whether social benefits are awarded as a matter of right, rather than on the basis of labor market performance or status), social stratification (whether programs are universal, means-tested, or occupationally based), and the relationship between state, market and family (the extent of state produced and financed welfare as opposed to family or market produced welfare). The notion of social rights also captures the extent to which welfare states promote "decommodification," or the ability of citizens to secure basic needs outside the market.⁶

In welfare states like Sweden's where organized labor has been a potent force driving welfare state development, Social Democratic values are deeply embedded in social policy. As Esping-Andersen puts it, Social Democratic social policy must promote three goals: solidarity, decommodification, and equality. First, solidarity is created and maintained through universal benefits and the absence of meaningful private alternatives to state social insurance schemes. This is most evident in the areas of social services and social insurance. Private health care, child care, and pension schemes are very rare, at

⁶For criticisms of Esping-Andersen's typology, see especially Ann Shola Orloff, "Gender and the Social Rights of Citizenship: the Comparative Analysis of Gender Relations and Welfare States," *American Sociological Review* 58 (1993); and Francis G. Castles and Deborah Mitchell, "Identifying Welfare State Regimes: The Links Between Politics, Instruments and Outcomes," *Governance* 5:1 (January 1992).

least they have been until recently. Second, decommodification, or freeing workers from the market imperative in securing basic needs, is achieved through high income replacement rates in social insurance programs, few or no qualifying days in sickness insurance and similar programs. Third, equality is guaranteed through state provision and financing of services such as health care, education, and care for the elderly and handicapped. However, Esping-Andersen notes that where corporate and private alternatives to state programs proliferate, middle class support of the welfare state may diminish and lead to welfare backlash and retrenchment. Thus, the political risks are very high for a Social Democratic government that presides over a divisive welfare state that weakens popular attachments to state-sponsored welfare programs.

In sum, Esping-Andersen argues that comprehensive, universal programs will generate support beyond the working class and enhance the power resources of the labor movement. Thus, state policy plays a critical role in generating support for both the social democratic welfare state and the party itself. High earnings-related benefits in, for example, pensions meant that private alternatives were crowded out. Thus, social policy wedded the emerging middle classes to the Social Democratic project and cemented the working class-middle class coalition supporting the welfare state. Once in place, the universalist welfare state proved to be hugely popular and became a more or less uncontested part of the political landscape. All political parties in Sweden except for the conservatives support the universal model (*generell välfärdspolitik*) as an article of faith,

although they differ on other aspects of the welfare model.⁷ Thus, regime institutionalization not only generated cross class support for the welfare state, but it also led several other parties to adopt the main features of the welfare model as their own.

Although Esping-Andersen does not analyze retrenchment per se, he argues that "a theory that seeks to explain welfare-state growth should also be able to understand its retrenchment or demise."⁸ Thus, the prospects for retrenchment depend on the class character of welfare state regimes. Thus, "the class coalitions in whichwelfare-state regimes were founded explain not only their past evolution but also their future prospects."⁹ Esping-Andersen's theory of Social Democratic decomposition and welfare state variations would locate the causes of welfare state restructuring in the failure of Social Democratic strategies to maintain and/or broaden class coalitions. If the political power resources of class actors, class coalitions, and regime institutionalization explain policy outcomes, the task for Social Democratic governments is to keep the middle classes loyal to the welfare state. The irony is that a Social Democratic government now finds itself presiding over the kinds of cuts that have the potential to undermine middle class support in the long run. In the past, new reforms such as the national supplementary pension system (ATP), parental insurance, and the like, have served to attract and consolidate middle class support for the welfare state. Now, however, it seems inconceivable that there will be room for this type of strategy in the foreseeable future.

⁷For example, the Center Party advocates a fairly high level of basic security (*grundtrygghet*) which can be supplemented with private insurance, and the Liberal Party favors more market mechanisms within state sponsored programs. But neither party advocates abolishing the universal model.

⁸Esping-Andersen, *The Three Worlds*, p. 32.

⁹*Ibid.*, p. 33.

Thus, even when labor's power resources are still considerable, and there is cross-class support for the welfare state, restructuring and retrenchment are squarely on the national agenda.

The preceding discussion does not mean, however, that Esping-Andersen's arguments offer no insight into the politics of retrenchment. As argued in chapter one, the power resources/class coalitions approach underplays the role of organized capital in welfare state politics, fails to examine labor's internal divisions, and attaches little significance to the impact of international economic processes. As argued later in this chapter, modifying Esping-Andersen's arguments to include these variables provides the basis for a plausible explanation of the politics of retrenchment in Sweden. Before turning to this task, the next section discusses the utility of Pierson's policy feedback model.

The Policy Feedback Model

In one of the few theoretically informed studies of retrenchment, Pierson argues that the politics of retrenchment are fundamentally different from the politics of welfare state expansion. Because retrenchment is not simply the "mirror image" of expansion, the dominant approaches for explaining welfare state development will be of little use in the current period. Pierson argues that because retrenchment is generally unpopular, politicians pursue strategies designed to avoid blame, instead of taking credit for scaling back welfare programs. Policy feedback from existing programs, rather than the influence of political parties, social movements, and labor organizations, is the crucial variable in Pierson's analysis of the politics of retrenchment.¹⁰ The expansion of the welfare state has

¹⁰Pierson, *Dismantling the Welfare State?*

led to the emergence of organized and influential interest groups that derive direct benefits from social programs whose costs are spread across a wide population. When threatened with retrenchment, these groups can organize effective campaigns against benefit cuts. Thus, governments hoping for reelection face almost insurmountable obstacles in their retrenchment attempts. In this new political landscape transformed by the growth of the welfare state itself, retrenchment is possible only when governments can hide their actions from potential opponents, compensate groups negatively affected by cuts, or divide supporters of social welfare programs.

Pierson uses this theoretical framework to explain why even determined conservative governments such as Reagan's and Thatcher's quickly retreated when faced with the backlash that would have accompanied cuts in popular middle class programs with strong interest groups behind them. Overall, Pierson finds little evidence of programmatic retrenchment in the United States and Great Britain, although some programs and policies were more vulnerable to cuts than others. Reagan and Thatcher were more successful, however, in their attempts to carry out "systemic retrenchment" or policy changes that increase the likelihood of future cutbacks.¹¹

Pierson's theoretical framework for analyzing retrenchment emphasizes three variables: the goals and incentives of important political actors, the distribution of political resources, and the institutional "rules of the game." The first variable concerns retrenchment strategy, while the second two variables have to do with the context within which retrenchment strategies are carried out.

¹¹Ibid.

Based on the claim that retrenchment is a difficult political project, Pierson identifies three strategies for minimizing political opposition: obfuscation, division, and compensation. Obfuscation is the most important of the three strategies for minimizing resistance to retrenchment because it provides politicians with the greatest number of potentially effective options at the least cost. Obfuscation entails attempts to control and/or manage information about policy changes so that there is low public awareness of impending cuts. Strategies of division involve designing cutbacks so that they affect some groups and not others. This is essentially a “divide and conquer” strategy for minimizing opposition. Finally, strategies of compensation provide protection from cuts to groups likely to be outspoken in their opposition to retrenchment.

The political viability of these three retrenchment strategies turns on their interaction with two contextual variables: the distribution of political resources and the structure of institutions. Thus, the “organizational capacities of welfare state supporters matter” but Pierson emphasizes the declining importance of organized labor for defending the welfare state from retrenchment. As Pierson puts it, “the study of retrenchment must shift from labor to the more varied constituents of individual programs....Interest groups linked to particular policies are now prominent political actors.” Thus, Pierson attributes the rise of pro-welfare interest groups as “one of the clearest examples of how policy feedback from previous political choices influence current struggles.” Prominent among these interest groups are organizations representing pensioners, the disabled, health care providers, and so on.¹²

¹²Ibid., pp. 28-29.

As Pierson notes, interest group influence on retrenchment outcomes depends on whether the membership can be mobilized. The structure of both formal political institutions as well as the institutional effects of policy legacies provide the context within which retrenchment strategies play out. As Pierson puts it, “institutions set the rules of the game for political struggles, shaping group identities and their coalitional choices, enhancing the bargaining power of some while devaluing that of others.”¹³ Pierson focuses on two types of institutional factors: formal political institutions and policy feedback. Both variables influence the viability of specific retrenchment strategies.

Pierson highlights two aspects of formal political institutions especially relevant to retrenchment politics: horizontal (parliamentary vs. separation of powers systems) and vertical integration (federal vs. centralized systems). Whether political systems are organized in a federal or parliamentary system, for example, influences the viability of strategies for defusing opposition to retrenchment. In centralized political systems like Great Britain’s, both power and accountability are concentrated. This means that even governments well-positioned to impose losses hesitate to do so because of their accountability at the polls. The structure of national-local governmental relations also opens up the possibility of shifting retrenchment burdens onto subnational levels of government, by decentralizing fiscal and/or implementation responsibility to local government units.

Pierson argues that social policies themselves “constitute important rules, influencing the allocation of economic and political resources, modifying the costs and

¹³Ibid., p. 31.

benefits associated with alternative political strategies, and thus altering ensuing political development.”¹⁴ Pierson identifies three types of policy feedback that help influence the viability of retrenchment strategy: interest group activity, lock-in effects, and information effects. Policy designs offer incentives and resources that channel interest group formation and development in specific ways. Lock-in effects refer to the ways in which policy designs influence individual behavior such that previous policy choices become difficult to reverse. For example, public pension schemes encourage individuals to adapt their retirement planning to include the provision of a public pension. Finally, information effects include “policy-induced cues (that) may influence a private individual’s awareness of government activity.”¹⁵ Social policy structures provide information to individuals that affect perceptions of interest and influence the traceability of retrenchment.

Pierson’s framework provides a compelling explanation for the limited success of retrenchment policies in the USA and Great Britain. In particular, Pierson’s emphasis on the constraints and opportunities for retrenchment created by institutions and policy feedback is an extremely effective way of analyzing retrenchment. However, the framework can be criticized on several points.

The first criticism concerns case selection. Pierson may be too quick to dismiss theories of welfare state expansion since the two cases he studies, Reagan’s America and Thatcher’s Britain, represent attempts by determined conservative governments to dismantle the welfare state. In particular, Pierson’s claim concerning the declining political

¹⁴Ibid., p. 40.

¹⁵Ibid., p. 45

importance of the labor movement in welfare state politics is premature. Esping-Andersen reminds us that there is nothing especially socialist about welfare state policies since the first social programs were enacted by conservative regimes in Germany and elsewhere. Welfare capitalism exists in various forms across the advanced capitalist states, and organized labor has not been the dominant force behind these developments except in Scandinavia. What matters is the nature of working class mobilization, labor's ability to forge coalitions with other social classes and its effectiveness in influencing the types of social policies adopted.¹⁶ In the US and the UK, labor was not the dominant force in welfare state development, and so labor power cannot be invoked to explain retrenchment outcomes.

Second, Pierson's framework rests on the implicit assumption that the relationship between interest group structure and welfare state structure in other welfare states is broadly similar to the pluralist systems of the USA and Great Britain.¹⁷ Pierson argues that feedback effects from previous policies has led to the emergence of interest groups that owe much of their political resources and public support and sometimes even their very existence to the creation and expansion of welfare state programs. However, to the extent that the labor movement represents the interests of welfare state client groups, labor is likely to lead the opposition to retrenchment, dictate the terms of retrenchment, or both. Whether or not this is the case depends to a large extent on the role of labor during

¹⁶Esping-Anderson, *Politics Against Markets. The Social Democratic Road to Power* (Princeton: Princeton University Press, 1985); and Esping-Andersen, *The Three Worlds*

¹⁷For a similar criticism, see Jelle Visser and Anton Hemerijck, 'A Dutch Miracle.' *Job Growth, Welfare Reform and Corporatism in the Netherlands* (Amsterdam: Amsterdam University Press, 1997), chapter three.

the long period of welfare state expansion. Where centralized and powerful unions and social democratic parties have dominated welfare state development, client groups separate and autonomous from the labor movement are less likely to emerge. As a result, interest group politics are solidaristic rather than segmented and the labor movement dominates the representation of the interests of welfare state clients. This claim is consistent with Pierson's focus on the role of interest groups and policy feedback, but it contradicts his conclusion about the declining significance of organized labor in retrenchment politics.

This alternative line of argument is supported by the Swedish case. The effect of SAP dominance in social policy development in the decades following WWII has had a marked impact on the organization of interest groups in Swedish society. As a result, the interest groups with a large stake in existing welfare state policies and programs are virtually one and the same with the labor movement, and the existence of these interest groups predates if not the creation, then at least the expansion of most welfare state programs. In fact, the two largest union confederations, the LO (Trade Union Confederation) and TCO (Confederation of White Collar Employees), have been the most influential groups driving welfare state expansion, effectively crowding out the emergence of segmented interest groups characteristic of the US and UK.

Third, Pierson focuses primarily on interest groups representing the beneficiaries of welfare state programs. Despite the utility of this emphasis, it obscures potentially important retrenchment dynamics created by groups affected by the financing and administrative aspects of program design. This study argues that the interest groups

representing those who finance social welfare benefits must also be brought in the analysis of retrenchment politics because these groups might actively seek retrenchment, and their influence may exceed that of groups representing beneficiaries. For example, where business is highly organized and dominated by multinational corporations, it may push for retrenchment. In Sweden, employers have traditionally financed the social insurance system through payroll taxes invisible to the employee, and since the 1970s they have pushed for reductions in these charges, arguing that high labor costs hinder competitiveness. In other words, retrenchment efforts may involve specific and concentrated benefits rather than the diffuse benefits that Pierson claims. Pierson's analysis largely ignores the role of organized business in retrenchment politics.

Similarly, Pierson largely neglects the question of who administers social welfare programs by merging this issue with that of who benefits. For example, public health care providers would be expected to oppose the privatization of a national health service, as was the case in Great Britain in the 1980s. However, the issue of provision must be distinguished from that of administration. In the former case, the interests of providers are based on their role as employees. Thus, the interest groups representing welfare service providers would be expected to promote the interests of their members as wage-earners. There are other types of administrative arrangements which result in a different set of political dynamics such as when the administration of a social welfare program by an interest group allows for the provision of selective incentives to members. As Mancur Olson has shown, interest groups rely on the provision of selective incentives to members

to increase their membership and thereby their organizational resources.¹⁸ Because of this, the question of who administers may be just as politically important as who benefits. For example, the unions administer the unemployment insurance system in several West European welfare states, including Sweden, and this arrangement provides powerful incentives for wage-earners to become union members.¹⁹ For governments intent on curbing union power, the de-corporatization of such administrative arrangements may be a high priority even though the issue of benefits is not directly at stake. Similarly, we would expect labor parties to jealously guard existing administrative arrangements which enhance the organizational resources of unions.²⁰

Fourth, Pierson limits his focus on formal institutions to the distinction between horizontal and vertical institutional integration. This study departs from Pierson's analytical framework by examining the importance of three additional institutional features: the system of interest intermediation, the rules of electoral competition, and the structure of the party system. These three types of institutions not only provide the "rules of the game" for political struggles, but they can also contribute to the relative political power of important societal actors like the labor movement. Interest group influence on retrenchment outcomes depends on whether interest groups are segmented or solidaristic,

¹⁸Mancur Olson, *The Logic of Collective Action* (Cambridge: Harvard University Press, 1965).

¹⁹Bo Rothstein, "Labor-Market Institutions and Working-Class Strength," in Sven Steinmo, Kathleen Thelen, and Frank Longstreth, eds., *Structuring Politics. Historical Institutionalism in Comparative Analysis* (Cambridge: Cambridge University Press, 1992).

²⁰The issue of corporatist administration of social welfare benefits is addressed in Claus Offe, "Smooth Consolidation in the West German Welfare State: Structural Change, Fiscal Policies, and Populist Politics," in Frances Fox Piven, ed., *Labor Parties in Post-industrial Societies* (New York: Oxford University Press, 1992); and Visser and Hemerijk, 'A Dutch Miracle.'

whether they are linked to political parties, and how they are incorporated into the policymaking process. Electoral rules are important because they influence the number of parties in the legislature and whether governments are likely to be minority, majority, and/or coalitions. The organization of the party system structures the way that cross-party coalitions can be mobilized in favor of retrenchment. Whether the right or left-wing bloc of parties is split into several parties or whether it is dominated by one large party may be very important in the politics of retrenchment. Similarly, the internal organization of political parties influences whether parties can overcome internal opposition to retrenchment efforts.

The Swedish system of interest intermediation is typically classified as corporatist. This means that interest groups cooperate in the formulation and administration of public policies to a greater extent than in pluralist systems. However, Swedish policymaking institutions provide governments with important options for limiting the influence of interest groups opposed to retrenchment. Interest groups typically participate in the policy process in three ways. First, interest groups may take part in the Official Commissions of Inquiry which investigate reforms and make proposals. Second, interest groups respond to Official Commissions of Inquiry and the resulting government proposals in an official comment (*remissvar*). The government is obligated to consider these comments before presenting legislation to parliament. Third, interest groups may consult informally with the government itself. This avenue is usually exercised when the

SAP controls the government and engages in regular consultation with the LO.²¹

Of these three avenues for influence, only the official comment period is required by law. Thus, a government seeking to limit interest group influence may decide to exclude the interest groups from the Commissions of Inquiry or it may decline to consult with interest groups outside the formal policymaking channels.²² As the case studies show, the bourgeois government used both of these strategies, while the SAP has been more cautious in limiting interest group participation. Nevertheless, despite the close relationship between the SAP and LO, the SAP has resisted LO objections on many occasions.

As the case studies will demonstrate, the process of social insurance retrenchment was most successful when politicians were able to minimize "veto points." Immergut observes that passing legislation requires a sequence of affirmative votes at all points in the decision-making process. Swedish institutions privilege the executive in the policymaking process, and the use of Official Commissions of Inquiry ensures that the interests of affected groups are incorporated into the policymaking process.²³ Executive dominance in policymaking means that majority cross-party alliances can be struck even

²¹On Swedish political institutions, see Olof Pettersson, *Swedish Government and Politics* (Stockholm: Fritzes, 1995); Torbjörn Larsson, *Det svenska statskicket* (Lund: Studentlitteratur, 1993); Nils Elvander, *Intresseorganisationerna i dagens Sverige* (Lund: Gleerups, 1972); and Thomas J. Anton, *Administered Politics. Elite Political Culture in Sweden* (Boston: Martinus Nijhoff Publishing, 1980).

²²This would constitute a breach of long-established corporatist consultation norms. However, it is important to note that this is not the first time that the interests of a powerful group have been ignored. In both the 1959 ATP reform and the 1982 wage-earner fund reform, the SAP completely ignored the protests of the employers organizations.

²³Ellen M. Immergut, "The Rules of the Game. The Logic of Health Policy-Making in France, Switzerland, and Sweden," in Sven Steinmo, Kathleen Thelen, and Frank Longstreth, eds., *Structuring Politics. Historical Institutionalism in Comparative Analysis*, (Cambridge: Cambridge University Press).

before the investigative process begins. Whereas the Official Commissions of Inquiry have typically been used to maximize the incorporation of interest in the policy process, social insurance reform demonstrates that the Commissions can also be used to exclude interest groups and thereby limit their capacity to block legislation. In contrast, short-term social insurance cuts usually unfold very rapidly and do not rely on the investigative process. In this type of policy process, the logic of decision-making within Swedish political institutions dictates that minority governments seek support from one or more opposition parties before legislation is drafted. Thus, short-term social insurance retrenchment involves continuous bargaining between the government and opposition parties.

The interaction of Swedish electoral rules²⁴ with the enduring capacity of the labor movement for political mobilization means that Swedish politics is characterized by the division of political parties into a socialist bloc dominated by the Social Democrats (SAP) and a fragmented non-socialist bloc consisting of three or four parties. Since the constitutional reform in 1969, Swedish electoral rules have tended to produce minority governments. The SAP has chosen to form minority governments and rely on the support of the Left Party, while bourgeois governments have typically formed multiparty governments consisting of three or four parties. Given that retrenchment is a difficult task, bourgeois governments face formidable constraints in their capacity to impose losses on voters. First, the non-socialist parties do not share fundamental assumptions about the welfare state, so agreement on painful cuts is difficult. Second, a non-socialist minority

²⁴Sweden has a unicameral parliament elected according to proportional representation. Parties must gain at least 4% of the national vote in order to win seats in parliament.

government faces even greater obstacles since it must attract support for its policies from at least one other party.²⁵ For the Bildt government (1991-1994), this meant gaining the support of the recently elected populist New Democracy Party,²⁶ or cooperating with the SAP. Both options would prove difficult, as later chapters demonstrate. Moreover, social insurance cuts adopted without the consent of the SAP run the risk of reversal under a future SAP government. This constraint holds even when the bourgeois governments can form a majority government. Given the volatility of Swedish politics since 1976, the risk of reversal was a serious concern.

Two aspects of the party system are important for analyzing the politics of retrenchment. First, as noted, retrenchment dynamics are likely to be very different in multiparty systems than in the two party systems Pierson analyzes. Second, internal party decision-making processes may be a critical factor in overcoming internal opposition to retrenchment and minimizing political costs. Strong political parties capable of reconciling general societal goals with the particular interests of their constituencies are ideally positioned to pursue retrenchment policies if they can formulate retrenchment strategies that satisfy both sets of goals. Strong political parties able to overcome inevitable internal opposition to tough cuts increases the likelihood of successful retrenchment.²⁷

²⁵One might argue that multiparty coalitions facilitate “blame avoidance,” but this can only be the case if the coalition parties can agree on a course of action in the first place.

²⁶New Democracy was formed in 1991 and was voted out of parliament in the September 1991 election. The party left the Riksdag in 1994 when they failed to receive enough votes in the national election.

²⁷For treatments of the internal organization of the SAP and its relationship with the LO, see Gullan Gidlund, “From Popular Movement to Political Party: Development of the Social Democratic Labor Party Organization,” and Klas Åmark, “Social Democracy and the Trade Union Movement: Solidarity and the Politics of Self-Interest,” in Klaus Misgeld, Karl Molin, and Klas Åmark, eds., *Creating Social Democracy. A Century of the Social Democratic Labor Party in Sweden* (University Park, Pennsylvania: Pennsylvania State Press, 1992).

Finally, Pierson underestimates the importance of policy learning as a feedback variable. As the case studies will show, the Swedish investigative process played an important role in identifying the perceived weaknesses in the social insurance system and in providing opportunities for minimizing interest group opposition to reform. The National Insurance Board served a similar function. Thus, one crucial aspect of policy feedback has been the recognition that several aspects of the existing social insurance system were severely out of step with international and domestic economic developments. In sum, feedback from previous policy choices may result not only in widespread support for the social insurance system, but also in the identification of serious problems. Thus, the motivation for reform and retrenchment may not be hostility to social insurance provision, but rather the perceived weaknesses of the system and its contribution to national economic difficulties. Thus, politicians may choose to reduce benefits and alter the structure of eligibility rules which involve a recommodification of wage-earners in order to adjust the system to a new and harsher economic climate. When the public begins to doubt the credibility of the social insurance system, even tough cuts may lead to greater legitimacy and thus increased public support.

In sum, the interaction of political institutions, program structures, and labor power means that the SAP is best positioned to influence retrenchment initiatives, and long term retrenchment is virtually impossible without the cooperation of the SAP. The willingness of both bourgeois and Social Democratic governments to attempt retrenchment is explained largely by the fiscal crisis of the state in the wake of the recession of 1991-1993. However, large program and government budget deficits were a

necessary, but not sufficient condition for substantial retrenchment. Recent research demonstrates that seemingly powerful economic constraints do not necessarily lead to welfare state cutbacks.²⁸ Groups representing the interests of retrenchment advocates, especially organized business, must be able to translate increased resources into political influence, and this occurs only if governments are both able to construct a parliamentary coalition in favor of cutbacks and willing to withstand the electoral risks of retrenchment.

The SAP possessed an effective veto over non-socialist government proposals at least under the conditions prevailing from 1991 to 1994. In government (1988-1991 and 1994-), the SAP has had multiple coalition possibilities for attracting support for tough cuts. The SAP is also better positioned to withstand electoral punishment for retrenchment. When retrenchment is perceived by substantial sectors of the electorate as inevitable because of economic crisis, voters face the choice of social democratic retrenchment or bourgeois retrenchment. Given the popularity of the welfare state and the role of the SAP in building it, the SAP is likely to be able to weather the kind of public opposition which spells trouble for a bourgeois government.

Nowhere is the continued influence of the SAP more visible than in social insurance retrenchment. Income maintenance programs are arguably some of the most difficult targets for retrenchment since cuts are immediately and directly felt by voters. Moreover, because most income maintenance programs are constructed as contributory insurance schemes, voters feel entitled to benefits since they have paid into the system. In

²⁸Kurt Weyland, "How Much Political Power do Economic Forces Have? Conflict Over Social Insurance Reform in Brazil," *Journal of Public Policy* 16 (1996). Weyland focuses on the limited impact of international financial institutions and other economic interests.

Sweden, the most important interest groups representing the beneficiaries of welfare programs are the LO and TCO. Thus, overcoming opposition to retrenchment means either convincing the trade union confederations, the LO and TCO, of the need for retrenchment and incorporating their interests in the retrenchment process, limiting their influence, or both. For a bourgeois government, minimizing union opposition requires the cooperation of the SAP since the SAP historically has moderated disaffection within the ranks of the labor movement. For an SAP government, reducing union opposition entails consultation with the LO, and to a lesser extent the TCO, about the form and content of retrenchment. For the labor movement, the task is to manage the retrenchment process so that social democratic values can be preserved in the long run. Above all, governments must convince the LO and TCO of the need for reform, and only the SAP is equipped to accomplish this.²⁹

The SAP has the most at stake in the retrenchment process because the welfare state is largely a Social Democratic achievement. However, because of its institutional advantage, the SAP is best positioned to achieve retrenchment and to manage the process so that it least jeopardizes its goals in the long run. The SAP is the most influential player in the retrenchment process because reforms legislated without its consent run the risk of reversal. Multiparty agreement including the SAP is the sine qua non for long term retrenchment success.

Conceptualizing Retrenchment

²⁹According to Heclø and Madsen, the SAP has an enormous capacity for overcoming dissent within the party and the unions. See Hugh Heclø and Henrik Madsen, *Policy and Politics in Sweden. Principled Pragmatism* (Philadelphia: Temple University Press, 1987).

Pierson relies on Titmuss's distinction between "residual" and "institutional"³⁰ welfare states for his conceptualization of retrenchment. Pierson defines retrenchment as "policy changes that either cut social expenditure or restructure welfare state programs to conform more closely to the residual welfare state model, or that alter the political environment in ways that enhance the probability of such outcomes in the future."³¹ This focus on retrenchment as moves toward welfare state residualism is problematic. If we accept that welfare capitalism is here to stay, albeit in changing forms, then retrenchment may not be an issue of whether welfare states are becoming more residual. Adopting Esping-Andersen's typology as a baseline for assessing welfare state retrenchment provides for a better conceptualization of retrenchment. Retrenchment is better viewed as weakening within a particular regime type, or a move toward another regime type. This approach also allows for explaining cases in which retrenchment occurs, but where the movement is not necessarily in the direction of the residual welfare state model. Clearly, there can be considerable retrenchment according to Pierson's definition, but this may not mean that a welfare state is becoming more residual.

It is necessary to distinguish between retrenchment in particular welfare sectors and retrenchment in the welfare state as a whole. Pierson attempts to solve this problem by distinguishing "programmatic" retrenchment from "systemic" retrenchment.

³⁰Institutional welfare states consist mainly of comprehensive programs and rely mainly on public provision of welfare services. These welfare states generally work toward reducing distinctions based on class or status and attempt to limit the impact of market mechanisms in securing basic needs. In contrast, residual welfare states interfere much less with the market, opting instead for public financing or subsidization of private services, rely more on means-tested programs, and generally work to reinforce the patterns of social stratification produced by the market. See Richard Titmuss, *Social Policy* (New York: Pantheon, 1974).

³¹Pierson, *Dismantling the Welfare State?* p. 17.

Programmatic retrenchment refers to spending cuts or reorganization in specific programs while policy changes³² that alter the context for future spending decisions constitute systemic retrenchment. This distinction obscures the fact that retrenchment may occur simultaneously with expansion. Politicians faced with difficult decisions about how to cut welfare spending may choose to sacrifice one program in order to save or expand another.

These criticisms suggest that the politics of retrenchment may not be adequately captured by Pierson's definition of retrenchment. Many changes in program structure, financing, and in the relationship between public and private provision cannot be illuminated by Pierson's definition of retrenchment. Major changes in welfare policies and programs can be carried out without necessarily involving more residualism. Thus, retrenchment may not be a matter of more residualism, but rather, changes within regimes that imply a weakening of the most salient characteristics of that regime. Thus, this study distinguishes between *structural programmatic retrenchment* and *within-regime programmatic retrenchment*. *Structural programmatic retrenchment* refers to policy changes which entail movement toward residualism. *Within-regime programmatic retrenchment* occurs when we see a weakening in any of three central dimensions (social rights, social stratification effects, and the relationship between state, family and market) which constitute a regime. For Social Democratic welfare states, this entails a close

³²Pierson identifies four types of systemic retrenchment. First, policy changes such as tax cuts or limits on future tax increases may result in "defunding" of the welfare state. Second, policy-induced changes in public opinion can decrease support for welfare programs and enhance the possibilities for public acceptance of private schemes. Third, reforming political institutions may change the way the welfare state is administered and thereby influence policy outcomes. This may include either decentralization of political control or centralization. Fourth, government policy can attempt to weaken the interest groups favoring certain programs. This can be accomplished through the tax code or by changing rules for government funding of interest groups.

examination of the degree of universalism in welfare programs, their decommodifying effects (levels of compensation, the extent of user fees, and the existence of waiting days), the extent of state sponsored social service provision, and the degree to which private alternatives compete with state programs.³³

The process of retrenchment in Sweden suggests that we should be wary of attempts to conceptualize retrenchment as policy changes that only entail residualism. Where welfare reform is on the agenda, retrenchment is most likely to occur within the structure of existing programs, and this may or not involve residualism, depending on the character of the welfare state regime. This conclusion confirms Pierson's claim that radical retrenchment is unlikely even in the event of a severe economic crisis. But if radical retrenchment is an unlikely outcome, this need not preclude the study of restructuring and reform that constitute significant departures from existing program commitments. Surely, these kinds of policy changes are theoretically interesting, even if they do not entail residualism. The fact that welfare states are now mature reflects the fact that the process of constructing welfare states has been a long and politically contested process. Welfare states took decades to build, and so it is likely that the process of retrenchment will also be a long and contested process. But the politics of retrenchment are also likely to occur simultaneously with the politics of welfare state expansion. Thus, the process is likely to be fraught with contradictions, as politicians sometimes roll back some programs and sometimes expand others.

³³Sainsbury uses the term "downsizing" to refer to what I call "within-regime retrenchment." See Diane Sainsbury, *Gender, Equality, and Welfare States* (Cambridge: Cambridge University Press, 1996), chapter nine.

CHAPTER 4: SUBSTANTIAL RETRENCHMENT: SICKNESS CASH BENEFITS AND WORK INJURY INSURANCE

This chapter analyzes the process of retrenchment in two programs providing income support for the employed: the sickness cash benefit system and work injury insurance. These two programs are examined together for several reasons. First, the programs are closely related in terms of function: both provide income security for members of the labor force who cannot work because of medical reasons. In other words, these two programs provide the bulk of income support for active members of the labor force (people who hold regular employment), unlike pensions or unemployment insurance. Second, the sickness cash benefit system shares many eligibility and benefit rules with the work injury insurance system, and the two programs are often considered in a single piece of legislation. Finally, the perceived problems of both sickness insurance and work injury insurance are closely related. Rising take-up rates and skyrocketing costs in both programs became a serious cause for concern throughout the 1980s and 1990s.

In contrast to pensions and unemployment insurance, cuts were earliest and deepest in sickness insurance and work injury insurance. Between 1990 and 1998, Social Democratic and non-socialist governments implemented a partial privatization of sickness cash benefits; reduced benefits from 100 to 75% of qualifying income; shifted a large proportion of program financing from employers to employees; tightened eligibility; and replaced work injury cash benefits with sickness cash benefits. These changes were achieved not via large scale reform, but through the adoption of a series of incremental cuts. In sum, sickness and work injury benefits were the first of the three policy areas to

be cut, and retrenchment in these two programs has been most successful. Although benefits remain universal and income-related, the new systems of sickness and work injury insurance are significantly less “decommodifying” than before. In other words, wage earners face a radically different set of incentives when deciding between work and absence.

Why did politicians choose sickness and work injury insurance as their first target for cuts? What accounts for the success of sickness and work injury insurance retrenchment relative to outcomes in pensions and unemployment insurance? The distinctive features of the sickness and work injury insurance systems explain a large part of their political vulnerability to retrenchment. By the end of the 1980s, Sweden was home to the highest rates of sickness absence in the OECD. Rising costs for the state, and high absences in workplaces created a double-edged source of support for reform. Employers wanted lower sickness absences in order to improve productivity, and politicians grappled with the problem of how to reduce costs in programs running large deficits. The SAP lined up decisively in favor of retrenchment at an early stage and was willing to risk conflict with the LO on the issues of privatization and benefit cuts. The employers and non-socialist parties had long advocated reform along these lines, so the basis for support was already present.

Unlike pensions and unemployment insurance, comprehensive, public sickness cash benefits directly influence the productive conditions of firms. Thus, the impact of internationalization has been greatest in sickness and work injury insurance systems. Cuts in sick pay would not only reduce costs for the state, but would also reduce worker

absenteeism and result in productivity gains for firms, thereby improving competitiveness. Because both programs were financed largely by employer payroll contributions, retrenchment advocates charged that they contributed to unacceptably high non-wage labor costs. Organized business was unified in its criticism of how the operation and financing of both programs contributed to declining competitiveness. This aspect of sickness insurance also helps explain the willingness of the SAP to support retrenchment during a period of declining competitiveness, as well as the grudging acceptance of reform by the LO.

SAP and LO support for reform is also explained by other aspects of program structure. Privatization could be implemented without a reduction in benefits, and costs could be relatively easily transferred to employees from employers. The reliance of both sickness and work injury insurance on trust fund financing also meant that program deficits were highly visible, heightening their vulnerability to program cuts. In addition, the impact of benefit reductions would be spread across a relatively large group, the entire labor force. Moreover, because of the nature of sickness and work injury frequency, benefit cuts would have a wide variation of impact. The biggest losers in terms of nominal benefit cuts were those with long-term illnesses and work-related illnesses lasting more than one year. Cuts in sickness cash benefits and work injury insurance therefore involved lower political costs for the SAP, LO, and the non-socialist parties.

Once the SAP and the unions ceased to block reform, retrenchment came fairly easily. This is not to say that the SAP and LO enthusiastically promoted retrenchment. However, this policy area was not nearly as important to the labor movement as

unemployment insurance, so LO opposition to cuts must be interpreted as mainly symbolic protests to changes deemed inevitable. Finally, cuts in sickness and work injury insurance could be used as bargaining chips by the SAP in its negotiations with the non-socialist parties about cuts in other policy areas, particularly unemployment insurance. Faced with the inevitability of cuts because of the economic crisis, the SAP chose to sacrifice sickness insurance in order to protect unemployment insurance from nationalization. That the SAP was willing to cooperate in substantial retrenchment is therefore also the result of the lower political salience of this policy area for the labor movement.

The structure of both programs also provided ample opportunities for retrenchment. Politicians could claim that reforms would result in less sickness, for example, by stepping up rehabilitation efforts. Attempts to prevent illness were one way to achieve cost control, which would result in savings for the state, workers, and employers. Additionally, reforms could be packaged in terms of fairness: cuts were designed so that all wage-earners were affected equally. White collar workers would not receive higher benefits via employment contracts, and private insurance possibilities were limited. This was clearly a concession formulated by the SAP to appease LO and lower the political risks of retrenchment. Finally, recommodification in these two policy areas fit well with existing SAP ideas about the value of the “work line,” that is, the SAP’s emphasis on labor market participation rather than the passive receipt of a benefit check.

As was the case in both pension and unemployment insurance reform, the Social Democratic Party has dominated the retrenchment process in sickness and work injury insurance. In government from 1990-1991 and again since 1994, the SAP has been able

to forge parliamentary alliances with other parties to gain support for tough cuts. As the major opposition party to the Bildt government between 1991 and 1994, the SAP could often block reforms it found unacceptable or negotiate with the government for less drastic cuts. Either way, the Bildt government was hampered by its minority government status and could usually only pass its reform initiatives when the SAP offered its support.

Historical Background

Sickness insurance has its roots in the voluntary sickness funds established in the second half of the 1800s. Although modest state financing and regulation began in the 1930s, a national system of sickness insurance was not fully established until the 1950s. In contrast, work injury insurance is one of the oldest state income support programs in Sweden, and through the 1940s, it was one of Sweden's most comprehensive and developed social insurance schemes. In the decades following World War II, Social Democratic governments spearheaded the expansion of both programs. This social democratization is reflected in the financing and benefit rules of both programs: they are financed by employer contributions, benefits are income-related, and coverage is universal. Private alternatives to these two public programs were virtually non-existent.

As noted, a loose network of voluntary sickness insurance funds emerged in the second half of the 1800s as a response to pressures of industrialization.¹ In the absence of

¹This section draws on Åke Elmér, *Svensk Socialpolitik*, 17th edition (Uddevala: Almqvist & Wiksell Förlag, 1991); Rafael Lindqvist, *Från folkörelse till välfärdsbyråkratin. Det svenska sjukförsäkringssystemets utveckling 1900-1990* (Lund: Arkiv Förlag, 1990); Torsten Svensson, *Socialdemokratins dominans. En studie av den svenska socialdemokratins partistrategi* (Uppsala: Acta Universitatis Upsaliensis, 1994); Magnus Henreksen, Kari Lantto, and Mats Persson, *Bruk och missbruk av sjukförsäkringen* (Stockholm: SNS Förlag, 1992); and Ellen Immergut, *Health Politics. Interests and Institutions in Western Europe* (Cambridge: Cambridge University Press, 1992), chapter 5.

state or employer-sponsored sickness benefits, wage earners set up their own voluntary funds to provide income support during illness. As the number and size of the funds grew, the state stepped in to provide modest financing and regulation in 1891, 1910, and 1931.² These early reforms were not the result of Social Democratic demands, but rather, they were initiated by a Liberal government (1891), a Conservative government (1910) and a Liberal government (1931). Nevertheless, parliamentary discussions continued about how to improve the operation of the sickness fund network as well as how to eventually replace them with a system administered by the state. The 1931 legislation passed with near unanimity in parliament, and it provided the most far-reaching state regulation of the existing funds. The legislation provided for a 100 percent increase in state subsidies to the funds, and membership increased from about one million members in the early 1930s to three million members by 1954, or about 60-65% percent of the population. As Immergut puts it, the 1931 law “transformed the sickness fund movement from a randomly scattered group of voluntary associations to a national network of coordinated insurance funds.”³

Despite the growth of the funds, benefits were meager; the daily benefit was not even enough to support one person. Besides this, many workers were not members; the early system never included more than 60% of the active labor force because membership was voluntary and good health was required for coverage. With the SAP firmly in power after World War II, parliament again considered major reform, this time with the aim of transforming the existing sickness funds into a state-sponsored, obligatory system of

²The most thorough discussion of these reforms is provided by Immergut, *Health Politics*, pp. 194-202.

³*Ibid.*, p. 201. The system also partially financed some medical care costs.

sickness insurance. In 1946, the SAP secured passage of legislation creating a national system of flat-rate sickness cash benefits, but the system was not implemented until 1955.⁴ The SAP repeatedly opted to delay implementation because of internal disagreements about whether cash benefits should be flat-rate or income related. Thus, after nearly a decade of internal party debate and several official investigations, the Social Democratic government finally achieved the introduction of a universal, obligatory, earnings-related sickness insurance scheme in 1953. The new insurance included three waiting days and took effect in 1955.⁵ All parties in parliament except for the Conservatives (Högern) supported the legislation.⁶

In 1962 parliament adopted the law on public insurance (LAF) which abolished the remaining sickness funds and replaced them with public insurance offices (försäkringskassor). The public insurance offices took over the administration of sickness insurance, pensions and work injury insurance. This arrangement has been reformed in several stages: legislation adopted in 1963 removed the formal limit on benefit length and raised the level of compensation. In 1967 the number of waiting days was reduced from three to one and the level of compensation was raised again.⁷ In 1974, benefits were

⁴The state now took over the medical care functions of the sickness funds with the introduction of national health insurance. See *Ibid.*, chapter 7.

⁵The greatest disagreement within the SAP concerned the issue of whether the program should provide flat-rate or income-related benefits. In the late 1940s, the Minister of Social Affairs, Gustav Möller, advocated the former alternative and provisional legislation was adopted but never implemented. By 1951, Möller had resigned and his replacement, Gunnar Sträng, actively promoted the principle of income replacement. This was the orientation that prevailed in the 1953 legislation. See Svensson, *Socialdemokratins dominans*, pp. 196-206.

⁶Lindqvist, *Från folkrörelse till välfärdsbyråkratin*, p. 174.

⁷In practice this would usually mean that the first waiting day did not result in income loss because wage earners could work a full day and then call in sick to the insurance office for the next day.

raised again but at the same time they became taxable and eligible for pension points. The result was that after tax, benefits were the same.

The emergence of large budget deficits in the late 1970s was the impetus for the first attempts at reductions in sickness cash benefits. In the spring of 1982, the Center-Liberal government adopted legislation requiring two additional waiting days in sickness insurance as well as decreased nominal benefits. These measures were explicitly intended to reduce worker absenteeism in the midst of a severe cost crisis for Swedish firms, and to save SEK 1.4 billion per year for the state.⁸ The official commission investigating the reform also proposed the introduction of a two week employer period in sickness insurance, but this idea was shelved because of bitter opposition from LO.⁹ As Immergut describes it, “the privatization of sick pay was seen as an attempt by the state to renege on its commitment to the rights of workers.”¹⁰ The SAP vigorously opposed the cuts and promised to reverse them if returned to office in the fall of 1982.

After their election victory, the SAP quickly moved to restore the previous benefit rules. The SAP added one more improvement in 1987, by abolishing the one remaining waiting day. This change was seen as a victory for the LO because most white collar workers received benefits from the first day of illness as the result of collective agreements. Thus, according to the new rules, LO and TCO members would receive the

⁸Richard M. Coughlin and Richard F. Tomasson, “Sweden,” in Martin B. Tracy and Fred C. Pampel, eds., *International Handbook on Old-Age Insurance* (New York: Greenwood Press, 1991).

⁹The official commission which studied the issue proposed the introduction of an employer period and lower benefit levels but these proposals were not included in the government bill. See SOU 1981: 22, *Sjukersättningsfrågor, m.m.*

¹⁰Immergut, *Health Politics*.

same benefits.¹¹ In sum, by 1990, benefits were comprehensive, generous, and virtually unlimited in duration.

The development of work injury benefits followed a similar trajectory. As noted, work injury insurance is one of the oldest state income support programs in Sweden. The first legislation in the area of work injury was adopted in 1889 at the initiative of a Liberal government. In 1901, The first law providing universal, flat-rate work injury benefits was passed, and in 1918, parliament passed legislation requiring employers to provide income-related work injury insurance.¹² During the postwar period, Social Democratic governments gradually expanded the program, with subsequent reforms aimed at coordinating work injury insurance with the sickness insurance introduced in 1955 and improving benefits.¹³ Financing was reformed in 1977 with the establishment of the work injury insurance fund financed with employer payroll contributions (.6% of payroll). Finally, the 1980s were marked by the steady expansion of benefits because of the emerging practice of liberal interpretation of the definition of work injury.¹⁴

¹¹The system was complicated by the fact that white collar workers had collective agreements covering sick pay in addition to the state system. Additionally, a number of group insurance schemes among LO unions emerged. For many wage-earners, actual compensation was thus higher than that guaranteed by the public system. Before the 1987 reform, about 40% of workers had a level of compensation of 90% of income for every day of sickness. After the 1987 reform, everyone got a compensation of 100% of income. The preceding discussion is from Henrekson, et al., *Bruk och missbruk*, pp. 46-47.

¹²This arrangement remained in place until 1949.

¹³The 1955 legislation provided for the coordination of work injury and sickness insurance for the first 90 days.

¹⁴The preceding discussion draws on Bill Sund and Klas Åmark, *Makt och arbetsskador under 1900-talet* (Stockholm: Carlssons, 1990), chapter two; and Hans Esping and Aira Filppa, *Privatisera arbetsskade försäkringen?* (Stockholm: SNS Förlag, 1990).

Program Characteristics in 1990

This section provides a more detailed description of program characteristics and discusses how these influenced policy debates about the perceived need for reform.

Eligibility All wage earners over the age of sixteen with an income at least SEK 6,000 per year were eligible for sickness insurance with full coverage from the first day of employment. Since 1986, wage-earners have been required to provide a medical certificate after the seventh day of absence due to illness. This means that, in effect, wage-earners themselves determine whether their health prevents them from going to work during the first week of illness. In comparative international terms, this is a relatively generous rule. The program is universal and obligatory so all wage earners have a large stake in the program, and it enjoys widespread support.

The work injury insurance system covers persons who are employed or enrolled in formal education. Social insurance court decisions since the 1970s have resulted in a fairly broad definition of work injury. By 1990, conditions qualifying for work injury status included workplace accidents, sicknesses caused by harmful work environment (including infectious workplace conditions), and accidents occurring on the way to or from the workplace. As noted, the definition of harmful work environment was especially broad.

Financing Both the sickness and work injury insurance systems are constructed according to trust fund principles with employer payroll taxes providing the bulk of financing. In 1991, employers paid 10.10% of payroll in ear-marked contributions to the sickness insurance fund, with state grants covering the remaining 15 percent of costs.¹⁵ At the

¹⁵The fee also covers parts of the health care system which is not dealt with here.

same time, employers paid an earmarked payroll contribution (0.90% of payroll) to the work injury insurance fund. In the latter case, employer payroll contributions provided 100 percent of program financing.

Benefit levels In 1990, Sickness cash benefits were calculated at 90% of income loss up to 7.5 base amounts.¹⁶ However, most wage earners received an additional 10% from collective agreements so the effective replacement rate was 100%. Because the base amount is adjusted each year for changes in the price level, the benefit ceiling is protected against inflation. Qualifying income (sjukpenninggrundade inkomst, SGI) was calculated using a fairly generous formula based on future rather than historical income, which is usually lower, as well as taxable fringe benefits and vacation pay. There were no formal limits to the duration of sickness cash benefits.

The work injury insurance system provided both cash benefits and annuities. For the first 90 days of work-related illness or injury, wage earners received cash benefits from the sickness insurance system. Thereafter, the work injury insurance program provided cash benefits, as well as compensation for medical and dental care. Wage-earners with permanent work-related injuries received an annuity from the work injury fund. The system has historically been based on the assumption that wage earners should not experience a decrease in income as the result of a work injury. Thus, after the coordination period with the sickness insurance system, benefits paid 100 percent of lost income up to the income ceiling of 7.5 base amounts.

¹⁶The base amount (basbelopp) is an accounting unit used to calculate qualifying income and benefits in all social insurance systems. See chapter five for a more detailed discussion of the role of the base amount in the social insurance system.

Role of Private Provision In 1990, the role of private compensation for both sickness and work injury insurance was virtually non-existent although collective agreements reached between employers and unions typically added ten percent to the sick pay benefits for white collar employees.

In sum, the structure of both programs had several important policy effects. First, nearly all wage-earners received 100% compensation from the first day of illness or work injury and controls were fairly loose. In the context of the tight labor markets prevailing until 1990, wage earners could draw sickness or work injury benefits with little fear of disciplinary action from employers. In short, wage earners might be said to be highly decommodified in that sickness absence resulted in little or no reduction in income. Second, the structure of financing meant that firms had very little incentive to control sickness absence and work injury rates because costs were spread across all employers, public and private. This also meant that employers faced few incentives to improve the work environment and thereby reduced worker absenteeism. Finally, the method of earmarked employer contributions and trust fund financing used in both programs meant that economic performance could be tracked fairly easily. As figures 4.1 and 4.2 show, both programs experienced skyrocketing costs during the late 1980s and early 1990s, creating huge program deficits. These program deficits were highly visible and could only be corrected by increasing employer payroll taxes, increasing state grants, or reducing take-up rates. In the context of large state budget deficits and employer complaints about the burden of payroll taxes, retrenchment focused mostly on the last option.

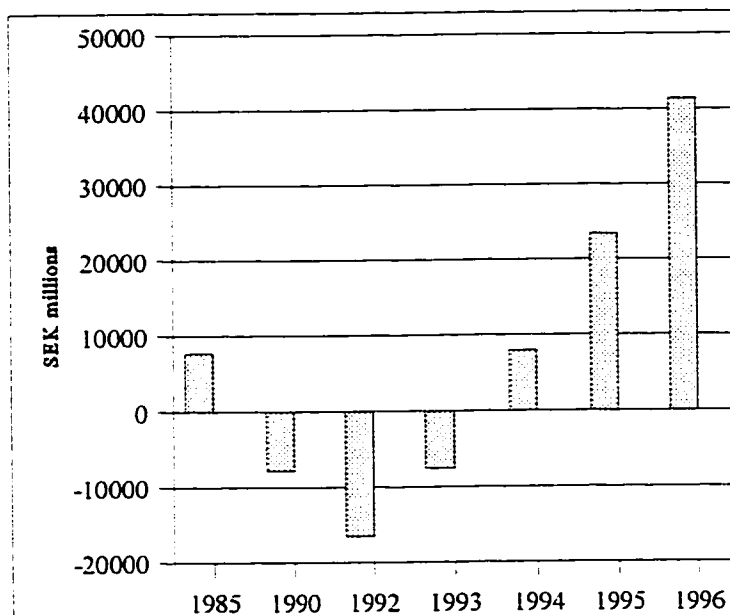


FIGURE 4.1: Accumulated Balance in the Sickness Insurance fund 1985-1996*

Source: SOU 1996: 113, *En allmän och aktiv försäkring vid sjukdom och rehabilitering*, p. 531.

Note: *1996 figure is a forecast.

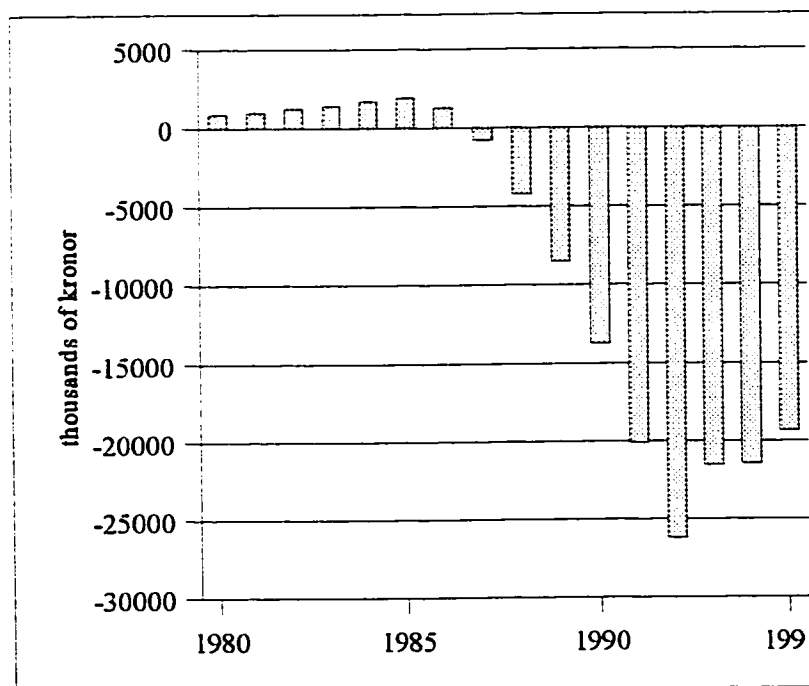


FIGURE 4.2: Work Injury Fund Balance 1980-1995

Source: RRV, *Social Insurance Statistics. Facts* (Stockholm: RRV, 1994); and Ministry of Finance, *The Swedish Budget*, various years.

Sickness and work injury insurance as a distinct policy area

As Immergut observes, sickness cash benefits were one of the earliest concerns of labor movements in Europe. As workers began to enter into paid employment, sickness absence ceased to be a purely private social issue and took on important political significance. Wage laborers now faced an immediate loss of income as the result of sickness absence.¹⁷ In Sweden, as elsewhere, the trade unions responded to this emerging problem by setting up voluntary sickness funds to provide cash benefits during sickness absence. Unlike other countries such as Germany, however, the unions did not dominate the sickness funds and the funds were not a meaningful union recruitment device as the unemployment insurance funds have been.¹⁸

Unlike other parts of the social insurance system, programs providing income support for the employed are intimately related to employers' concerns about production costs and competitiveness. In Sweden's export-oriented economy, high sickness absence rates contributed to the declining competitiveness of export firms due to productivity losses. In the late 1980s, high sickness rates exacerbated labor shortages in tight labor markets, sapping productivity and contributing to the onset of a what Swedish observers typically refer to as a "cost crisis" (*kostnadskris*). Moreover, the method of employer payroll tax financing added to the non-wage labor costs of firms. Thus, in contrast to retrenchment in pensions and unemployment insurance, cuts in sickness cash benefits

¹⁷Ellen Immergut, "Between State and Market: Sickness Benefits and Social Control," in Martin Rein and Lee Rainwater, eds., *Public/Private Interplay in Social Protection. A Comparative Study*, (Armonk, NY: M.E. Sharpe, 1986).

¹⁸See chapter six.

would almost certainly lead to decreased worker absenteeism and thereby improve the productive conditions of firms. Having ruled out devaluation as the solution to the cost crisis, recommodification in the sickness cash benefit system became a default strategy for reform. Cuts would reduce costs for the state, at the same time that firms would benefit from lower levels of absenteeism and reduced wage costs. Thus, it is no accident that among social insurance programs, sickness cash benefits and work injury benefits were the first to be cut, and cuts have been deepest in these policy areas. Similar results could not be achieved through cuts in pensions and unemployment insurance.

By the late 1980s, wage earners received full compensation from the first day of illness, and benefits lasted indefinitely. Between 1983 and 1988, the number of sick days per worker had increased from 19.6 to 26.1, an increase of one third.¹⁹ The problem was especially worrisome in large industrial firms such as Volvo which frequently experienced absenteeism rates of 20 percent. In other words, one in five workers in firms such as Volvo called in sick every day.²⁰ The seemingly high rate of sickness absenteeism was widely discussed in the media, and it became a rallying cry for efforts by the non-socialist parties and the employers to demand tough rule changes (see table 4.1 and figures 4.1 and 4.2).

Immergut discusses the impact of worker absenteeism on both large and small firms. In general, large, capital intensive firms tend to be more concerned with idle productive capacity resulting from absenteeism than they are with the actual wage costs.

¹⁹This statistic is from SAF, *The Dynamic 90s* (Stockholm: SAF, 1990).

²⁰Coughlin and Tomasson, "Sweden," p. 159.

For firms in this sector, worker absence may be so damaging that firms assume a given rate of absence and respond by hiring more employees. In the context of relatively stable demand for its products, the firm can then simply raise prices to recover its higher wage costs. For small firms facing fluctuations in product demand, however, a different set of incentives is at work. Because production is more sensitive to variations in demand, small firms would tend to be less accepting of high sickness absenteeism because of the higher wage costs involved. As Immergut summarizes, “large firms can overemploy in order to minimize risk while small firms are risk averse.”²¹ As discussed in chapter two, the Swedish economy is dominated by large, export firms, so the problem was especially apparent.

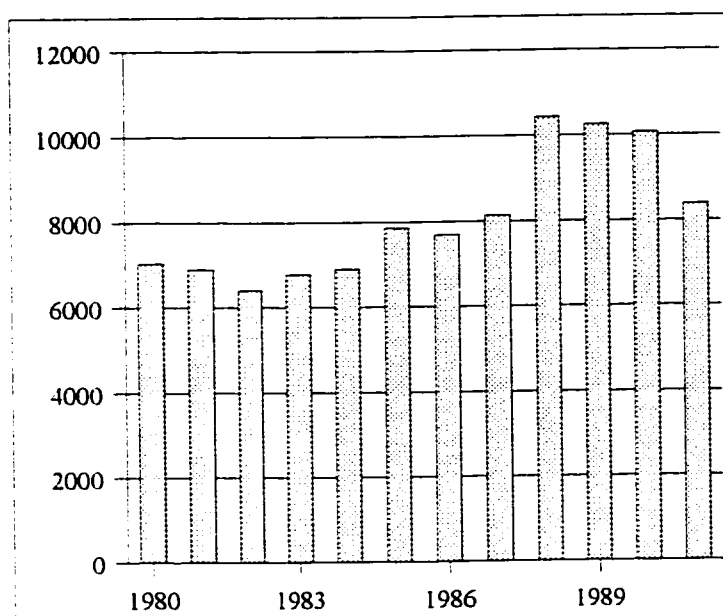
²¹Immergut, “Between State and Market.”

TABLE 4.1: Sickness Frequency

year	sickness days per person	sickness frequency rate	durability rate	# of benefit days in millions
1980	21.2	1.5		99
1981	19.6	1.47	13.6	92
1982	18.5	1.38	13.4	86
1983	18.4	1.46	12.5	86
1984	18.8	1.47	12.4	88
1985	20.9	1.68	11.8	98
1986	21.5	1.66	12.2	100
1987	23.1	1.75	12.3	107
1988	25.3	2.23	10.4	118
1989	24.5	2.18	10.6	116
1990	24	2.13	10.8	114
1991	22.5	1.78	12.2	106
1992	15.2	.3	55	70
1993	14.2	.24	66.9	64
1994	13.6	.18	80.5	60
1995	12.9	.17	79.5	57
1996	11.8	.14	59.8	51

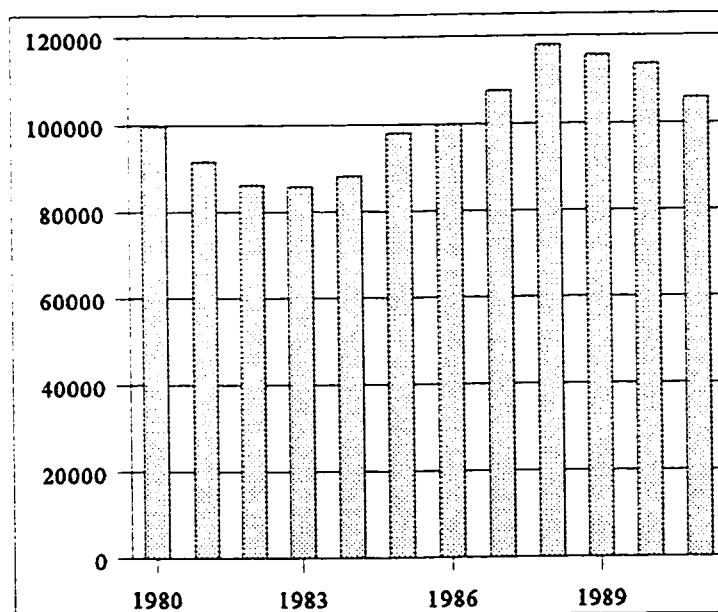
Source: RRV, *Social Insurance Statistics*.

Notes: the sickness rate per insured person is the annual number of benefit days in relation to the number of insured persons. The sickness frequency rate is the annual number of concluded cases of sickness in relation to the number of insured persons. The durability rate is the average number of benefit days in cases of sickness during the year. Since the employer period began in 1992, public statistics only cover instances of sickness longer than 14 days. These illnesses comprise only 10 percent of cases.



**FIGURE 4.3: Number of Cases of SI Cash Benefits
1980-1991**

Source: RRV, *Social Insurance Facts*.



**FIGURE 4.4: Number of Compensated Days of SI
1980-1991**

Source: RRV, *Social Insurance Facts*.

Despite widespread attention to the problems of worker absenteeism, the Social Democratic Party has not been especially eager to pursue retrenchment in sickness benefits and work injury insurance. The SAP leadership only reluctantly accepted some of the criticisms of the sickness benefit system offered by many economists and forcefully articulated by the Employers Federation (SAF). The onset of several currency crisis between 1990 and 1992, and the dramatic deterioration of public finances between 1991 and 1994 shoved the issue of reform to the top of the national political agenda. As export competitiveness took on new salience, the SAP accepted the perceived necessity of reform.

Employers' Interests and Mounting Pressure for Reform

The Swedish export sector is dominated by several large capital intensive firms which wield considerable influence within the Employers Federation (SAF). In the late 1980s, the public debate about high sickness absence rates reached a fever pitch. Economists and representatives of the business community reminded the public at every opportunity that Swedish productivity levels had been comparatively low since the 1970s. The low level of productivity, it was claimed, was one of the major causes of the cost crisis. In particular, the employers identified regulations governing sickness leave as major problems.²² Whereas tight labor markets made it difficult for firms to recruit new employees, benefits covering work absence were seen as obstacles to the effective use of labor. Particularly in firms using team work, sickness absence was a drag on

²²See, for example, Hans Tson, Söderström, ed., *Sverige vid vändpunkten. Konjunkturrådets rapport 1991*. SAF also complained about the negative effects of workplace regulations and parental insurance on labor supply.

productivity.²³ In particular, the employers and economists argued that the introduction of waiting days would radically decrease short term absence and thereby increase productivity. Whether or not these claims are valid is not in question; what matters is how actors perceived the situation.

SAF complained that wage contracts in the 1980s exceeded levels justified by increases in productivity and specifically cited sickness absenteeism as a major contributing factor to sluggish productivity. According to SAF statistics, each day of absence per worker per year (19.6 in 1983 and 26.1 in 1988) represented approximately 19,000 jobs calculated in terms of man years. A reduction in the average sickness rate to 1983 levels (a difference of 6.5 sick days) would yield the equivalent of 123,000 additional wage earners (6.5 x 19,000) to the labor market. Thus, SAF claimed that a significant reserve of labor existed among those already employed if sickness absences could be reduced. To address this problem, SAF promoted the introduction of an employer period so that firms would face greater incentives to improve the work environment and thereby reduce worker absenteeism. As a result, firm costs for sickness absence would be more directly linked to the actual rate of absence, instead of being spread over the entire economy. In addition, SAF also pushed for the introduction of waiting days and lower benefit levels so that wage earners would receive higher compensation for going to work than for calling in sick.²⁴ In sum, SAF was united and vocal about its demands for reform.

²³This conclusion is reached from a questionnaire cited in Söderström, ed., *Sverige vid vändpunkten*.

²⁴SAF, *The Dynamic '90s*.

Labor's Preferences

For the labor movement, both sickness and work injury insurance are important from the point of view of working class mobilization and the goals of solidarity, decommodification, and equality shape the design of both programs.²⁵ Universal and generous public benefits provided virtually full compensation for lost income from the first day of illness or work injury. The remaining differences between blue and white collar workers were eliminated in the late 1980s with the abolition of the remaining waiting day. The financing structure is especially important in that it constitutes solidaristic financing. Employers pay contributions calculated on total payroll. Thus, "production" pays the costs of benefits, and there is no ceiling on these contributions.

The social democratization of sickness and work injury insurance during the postwar period also solidified the position of the unions and the Social Democratic Party as the principal defenders of the status quo. As in other policy areas, the emergence of the social democratic welfare state encouraged the development of a solidaristic rather than segmented interest group structure. Thus, the LO and TCO are the most important interest organizations promoting the rights of both actual and potential sickness and work injury beneficiaries. Governments intent on retrenchment in sickness and work injury insurance would have to deal with the concerns of these two peak level organizations.

Despite the perceived achievements of sickness and work injury insurance from the point of view of the labor movement, the SAP leadership, and to a lesser extent, the LO, were well aware of problems in both systems. However, neither the party nor the unions

²⁵See chapter three for a discussion of social democratic social policy priorities.

was especially eager to pursue reform. The SAP leadership faced internal opposition to retrenchment while the LO was highly suspicious of any attempts at departure from the public system.

The best statement of the SAP and LO's view of sickness and work injury insurance during this period is found in a debate book published by the SAP in 1989, the *Labor Movement's Program for the 1990s (90-talsprogrammet)*. Among other things, the book pointed to increased sickness absences as a serious problem in terms of government spending, public health, and production costs. The authors recognized that sickness absences had increased greatly during the 1980s largely as a result of absences longer than 14 days,²⁶ and they laid out several alternatives for reform, all aimed at improving the work environment and increasing rehabilitation efforts. The authors suggested the possible introduction of an employer period into the sickness insurance system in order to create "a direct pressure on employers to improve the work environment."²⁷ The result, it was hoped, would be a healthier work environment and a healthier labor force. In addition, relieving the insurance offices of the responsibility of administering the first two weeks of sickness cash benefits would free up resources so that the insurance offices could increase efforts at rehabilitation of those with long-term illnesses. If the work environment and worker's health could be improved, costs for benefits would decrease at the same time that the tax base would increase. Because this avenue would obviate the need for benefit cuts or tax increases, the authors argued that

²⁶SAP, *90-talsprogrammet. En debattbok om arbetarrörelsens viktigaste frågor under 90-talet* (Stockholm: Tiden, 1989), p. 147. Absences less than 14 days only accounted for one fifth of total costs.

²⁷Ibid., p. 150.

the labor movement must move in this direction. The report also pointed to increasing costs in the work injury insurance system and suggested the possibility of combining work injury with sickness insurance in order to improve administrative effectiveness and reduce waiting times for rehabilitation. The authors linked their recommendations to the long-standing emphasis on the work line, proposing to radically expand the concept to include rehabilitation efforts and improvements in the work environment.²⁸ In sum, discussions about reforming sickness and work injury insurance would satisfy several goals: reducing costs, freeing resources for rehabilitation, improving productivity, and alleviating human suffering.

Despite the appearance of labor movement unanimity on these issues, LO remained skeptical of the proposal to introduce an employer period in sickness insurance, charging that this would give employers too much control over shorter sickness absences at the expense of wage earner autonomy. Moreover, such a change would create incentives for the employers to hire fewer people with health problems.²⁹

Stalled Reform Efforts 1989-1990

Discussions within the SAP government about taking the first steps toward sickness insurance reform began during the Fall of 1989 in connection with the preparation of the budget. Because the SAP planned to add one week of vacation and to expand

²⁸Two percent of sickness cases account for almost 50% of costs. These are long-term sicknesses.

²⁹According to Feldt, LO's shift is explained by the fact that many more union members would be affected by an employer period for short-term illness and many would be upset if they could not continue to call in sick as before, without an explanation to their employer. Kjell-Olof Feldt, *Alla dessa dagar...i regeringen* (Stockholm: Norstedts, 1991), p. 434.

parental insurance, the Ministry of Finance considered savings in sickness and work injury insurance the most appropriate way to finance these reforms. As Finance Minister Feldt put it, within the Ministry of Finance there was a “strong conviction that structural reforms of the social insurance system were absolutely necessary.”³⁰ Because the expansion of parental insurance and the addition of one week of statutory vacation would reduce the supply of labor, sickness insurance reform would not only reduce costs, but also reduce absences from work, thereby increasing the supply of labor. Feldt presented two alternatives to Prime Minister Ingvar Carlsson: either substantial reform of sickness and work injury insurance should occur, or no new reforms, even those already promised, could be implemented.

Feldt’s recommendations met immediate criticism, not only in the Ministry of Social Affairs, but also in the Prime Minister’s Office. The only thing the SAP leadership could agree on was a declaration which specifically ruled out new reforms unless they could be financed without tax increases, but sickness insurance and work injury insurance were not mentioned specifically.³¹ When the budget was presented in January 1990, it contained no recommendations for sickness or work injury insurance reform but still affirmed the government’s commitment to expand parental insurance and add a sixth week of vacation.³² The only concrete statement about how to deal with increased long term sickness absence costs was to recommend the introduction of an active rehabilitation

³⁰Ibid., p. 434.

³¹Ibid., p. 436.

³²According to Feldt, balance was achieved in the budget because of the surplus from the previous year. In effect, therefore, the new budget was less restrictive than the previous year’s. See *ibid.*, p. 444.

policy. Finance Minister Feldt warned about the serious economic situation and the risk that high wage agreements would fuel inflation, already running at well over 10 percent. To address the problem of wage costs, the government planned to invite the employers and unions to negotiations.³³ As the government stalled, the leaders of the opposition parties criticized the government's policy for causing another cost crisis, with wage increases and inflation exceeding that of important competitors. The stage was set for a showdown on the issues of sickness and work injury insurance.

The First Cuts: Crisis Management, Privatization, and Benefit Reductions

Despite the seriousness of the situation, the SAP had no appetite for retrenchment. Instead, the SAP focused on alternative means of solving the problem of skyrocketing absences and increased costs. The SAP's initial policy stance centered on increasing the capacity of the insurance offices to monitor the causes of short term sickness, and to promote active rehabilitation policies in the workplace. However, this type of reform would require a lengthy period of investigation as is customary in the Swedish policymaking process. No sooner had the government announced its intention to enhance rehabilitation efforts than the first of a series of currency crises occurred, forcing cuts in sickness and work injury insurance.

The First Crisis: February 1990

The onset of economic crisis in February 1990 dramatically altered the context for the viability of work injury insurance and the sickness cash benefit system. The roots of the crisis were the overheated economy and increasing inflation. When corporatist-style

³³*Proposition 1989/90:100*. Feldt made these comments during the parliamentary debate on the budget.

negotiations failed to generate agreement on low wage increases, the Ministry of Finance pressed the SAP leadership to introduce the employer period and decrease benefits in sickness insurance. Several rounds of negotiations between the SAP government, LO, and SAF resulted in the ill-fated stop package which later toppled the government. Unable to stabilize the economy by other means, the SAP proposed a set of emergency measures intended to halt inflation, including a wage freeze and temporary ban on strikes.³⁴

The SAP leadership gambled that the Left Party would not support a vote of no confidence for a Social Democratic government, despite the controversial proposals to introduce a strike ban and wage freeze. These measures attracted so much criticism, however, that the Left Party broke from its traditional line of supporting the SAP, and the government resigned after a vote of no confidence on February 15. The non-socialist parties were unable to form a government, so the SAP presented a watered down crisis package on February 23, and two days later a new SAP government was voted in again, with Left Party support.³⁵ The new government announced that it would go ahead with plans to introduce a two week employer period in sickness insurance and take other measures to stabilize the economy.³⁶

In the meantime, the SAP had initiated discussions with the Liberal Party on a new set of crisis measures. Because of the opposition of the Left Party to its retrenchment

³⁴The SAP government had already attempted to reduce demand in the Spring of 1989 by increasing the VAT, but could not obtain support in parliament. High Swedish production costs had actually existed for a few years, but they were offset by the upturn in the world economy. World demand for Swedish exports was so high that Sweden could sell everything it produced. At the same time, import prices were low, especially for oil. So when the world recession set in, the impact on the Swedish economy was swift.

³⁵The Conservatives and Liberals voted against the new SAP government, while the Center Party and Greens abstained.

³⁶*Riksdag och Departement*, 9 (1990).

proposals, the SAP had no choice but to negotiate with the non-socialist parties, and the Liberals were a natural target because of their cooperation with the SAP on comprehensive tax reform. On April 5, 1990, the government announced the details of its deal with the Liberals, including the cancellation of parental insurance expansion and the introduction of the employer period in 1991.³⁷ The agreement also included plans to increase the coordination period between sickness and work injury insurance.

With the support of the Liberal Party secured, the government continued to try to find ways to address the emerging economic crisis. When parliament opened in September, the SAP again stressed the necessity of a restrictive fiscal policy in its Autumn bill on the direction of economic policy.³⁸ During the summer, interest rates had risen significantly, and the volume of capital outflows began to worry the government. The bill identified the main economic problems as: high inflation, rapidly rising wages, low growth and increasing unemployment. Nevertheless, the government hoped to avoid drastic measures by exhorting the labor market parties to agree to low wage contracts and by following a restrictive fiscal policy stance. Both would be difficult to achieve since labor market actors determine wages, and a minority government needs support for its fiscal policy. Concerning sickness insurance, the government set the goal of decreasing sickness absence by two days during the current budget year in order to save SEK 2.8 billion per year. In the next five years, the government aimed to decrease absences by two more days per year for total savings of SEK 10 billion. Despite this ambitious goal, the bill was

³⁷*Socialförsäkringsutskottet 1989/90: 11 and 24.*

³⁸*Proposition 1990/91:39; and Riksdag och Departement 32 (1991).*

devoid of concrete measures on how to achieve it except to recommend increased efforts at rehabilitation and the introduction of the employer period.

The Second Crisis: October 1990

In October 1990, another crisis hit the Swedish economy, and the SAP responded with a package of emergency proposals including a Swedish yes to the EC, and decreases in sickness insurance benefits. As was the case in February, rising interest rates and large capital outflows (in September) prompted the government to propose drastic measures. That the SAP proposed EC membership and sickness insurance cuts was explicitly motivated by the goal of increasing export competitiveness without resorting to devaluation. The government also announced that it planned to establish a commission to investigate the increased coordination of sickness and work injury insurance. However, earlier plans to introduce an employer period were shelved, no doubt because of protests from the LO. Clearly, reductions in nominal benefits were preferable to the LO than the introduction of the employer period. Nevertheless, decreased sickness cash benefits would result in substantial savings for the state as well as increase work incentives and thus labor supply.³⁹ The October crisis marked a turning point because it was the first time a Social Democratic government reduced benefit levels in an income maintenance program. As a weekly business magazine put it, "after years of trimming at the edges the SAP sticks the knife in sickness insurance...and all this without too much protest."⁴⁰

In late November, the government presented its bill concerning sickness insurance

³⁹The new benefit levels were 75% for the first three days and 90% thereafter. *Riksdag och Departement* 34 (1990).

⁴⁰*Affärsvärlden*, November 11, 1990.

cuts, calculating on the support of one or more of the non-socialist parties.⁴¹ The cuts were projected to save SEK 5.9 billion per year and to reduce short term sickness absences (one or two days) by one third. Because of the unpopularity of the cuts, the government designed the legislation so that all wage-earners would be affected equally.⁴² Cuts experienced by LO members would not doubt be easier to accept if even better-off groups were prevented from receiving higher compensation. The bill also promised that detailed proposals on increasing the coordination between sickness and work injury insurance would come in the Spring.⁴³

In order to pass the bill, the government had to navigate among several preferences among the bourgeois parties but there was enough similarity of opinion among the remaining parties to reach a broad compromise. Only the Left Party and the Green Party opposed the cuts, arguing that the economic situation was not serious enough to warrant reductions in social insurance benefits. As a result of negotiations with the Conservatives and the Center Party, the SAP agreed to revive the idea of the employer period, and to implement this by January 1, 1992. Now that the SAP had reversed its position, the government presented legislation the following April proposing the introduction of an employer period into the sickness insurance system. Consistent with previous policy debate, the bill argued that the change would provide incentives for employers to improve the work environment and would free administrative resources in

⁴¹*Proposition 1990/91:59.*

⁴²The bill contained provisions preventing employers from paying supplemental benefits above the levels mandated in the bill.

⁴³In 1981 the SAP opposed the idea of an employer period because it would lead to changes which would mean that health might be taken into account in hiring. SOU 1981:22 *Sjukpenningkommitténs betänkande.*

the insurance offices.⁴⁴ Because of higher costs for employers, the bill provided for a reduction in the employer payroll contribution from 10.1 to 8.2 percent.⁴⁵ Thus, the employer period would not result in meaningful savings for the state.

Because support for the employer period had already been secured, the bill passed easily with only the Left Party opposed it. The Conservative member of the parliamentary social insurance committee, Gullan Lindblad, called the agreement an epoch making change in the social insurance system” and one of the most important decisions in decades.⁴⁶

It was no accident that sickness insurance was the first program to be cut. Cuts would not only save money, but also improve competitiveness, alleviating some of the symptoms of the cost crisis. According to one observer, the introduction of the employer period amounts to "the biggest privatization of a previously public activity which has occurred in Sweden."⁴⁷ The reform also amounts to a tightening of the eligibility rules for obtaining insurance. Previously, a medical certificate was required after the first week of illness, but this was mostly a formality since it was automatically accepted by the insurance offices. Now for the first two weeks illness, the employer must process the medical certificate, and employers may have more of an incentive to challenge the worker's claims

⁴⁴*Proposition 1990/91:181*. The bill also contained provisions protecting persons who are sick often. In addition, small firms would be allowed to purchase supplementary insurance from the insurance offices. At the time, 89% of all sickness cases were less than 14 days; and SOU 1991:35 *Några frågor i anslutning till en arbetsgivarperiod inom sjukförsäkringen*. This committee was set up on January 1, 1991 to investigate how to formulate the employer period legislation.

⁴⁵Because of the reduction in employer contributions, the financial effect is neutral. SEK 881 million less would be budgeted for sickness insurance, but lost revenue from contributions would cancel this out.

⁴⁶*Riksdag och Departement 22* (1991).

⁴⁷Henrekson et al., *Bruk och missbruk av sjukförsäkringen*, p. 95.

of sickness. According to the same observer, "To put it sharply, one can say that the doctor's role has changed from being a simple messenger, which more or less passively passed on information from the employee to the insurance office, to a kind of lawyer, who will try to convince a suspicious party that the sickness actually exists."⁴⁸ The result is that would now be potentially more difficult for wage earners to qualify for benefits.

Bourgeois minority coalition government 1991-1994

After the election of 1991, the Bildt government took office intent on reforming the excesses of the social democratic welfare state. High on their agenda were the reform of work injury insurance and the introduction of waiting days in sickness insurance. However, the new government was a minority government, dependent on the unpredictable New Democracy Party for support. As in pensions and unemployment insurance, the SAP occupied the role of veto player to the Bildt government's proposals. Even if the Bildt government could secure the support of New Democracy, it had every incentive to negotiate with the SAP in order to prevent the reversal of its policies under a future SAP government.

In the Autumn 1991 session of parliament, the Bildt government moved quickly to introduce cuts in the work injury insurance system.⁴⁹ Both the Liberals and Conservatives promised work injury insurance reform during the election campaign, so there was internal unity on this issue. The government appointed a commission to study comprehensive reform, and in the meantime proposed piecemeal changes as a first step in the reform

⁴⁸Ibid., p. 101.

⁴⁹*Proposition 1991:92: 40*; and *Riksdag och Departement 35* (1991).

process. The government proposed to double the coordination period of the work injury insurance with the sickness insurance system from 90 to 180 days. Because work injury benefits were higher than sickness insurance benefits for days 90-180, this move would result in the reduction of work injury benefits from 100% to 90% of qualifying income. The government argued that the extension would provide incentives for those receiving work injury benefit to begin rehabilitation earlier. To bolster its case for reform, the government cited a study carried out by the Parliamentary Auditors (*riksdagens revisorer*) which found that the different rules in sickness and work injury insurance created obstacles to early rehabilitation efforts.⁵⁰ The doubling of the coordination time was calculated to save SEK 140 million in insurance costs and SEK 100 million in administrative costs per year.

To support the government's case for reform, the bill cited statistics about the rapidly rising costs of work injury insurance. Between 1985 and 1989, the number of work injury benefit applications had increased from 64,000 to 119,000. Between 1985 and 1990 costs increased from SEK 1,813 million to SEK 9,839 million. More ominously, the work injury insurance fund had been in deficit since 1987 with an accumulated deficit in 1990 of SEK 14,000 million. Despite the cost savings, the government insisted that the main goal of the bill was to improve incentives to take part in rehabilitation. The SAP immediately voiced its opposition to the cuts and was joined by the Left Party. Nevertheless, New Democracy supported the government on this issue, and parliament

⁵⁰*Riksdagens Revisorer* 5 (1988/89).

passed the bill.⁵¹

The Bildt government's next move was to propose two waiting days in the sickness insurance system in its January 1992 budget.⁵² This policy change was designed to reduce spending in what the government considered to be an excessively costly system. The budget also emphasized the rising costs of work injury insurance and attributed higher costs to the more generous definition of work injury. The government argued that the social insurance system encouraged absence from work and the proposed changes were aimed at increasing incentives for wage earners to decrease their absence from work because of illness.

Not surprisingly, the SAP fiercely opposed these cuts, claiming that the waiting days would disproportionately hurt low income earners, women, and those who work in unhealthy environments. The unions were also extremely critical of the government's plans. TCO argued that the waiting days would not result in much savings for the state because one half of all sickness days are accounted for by 4.5 percent of workers. Instead of attacking the less serious problem of short term illness by introducing waiting days, TCO exhorted the government to address the problem of long term cases of illness.⁵³

The Third Crisis: Autumn 1992

The government's plans were quickly derailed by the currency crisis in the Autumn. During the summer, rising interest rates and pressure on the currency contributed to national awareness of impending economic crisis. On August 21 *Dagens*

⁵¹*Socialförsäkringsutskottet 1991/93:5.*

⁵²*Proposition 1991/92: 100.*

⁵³*TCO Valfärdsfakta 1 (1992).*

Nyheter published an article analyzing the economic situation and called for crisis negotiations between government and the SAP. On the same day, the SAP published a press release demanding that the government immediately cancel all planned reforms in order to stabilize the deficit and increase confidence in the currency.⁵⁴

For the Bildt government, the situation was alarming enough that Liberal Party leader Bengt Westerberg and Center Party leader Olof Johansson proposed that the government initiate contact with the SAP to discuss how to respond to the situation. The Liberals' and Centers' reasoned that if tough cuts had to be made, they should be able to survive beyond the next election. This would only be possible with the support of the SAP. The SAP leadership responded favorably to this overture; SAP leader Ingvar Carlsson publicly requested that the government immediately present a package of cuts and expressed the SAP's willingness to cooperate.⁵⁵

By September 16, the central bank had raised overnight interest rates to 500 percent in order to stem the outflow of capital. On September 19 top-level, secret negotiations began between the government and SAP, and the following day they presented the first of two crisis packages. The first package of emergency measures contained substantial cuts in both sickness and work injury insurance, including the introduction of one qualifying day in sickness insurance and further benefit cuts.⁵⁶ The negotiators also agreed on the introduction of a monthly individual payroll charge for

⁵⁴Christer Isaksson, *Världens bästa regering. Tusen dagar som förändrade Sverige* (Stockholm: Norstedts, 1994), p. 172.

⁵⁵Björn Elmbrandt, *Så föll den svenska modellen* (Stockholm: Norstedts, 1993), pp. 297-298.

⁵⁶The level of sickness insurance benefits would be reduced to 75% for days two and three, 80% for days 4-90, and 70% thereafter.

sickness insurance. To compensate wage earners, a planned increase in fees to unemployment insurance was canceled. The entire package of emergency measures was projected to strengthen the budget by SEK 40 billion over five years, with SEK 27.6 billion of the savings in 1993. Savings in sickness and work injury insurance were calculated at SEK 8.2 billion per year. The individual fee as well as decreased grants to sickness insurance would save SEK 3.7 billion per year. At the initiative of the SAP, the negotiators agreed to investigate the possibility of transferring the administration of sickness and work injury insurance from the state budget to the labor market parties by the end of the decade. This way the insurance could not operate with a deficit and the employers would have incentives to improve the working environment. Compromise across the political blocs on retrenchment was short-lived, however. After the SAP rejected a third crisis package in November, the Central Bank was forced to let the krona float.

The crisis packages were motivated above all by the desire to influence the expectations of financial markets and dampen fears of a devaluation. There is no doubt that the atmosphere of crisis created extraordinary policymaking conditions which facilitated the imposition of losses of beneficiaries. Decisions were negotiated privately by party leaders under severe time constraints and without public debate.

With support from the SAP secured, the government presented a series of bills in November and December to implement the emergency measures. First, the government presented legislation outlining the main principles of the crisis measures.⁵⁷ In the bill the

⁵⁷*Proposition 1992/93:50. Åtgärder för att stabilisera den svenska ekonomin.*

government projected unemployment to be 6 percent by the end of the year, 6.2 percent in 1993 and 7 percent in 1994. In addition, five percent of the labor force would be engaged in labor market programs. The bill also included ominous statistics about the health of central government finances: the deficit forecast for 1992 was SEK 111.6 billion and projected to be SEK 147.3 billion in 1994.

The government followed up on these general principles with detailed legislation on benefit cuts and the introduction of the individual payroll tax to sickness insurance. The new individual payroll tax would be .95 percent of income up to 7.5 base amounts and take effect January 1, 1993.⁵⁸ In addition to raising revenue, the government portrayed the individual tax fee as the first step in the process of transforming the current system into a new insurance model.

A second bill detailed the benefit cuts: one waiting day and decreased compensation for short-term illnesses. The bill was based on a report issued by the Ministry of Social Affairs the previous May. Consistent with earlier SAP efforts to ensure that cuts affect all wage earners equally, the bill was based on the reduction rule; if employers pay more than ten percent in supplemental benefits, the insurance offices pay lower benefits. In terms of concrete savings, the waiting day was calculated to reduce costs for the state by SEK 3.4 billion per year. Because the employers' costs would decrease, their payroll contribution to sickness insurance would be increased by .47 percent for a total of 8.27 percent in 1993. In 1994 the employer payroll contribution to sickness insurance would further increase by .16 percent for a total of 8.43 percent. Thus,

⁵⁸*Proposition 1992/93: 136.*

the financial impact on employers was neutral.⁵⁹

For the Bildt government, the crisis negotiations with the SAP resulted in the passage of reforms which would have been difficult to achieve under normal circumstances. Thus, the Bildt government avoided difficult negotiations with New Democracy and could bargain with the SAP on a package of cuts. Although the government granted several important concessions to the SAP in return for their support, the government nevertheless achieved the important goal of significantly increasing the level of self-risk in the sickness insurance system.

For the SAP, the crisis negotiations were a way for the party to cooperate in efforts to stabilize the national economy. The party leadership considered this goal so important that it was willing to risk opposition from the rank and file members and the LO. Moreover, the SAP extracted several important concessions from the Bildt government in return for its support: the cancellation of plans to nationalize the unemployment insurance system, and the principle that benefit cuts must apply equally to all wage earners. The SAP still faced intense criticism from the unions for its cooperation in social insurance cuts. TCO complained about the introduction of the individual fee in sickness insurance, charging that it was a break with the current method of "solidaristic" financing, or the payment of taxes by the employers on total payroll.⁶⁰

In addition to these crisis measures, the Bildt government continued its effort to achieve savings in the work injury insurance program. Legislation presented in late 1992

⁵⁹*Proposition 1992/93:31 Ändrad sjukersättning*, m.m.; and Ds 1992:49, *Karensdagar vid sjukersättning*.

⁶⁰TCO, *Krispaketen och socialförsäkringarna* (Stockholm; TCO 1992).

was based on the report issued by the official commission of inquiry and resulted in a major tightening of eligibility criteria for benefits.⁶¹ The major innovation of the legislation was to sharpen the requirement for injury so that there would be less difference between the judgements of the insurance offices and medical doctors. The bill also raised the burden of proof on wage earners for showing that an injury was caused by circumstances at the workplace.⁶² The bill emphasized the increasing costs in the work injury insurance program as well as the existence of a deficit in the program since 1987. In May 1992 the work injury insurance fund deficit was SEK 23,000 million and the bill claimed that much of this deficit could be explained by the loose application of rules. The government emphasized that the measures contained in the bill were only the first steps toward major reform. A more comprehensive proposal would follow when the commission investigating structural reform was finished. The SAP opposed the legislation, but with the support of New Democracy, however, it easily passed in parliament.

The unions were more direct than the SAP in their criticism of the cutbacks in work injury insurance. TCO was particularly critical of the proposals, arguing that the older rules were already too strict, so any restrictions on the definition of work injury would be entirely unacceptable. Moreover, TCO explained the program deficit as the result of employers not paying their full share of the costs for work injury insurance; instead, taxpayers paid the deficit via the regular budget. Thus, TCO argued that the cuts

⁶¹SOU 1992:39, *Begreppet arbetsskada*; and *Proposition 1992/93: 30 Ändring av begreppet arbetsskada*.

⁶²The standard was changed from "probability" (*sannolikhet*) to "high probability" (*hög grad av sannolikhet*).

amounted to the retroactive payment by wage earners of the employers' debt to the work injury fund.⁶³

Return to Normalcy: Bourgeois Cuts 1992-1994

Aside from the extraordinary cooperation prompted by the currency crisis, the Bildt government had difficulty agreeing on cuts as well as gaining the support of one of the opposition parties for its reform proposals. The government itself was split on the issue of social insurance; the Center Party and the Christian Democrats continued to push for a basic security system while the Liberal Party remained the strongest advocate of the income replacement principle.⁶⁴ At the same time, both the SAP and New Democracy sought to take advantage of the unstable situation. In the February 1993 general political debate, both the SAP and New Democracy declared their unwillingness to cooperate on piecemeal savings in different areas. Instead, each party announced its intention to support government policy only as part of package deals where their influence would be greater.

In the January 1993 budget bill, Finance Minister Anne Wibble announced a new round of cuts aimed at reducing the deficit and thereby lowering interest rates. In addition to cuts in unemployment insurance, the government proposed eliminating work injury benefits and replacing them with sickness insurance. If the government could secure support for this proposal, the reform would mean a cut in work injury benefits from 100 to 70 percent of qualifying income for savings of SEK 1.6 billion per year. The cut was part

⁶³TCO, *Välfärdsfakta* 6 (1992).

⁶⁴*Riksdag och departement* 6 (1993).

of a package of cuts with total savings of SEK 17 billion in 1993/94 fiscal year.⁶⁵

In their shadow budget, the SAP declared itself ready to discuss more cuts in exchange for increases in income taxes for high income groups. The SAP criticized the government's budget proposal, charging that the proposed cuts would fall disproportionately on the unemployed and those with work injuries. However, the SAP did not explicitly reject savings in work injury insurance. Significantly, the SAP agreed with the government's goal of achieving at least SEK 12 billion in cuts, but the party opposed the government's proposals about where the cuts should fall. Even so, the SAP remained remarkably silent on the kinds of cuts it might support. This was no doubt part of a strategy to prevent the government from getting the support of New Democracy on individual savings items. Instead, the SAP calculated on its inclusion in package negotiations in which it could trade specific cuts for tax increases. In sum, the SAP agreed with the government on the issue of budget savings, but the party had different ideas concerning where the cuts should fall.

The government quickly followed up on its intention to completely coordinate sickness and work injury insurance.⁶⁶ The main rationale for this cut was the skyrocketing cost of work injury benefits. At the end of 1992, the deficit in the work injury insurance fund was SEK 26,000 million despite the recent increase in employer contributions to 1.38% of payroll and a one time transfer of SEK 8.3 billion from the partial pension fund. To increase incentives for workers to return to their jobs, the bill proposed that those

⁶⁵*Proposition 1992/93:100.*

⁶⁶*Proposition 1992/93: 178.*

taking part in rehabilitation receive higher compensation. In sum, the government claimed that the current rules resulted in high costs and ineffective rehabilitation efforts.

New Democracy was notably cooperative in negotiations on work injury insurance, and the bill passed with New Democracy's support. The SAP held to its earlier criticisms of the proposals, but had little influence once New Democracy lined up in support of the government's bill. For all practical purposes, the work injury insurance would be abolished and replaced with sickness cash benefits, except for annuities paid to the permanently disabled. The changes would result in savings of SEK 1.7 billion.⁶⁷

With a general election scheduled for September 1994, the Bildt government was careful not to propose any more significant cuts in sickness and work injury insurance. The only concrete measure the government could agree on was a proposal to alter the basis for calculating qualifying income in the sickness insurance system (SGI). In fact, this cost-saving proposal virtually fell into the government's lap because it was proposed by the National Audit Board in an internal study of the sickness insurance system. The report argued that the generous SGI rules resulted in many cases of "overcompensation," or wage earners receiving more than 100 percent of their nominal wages. In the context of ongoing reform of the social insurance system, tightening the rules for qualifying income was a way of achieving small savings at low political costs. Because it was difficult to argue in favor of overcompensation, the legislation passed easily in parliament.⁶⁸

⁶⁷At the time, work injury benefit costs were SEK 6.2 billion per year. This expenditure would disappear at the same time that sickness insurance costs would increase by SEK 4.5 billion, for net savings of SEK 1.7 billion.

⁶⁸*Proposition 1993/94:59*; and *RRV Anser 4* (1992).

During 1994, the SAP gained steadily in public opinion polls as voters increasingly viewed the Bildt government's policies with skepticism. Indeed, during the Bildt government's tenure in office (1991-1994), the deficit increased from zero to 13% of GDP, and total unemployment climbed from 3% to 13%. During the election campaign, the SAP presented the electorate with a detailed plan to stabilize state finances, revive economic growth, and reduce unemployment. The SAP also asked the electorate for an "open mandate" to take additional measures as needed in order to address the budget deficit problem. Plagued by internal disagreements, the non-socialist parties campaigned independently and appeared to offer little in terms of concrete ideas about how to solve the country's economic problems. The September 1994 election was a resounding victory for the SAP, and the party scored its best result (44% of the vote) since 1982. The SAP formed a minority government, calculating on the support of the smaller parties (Left Party, Center Party, and Liberal Party) to pass its legislation.

SAP Retrenchment 1994-1997

After their election victory in September 1994, the SAP moved quickly toward deficit reduction. Like the Bildt government, the SAP placed high priority on budget balance, but its strategy was to design cuts so that low income groups suffered least. The SAP argued that if budget cuts were inevitable, then the burden should be distributed fairly. Thus the SAP embarked on a careful strategy of packaging cuts in terms of "fairness" in order to gain support within the party and the LO.

In one of his first parliamentary debates concerning budget policy, Finance Minister Göran Persson summarized the government's approach as follows: The Swedish

economy was in an vicious circle with the budget deficit pushing up interest rates and decreasing the value of the currency. High interest rates, in turn, led to further increases in the budget deficit. In order to get out of the vicious circle, inflation would have to be low and the deficit would have to be reduced. This was the rationale for further cuts in social insurance, especially sickness insurance.

The government's first bill concerning economic policy passed easily in parliament with the support of the Left Party. Besides containing specific deficit reduction measures, the bill was a significant statement of policy priorities for the SAP. The legislation emphasized that the most important task facing the government was to improve state finances and it was based on the promises made by the SAP during the election campaign. The SAP strategy announced during the election campaign was to attack the increasing imbalances in the economy in order to restore economic growth and protect the welfare state. Thus, this first major bill set the tone for the SAP's tenure in office between 1994 and 1998.⁶⁹

The SAP declared that "budget improvements" would lead to a virtuous circle with lower interest rates, stronger growth, increased investments, a stronger currency, and lower inflation expectations. Based on this reasoning, the government outlined a four-year program containing cuts and tax increases totaling SEK 57 billion by 1998, including SEK 30 billion in fiscal year 1995/96. Budget cuts were aimed primarily at families with children, pensioners, and high income earners. The SAP stated that its goal was to eliminate the deficit by 1998. The government called its budget consolidation measures a

⁶⁹*Proposition 1994/95:25.*

“gigantic” program for deficit reduction.

The bill also outlined the government’s intentions concerning further reform of the sickness insurance system: sickness insurance benefits (and disability pensions) should only provide benefits for strict medical reasons, and rehabilitation efforts should be increased. These statements of principle provided the foundation for specific proposals which would come later. The largest revenue generating measure in the bill was the proposal to increase the individual contribution to sickness insurance. In 1995 the individual fee would be 2 percent, and it would increase by one percent per year in 1996, 1997 and 1998.⁷⁰ The hike in individual contributions to sickness insurance would generate revenues of SEK 14.4 billion in 1998. However, these savings would be offset by a planned reduction in the employers’ share of sickness insurance financing. However, employers would now pay a higher general wage tax which finances EU membership. This peculiar switch in financing seems insignificant at first, but it had important effects. For the SAP, it was important to create the appearance that the employers were financing Sweden’s EU membership fee since EU membership was perceived as something which primarily benefitted business. Thus, by raising individual contributions to the sickness insurance system, the government could lower employer contributions by the same amount, thereby creating some “financing room” to raise the employer payroll tax which financed EU membership.

In the January 1995 budget bill, the SAP proposed sweeping reductions in transfers to households, including sickness insurance. Again, the SAP emphasized that the proposed cuts must be fair, otherwise the public would not accept them. By cutting

⁷⁰*Proposition 1994/95:25.*

transfer payments, the government hoped to safeguard welfare services which had experienced substantial program cuts since 1990. Reducing transfer payments was also rationalized by the economic upswing. At the time, the economy had entered a recovery phase and economic growth was projected to be about 2% in 1995. As long as increasing exports stimulated the economy, the SAP reasoned that household purchasing power could be cut by reducing transfers. And as public finances stabilized, interest rates would fall. The government hoped that these reforms along with EU membership would encourage investment in Sweden.

In terms of concrete benefit cuts, the government proposed to reduce sickness insurance benefits to 75 percent of qualifying income. At the same time, the waiting day would be abolished, clearly a concession to LO. Besides cutting expenditure, the government's goal was to introduce uniform benefit levels in all parts of the social insurance system in order to reduce incentives for beneficiaries to take advantage of different program rules. The government promised that concrete proposals after the Sickness and Work Injury Commission (SWI) presented its report.⁷¹

The announcement of the SAP's plans for additional cuts in nominal benefits in its budget bill precipitated the breakup of the Left Party-SAP informal alliance supporting budget deficit reduction. By Spring, however, the SAP had found a new partner for parliamentary cooperation: the Center Party. With parliamentary support secured, the government presented a bill introducing tougher qualifying rules for disability pensions and

⁷¹The original commission was set up in April 1993 in the aftermath of the 1992 currency crisis.

sickness insurance.⁷² The bill also recommended tougher rules for sickness cash benefits; now, wage earners applying for benefits would be required to explain how their sickness prevented them from working, and the bill proposed increased powers for the insurance offices in order to facilitate the speedy return of those receiving benefits to the workplace, either by providing transport or finding other employment for the sick person. In addition to requiring a medical certificate from the seventh day of absence due to sickness, wage earners would also now be required to obtain a more detailed statement from a doctor starting with the 28th day of sickness. This new rule would require doctors to comment on how an illness affects a wage earner's work capacity and was intended to clarify the respective roles of the insurance offices and doctors. If implemented, the insurance office, not the doctor, would have the final decision power about the capacity of wage earners to work. The bill also sought to make the legal definition of sickness clearer, and thus stricter. Over the years, the definition of sickness had become quite broad in practice. As a result, both sickness cash benefits and disability pensions were being granted in cases without "clear medical rationale." The government argued that it was important for the legitimacy of the social insurance system that it provide benefits only for those meeting specific medical criteria. In the future, sickness benefits would be granted for strictly medical reasons and not economic or social conditions. In sum, the new rules meant that beneficiaries would face greater incentives to seek medical treatment early. These changes were calculated to save SEK 1.5 billion in sickness insurance costs and SEK 750 million in

⁷²*Proposition 1994/95:147*. The bill proposed that disability pensions be granted only on the basis of strict medical criteria..

disability pension costs.

Both LO and TCO were critical of many of the proposed changes, arguing that problems would simply be transferred to other systems. Rather than take action now, LO and TCO argued that the Sickness and Work Injury Committee should investigate the issue. Despite these criticisms, the bill passed easily in parliament with the support of the Center Party.

In late October the government followed up on its plans to reduce sickness cash benefits to 75% of qualifying income.⁷³ However, cooperation with the Center Party on benefit cuts came at a high price. At Center's insistence, the SAP scrapped its plans to abolish the waiting day in sickness insurance. The bill also increased the individual fee to sickness insurance to 3.95 percent and extended the "reduction rule" which prevents employers from paying benefits above the publicly mandated level. Finally, compensation for those participating in rehabilitation was lowered to 75%.

The bill also contained provisions for a fee swap between sickness and unemployment insurance. The new financing rules reduced the employer payroll tax to sickness insurance is reduced by 1.10 % and raised the contribution to the unemployment insurance system by the same amount. With the changes, the new employer payroll tax to the sickness insurance system is 5.28% of payroll and the payroll tax to the unemployment insurance system is 5.42% of payroll.

As the SAP-Center alliance took on the appearance of permanence, the opposition parties found themselves decisively shut out and would exert little influence on the

⁷³*Proposition 1995/96: 69.*

government's policies. However, the SAP faced internal opposition to its austerity policies as well as criticism from LO. SAP Party Leader Ingvar Carlsson's retirement in late 1995 threatened to force an internal party debate about the government's policies. By early 1996, Finance Minister Göran Persson had emerged as Carlsson's likely successor, and the party leadership devoted considerable efforts to depoliticizing the change in leadership. The SAP extra party congress did not occasion a serious debate about the government's austerity policies, and the prime minister's post passed smoothly to Persson. In fact, in the new government's first major bill, the Spring Economic Policy bill,⁷⁴ Persson announced a new round of cuts supported by the Center Party. Like previous bills, the legislation emphasized the need to improve public finances and maintain price stability. Because this was the first bill to fall under the new three year budget ceiling, the government proposed a combination of benefit improvements and cuts. The Spring Economic Policy Bill was also the first legislation to provide details about the government's plans to achieve the EU's convergence criteria. Now that the government has committed itself to specific targets in terms of the deficit, inflation, and interest rates, the rationale for further cuts was strengthened.

By this time, the economic situation had improved enough that the government felt confident in promising improvements in sickness cash benefits. However, the restoration of the 80 percent benefit level in 1998 would be financed with changes in the qualifying income calculation formula (SGI).⁷⁵ However, the government was still intent on

⁷⁴*Proposition 1995/96:150.*

⁷⁵The same bill also proposed raising unemployment insurance benefits to 80 percent of qualifying income.

achieving additional savings in the program, SEK 800 million starting in 1998.⁷⁶ The government also proposed the extension of the employer period in sickness insurance from two to four weeks in 1998, for savings of SEK 1.1 billion. Changes in SGI would result in savings of SEK 980 million starting in 1998. The government promised detailed legislation on the employer period and SGI later in the Spring.⁷⁷

The government quickly followed up on its additional reform plans. In May, the government presented legislation extending the employer period in sickness insurance to four weeks, changing the calculation of the SGI, and increasing individual contributions to sickness insurance.⁷⁸ As the government argued previously, the employer period was designed to increase incentives for employers to further improve the workplace environment and undertake active rehabilitation measures for employees on sick leave. Moreover, the reform should also contribute to budget consolidation. Thus, even though the extension of the employer period would increase employer costs by an estimated SEK 2.2 billion per year, employers would only receive half the savings in decreased employer contributions (0.14%). According to the government, employers had benefitted more than expected from the previous rule changes, so less than full compensation was justified.

To bolster its case for extending the employer period, the bill pointed to a report from the National Audit Office (RRV),⁷⁹ evaluating the effects of the employer period, waiting day, and lower benefit levels. The report claimed that in administrative terms, the

⁷⁶This figure also includes intended savings in parental insurance.

⁷⁷*Riksdag och Departement* 13 (1996).

⁷⁸*Proposition 1995/96:209*.

⁷⁹RRV, "Effekter och resultat av sjuklönereformen, karensdagen och sänkta kompensationsnivåer inom sjukpenningförsäkringen," *RRV Anser* 14 (1995).

new system functioned satisfactorily. The number of cases of illness processed by the insurance offices had decreased from 8.4 million in 1991 to 0.9 million in 1994. Thus, the bill argued that the reform had significant advantages for employers, wage earners and the insurance offices. Additionally, because the introduction of employer responsibility for rehabilitation in January 1992 had not functioned satisfactorily, extending the employer period would address this problem. With the extension to four weeks, employers' costs are more variable and therefore easier to influence, so the incentive for improving the work environment and promoting rehabilitation increases. In turn, the insurance offices would be freed of more work so they could devote more resources to rehabilitation efforts for long term sickness cases. The government estimated that the insurance offices' caseload would decrease by 165,000 cases per year.

The bill also proposed that SGI be calculated on actual historical income, excluding higher vacation pay and fringe benefits.⁸⁰ This proposal was based on a preliminary report issued by the Sickness and Work Injury Committee in January 1996.⁸¹ The report and the bill argued that including higher vacation pay resulted in overcompensation for most wage-earners. As was the case in the previous change in the SGI formula, this measure provoked little controversy and was a low-visibility way of achieving small savings at low political cost. The bill also contained provisions to increase individual contributions to sickness insurance by one percent in both 1997 and 1998. For employers the payroll contribution to sickness insurance would decrease by 1.24 percent

⁸⁰Since fringe benefits such as a company car or free housing are taxable income, this is an additional loss for wage earners receiving these benefits.

⁸¹SOU 1995:149, *Försäkringskydd vid sjukdom*.

beginning in January 1997 and 1.10 percent beginning in January 1998.

The changes proposed in the bill were designed to improve state finances, and both LO and TCO supported the measures. Although the unions were more or less satisfied, the employers were critical. The Employers' Confederation (SAF) reacted sharply to the proposal to extend the employer period, arguing that it amounted to a tax increase for employers because costs to firms would only be compensated by one third instead of one half. In particular, small firms objected to the proposal.⁸² SAF called on the government to withdraw this particular proposal.

The proposals also prompted criticism from the opposition parties. However, with the Center Party firmly behind the government's policies, there was little the opposition could do to influence the legislation. The Conservatives, Liberals, Christian Democrats, and Left Party opposed the extension of the employers' period. The Conservatives joined the employers in arguing that the move would particularly disadvantage small firms which would not be as able to bear the costs of the arrangement as larger firms. Both the Liberals and the Christian Democrats argued that the measure amounted to a tax increase (for employers and employees). The Liberals, Conservatives, Greens, and Christian Democrats also opposed the increases in individual payroll taxes.

Although the SAP-Center Party parliamentary alliance ensured the passage of this legislation, it is important to note that at the time, the sickness insurance program was over-financed. The low political costs of sickness insurance retrenchment for the SAP meant that the SAP could pursue cuts beyond those dictated by program deficits. The

⁸²SAF, *Press Release*, 5/29/96 and 5/21 96.

financial resources generated by these cuts could be used to finance other goals, such as the cost of EU membership, and the increasing costs of unemployment insurance. The resort to cost-shifting among programs was possible only because of the peculiar financing structure of sickness insurance and other social insurance programs.

By October, SAF was demanding that the government scrap the four week employer period.⁸³ LO joined SAF in this criticism and representatives from both organizations met with the Minister of Social Insurance Maj-Inger Klingvall to try to get the government to reverse the policy.⁸⁴ The irony was the SAF had earlier advocated such a change, and now was asking the government to reverse a privatization measure. As complaints from SAF and LO about the longer employer period mounted, the SAP finally agreed to reverse this rule in 1998.

The End of the Retrenchment Process: Preventing Fraud and Raising Benefits

In the Autumn 1996 session of parliament, the government introduced legislation limiting sickness and insurance and disability pensions to wage earners with sicknesses directly attributable to medical reasons.⁸⁵ The bill was based on previous statements of intent by the government, and it sailed through parliament with only the Left Party and the Greens opposing it.⁸⁶ Savings for both programs were calculated at SEK 1.2 billion for 1997 and SEK 2.3 billion for 1998.

In March 1997, the government stepped up its efforts to increase the powers of the

⁸³SAF, *Press Release*, 10/4/96.

⁸⁴*Ibid.*

⁸⁵*Proposition 1996/97:28.*

⁸⁶*Socialförsäkringsutskottet 1996/97:6.* Only the Left and Greens voted against the bill.

insurance offices to verify benefit eligibility and thereby reduce fraud. Legislation presented by the SAP proposed to grant the insurance offices the right to make home visits to any person receiving social insurance benefits, including sickness cash benefits and work injury benefits.⁸⁷ If passed, the legislation would grant the insurance offices the right to carry out random checks on benefit recipients. By presenting the bill, the government explicitly ignored the objections of the Legal Council which emphasized how the proposed rules involved potential violations of individual rights.

The government defended its stance by arguing that fraud undermines public faith in the system. Thus, steps to reduce fraud would enhance the legitimacy of the system. A recent report from the National Audit Office (RRV) calculated that cheating, overcompensation and system weaknesses cost the state SEK 5-7 billion per year.⁸⁸ The report noted that sickness insurance was one of the programs most prone to fraud.

In April 1997, the government presented a bill raising sick pay to 80 percent on January 1, 1998.⁸⁹ The bill reiterated the themes addressed in earlier legislation: public insurance should provide income security in the case of illness, but the system should also provide strong work incentives. The insurance should be constructed so that individuals are stimulated to work rather than receive benefits. In other words, the bill emphasized rehabilitation and the work line. In sum, besides providing income security during illness, the insurance system should promote two equally important goals: improving the work

⁸⁷*Proposition 1996/97:121.*

⁸⁸In 1995 a working group was set up at RRV which presented the report, "Missbruk och fusk med försäkring och bidrag," *RFV Anser 2* (1996).

⁸⁹*Proposition 1996/97:63.*

environment and promoting rehabilitation. Thus, there should be a balance between the goals of proving income security and maintaining the work line. No one should be passively sicklisted.

The last action taken by the SAP in this cycle of retrenchment was the proposal to implement a fee swap between the sickness insurance system and the new supplementary pension system. By now, increased individual payroll taxes to sickness insurance had resulted in significant over-financing of the program. This over-financing provided a clever solution to the problem of introducing individual payroll taxes to the reformed ATP system. The 6.95 percent individual payroll tax would simply be transferred from sickness insurance to the pension system. The remaining employer payroll tax for sickness insurance would be sufficient to finance program costs, at the same time that the ATP employer payroll tax could be reduced from 13 to 6.4 percent.⁹⁰

The Role of the Official Commissions of Inquiry: the Sickness and Work Injury Committee

Despite the rapid pace of reform in sickness and work injury insurance, both the Bildt and SAP governments attempted to use the traditional mechanisms of the Swedish investigatory process in their reform efforts. However, the official commissions appointed by both governments had only limited influence on both governments' reform plans. Additionally, the commissions were not used as forums for negotiating broad

⁹⁰The pension reform contained provisions for transferring half of program financing from employers to employees. It was thought that when the employers received this payroll tax cut that they would raise wages by a corresponding amount so that the financial impact would be neutral. However, SAF would not guarantee equal wage increases. By transferring payroll taxes be from sickness insurance to pensions, however, the SAP achieved the same result.

compromises as was the case in the pension reform process.⁹¹ For one thing, the rapid deterioration of the economy and the onset of the currency crises in 1990 and 1992 prevented both governments from relying solely on the time-consuming commissions to investigate reform. Instead, both governments resorted to proposing ad hoc measures to cut costs in sickness and work injury insurance because of the time constraints imposed by the deterioration of the economy and the perceived need for immediate action. When both governments did appoint official commissions to investigate reform, the commissions' work was often interrupted, derailed, or redirected by the actions of the government.

Several commissions were appointed to investigate sickness and work injury reform. The first was established in 1993 in the aftermath of the 1992 currency crisis.⁹² When the commission was set up, the Bildt government's goal (supported by the SAP) was to remove work injury and sickness from the state budget and let the labor market parties administer the system. It soon became clear, however, that both SAF and LO opposed such an arrangement. Against this backdrop, when the SAP returned to office in 1994, it downplayed the issue of who would administer the reformed system(s) and instead emphasized the goals of reducing costs, strengthening the work line, and ensuring that a reformed system would not create new inequalities. The SAP government also changed the membership of the commission; the redesigned commission would not include representatives from the labor market parties, only members of parliament.

The redesigned commission presented several reports but none of its major

⁹¹See chapter five.

⁹²*Riksdag och Departement* 16 and 31 (1993).

proposals had much influence on actual legislation. For example, the committee proposed sweeping changes in both work injury insurance and disability pension systems; increasing the income ceiling for sickness cash benefits; and merging the sickness, work injury, and disability pension programs into a single system.⁹³ In contrast, commission proposals about less politicized aspects of the sickness and work injury insurance systems, such as changing the calculation of SGI, did have some impact on legislative proposals.

In sum, the role of the Official Commissions of Inquiry has been difficult, and commission recommendations have usually served only as the basis for piecemeal changes in sickness and work injury insurance. The SAP government appears unlikely to adopt some of the more far-reaching recommendations of the SWI Commission, especially the restoration of higher benefits in work injury insurance. Thus, in contrast to the pension reform process, the official commissions did not play a major role in the sickness and work injury insurance retrenchment process.

Explaining Outcomes: Social Democracy and Policy Feedback

In contrast to pensions and unemployment insurance, cuts were deepest and earliest in sickness and work injury insurance. Work injury cash benefits were completely abolished and replaced with lower sickness cash benefits, sickness insurance was partially privatized with the introduction of the employer period, and nominal benefit cuts and increased employee financing mean that both systems are significantly less decommodifying than they were in 1990 when the retrenchment process began. Tables

⁹³SOU 1995:149, *Försäkringsskydd vid sjukdom*; and SOU 1996: 113 *En allmän och aktiv försäkring vid sjukdom och rehabilitering*.

4.2 and 4.3 show the differences in program rules in 1990 when the systems were most generous and 1997, when cumulative cuts had their deepest impact. As the tables show, between 1990 and 1997, nominal benefits in both programs were reduced by one fourth, eligibility tightened, and financing shifted from employers to employees.

This chapter emphasizes the role of labor power and policy feedback in explaining these outcomes. Before turning to this specific explanation, however, it would be useful to examine more closely the predictions of both Pierson's policy feedback model and the power resource school. A straightforward application of the policy feedback model yields mixed results. Pierson argues that policy inheritances channel retrenchment attempts in specific ways. When facing the difficult task of retrenchment, program structures determine whether it is possible for governments to defuse opposition to benefit cuts by using strategies of obfuscation, compensation, or division. None of these three strategies was particularly important in sickness and work injury insurance retrenchment. Nominal benefits cuts and the introduction of waiting days were highly visible. The strategy of obfuscation was important only in terms of changing the calculation of qualifying income, but this particular retrenchment tool was not particularly significant in terms of cost savings. Finally, strategies of compensation played only a small role.

The policy feedback model also emphasizes the emergence of powerful interest groups organized around specific programs. Interest groups with a stake in welfare

TABLE 4.2: Sickness Insurance Program Characteristics 1990 and 1997

day of sickness period	1990	1997
1	100%	0
2-3	100%	75% paid by employer
4-14	100%	75% paid by employer
15-28	100%	75%+10%*
29-90	100%	75%+10%*
91-365	100%	75%
366-	100%	75%
definition of sickness	broad, including "non-medical" criteria	strict medical criteria
calculation of SGI	includes vacation pay and fringe benefits	based on wage income only
individual contributions	none	5% of salary up to 7.5 base amounts

Note: *10% is added through collective agreements.

TABLE 4.3: Work Injury Insurance Program Characteristics 1990 and 1997

day of benefit period	1990	1997
1	100%	0
2-3	100%	75% paid by employer
4-14	100%	75% paid by employer
15-28	100%	75%+10%*
29-90	100%	75%+10%*
91-365	100%	75%
366-	100%	75%
definition of work injury	broad	strict medical criteria

Note: *10% is added via collective agreements.

programs can often mobilize powerful opposition to retrenchment efforts. Both sickness and work injury insurance are universal programs providing benefits to the entire working population. As such we would expect a lot of opposition to benefit cuts. Indeed, the LO and TCO vigorously criticized most of the retrenchment attempts, but they did not wield as much influence in the process as the policy feedback model would predict. Once the SAP leadership made up its mind about the necessity of retrenchment, the union federations were virtually ignored. With the non-socialist parties supporting retrenchment, the only exit option for the union federations was to throw their support behind the Left Party, and this was neither feasible nor attractive. In order to defuse some of this union opposition, the SAP attempted to package its cuts in terms of fairness.

Thus, Pierson's policy feedback model fails to consider the importance of the labor movement in retrenchment politics. The policy feedback model also fails to examine the

ways in which social insurance programs may be implicated in national debates about competitiveness and budget deficits. When social insurance programs are perceived as significant causal factors in national economic problems, retrenchment is much more likely. The operation of the sickness insurance system was identified as a major contributor to Sweden's declining competitiveness. The method of trust fund financing made program deficits highly visible adding to the perceived urgency of reform. These two "negative" aspects of policy feedback were important causes of retrenchment.

The power resources approach certainly brings the politics of labor back into the study of welfare state development. For adherents of this approach, social policy is seen as an attempt to modify the effect of market forces on wage earners. Social insurance programs introduce legislated social rights which decrease the dependence of wage earners on the market. Strong social democratic parties and high levels of union density are important variables in explaining the emergence of legislated social rights. Although I have argued that labor has been the dominant actor in the retrenchment process, the discussion in this chapter also highlights divisions between the Social Democratic Party and the union federations. This aspect of labor politics is neglected in the power resource approach. Moreover, like the policy feedback model, the power resource approach cannot tell us why a powerful social democratic party might advocate retrenchment. Finally, like Pierson's policy feedback model, the power resources approach provides little guidance about the ways in which social insurance programs differ in their importance to the labor movement.

Accounting for why retrenchment in sickness and work injury insurance was more

successful than in pensions and unemployment insurance requires attention to both policy feedback effects and the politics of the labor movement. The explanation offered here draws on both kinds of arguments but differs from them based on the criticisms discussed above. To summarize the argument, cuts were deepest and quickest in sickness and work injury insurance because of the relatively low political costs of reform and labor's willingness to cooperate in reform. Five aspects of program structure are important for explaining why this was the case.

First, although sickness and work injury benefits are universal, take-up rates follow a very different logic than in pensions and unemployment insurance. Whereas retirement is a certainty or an accomplished fact for those past retirement age, wage earners use sickness and work injury benefits very differently. In any given year, about one half of those currently employed do not use sickness or work injury benefits because they are at low risk for illness or injury. For most wage earners who do draw benefits, the benefit period is less than two weeks. Moreover, because those with jobs currently draw a salary, the loss of income for short periods of illness was not as great as the loss of income associated with unemployment, or reduced pension payments. The toughest cuts were concentrated on a very small group: those on the long-term sicklist. Thus, different social insurance programs protect against different kinds of risk, and the lower risk of sickness and work injury made retrenchment in these programs less politically costly (table 4.4).

TABLE 4.4: Sickness Insurance Benefit Days 1981-1990

year		Number of benefit days during the year				
		0	1-6	7-89	90-	total
1981	men	40.5	25.2	29.6	4.7	100.0
	women	38.1	24.4	32.6	4.9	100.0
1982	men	43.7	24.4	27.6	4.3	100.0
	women	40.1	24.3	30.8	4.8	100.0
1983	men	41.8	24.8	29.7	4.7	100.0
	women	37.5	24.7	32.6	5.2	100.0
1984	men	43.2	24.5	28.0	4.3	100.0
	women	37.9	25.0	31.9	5.2	100.0
1985	men	38.9	25.8	30.7	4.6	100.0
	women	33.4	25.8	35.1	5.7	100.0
1986	men	40.3	25.2	29.8	4.7	100.0
	women	33.3	26.0	34.5	6.2	100.0
1987	men	39.3	24.8	30.8	5.1	100.0
	women	31.5	25.8	35.7	7.0	100.0
1988	men	33.5	24.1	37.2	5.2	100.0
	women	24.8	24.3	43.4	7.5	100.0
1989	men	35.4	24.8	34.8	5.0	100.0
	women	25.7	25.7	41.2	7.4	100.0
1990	men	35.6	25.4	34.1	4.9	100.0
	women	25.3	26.4	41.0	7.3	100.0

Source: RRV, *Social Insurance Statistics*.

Note: These numbers mean, for example, that in 1990, 35.6% of men had no benefit days; 25.4% of men had 1-6 benefit days; 34.1% of men had 7-89 benefit days; and 4.9% of men had 90+ benefit days.

Second, the structure of both sickness and work injury insurance provided opportunities for privatization and abolition that were not available in the pension or unemployment insurance system. Although the introduction of the employer period in sickness insurance carried the potential that employers would exercise greater control over worker sickness, the change was palatable to the SAP because it did not involve a reduction in nominal benefits. Moreover, the employer period was a way to pressure firms into improving the work environment, something which clearly appealed to the SAP, SAF, and the non-socialist parties. Firms would be able to influence their own sickness absence costs, the SAP could claim it was doing something to improve the work environment, and the non-socialist parties could credit themselves with helping to engineer the transfer of a public activity to the private sector. The attractiveness of the proposal to all of these actors trumped the objections of the LO.

The close connection between the structures of both work injury insurance and sickness insurance also provided the opportunity to abolish work injury cash benefits entirely and to transfer this responsibility to the sickness insurance system.

Third, as was the case in pensions and unemployment insurance, the method of ear-marked employer payroll tax and trust fund financing influenced the reform agenda in decisive ways. Program deficits were easy to track, and in the context of large government budget deficits, the state could hardly make up the shortfall.

Fourth, sickness insurance and work injury benefits mattered to the labor movement in ways that were very different from pensions and unemployment insurance. The sickness insurance and work injury insurance systems were not nearly as important to

the SAP's core constituencies as unemployment insurance. The structure of both programs did not provide incentives for union recruitment, and for almost half of those with steady employment, neither program had much importance because they did not draw benefits from them. Thus, the political costs of reform were much lower in sickness and work injury insurance than in either pensions or unemployment insurance.

Similarly, the two programs mattered differently to the employers because of the direct link between the conditions affecting production and the operational characteristics of the sickness and work injury programs. More than pensions and unemployment insurance, the employers linked sickness cash benefits directly to the declining competitiveness of export industry. The employers were unified and vocal about how they thought the system should be reformed. For the SAP, sickness insurance retrenchment was a quick and low cost way to address high wage costs and declining productivity.

In sum, retrenchment in sickness and work injury insurance provided a solution to two problems: increasing worker absenteeism and skyrocketing program deficits. Both of these problems were the result of feedback effects from both programs. In the debates concerning both programs, policymakers argued that worker absenteeism significantly contributed to the declining productivity and high wage costs in the sector of the economy exposed to international competition. Moreover, the structure of both programs made it easy for politicians to track program deficits. However, the identification of serious program deficiencies is a necessary, rather than sufficient cause of reform. Governments may be willing to allow program deficits to persist and to downplay the supposedly negative effects of program benefits on national economic performance, including

competitiveness. Whether governments are willing to do so depends on the political importance of a social insurance program to its core constituencies.

As the chapter on unemployment insurance reform shows, the SAP was willing to permit huge program deficits to continue because of the importance of that program to the internal cohesion of the labor movement. Even though the structure of unemployment insurance was argued to drive up wage costs and hinder labor market flexibility, the SAP chose to downplay these criticisms. In its reform of unemployment insurance, the SAP orchestrated large additional infusions of revenue into the system and changed program structures so that deficits would not be visible. That the SAP chose to insulate unemployment insurance from radical retrenchment is explained by the importance of the program to union recruitment and the political importance of cash benefits for the unemployed.

TABLE 4.5: Summary of Changes in Sickness and Work Injury Insurance

reform and year enacted	impact	imple- mentation	parties supporting
SAP government 1988-1991			
October 1990 cuts in benefits: days 1-3=65% + 10% then 80% + 10%	savings of SEK 6.0 billion per year	yes	SAP + Ce + Li + Con
Spring 1991 employers responsible for rehab	neutral	yes	SAP + Ce + Li + Con
Spring 1991 two week employer period	savings of SEK 881 million per year	yes	SAP + Ce + Li + Con
Bildt government 1991-1994			
Fall 1991 coordination of SI and WI from 90 to 180 days	SEK 240 million	yes	Ce + Li + Con + ND
Fall 1992 one waiting day, individual fee; days 2-3=75%; days 4-8=80% days 90-=70%	SEK 8.2 billion (including WI)	yes	Ce + Li + Con + ND
Fall 1992 stricter eligibility rules for WI	(data not available)	yes	Ce + Li + Con + ND
Spring 1993 abolish WI and replace with SI	SEK 1.7 billion	yes	Ce + Li + Con + ND
SAP government 1994-1998			
Fall 1994 increase indiv. fee to SI	14.4 billion by 1998	yes	SAP+Left Party
Winter/Spring 1994 tougher eligibility for SI	SEK 1.5 billion for SI	yes	SAP+Ce
Fall 1995 benefits reduced to 75% increase indiv. fee to 3.95%	data not available	yes	SAP+Ce
Spring 1996 four week employer period, increase ind. fee; change in calculation of SGI	SEK 1.9 billion	yes	SAP+Ce
Fall 1996 SI and DI for strictly medical reasons	1.2 billion in 1997 2.3 billion in 1998	yes	SAP+Ce

CHAPTER 5:

MODERATE RETRENCHMENT: OLD-AGE PENSIONS

This chapter analyzes the politics of retrenchment in a central welfare state policy area: old-age pensions. Sweden has one of the oldest and most comprehensive public pension systems in the world. A system of both flat rate and earnings-related pensions covers the entire population, and private pensions play a relatively insignificant role in the retirement packages of most wage-earners.¹ The pension system is the largest single welfare state program in terms of spending, and expenditures have increased dramatically over the past three decades. In 1965, expenditure for old age pensions totaled 4.3 percent of GDP and had risen to 12.2 percent of GDP in 1992.² Moreover, the Swedish pension system is notable for the relatively large publicly controlled pension funds (AP Funds) that it generates. In 1992, these funds stood at 512 billion kronor, or 35 percent of GDP. Thus, the outstanding features of the Swedish public pension system are the overwhelming dominance of the state in pension provision as well as its important role in generating national savings.

Until the early 1990's, the politics of old age pensions in Sweden was characterized by the steady expansion and improvement of benefits. By the late 1980s, retired persons received generous old age pensions from either the basic pension (folkpension) system or the national earnings-related pension scheme (ATP, allmänna tilläggspensionssystem), or both. In contrast to pension schemes in other West European states, the Swedish system has been characterized by a relatively generous set of eligibility rules designed to enable

¹Private pensions, including occupational pensions, account for about 10% of the income of pensioners.

²*Proposition 1993/94:250, Reformering av det allmänna pensionssystemet*, p. 16.

wage-earners to withdraw from full-time participation in the labor market for education, care of children, or part-time employment without significantly reducing their public pension benefits. In addition, workers could turn to partial pensions (delpensioner) and disability pensions (förtidspensioner) for early retirement. In his study of welfare state regimes, Esping-Andersen finds that among advanced capitalist states, the Swedish pension system has the highest degree of "decommodification," or the degree to which wage-earners can maintain an acceptable standard of living independently of market participation.³

Before 1990 major pension reform was never seriously discussed or attempted even though pension expenditures increased significantly during the previous decade. The few pension retrenchment measures carried out by non-socialist governments in the early 1980s provoked widespread public outcry and helped to return the Social Democrats to power in 1982, when they quickly moved to reverse these modest cuts.⁴ In the elections of 1985 and 1988, the future of the welfare state featured prominently, and the bourgeois parties were repudiated at the polls for suggesting modest reductions in social insurance benefits, including pensions. In sum, in 1982, 1985, and 1988, maintaining the current pension system was still a winning electoral strategy for the SAP, and the party's political success attests to the nearly untouchable status that the pension system enjoyed until the late 1980s.

³Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton: Princeton University Press, 1990).

⁴Reductions in pension benefits were achieved by adjusting the index used to calculate pension payments in 1981. Restoring the value of pensions was one of the SAP's four election promises in 1982, and they fulfilled this promise in late 1982. The partial pension was also reduced from 65% of eligible earnings to 50%. The SAP reversed this in 1987.

The rapid deterioration of the Swedish economy in the late 1980s dramatically altered the political and economic foundations of the public pension system. Between 1990 and 1993, Sweden experienced its worst recession since the 1930s. In the wake of stagnant economic growth and rapidly rising levels of unemployment, the pension system faced the twin shocks of shrinking tax revenues and increasing expenditures because of the growing number of retired persons. The economic crisis exposed the instability of the pension system and shoved the issue of pension reform to the top of the political agenda. Changes adopted between 1990 and 1996 have resulted in a significant decrease in benefits for current pensioners, and future pensioners will be subject to a radically different set of rules governing eligibility, financing, and benefit indexing. Governments have legislated both short-term reductions in pension payments by adjusting the index used to calculate benefits, and they have embarked on a far-reaching, long-term reform of the entire pension system which entails significant reductions in future pension benefits. As a result, the new pension system will lose much of its redistributive character, and the ATP system will play a much smaller role in generating future national savings.

Both Social Democratic and bourgeois governments have cut pensions in order to achieve immediate budget relief, and they have focused on structural reform of the entire pension system in order to make the pension system self-financing and thereby resistant to future economic and demographic shocks. In this respect, the desire to make social insurance programs self-financing reflects the goal of *protecting* the welfare state. A striking feature of both short-term and long-term pension reform is the cross-party parliamentary alliance behind it. Although the major political parties disagree on some

details, they have largely put these differences aside in favor of a series of broad compromises.

For the SAP, retrenchment has been both a painful necessity brought on by the severe economic crisis and an opportunity to preserve the basic structure and scope of the pension system by correcting its perceived weaknesses. The price of reform, however, is that the pension system will become less generous and redistributive. For the bourgeois parties, the economic crisis provided the strategic opportunity to challenge social democratic hegemony in pension policy and advocate changes only recently considered politically impossible.

Why did the SAP change its position about the necessity of pension reform? Why has pension reform taken place in the absence of avowedly conservative governments? There has been no discernable shift in political preferences among the major political parties toward a conservative dismantling of the public pension system. The pension system enjoys widespread public support, and none of the political parties has openly challenged the notion of the state continuing to play the predominant role in pension provision. Given the stability of public and party political preferences in favor of the public pension scheme, why have politicians embarked on major reform? Once the retrenchment process has been initiated, which factors contributed to successful retrenchment?

The explanation of pension reform and retrenchment advanced in this chapter emphasizes organized interests, institutions, and policy feedback. The failure of economic policy in the 1980s and the dramatic surge in unemployment largely explain the massive

fiscal pressure on the pension system. The constraints of capital market integration increased the urgency of reform and provide an answer to the question of why elected officials have moved so quickly to reform to the pension system. Rising interest rates, capital outflows, and pressure on the currency limited the ability of governments to maintain large deficits to support current pension spending levels. However, these factors cannot account for the ways in which economic crisis and financial market constraints are channeled into policy change.

A surprising feature of the retrenchment process is the fact that the SAP and labor unions have not always blocked the retrenchment process. Indeed, labor has occupied center stage in the Swedish retrenchment process both in blocking cuts that it opposes and in facilitating retrenchment according to social democratic values. Labor has not always gotten its way, but it is by far the most important actor in the retrenchment process. This observation challenges Pierson's assertion about the irrelevance of organized labor for the politics of retrenchment. Labor may indeed have a substantial stake in retrenchment and may even actively facilitate the process of reform. Throughout the process of pension reform, the SAP has imposed its will on a reluctant LO.

This chapter demonstrates the importance of the Swedish investigative process in identifying perceived weaknesses in the pension system and in providing opportunities for minimizing interest group opposition to reform. The domestic and international economic climate prevailing since the 1970s is one which the current pension system is not designed for. The current supplementary pension scheme was designed in the 1950s and assumes both an annual economic growth rate of 3-5% and full employment. One crucial aspect of

policy feedback, then, has been the recognition that the existing pension structure was severely out of step with international and domestic economic developments. Although the number of retired persons has increased, there is widespread agreement that *economic* rather than demographic factors are the main cause for the pension system's instability. In sum, feedback from previous pension policy choices resulted not only in widespread support for the public pension system, but also in the identification of serious problems in it. Thus, the motivation for reform and retrenchment is not hostility to public pension provision, but rather the perceived weaknesses of the system and its contribution to Sweden's economic difficulties such as a low savings rate and decreased work incentives.

The legacies of previous policy choices also influenced the retrenchment process in decisive ways. As Pierson argues, the structure of existing policies influences the setting of political agendas, the likelihood of blocking opposition to cutbacks, and in the case of mature pension schemes, creating lock-in effects which inhibit the prospects for radical reform.⁵ In Sweden, politicians faced a universal, comprehensive pension system that was nearly mature. The "lock-in"⁶ effects of pension policy development dictated that reform would have to take place within the confines of the existing system. As in the United States, the structure of the ATP system created a "trust-fund driven politics."⁷ In the late 1980s, rising expenditures for ATP pensions dramatically reduced the strength of the AP

⁵Paul Pierson, *Dismantling the Welfare State? Reagan, Thatcher, and the Politics of Retrenchment* (Cambridge: Cambridge University Press), p. 54.

⁶"Lock-in" effects refer to the impact of previous policy commitments in structuring retrenchment strategy. Where pension systems are mature, as in the US, or nearly mature, as in Sweden, politicians are exceedingly reluctant to introduce radical changes because pension promises have been made far into the future.

⁷On the US case, see *ibid.*, chapter 3.

Funds and triggered an intense policy debate about how to reform the system. Although the basic pension system did not generate a similar trust-fund driven politics, the rapid increase in state grants to cover the shortfall in the system was implicated in discussions about how to deal with the fiscal crisis. The financing structure of the basic pension scheme permitted political actors to easily to determine the extent to which the program was under-financed. In sum, the universal and overwhelmingly public character of the pension system generated wide-spread support, but central features of the system were singled out as serious threats to Sweden's long-term economic stability.

As budget deficits mounted, the LO and TCO could offer no real alternative to retrenchment; they could only attempt to influence the form that retrenchment would take. In the case of short-term retrenchment, cutbacks have been highly visible, and politicians have engaged in "blame avoidance" by claiming that budget deficits and financial markets made retrenchment unavoidable. Moreover, politicians could package reform in terms of fairness by arguing that pensioners should contribute their share to deficit reduction. Cutbacks have been much less visible in the structural reform process, and again politicians resorted to blame avoidance by attributing changes in the pension system to the economic crisis and by constructing a five-party coalition in favor of reform. With five parties behind the agreement, it would be difficult to blame any particular party for future pension benefit changes. The next section briefly summarizes the historical development and main features of the pension system.

Historical Development of the Pension System

The current pension system consists of three parts: the basic pension, the national supplementary pension (ATP), and collective agreement pensions.⁸ All citizens are entitled to the basic pension while ATP and the labor market pensions provide benefits based on previous income from work. In addition, the partial pension and disability pension provide benefits for early retirees. Although the current pension system is often seen as a social democratic achievement, the pension system is better viewed as the product of a wide range of decisions adopted and amended over nearly a century by different political actors and under a wide variety of economic circumstances. By the early 1990s, the pension system included a complex mix of programs, and the results were not always in line with original intentions.

Sweden has one of the oldest and most comprehensive public pension systems in the world. In 1914, the Liberal government introduced an old age and invalidity pension scheme available to all citizens as a matter of right. The basic pension was low, and in 1935 it was replaced by the flat rate basic pension (folkpension). In 1948, the basic pension was raised significantly so that pensions would cover basic living costs. By the early 1950s, the size of the pension equaled about 30% of an average industrial wage.⁹

During the 1950s, two groups enjoyed generous occupational pensions: state and white collar employees. The average pension for these groups was 50 to 70 percent of terminal pay (slutlön) while the majority of households only had access to the basic

⁸The collective agreement pensions provide pension benefits for income over the ATP ceiling, and four such systems today cover 90% of the labor market.

⁹Stefan Ackerby, *Pensionsfrågan. Bilaga 12 till Långtidsutredningen 1992*.

pension. In the 1950s, manual workers led by LO and backed by the SAP pressed for a legislation to even out the difference between white and blue collar workers pension levels. After several years of contentious debate, the Riksdag approved an earnings-related pension scheme in 1959.¹⁰ The new national supplementary pension scheme (ATP) was designed to give all workers, not just white collar workers, an earnings-related pension. Collectively agreed white collar pensions were retained, and in 1971 LO members got their own collective pensions.¹¹

The ATP reform meant that the basic pension was supplemented with an obligatory pension based on previous income. The ATP reform was significant in that it marked a new orientation in social welfare reform: benefits were now based on the principle of income replacement rather than meager flat rate benefits.¹² Together with the people's pension, ATP was designed to provide 65% of previous income up to the ATP ceiling. According to the generous transition rules, the system would approach maturity by the early 1990s. The ATP system also included provisions for disability pensions (förtidspensioner) and family pensions (familj pensioner). Disability pensions became available for wage-earners whose ability to work was reduced because of a physical disability before they reached retirement age. Family pensions provided both a widow's pension payable until retirement age and a child pension available until the child reached legal age. The ATP reform marked a turning point in Swedish politics and social

¹⁰For discussions of the ATP reform, see Hecló, *Modern Social Politics in Britain and Sweden*, chapter five.

¹¹Ann-Charlotte Ståhlberg, *Våra pensionssystem* (Stockholm: SNS Förlag, 1993), p. 13.

¹²Esping-Andersen, *Politics Against Markets*.

democratic strategy. Esping-Andersen argues that the ATP reform marked the shift from the red-green coalition to a new wage-earner alliance based on the confluence of interests of both manual and salaried wage earners.¹³

The decades after the ATP reform were marked by the steady expansion and improvement of pension benefits. In 1969, the basic pension was complemented with the pension supplement (pensionstillskott) for those who were not included in ATP or who had low ATP points. This supplement was small at first, but was successively raised so that it corresponded to about half the basic pension in the early 1990s. Between 1970 and 1972, eligibility rules were loosened for disability pensions so that this type of pension became available for so-called labor market reasons.¹⁴ In 1974, sickness and unemployment insurance were made taxable and eligible for pension points. In 1976, the pension age was reduced from 67 to 65, and the partial pension (delpension) was introduced. Workers aged 60-64 who switched to part-time employment became eligible for the partial pension¹⁵ until they reached retirement age. In 1982, the basis for ATP contributions was increased to include the entire wage sum even though only incomes up to a specified ceiling earned pension points. Since 1982, the care of small children has also been eligible for ATP pension points. Throughout the 1970s and 1980s, employer contributions to both the basic pension and ATP pension system were raised several times. Table 5.1 summarizes the expansion of pension benefits since 1914.

¹³Esping-Andersen, *Politics Against Markets*.

¹⁴This change was intended to help wage-earners between the ages of 60 and 64 who had physically taxing jobs or who were not in good health.

¹⁵The partial pension paid 65 percent of lost income without reducing the amount of pension points earned until retirement age.

TABLE 5.1: Chronological Development of the Pension System

1913	Universal Pension Insurance introduced
1935	Basic pension system replaces universal pension insurance
1946	Significant increase in pensions
1950s	Steady increases in basic pension; indexing to CPI introduced
1959	ATP reform adopted, including disability and widow's pensions
1969	Pension supplement introduced for pensioners with low ATP points
1970s	Looser eligibility rules for disability pension; sick pay, parental insurance, and unemployment insurance become eligible for pension points
1976	Decreased pension age from 67 to 65
1976	Partial pension introduced
1981	Ceiling for ATP contributions abolished
1982	Pension points for care of children

Source: Ståhlberg, *Våra pensionssystem*, p. 15; and SOU 1994: 20, *Reformerat pensionssystem*, pp. 19-21.

The Structure of Old-Age Pensions

Inclusiveness All Swedish citizens are eligible for the basic pension. Beyond this basic level of income support, the bulk of earnings-related pensions for the vast majority of Swedes is provided by the ATP system since collective agreements add only about 10% to the public pension system. Thus, the entire population has a large stake in the pension system.

As in the United States, the emergence of a large public pension scheme has contributed to the rise of interest groups representing the interests of pensioners. In Sweden, there are two main pensioners organizations, but they are not nearly as powerful as the AARP in the United States and they each are linked to a political party or group of

parties.¹⁶ Because of the dominance of peak-level labor organizations such as the LO and TCO in Swedish politics, the pensioners organizations have exerted relatively little influence on pension policy through regular policymaking channels. Instead, the LO and TCO are the main interest group actors in Swedish pension politics.

Maturity As a result of the generous transition rules adopted when it was introduced, the ATP system approached maturity in the early 1990s. Because the ATP system is a pay-as-you-go system with pension benefits financed by current contributions, the system involves what Pierson calls an "intergenerational contract" in which each generation depends on future generations to pay its pension benefits.¹⁷ The importance of this intergenerational contract is repeatedly mentioned in every public document concerning pension reform, and it made radical privatization or contracting out unlikely because of the lock-in effects of previous policy choices.

Treatment of Private Provision As noted, private pensions in Sweden play a relatively minor role in pension provision except for the collective agreements which pay about 10% of the terminal salary for 90% of the labor force. In addition, the tax code provides for a number of private pension savings schemes, but these are largely insignificant for most pensioners.¹⁸ In any case, the collective agreements are designed to provide a small supplement to public pensions rather than compete with them. The relative unimportance of private pension provision meant that retrenchment could hardly involve contracting out

¹⁶The PRO maintains links with the SAP, while the SPF is affiliated with several of the bourgeois parties.

¹⁷Pierson, *Dismantling the Welfare State?*

¹⁸Private pension savings are relatively insignificant in Sweden because the SAP has repeatedly resisted the sort of legislation required to make such schemes attractive, such as tax deductibility.

or public financing of private alternatives. Reform would necessarily have to occur within the confines of the existing public system.

Financing Whereas both the basic pension and ATP pension schemes are constructed as pay-as-you-go systems, only the ATP system is financed through a trust fund separate from the state budget. In both cases, employer payroll contributions invisible to the wage-earner are intended to finance current pension outlays. For basic pensions, state grants cover any shortfall in pension payments, while accumulated capital in the AP Funds operates as a buffer fund for periods when expenditures exceed revenues. Thus, economic crisis and the dramatic deterioration of state finances exposed different problems in each system. Ongoing shortfalls in the basic pension system created added pressure on the government budget, whereas falling ATP revenues reduced the strength of the AP Funds and raised the specter of rapidly diminishing pension capital. The growing weakness of the AP Funds reduced its role as a source of national savings and exposed its instability in the wake of weak economic growth.

The basic pension is a pay-as-you-go system financed by employer contributions and state grants. All income from basic pension contributions are paid out to cover pensions for the current year. In 1993 the basic pension employer's contribution was 5.66 percent of the wage sum and this revenue covered 52 percent of pension payments.¹⁹ In the Swedish debate, analysts and politicians consistently point out that contributions paid

¹⁹In 1992 the employer contribution was 7.45% of the wage sum, and this covered 70-80% of pension costs. In 1992, the basic pension contribution was reduced by 2% and the ATP contribution raised by the same amount. This accounting change was designed to restore balance between ATP revenues and expenditures, but it also meant that now the state budget covered a higher proportion of basic pension costs.

to the people's pension have the character of a "tax" since there is no link between contributions and benefits. As budget deficits ballooned, the rising cost of state grants to the basic pension scheme made the financing of the basic pension system a target for retrenchment. Table 5.2 shows the rapid increase of state grants to the basic pension system between 1981 and 1994.

TABLE 5.2: Basic Pension Expenditure 1981-1994

year	contributions (millions SEK)	state grants (millions SEK)	expenditure (millions SEK)	employer contribution (% of payroll)
1981	24,533	9,214	33,747	8.4
1982	24,336	11,482	35,818	8.45
1983	29,465	10,221	39,686	9.45
1984	31,792	9,685	41,450	9.45
1985	32,953	11,497	44,450	9.45
1986	38,482	9,062	47,544	9.45
1987	41,761	7,883	49,644	9.45
1988	44,750	7,993	52,743	9.45
1989	50,105	6,918	56,933	9.45
1990	45,963	15,019	60,982	7.45
1991	47,975	18,830	66,805	7.45
1992	47,707	22,064	69,771	7.45
1993	36,727	33,827	70,554	5.66
1994	36,338	35,666	72,004	5.86

Source: RRV, *Social Insurance Statistics. Facts* (Stockholm: RRV, various years).

The ATP system is a modified pay-as-you-go-system in that it has the additional feature of five trust funds (AP Funds) invested in stocks and bonds. The AP trust funds were built up during the first 30 years of the system's operation because contributions exceeded expenditures. The AP funds were designed to serve as both a buffer fund²⁰ and an accumulation of national savings that would offset the eventual decrease in private retirement savings. At the end of 1992, the AP funds totaled SEK 512 billion. The ATP contribution is 13% of the wage sum and is currently financed by the employer. In contrast to the basic pension, the ATP system operates as a separate trust fund. Although the AP funds remain large, rising pension costs have rapidly weakened the funds, leading to a trust-fund driven politics. Table 5.3 and figure 5.1 show the substantial decrease in AP fund strength since 1981. This deterioration has occurred even though ATP contributions have been paid on income above the ATP income ceiling since 1982. In addition, the level of contributions has been increased several times. The decreasing size of the AP Funds in relation to accumulated pension rights dramatically weakened the role of the AP Funds as a source of national savings. Because private pension funds play a relatively small role in generating national savings, the weakening of the AP Funds was implicated in the structural weaknesses of the Swedish economy, including the low savings rate.

²⁰Profits from previously funded ATP contributions in the AP Funds would serve to offset temporary deficits in the ATP system. The first three funds are invested mostly in bonds while the fourth and fifth funds are invested in stocks.

TABLE 5.3: ATP Revenues and Expenditures: 1981-1994 (SEK millions)

Year	Revenue		Expenditure		Fund at Dec 31st	Fund Strength	Employer Contributions
	contri- butions	interest	benefits	admini- stration			percent of payroll
1981	25,795	16,499	23,537	259	183,492	7.7	12.25
1982	27,150	19,234	27,013	207	202,656	7.4	9.4
1983	29,574	23,306	32,467	283	222,786	6.8	9.6
1984	33,283	25,868	36,172	309	245,356	6.7	10
1985	35,172	28,535	42,116	336	266,611	6.3	10
1986	40,193	34,675	48,418	375	292,686	6.0	10
1987	45,030	36,648	53,801	399	320,064	5.9	10.2
1988	50,008	41,014	60,558	512	350,016	5.7	10.6
1989	59,864	44,248	69,178	540	384,410	5.5	11
1990	78,927	46,423	77,406	582	431,772	5.5	13
1991	83,145	54,780	87,861	702	480,734	5.4	13
1992	83,796	54,211	96,381	666	498,775	5.1	13
1993	81,014	53,705	101,438	779	531,277	5.2	13
1994	82,684	36,473	108,371	659	541,404	5.0	13

Source: RRV, *Social Insurance Facts*.

Note: *Fund strength is fund value at the end of the year divided by expenditure for the year.

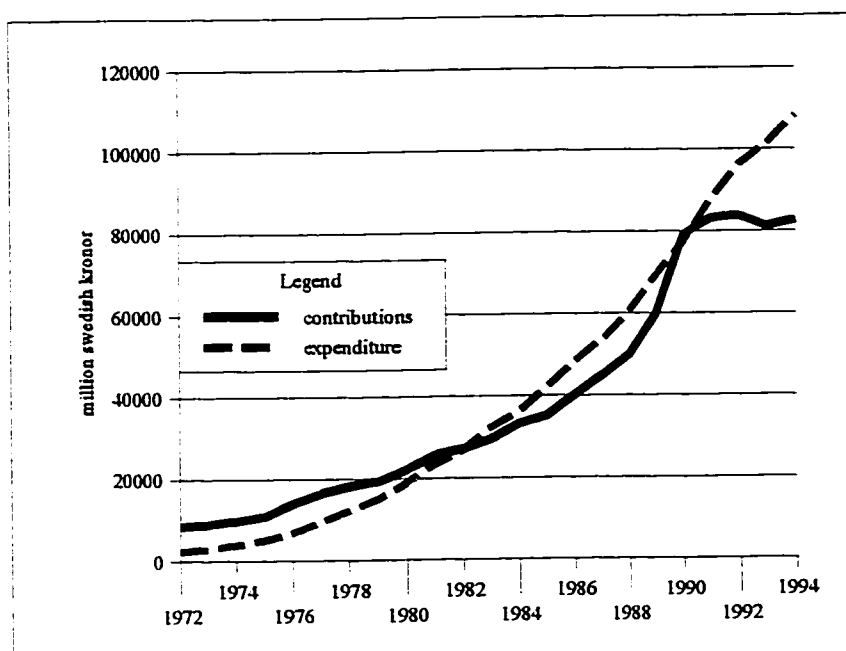


Figure 5.1: ATP Benefits and Contributions 1972-1994.

Source: RRV, *Social Insurance Statistics* 1994.

The structure of financing for both systems would become a target for reform. Since 1982, ATP contributions have not been sufficient to finance expenditures, and the gap has increased because of the economic crisis.²¹ Moreover, experts in the Pensions Commissions and National Insurance Board predicted politically unsustainable increases in future contributions and the rapid depletion of the AP funds. Revenue shortfalls in the basic pension system also exacerbated central budget deficits as the state picked higher proportions of the financing for this system. In sum, revenues ceased to adequately cover pension payments, and calls for reform focused on this central aspect of the system.

Critics of the pension system also focused on the allocation of pension

²¹In a single year, 1990, ATP contributions balanced expenditures because of the legislated increase in contributions.

contributions between employers and employees. When employer contributions were first introduced, this was seen as a victory for the labor movement. In the 1990s, however, this aspect of pension financing was attacked by those who argued that the invisibility of pension contributions to the wage earner fueled demands for higher wages and improved pension benefits. As the discussion later in this chapter demonstrates, altering the visibility of pension contributions was a major issue in the pension reform process even though this would not change the actual amount of contributions paid. Making pension contributions visible would serve the pedagogical purpose of informing wage-earners that pension rights are deferred income and thereby change popular expectations about the role of the pension system.

Indexing As Pierson points out, two types of indexing are important for public pension systems: indexing to compensate for price increases, and the index mechanism used to calculate benefits in an earnings-related system. The way that both indices are constructed can have dramatic effects on pension expenditures. Thus, indexing mechanisms are prime retrenchment tools. For the Swedish pension system, the construction of the "base amount" (basbelopp) is of crucial importance for understanding pension indexing. The base amount was introduced with the ATP reform in 1960, and it determines the level of benefits (pre-retirement) and price indexing (post-retirement) for all pension programs. In 1960, the base amount was fixed for the first time, and in principle it has been adjusted for price increases every year. Since the basic pension is not calculated on previous income, the discussion for pre-retirement indexing is confined to the ATP system.

Pre-retirement indexing The ATP system was constructed as a defined benefit system which means that benefits are calculated in advance and after retirement the value of pensions is maintained by price indexing. Pension-carrying income is the amount that exceeds one base amount, up to the ATP ceiling of 7.5 base amounts.²² Upon retirement, a full ATP pension is 60 percent of the average of pension-carrying income (expressed in terms of the base amount) for the best 15 years of at least 30 years of labor market participation. This formula was intended to benefit women and white collar workers who tend to work fewer years and experience more rapid wage growth in their later years of employment. The 15-30 rule was the primary concession made to white collar groups in order to gain the support of TCO for the ATP reform in 1959.

When it was introduced, ATP functioned more like a defined contribution pension system with strong links between contributions and benefits. This means that each krona paid into the system resulted in a pension benefit upon retirement. Because the ATP system has expanded and policymakers have adjusted the rules, the current ATP system has more of a "tax character" than it did at its inception. For example, ATP contributions on income from more than 30 years are now a "tax" as are contributions from those earnings that exceed the benefit ceiling. In other words, the link between contributions and benefits is weak in that a significant proportion of contributions do not result in pension benefits. In the policy debate surrounding ATP reform, this was identified as a major weakness in the system. In sum, contributions paid into the ATP system can be

²²In 1996, the base amount was SEK 36,200. Thus, incomes between SEK 36,600 and SEK 274,500 are pension-carrying.

characterized as a combination of tax and pension contribution.

Several policy adjustments have served to weaken the link between contributions and benefits. As noted, sick pay, unemployment insurance, parental insurance, and the years spent caring for children were made eligible for pension points in the 1970s and early 1980s. Another policy change driving this process occurred in 1982 when the SAP government won passage of legislation authorizing ATP contributions to be calculated on the entire wage sum, thereby eliminating the ceiling that had been in place since 1960. These policy adjustments along with the structure of the ceiling, the indexing formula (best 15 years of 30), and the effects of economic growth during the first three decades of ATP's existence mean that more and more pension contributions do not translate into benefits. Until recently, earnings have risen faster than benefits because of the effects of economic growth, so the tax proportion of ATP increases as the system matures.²³ As more and more incomes exceed the ceiling, ATP would begin to function more like a bigger basic pension than as an earnings-related pension system. According to one calculation, by 2025 with a annual economic growth rate of 2%, 75% of men and 50% of women would have had incomes over the ceiling for which they receive no benefits.²⁴

Those who were old or middle-aged when the ATP system was introduced have benefitted from its benefit index structure in that they receive much more than they paid in. This was intentional. The generation born in 1944 is the first to participate fully in the system, although the transition rules provided for generous benefits for previous

²³Pension benefits are calculated at retirement according to price increases during the period of labor market participation. See Ståhlberg, *Våra pensionsystem*, p. 85.

²⁴*Ibid.*, p. 87.

generations. According to Ståhlberg, those born after 1944 will receive less than they paid in, or about 80% of contributions.²⁵ In sum, ATP's earnings related aspect has been seriously weakened over time. Given the importance of the income-replacement principle in mobilizing support for the ATP reform in 1959, the unanticipated weakening of this feature threatened to undermine the legitimacy of the system among middle class wage-earners.

Post-retirement index Both the people's pension and the ATP pensions are indexed to inflation every year.²⁶ The ATP system is a defined benefit system in that benefits are calculated in advance and then adjusted each year for inflation. In this type of system, pension contributions must be adjusted whenever the discrepancy between revenues and expenditures becomes too great. With price indexing, the standard of living of pensioners is maintained over time, but retirees do not share in the wealth generated when wages exceed price increases. More important in the Swedish case is the fact that when the value of pensions is indexed to price increases, pensioners are not affected by the economic losses produced during recessions.²⁷ When inflation began to exceed real wage growth in the 1980s, the indexing mechanism resulted in rising pension costs relative to the revenues generated by pension contributions.

Because ATP is a pay-as-you-go system with a relatively generous eligibility index, it is sensitive to demographic and productivity changes, especially reductions in working

²⁵Ibid., p. 69.

²⁶Indexing for the basic pension was introduced in the 1950s. Since 1982, indexing to inflation has taken place once per year.

²⁷John Myles, *Old Age in the Welfare State. The Political Economy of Public Pensions.*(Lawrence, Kansas: University Press of Kansas, 1989), p. 58.

time. If work time decreases, wage-earners contribute less to the system so the revenue base for ATP decreases. Because of the generous 15-30 rules, many reductions in work time are not translated into reduced pension rights and lead to a permanent deficit in the ATP system. ATP is also particularly sensitive to changes in the level of economic growth. Because benefits are calculated in advance and protected from inflation, the system is not sensitive to changes in the real wage developments that finance the contributions. If real wages increase, wage-earners pay more in contributions, and the level of pension contributions can be contained more easily than during periods of slower wage growth. If economic growth is slow and wages stagnant, a higher contribution would be required to finance existing pension commitments. In the latter situation, the pensioner's standard of living remains constant, while the wage-earner's standard of living decreases, resulting in potential intergenerational conflict.. This was the problem that attracted attention in the 1980s and 1990s, and it became a central target for reform. Table x shows how different levels of real GDP growth affect the level of pension contributions required to finance existing pension rights. In periods of stagnant or slow real GDP growth, the required level of pension contributions is much higher than in periods of higher real GDP growth. This trend is much stronger over time.

TABLE 5.4 Projected Pension Expenditure as Percent of Payroll

year	yearly real GDP growth		
	0%	1%	2%
1995	26.5	24.7	23.3
2015	43.7	32.7	25.1
2025	48.1	33.1	23.3

Source: Ståhlberg, *Våra pensionssystem*, p. 85.

Note: does not include AP funds.

The ATP system has redistributed income in the opposite way than intended. The redistributive effect of ATP is regressive for the generation now in middle age. Those aged 45 to 50 in 1990 are projected to receive benefits lower than the amount they paid in. ATP has also redistributed income from lower social groups to higher social groups as a result of the best 15 of 30 years rule.²⁸ The best 15 of 30 years benefit formula advantages those who have income unevenly distributed over their working life and who do not work very long, and it hurts those who work a long time with slower increases in wages. In particular, the best 15 of 30 years rule helps those with higher education and women, who tend to work fewer years, rotate between full and part-time work and have a more uneven wage profile.

In summary, the indexing rules of the pension system became the single most important target in the retrenchment process. Both the formula used to calculate initial benefits as well as the method for maintaining the value of pensions were singled out as

²⁸Ståhlberg, *Våra pensionssystem*, pp. 90-91

major weaknesses in the system. In addition, reformers fixed their attention on the financing structure of pension system. Retrenchment attempts centered around these two central aspects of the system.

Retrenchment in the Pension System

The public pension system enjoys widespread support, but since it accounts for such a high proportion of public spending, 12% of GDP in 1995, it is a natural target for cutbacks in periods of budgetary pressure. Until 1990, the only attempt at retrenchment in pension provision occurred in 1980-81 when the bourgeois government changed the indexing formula for pensions. High inflation was pushing pension costs up at the same time that budget deficits were ballooning.²⁹ These changes provoked public outcry and the SAP promised to restore the full value of pensions if elected in 1982. The SAP fulfilled this promise in 1983, although pensioners were not fully compensated for lost purchasing power as a result of the 1982 devaluation.³⁰ The bourgeois government also reduced the benefit levels in the partial pension (delpension) from 65% to 50% in 1982 and this too was later reversed by the SAP, in 1987. In sum, prior to 1990, the only two attempts at retrenchment in pension provision were extremely unpopular, and they resulted in electoral punishment for the government that carried them out. These two cases also demonstrate the effective veto over retrenchment initiatives that the SAP possesses.

²⁹Items in the index that caused prices to increase faster than wages, such as indirect taxes, energy prices, food subsidies, and import duties, were removed from the index. Changes in the index would be made only once per year rather than every three months if prices rose more than 3% over the level of the previous adjustment.

³⁰Kent Weaver and Paul Pierson, "Imposing Losses in Pension Policy," in R. Kent Weaver and Bert A. Rockman, eds., *Do Institutions Matter? Government Capabilities in the US and Abroad*, p. 137.

Further attempts at pension retrenchment seemed a remote possibility until the recession hit the economy with full force in the early 1990s. Here, we need to distinguish between pension retrenchment designed to achieve short term budget relief, and long term structural reforms because each type of retrenchment conforms to a different political decisionmaking logic. Short term cuts typically result from multiparty bargaining in the executive arena and are susceptible to reversal. In fact, some cuts are designed for future reversal when the economy improves. Because of rapid pace of bargaining among the political parties, interest groups may find their attempts to influence policy thwarted. Long term structural reform occurs according to a different logic. The Official Commissions of Inquiry play a crucial role in the process of structural reform, and cuts are designed to be resistant to change over time. Political parties negotiate within the Commissions, and the process is more open to interest group influence because of the remiss system.

Short term Cuts

Since 1991, both SAP and bourgeois governments have enacted sharp cuts in pension benefits in order to improve the immediate state of public finances. Adjustments in pension indexing have been the primary tool for achieving short-term savings.³¹ Since 1991, the base amount (basbelopp) which is used to calculate all transfer payments has not followed the CPI. As part of the tax reform negotiated between the SAP and Liberal Party in 1990, the base amount for 1991 and 1992 was not adjusted for all price increases.

³¹The base amount is adjusted once per year for price increases. Because the base amount determines benefits in all pension programs (basic pension, ATP, disability pension, partial pension), a single adjustment would apply to all types of pension benefits.

Pensioners suffered a further reduction in benefits during the November 1992 currency crisis when the Bildt government and SAP opposition agreed that pensions would be calculated at 98% of the already reduced base amount. Because this cut is based on wide parliamentary support, this virtually guarantees that it will remain in place until state finances improve. Indeed, pensions have been calculated at 98 percent of the base amount for 1993, 1994, 1995 and 1996. The 1992 crisis package also raised the pension age by three months per year starting in 1994 to reach 66 years in 1997 for savings of 8.7 billion kronor by 1997.³² After the krona was allowed to float in November 1992, politicians agreed that pensioners would not be compensated for price increases caused by the devaluation.

In 1995, the SAP government secured support for an indexing rule in which the base amount is adjusted by 60% of the CPI as long as the budget deficit exceeds 100 billion kronor. Again, this cut applies to pension payments which have already been reduced by 2 percent. By linking pension raises to the state of government finances, politicians engaged in blame avoidance. Moreover, the cross-party alliance in support of these reductions meant that it would be difficult for voters to blame any single party for these cuts. Politicians have also resorted to compensation strategies; all reductions in pension adjustments have been accompanied by measures protecting low-income pensioners by raising other means-tested benefits such as municipal housing supplements. Changes in indexation have resulted in yearly savings of 18-19 billion kronor per year, and

³²This means that the pension age increases by three months per year for four years so that by 1997 the pension age is 66.

the changes are likely to remain in place until state finances improve.³³ Between 1991 and 1995, downward adjustments have reduced the value of the base amount by 11% relative to price increases.³⁴

TABLE 5.5 Changes in the Base amount 1980-1996

year	amount	increase in SEK	percent increase	CPI previous year	notes
1980	13,900	2,200	15.8	7.2	
1981	16,100	2,200	13.7	13.7	not all price increases included
1982	17,800	1,700	10	12.1	not all price increases included
1983	19,400	1,600	8.2	8.6	not all price increases included
1984	20,300	900	4.4	8.9	4% deduction for devaluation
1985	21,800	1,500	7.3	8	
1986	23,300	1,500	6.8	7.4	
1987	24,100	800	3.4	4.2	compensation for lost value
1988	25,800	1,700	7.0	4.3	compensation for lost value
1989	27,900	2,100	8.1	5.8	compensation for lost value
1990	29,700	1,800	6.5	6.4	
1991	32,200	2,500	8.4	10.4	not all price increases included
1992	33,700	1,500	4.6	9.4	not all price increases included
1993	34,400	700	2.0	2.3	pensions at 98%
1994	35,200	800	2.0	4.7	no compensation for devaluation; pensions at 98%
1995	35,700	500	1.4	2.2	pensions at 98%; 60% of CPI
1996	36,200	500	1.4	2.5	pensions at 98%; 60% of CPI

Source: RRV, *Social Insurance Statistics*; and Folksam, *Vår trygghet 1995* (Stockholm: Folksam, 1995).

³³State finances stabilized in 1997.

³⁴Folksam, *Vår trygghet 1996* (Stockholm: Folksam, 1996).

Given the dire state of public finances, pension indexation adjustment was a quick way for politicians to achieve immediate budget savings. The 1992 index changes were made behind closed doors by party leaders during a period of acute economic crisis. The atmosphere of crisis and cross-party agreement strengthened the ability of politicians to withstand the inevitable protests from the unions and pensioners groups. Once in place, changed indexing rules could be relied on for yearly savings as long as deficits remained high. Moreover, the 1995 index change which explicitly links the pension index to the size of the deficit provided an effective blame-avoidance technique for the SAP government. In sum, downward adjustments in the base amount are a relatively simple item to negotiate; Official Commissions of Inquiry played no role, and politicians did not need to attempt adjustments within other program structures. More important, downward adjustments in the base amount applied to all social insurance programs. Once adopted, changes in the base amount applied automatically to all transfer payments. Additionally, policy-makers adopted other downward adjustments in the base amount which applied only to pensions.

Partial Pension Cuts

Soon after taking office, the Bildt government attempted retrenchment in the partial pension system. The bourgeois parties have not been particularly fond of this type of pension and found little justification for keeping it as budget deficits increased. In its 1992 budget, the Bildt government proposed to eliminate the program in the spring of 1992 in order to reduce state spending. Clearly, the government attempted to use the budget crisis as the rationale for retrenchment in this program. The partial pension is

financed by an employer's contribution (0.5% of the wage sum) which is placed in an earmarked fund. In 1992, the fund was not in deficit and part of the proposal to eliminate this program included a provision to shift the contribution over to work injury insurance which was running a deficit. In other words, the net effect of the proposal was the elimination of the partial pension but employer contributions would remain at the same level. The SAP and Left Party vehemently opposed the proposal, and the move backfired when New Democracy came out against the proposal, arguing that eliminating the program would increase costs in long-term sick pay and disability pensions. The only thing the Bildt government could gain support for was a reduction in the partial pension fee from 0.5% to 0.2% with the difference going to work injury insurance.

Despite this initial failure, the Bildt government tried again the following year (1993) to cut partial pensions by increasing the qualifying age from 60 to 62 and reducing benefits from 65% to 50% of qualifying income. This move would save 200 million kronor per year. Again, this proposal was aimed at gaining the support of New Democracy in the Riksdag. New Democracy agreed to the cuts in committee but later reversed its decision, and the proposal failed to gain a majority in the Riksdag vote. Despite this second victory against bourgeois pension cuts, the SAP shifted course and did not specifically rule out future reductions in the partial pension system.

In the spring of 1994, the SAP was prepared to support retrenchment and specifically offered its support for reductions in the partial pensions. The SAP worked out a proposal with the bourgeois government, and SAP influence resulted in the retention of a fairly low age limit of 61 years for eligibility (rather than 62) as well as a more modest

reduction in benefits from 65% to 55% of qualifying income (rather than 50%). The cuts in the partial pension were the only concrete savings that Finance Minister Wibbe (Liberal Party) had in her last budget in January 1994. Thus, after three attempts, the Bildt government achieved only modest reductions in the partial pension program. At first, the savings would be small, but by 1999 they would have a bigger effect since the number of partial pensioners would be halved. Cuts in the partial pension were the first reductions in nominal benefits agreed to by the SAP.

Retrenchment in partial pensions demonstrates the powerful influence of the SAP on retrenchment outcomes. Given the prevailing balance of power in the Riksdag and the threat of a future SAP election victory, retrenchment could not be achieved without the consent of the SAP. Moreover, cuts would not be sustainable over time without SAP cooperation. Although LO and TCO vigorously objected to partial pension cuts, the economic crisis supplied the rationale for the Bildt government to attempt retrenchment. The crisis no doubt also prompted the SAP to cooperate on modest cuts. Significantly, partial pension retrenchment was not the focus of an Official Commission of Inquiry; instead, party leaders engaged in top-level negotiation in the executive arena.

Disability Pension Cuts

Dramatically rising costs made the disability pension one of the earliest targets for retrenchment. Eligibility rules for disability pensions were eased in the 1970s so that unemployed wage-earners over 60 became eligible for this type of pension. As a result, the disability pension system began to function more as a labor market policy instrument than as compensation for physical disability. As costs skyrocketed, the SAP government

appointed an Official Commission of Inquiry in 1989 to study the problem. The Commission proposed that disability pensions for those over 60 should no longer be allowed for labor market reasons and recommended stricter control of those who do take disability pensions for medical reasons. As the rationale for reform, the Commission cited its suspicion that many disability pensioners probably received pensions for non-medical reasons. In 1991, the Riksdag approved these reductions with wide agreement.

Disability pensioners experienced a sharp reduction in benefits as a result of proposals announced in the SAP's budget bill in 1994. With the support of the Center Party, the SAP adopted legislation reducing disability pensions to 78.5 percent of the base amount. At the same time, the means-tested pension supplement was raised for low-income disability pensioners. In addition, disability pensions for those with ATP pensions were further reduced. Predictably, LO and TCO opposed these changes, but the SAP continued to resist this pressure.

In sum, short term cuts have focused on indexation changes covering all pension programs and modest reductions in specialized pension programs. No sector of the pension system has escaped substantial short-term retrenchment. The partial pension cuts demonstrate the difficulty of enacting cuts even in small programs, and it shows that successful retrenchment is virtually impossible without the cooperation of the SAP. Reductions in disability pensions also show the institutional advantages possessed by the SAP in the retrenchment process. Throughout the process of short-term retrenchment, a series of shifting multiparty coalitions has provided support for benefit reductions. The cuts have been highly visible, but politicians have consistently compensated low-income

pensioners by raising means-tested benefits.

Long-Term, Structural Pension Reform

Reform of the supplementary old age pension system (ATP) had been studied since the mid 1980s, but until the recession of 1989-1993 there was little political support for major change. In 1984, the SAP government appointed an Official Commission of Inquiry to investigate pension reform. As Hecló and Madsen observe, Swedish "policymaking is in a state of constant adjustment and innovating to find desirable improvements."³⁵ In the early 1980s, the ATP system was approaching maturity, so the Pension Commission was charged with studying the effects of the system and pinpointing areas needing reform. In 1990, the Pension Commission presented its final report, and it was circulated for comment in 1991.³⁶

After 5 years of deliberations, the Pension Commission could not agree on significant proposals for reform despite widespread agreement about the need for adjustments in light of the previous 30 years' demographic and economic developments. The final report did, however, identify several serious weaknesses in the pension system and urged major reform. The final report argued that public confidence in the pension system was threatened by the weak link between contributions and benefits. Because of the relationship between the ATP system and the basic pension and means-tested benefits available to low-income pensioners, a person with a basic pension and no ATP points received a pension equal to the ATP pension of an industrial worker. In this sense, the

³⁵Hecló and Madsen, *Policy and Politics in Sweden*, p. 6.

³⁶SOU 1990: 76, *Allmän pension*.

earnings-related principle was seriously weakened. Moreover, these unintended consequences meant that the pension system was no longer performing its intended function: the earnings-related aspect of the pension system was meaningless for many groups of wage-earners. More ominously, ATP contributions ceased to cover current expenditures in 1984. Since then, income from the AP funds covered the shortfall.³⁷

The final report laid out several possible avenues for reform. First, the report argued that there should be a stronger link between contributions and benefits so that the ATP scheme functioned more like a pension insurance system. Second, the report proposed combining the means-tested benefits and the basic pension into a higher basic pension. There was also some discussion of raising the number of "best" years used to calculate benefits from 15 to 20, as well as increasing the number of minimum qualifying years and decreasing the level of benefits. On the issue of long-term stability, the report assumed that with two percent annual economic growth the ATP system would remain solvent until 2025. However, the report did identify the indexing mechanism as a weakness and discussed the possibility of linking the index to economic growth rather than to inflation. When the report was circulated for comment many of the groups responding considered the proposed changes to be inadequate and voiced their desire for substantial reform. Nearly all of the organizations commenting on the report voiced their support for a more actuarial ATP system. Only the pensioners groups opposed any change in benefit indexing.

Although there was little agreement on specific changes, the 1990 report marked a

³⁷A change in financing rules in 1990 solved this problem, but only temporarily.

significant shift in thinking about the role of the pension system. Whereas earlier studies focused on the welfare of the elderly, the 1990 report instead focused on the economic effects and the long-term stability of the pension system.³⁸ Nevertheless, the six year investigation of the pension system was crucially important in pinpointing weaknesses in the pension system and in advancing the policy debate about pension reform. Still, in 1990 the political mood was not urgent, and politicians felt no particular need to rush into pension reform.

The release of the Official Pension Commission Report was the first step in a series of studies focusing on pension reform. Because of the dramatic deterioration of the economy, all of the subsequent official reports were far less sanguine about the long-term stability of the ATP system. Building on the work carried out by the Pension Commission, a 1991 report released by the Expert Group for Public Finance,³⁹ an independent research unit in the Finance Department, predicted that if the current low economic growth rates continued, the ATP system would collapse within 20 years. The report identified two central causes for this dire scenario: a surge in pensioners in 2010 and the indexing rules of the ATP system. Wage-earners paying contributions face a heavier burden in times of low GDP growth than in times of higher GDP growth because current pension benefits are indexed to inflation. During the 1980s, the rate of inflation increased faster than real wages, resulting in rising pension payments which far outpaced pension contributions. When ATP was introduced in 1960, the average rate of growth was 3 to 4 percent per

³⁸Stefan Ackerby, *Pensionsfrågan*, p. 15.

³⁹DS 1991:27, *Det framtida pensionssystemet: två alternativ*. Rapport till ESO, Expertgruppen för studier i offentlig ekonomi.

year. In 1991, few observers counted on an annual rate much higher than 2 percent.

Moreover, the economic outlook at the time hinted that even 2 percent annual economic growth could not be taken for granted. The report sketched out two reform alternatives: either a system comprised only of a basic pension supplemented with housing subsidies, or an income-related system along with a basic security pension.

As the problems in the ATP system began to attract serious attention in the public debate and in policy circles, the SAP government identified pension reform as a top priority in its January 1991 budget proposal. This shift in preferences on the part of the SAP was a decisive turning point. In particular, the SAP called attention to the need to increase long-term savings via the pension system as well as the need to strengthen the earnings-related aspect of the system. The SAP argued that the pension system should help to strengthen work incentives for the active population by increasing the total amount of income that forms the base for pension benefits.⁴⁰ Nothing came of the SAP's policy statement, and the change in government in September 1991 meant that the initiative for reform now belonged to the bourgeois government headed by Carl Bildt. Nevertheless, the SAP had positioned itself decisively in favor major changes in the pension system.

One of the first steps taken by the Bildt government (November 1991) was to appoint a working group comprised of representatives from the parliamentary parties to further study the issue of pension reform and identify avenues for reform. Bo Könberg (Liberal Party), the Minister of Health and Social Affairs, chaired the working group. The working group was directed to make proposals aimed at making pensions more responsive

⁴⁰Ministry of Finance, *The Swedish Budget 1991-92*.

to the general state of the economy, strengthening the link between contributions and benefits, and encouraging an increase in long-term savings. The parties agreed that the broadest possible unity was desirable.

The pension working group has been unusual in a number of ways. Ordinarily, the government appoints an independent Official Commission of Inquiry composed of representatives of the political parties, labor market partners, experts, and other interested groups. The Commission then makes a proposal which the government can either use as the basis for a parliamentary proposal or reject. In this case, the five parties participating in the working group agreed early on to work out a compromise, and they precommitted to not unilaterally change any of the agreed provisions of the reform. My interviews indicate that this method was chosen for two reasons. First, the unstable political situation with a minority four party coalition dictated cooperation from the SAP. Between 1991 and 1994, New Democracy held the swing vote in the Riksdag and often played the bourgeois bloc off against the socialist bloc. Agreement across the blocs was one way to neutralize the influence of New Democracy. Second, the pension system affects so many people for such a long time that the participants agreed that a stable, sustainable reform was absolutely essential. This type of early compromise is likely to occur more often in the future because of the need for stable, long-term reform in the social insurance system.

Initially, the parliamentary working group included members of all Riksdag parties. As the working group deliberated, however, the representatives of the Left Party and New Democracy left the group because of disagreements with the other five parties. The Left Party in particular has been highly critical of the "undemocratic" and "rushed"

methods used within the group. The Left Party vehemently opposed any departure from the best 15/30 rule, and its representative criticized the other parties for shutting them out. More important, interest groups such as the LO and TCO were specifically excluded from the deliberations of the working group. Given the importance of the pension system to LO and TCO members, as well as their influence in the 1959 ATP reform, this move was surprising. Clearly, the working group intended to minimize the influence of the two most powerful potential opponents to pension reform.

The pension working group issued their first report⁴¹ in August 1992, and it included a sketch of proposed principles for reform. The report suggested that future pensions be based on lifetime earnings and that benefits be more clearly linked to contributions. The report also predicted that the ATP system would collapse in 20 or 30 years in its current form. On the financing side, slow economic growth and rising unemployment meant lower revenues. If contributions and benefits remained the same, the AP funds would be empty in 2025 with an average economic growth rate of 2%. If economic growth is slower, 1% or 0%, the AP Funds would be empty by 2015 or 2010 respectively.⁴² In order to prevent this, contributions would have to be raised to politically unacceptable levels in times of slow growth in order to maintain the value of benefits. With tax rates highest in the OECD, there was not much room for raising contributions. The report identified this as the central weakness of the system and recommended that reform insulate the system from economic and demographic shocks. On the expenditure

⁴¹DS 1992:89, *Ett reformerat pensionssystem- Bakgrund, principer och skiss*. En promemoria av Pensionsarbetsgruppen.

⁴²DS 1992:89, p. 30.

side, ATP's maturation meant higher average pensions for a growing number of pensioners and an increase in the number of pensions per wage-earner. In the context of low economic growth and rising unemployment, this development threatened the solvency of the system. According to the report, when the system was set up in 1960, no one foresaw that economic growth would be as low as zero to two percent. Pension costs were already higher than pension contributions, so the AP funds had to cover the deficit in current revenues. Also, the system disadvantaged manual workers whose incomes rose slowly over a long period of time, and helped those who had worked fewer years or who had worked part-time. Thus, a manual worker and white collar worker could have had the same lifetime earnings and pay in the same contributions, but the white collar worker would get a higher pension. This was one of the features of the system that the working group found unjust and in need of reform. The working group argued that the gradual erosion of the earnings-related aspect of the system was a serious threat to ATP's legitimacy. The reform sketch recommended that ATP remain income-related on top of the basic pension and that the system be made more insurance-like. The 15-30 rules would be abolished and pensions would be based on lifetime income instead. In short, ATP would be transformed from a defined benefit system to a defined contribution system. No promises would be made about the level of benefits in relation to the terminal salary (*slutlön*) or to the level of income for certain years. Simply put, an individual's pension would largely be determined by the amount actually paid into the system. The report also proposed that pensions be indexed to developments in real wages instead of to the price index. Such a change would make the system more responsive to actual

economic developments rather than simply to inflation. The switch to a more insurance-like system would insulate the system from future demographic and economic shocks and reduce the risk for future changes. The working group specifically rejected any type of reform that would transform the current system into a private premium reserve system because of the double payment problem involved.⁴³ Significantly, the preliminary sketch included no recommendations for pension points for higher education, a clear blow to TCO.

Several of the changes proposed in the 1992 report have been suggested elsewhere. Jan Bröms, chief economist for the Swedish Federation of Professional Employees (Sveriges Akademikers Centralorganisation, SACO), argued for an obligatory system based on actual work performance in a debate book published in 1990.⁴⁴ In its annual survey of the Swedish economy in 1991, the Institute for Economic Studies (Konjunkturrådet) painted a picture of the ATP system "in crisis" and argued more a more actuarial system, in particular through the abolition of the 15-30 rule.⁴⁵ In the analysis of pensions conducted as part of the 1992 Medium Term Survey of the Swedish economy, Stefan Akerby argued for a tighter link between contributions and benefits, the stimulation of savings, and an index based on economic growth rather than the CPI.⁴⁶ Economist Assar Lindbeck also argued for a shift to a more actuarial system based on

⁴³DS 1992:89, p. 52.

⁴⁴Jan Bröms, *Ur askan av ATP* (Stockholm: SACO, 1990).

⁴⁵Hans Tson Söderström, ed., *Sverige vid vändpunkten. Konjunkturrådets rapport 1991* (Stockholm: SNS Förlag, 1991).

⁴⁶Stefan Akerby, *Pensionsfrågan*.

defined contributions rather than defined benefits.⁴⁷ The Economic Commission appointed in 1993 by the Bildt government to propose changes in Swedish institutions also argued for similar provisions.⁴⁸ In sum, even before the working group issued its final report, the basic problems in the pension system had been identified, and the broad principles for pension reform had been made public.

For the Social Democrats, the pension reform process has been especially tricky. Coming on the heels of raised individual contributions and decreased levels of compensation in other social insurance programs, the pension reform could have been explosive. The pressure from LO and the rank and file to preserve the system has been strong. The ATP is, after all, the heart of SAP reform politics. As noted, the 1959 ATP reform marked the shift from flat rate benefits to the income replacement principle in social insurance programs. It was this decisive shift that sealed the alliance between the LO and TCO in favor of a vastly expanded state role in pension provision. The SAP faced pressure to defect from the parliamentary working group and postpone the reform until after an eventual SAP election victory in 1994, or to exclude the Conservatives by making a deal with the Liberals and Center party. As Åke Ekdahl wrote in *Dagens Nyheter* that "the message from the labor movement to the party leadership and the working group is that the party cannot bear yet another ideological departure in terms of pensions on top of cutbacks and individual fees in work injury insurance, unemployment insurance, and

⁴⁷Assar Lindbeck, *Klarar vi pensionerna?* (Stockholm: SNS Förlag, 1992). A shorter English version of Lindbeck's analysis is found in Assar Lindbeck, "How should the pension system be reformed?" *Skandinaviska Enskilda Banken Quarterly Review* 3:4 (1992).

⁴⁸SOU 1993: 16, *Nya villkor för ekonomi och politik*

sickness insurance before the (1994) election."⁴⁹ Throughout the process, the SAP has resisted these pressures.

Agreement on the final proposals for pension reform has been difficult. The final report was due in the summer of 1993, but was delayed until January 1994 because of lingering disagreements. In December 1993, the chairman of the working group, Bo Könberg, faced internal criticism for being too soft on the SAP. At the same time, there were widespread media reports that the group was headed for collapse. To head off these rumors, the working group issued a joint declaration in early December promising that the agreement would be ready before the new year. *Dagens Nyheter* wrote that this could be seen as an attempt to calm the markets and the public after all of the negative reports in the media. Above all, the working group tried to convince the public and the market that the governmental parties and the SAP were working hard to quickly solve the problem.⁵⁰ At the same time, criticism from pensioners groups was escalating. The two interest groups representing pensioners, Pensionärernas Riksförbund (PRO) and Sveriges Pensionärsförbund (SPF) declared that the economic conditions for large groups of pensioners had now decreased so that they no longer can be considered to have a satisfactory standard of living.⁵¹ In sum, financial markets and public opinion are thus two important constraints on the policy process.

Several points of intense disagreement remained in late 1993. The issue of whether to introduce a premium reserve into the ATP system and whether contributions

⁴⁹*Dagens Nyheter*, November 28, 1993.

⁵⁰*Dagens Nyheter*, December 2, 1993.

⁵¹*Dagens Nyheter*, December 2, 1993.

should be paid on incomes above the ceiling were the two biggest problems. The issue of contributions above the income ceiling resulted in tough last minute negotiations.⁵² In particular, the Liberals and Conservatives opposed the payment of contributions above the ceiling, arguing that because contributions paid above the income ceiling did not earn pension points, they amounted to a pure tax and should be abolished. With equal vigor, the SAP asserted that the system must retain its redistributive character, and they pressed for keeping contributions above the ceiling.⁵³ In January 1994 a compromise appeared imminent when the group agreed that half of the ATP contribution would be paid on incomes above the ceiling. As a concession, the SAP agreed that this would be called a "tax" rather than a contribution, and the revenue from it would go to the state budget rather than to the ATP system. As Bo Könberg put it, "the most important thing is to get the Social Democrats to agree. Then the proposal rests on a foundation that corresponds to 85 to 95 percent of the Parliament and the Swedish population."⁵⁴

On January 24, 1994, the working group presented its final report,⁵⁵ and it echoed many of the problems identified in earlier studies. The report cited the rising cost of pensions and low economic growth as the major reasons for reform and noted that there is widespread doubt that the pension system could remain solvent as the number of retired persons increases. The working group also linked the structure of the pension system to

⁵²The ceiling for ATP is 7.5 base amounts, or 264,000 kronor per year in 1994. Wage earners receive full pension points up to the income ceiling. For wages above the ceiling, wage earners continue to pay contributions but receive no pension points.

⁵³The SAP party congress in September 1993 decided that the party should continue to support the principle of contributions above the ceiling.

⁵⁴*Svenska Dagbladet*, January 12, 1994.

⁵⁵SOU 1994:20, *Reformerat pensionssystem*.

the structural problems of the Swedish economy such as low savings rate and a high tax burden. If anything, the economic instability of the pension system had increased since 1992. The report observed that the low growth rates of the past few years combined with the increasing number of pensioners receiving higher pensions exceeded the limits of this model's tolerance. Without fundamental reform, major problems would occur when the generation born during the 1940s begins to retire in 2010. Revamping the system to make it more responsive to economic developments would also increase public confidence in the pension system.

The final report outlined the principles of the proposed reform, and the legislation proposed to the Riksdag in late April 1994 conforms closely to these principles. The proposal departs from the existing system in several fundamental respects. First, ATP benefits will be based on lifetime earnings rather than the best 15 years of 30. This change is intended to increase incentives to work more and longer. Thus, in contrast the old defined benefit system, the link between pension contributions and benefits is made explicit, and the new system will lose much of its redistributive character. Previously, pension contributions were calculated on the entire wage sum even though pension points were accumulated only up to a specified ceiling (7.5 times the base amount, 264,000 kronor in 1994). In the new system, only one-half of pension contributions will be paid above the ceiling, thereby reducing the redistributive effects of the system. In the new system, it will be more difficult to calculate pensions in advance, and there are no advance promises about specific levels of benefits.

Second, pension contributions will be evenly split between employers and

employees with the transition complete 2000. The switch to employee payroll taxes is intended to increase public awareness of the costs of retirement. Previously, employers paid the pension payroll tax, and it was not reported on wage-earner's paychecks. This change is designed to influence popular expectations about the role of the pension system.

Third, benefits under the new system will be directly linked to the rate of real economic growth. The new kind of indexing is known as economic adjustment indexing and it considers both inflation and the development of real wages. Pensions will be computed on the basis of an assumed annual future real growth during the time the pension is paid out. The working group proposed a future growth rate of 1.5%. The pension will then be increased annually, taking into consideration both inflation and the development of real wages, by using the economic adjustment index. This means that pensions will be adjusted upwards by the amount of inflation if real wages have increased by the assumed rate of 1.5%. If the real wage growth rate turns out to be less, full compensation for inflation will not be paid. If wages increase by more than 1.5%, the pensioner will share in the rising standard of living.⁵⁶ The new indexing mechanism means that if real incomes grow, pensions will grow. If real incomes fall, pensions will fall. Pensions will also be adjusted if the average life expectancy of Swedish citizens changes. If life expectancy increases, pensions will be adjusted downward, and vice versa. Thus, the pension system will be more resistant to economic swings, and it will be self-financing regardless of the state of the economy. The new index will apply to pension benefits calculated partly or entirely by the new rules. Those born in 1935 will be the first to

⁵⁶*Proposition 1993/94: 250, Reformering av det allmänna pensionssystemet.*

receive pension benefits based on the new index.

Fourth, pension rights may be shared by spouses, and pension points will be earned for military service, the care of small children, and higher education. This compensates women and white collar workers adversely affected by the switch to the lifetime earnings principle. The inclusion of pension points for education was a concession to TCO after it had vigorously protested the absence of pension rights for education in the working group's 1992 report. The will pay the contribution for this type of eligibility. As in the old system, sickness and unemployment compensation earn pension points, but now the state or social insurance authority will pay the contributions for these benefits.⁵⁷ This would result in higher expenditures for the state.

Finally, the new system contains a premium reserve.⁵⁸ Of the total 18.5% in pension contributions, 2% will be placed in a premium reserve. Wage-earners can choose from among different mutual funds or they can opt for the state to manage their premium reserve savings. The premium reserve will increase with profits, and wage-earners will get a statement each year reporting the earnings for the year. Thus, the pension system is designed to be transparent in that individuals receive an annual statement about the size of their projected pension. For the bourgeois parties, the annual pension statement was an ideological victory. The annual statement would increase public awareness about the pension system; as one participant put it, "households will get an annual statement where they can see which pension rights they have. They can also see that it is more expensive

⁵⁷For sickness and unemployment benefits, pension contributions are calculated on the underlying income, not the level of benefits.

⁵⁸2% of the pension contribution will be put into something that resembles a mutual fund.

to retire at age 61 than at age 70."⁵⁹

In addition, the old basic pension (folkpension) and pension supplement (pensionstillskott) will be replaced by a higher guaranteed pension adjusted each year by the new type of index. The report also recommended the elimination of the partial pension in 2000 and replacing it with a flexible pension age from age 60. The disability pension will be removed from the old age pension system and joined with the sickness or work injury insurance system.⁶⁰ The new pension rules will apply to those born after 1954. Those born 1934 or earlier will be subject to the old ATP rules, and those born between 1935 and 1953 will get a mixture of both systems. Thus, the transition would take twenty years. Above all, the working group could promise that pensions would not be worse since the proposal assumes that the average wage earner who has worked 40 years will receive 60% of his or her terminal salary in pension.⁶¹

The final proposal reflects the nature of compromise among five parties. The Christian Democrats and Center Party wanted shared pension rights for spouses, the SAP wanted to retain the obligatory system with high replacement rates, while the Liberals and Conservatives wanted a more explicit link between contributions and benefits, the premium reserve, and the elimination of contributions above the ceiling. All of the political parties advocated the introduction of real wage indexing. Although the influence of the SAP in the reform process has been substantial, they have acquiesced in three main

⁵⁹Margit Gennser (Conservative) in *Svenska Dagbladet*, January 25, 1994.

⁶⁰As part of the crisis packages between the Bildt government and the SAP in the fall of 1992, an Official Commission of Inquiry was set up to investigate the disability pension system.

⁶¹*Dagens Nyheter*, January 25, 1994.

areas: contributions above the ATP ceiling, shared pension rights, and the premium reserve system. The switch to visible individual contributions was also a concession by the SAP. The Conservatives had to content themselves with the fact that the pension contributions above the ceiling would no longer be called employer contributions but rather a "general pension tax." In the end, the pressure to compromise was intense because of the desire to prevent pensions from becoming an election issue. SAP representative Anna Hedborg said, "the question is if we shall take the chance to get a broad agreement in the Riksdag or take the risk that something happens in the election campaign.....one never knows if one or several parties will defect."⁶²

Although the switch from employer contributions to individual contributions seems insignificant at first, it was a particularly difficult item to negotiate. Even though it would not affect the level of contributions, changing the rules for pension contributions meshed well with the working group's desire to remove certain social insurance programs from the state budget, such as sickness and work injury insurance. Although they opposed the switch to individual contributions, the SAP supports the principle of self-financing, and one way to promote this was to make the contributions visible to employees. This explains the SAP's grudging acceptance of this change. The contributions have always existed, but they have not been visible since the employers paid them and they were not reported on the paycheck. Having workers pay for half or all of the contributions is the same idea as making social insurance in other areas independent of the state budget. For the Liberal Party, the issue of individual contributions is related to changing popular

⁶²*Dagens Nyheter*, February 5, 1994.

expectations about pensions. Making the contributions visible means that people realize that they "don't get a pension from heaven. But one earns it...we think that we should make these things more and more visible to show that it costs money. Receiving the pension statement every year means that people can keep track of their pension savings so that they can plan for retirement."⁶³ Another participant stated that "receiving a statement about pension earnings is about information. People get a statement every year about their pension savings so that they can plan, and I must say that this is the biggest reform in the area of markets and economics. One should remember that in Sweden we have never socialized investment, we have socialized the households. This reform makes households plan."⁶⁴ Thus, even though changes in the structure of contributions involved no extra costs, it met the goals of both Social Democrats wanting to protect the pension system by making it independent and self-financing, but it also fit non-socialist goals of influencing popular expectations about the role of the state in pension provision. SAF had pushed the idea of individual fees instead of anonymous employer contributions for a long time. As one journalist put it, "the politicians want the public to understand that a pension is a delayed wage, not charity or citizen's wage which each and every one can collect at a certain age."⁶⁵

Both the bourgeois coalition government and the SAP immediately claimed credit for pension reform and each side declared its satisfaction with the results of the working

⁶³Interview with Liberal Party member of the Parliamentary Committee on Social Insurance, May 1994.

⁶⁴Interview with Conservative Party member of the Parliamentary Committee on Social Insurance, May 1994.

⁶⁵*Dagens Nyheter*, April 25, 1994.

group as well as the importance of the fact that there is broad parliamentary agreement about the proposal. The SAP also emphasized their view that the new pension system was acceptable from a redistributive point of view. Representatives for the bourgeois parties emphasized the significance of the fact that wage earners would now have better opportunities to plan for retirement.⁶⁶ In essence, the bourgeois government and the SAP had very different interpretations of the pension agreement. Prime Minister Carl Bildt (conservative) said that the pension proposal "meant a historical departure from a system that no longer functions and that the foundation had now been laid for a new and stable pension system in Sweden." At the same time, the SAP's representatives saw the agreement as a way to "modernize and maintain the system for a long time to come.....it means that one of the biggest and most important social reforms of our time will continue to play a decisive role for people's security and welfare."⁶⁷

When the details of the final report were made public in early February, they immediately attracted criticism. The leader of TCO, Björn Rosengren, attacked the proposal publicly, charging that the switch to the lifetime earnings principle was unfriendly to women.⁶⁸ According to TCO, the new pension system would disadvantage large groups of women who take time off or work part time in order to care for children. In addition, Rosengren complained that pension points for higher education were too low and would disadvantage white collar workers who have a longer education. In April 1994, TCO announced that it was prepared to join forces with LO and SACO to fell the

⁶⁶*Svenska Dagbladet*, January 25, 1994.

⁶⁷*Svenska Dagbladet*, January 25, 1994.

⁶⁸*Dagens Nyheter*, January 27, 1994

proposal.⁶⁹ As one federation leader put it, "it will be difficult for the Social Democrats and the Liberal Party to push the proposal through in conflict with the entire wage earner collectivity."⁷⁰ LO voiced its disapproval of several parts of the reform, declaring, for example, that the new system would benefit high income earners because their contributions would decrease. Despite this criticism, LO voiced its satisfaction that the bourgeois parties agreed on the principle that the pension system should be regulated and administered by the state. Whereas the labor organizations opposed many aspects of the proposal, business groups were more or less satisfied. The Employers Organization (SAF) applauded the proposal, saying that it would send a positive signal to the rest of the world, it would strengthen the krona, increase savings and enhance the will to work.⁷¹ In particular, SAF praised the tighter link between contributions and benefits as well as the change in indexing and the lifetime earnings principle.⁷² SAF called the proposal a step forward for Sweden, but complained that workers should still contribute more to their pensions.

In addition to opposition from the labor unions, the proposal also attracted the criticism of economists who pointed out that parts of the reform were not financed. Whereas the proposal largely solved the problem of future demographic shocks, it still did not adequately handle the current financing problems despite the introduction of the one percent employee payroll tax in 1995. In addition, the new system required the state to

⁶⁹*Dagens Nyheter*, April 25, 1994.

⁷⁰*Svenska Dagbladet*, March 29, 1994.

⁷¹*Dagens Nyheter*, February 22, 1994.

⁷²*Svenska Dagbladet*, January 25, 1994.

pay the pension contributions for education, care of small children, and military service. This would require additional state outlays and increase pressure on the budget. The working group proposed to use AP funds to cover these transition problems. Another problem was that the AP funds would have to cover the costs of the disability pension and partial pension until these were reformed or phased out. The reform also failed to adequately deal with the deficit in the basic pension system. Altogether the new pension system (guarantee and ATP pensions) was calculated to cost 26% of GDP while revenues would only provide 20% of GDP.⁷³ The AP funds would cover the shortfall, further reducing the strength of the AP funds. In the meantime, assets would accumulate in the new premium reserve, and it would eventually replace the AP funds as a source of savings and investment capital. Although this aspect of the reform would not affect the level of benefits, it was a major victory for the bourgeois parties in that they succeeded in the gradual privatization of very large state pension funds.

All of the parties to the reform proposal agreed that a decision in the Spring was absolutely necessary in order to preserve the compromise. If the pension legislation was not handled by the Riksdag in the spring, the risk for collapse would be great. Bo Könberg said that "the longer we wait, the greater the pressure the agreement is exposed to."⁷⁴ Such a quick parliamentary decision required a shorter comment period, and this prompted severe criticism, in particular from LO and TCO. Bo Könberg answered this

⁷³*Dagens Nyheter*, February 19, 1994.

⁷⁴*Dagens Nyheter*, February 5, 1994.

criticism by saying that "the pension issue had been investigated for ten years and already in the fall of 1992 the working group had presented a sketch of principles concerning the new system. It is primarily those who are against the reform who demand a longer comment period."⁷⁵

The SAP conducted an internal comment process in March, and two thirds of all responses advised that the reform should be postponed until after the election in September.⁷⁶ The SAP executive committee resisted this internal opposition and announced on April 8 that the Riksdag should make a decision on the principles for the reform but also remove certain issues from the decision for further investigation. In particular, the SAP wanted more deliberation about the change in contributions and the administration of the new premium reserve system.⁷⁷ The decision to proceed with legislation met with massive criticism in the media and in the comment statements. Many organizations wanted a longer comment period, but this would have prevented a decision in the Spring session of parliament. The working group's strategy has been to work out the proposal and present it to the Parliament in Spring so that it would not become an election issue. By doing so, the reform would be approved before the summer break and it would be stable and sustainable. But the pressure on the SAP to wait has been intense, especially from their youth organization and womens' organizations.⁷⁸

By late March, the unified union front against the proposal began to collapse. In

⁷⁵*Dagens Nyheter*, February 5, 1994.

⁷⁶*Svenska Dagbladet*, April 8, 1994.

⁷⁷*Dagens Nyheter*, April 9, 1994.

⁷⁸*Svenska Dagbladet*, April 8, 1994.

particular, the two dominant federations in LO, the Metalworkers Union (Metall) and the Municipal Workers Union (Kommunal), expressed very different opinions about the proposal. Whereas Metall opposed the proposal, Kommunal expressed its support. Because Kommunal is comprised mainly of women working in lower income jobs, many members stood to gain from the reformed system. The Paper Workers Union (Pappers) joined Kommunal in its support. On the union no side, only TCO, Metall, and the Union of Municipal Salaried Workers (Kommunaltjänstemannaförbundet, SKTF) remained.⁷⁹

The final report was circulated for comment in March and April. The comment period has been unusually short by Swedish standards even though the SAP demanded the previous Fall that the report be subject to comprehensive review by all interested parties. In their official comments, the SAF and the Federation of Swedish Industries (Industriförbundet, IF) echoed their initial opinion about the proposal but also expressed their desire for a lower pension level and more in the premium reserve. SAF welcomed the proposal but added that the benefit level was still too high and that they could only accept the one half contribution above the income ceiling as a transitional measure. LO, TCO, and SACO opposed the swap of employer contributions for individual contributions. In general, LO and TCO were intensely critical of the proposal, but few changes were made in response. The Metalworkers Union opposed the lifetime earnings principle and wanted a decrease in normal pension age to 60 or 61 since few of their members work until age 65. LO in particular voiced doubts that the employers would raise wages to compensate for the swap. SAF and IF fanned the flames of this

⁷⁹*Svenska Dagbladet*, March 3, 1994.

disagreement when they issued a joint statement declaring that it was not the intention of the working group that workers would be fully compensated for the change in financing. SAF accused the unions of using their opposition to the fee swap as a back door method to get SAF to agree to centralized wage bargaining. SAF agreed to the fee swap in principle, but would not promise anything. In particular, SAF pointed out that because of economic conditions or tax policies, there might not be room for wage increases equal to the decrease in employer contributions.⁸⁰ In response, Bo Könberg accused SAF of playing a high stakes game which could endanger the reform agreement.⁸¹

There are two national organizations representing the interests of pensioners, but their comments on the proposal were not nearly as important as those of LO and TCO. No changes were made in response to their criticisms. In particular, the PRO rejected the new index and the transition rules for it and instead wanted to keep the old CPI index. Despite their large membership, the pensioners organizations wield little political power in Swedish policymaking channels, and they had almost no influence on the working group's deliberations.

Clearly, the parties backing the agreement did their utmost to preserve the compromise and prevent pension reform from becoming an election issue. Having eliminated all veto points prior to formal approval by the Riksdag, the last thing the working group wanted was a potential veto point in the electorate. Moreover, sealing the agreement in the Spring would ensure that blame would be divided between five political

⁸⁰*Svenska Dagbladet*, February 9, 1994.

⁸¹*Dagens Nyheter*, February 4, 1994.

parties. To the extent that pension reform was discussed in the September election campaign, it would be difficult for voters to punish any one particular party for pension reform.

Several changes were made in response to the comments and these found their way into the legislation presented to the Riksdag. The most important change concerned the fee swap. Instead of phasing in the fee swap, the bill stated that this would occur all at once. This change would minimize the risk that employers failed to compensate wage earners fully for the reduction in employer contributions. Instead of 1995, the new system would go into effect in 1996 so that there would be more time to negotiate the unresolved issues. This change would not affect the introduction of payroll taxes in 1995 or the other provisions of the reform. The bill also left unresolved the issue of which economic adjustment index to use.

The Riksdag approved the basic contours of the pension reform in June 1994 and appointed an implementation group to work out remaining details for a more precise proposal in 1995. The items left unresolved were whether the new guarantee pension would be reduced for those who have collectively agreed upon pensions, the swap in contributions, the economic adjustment index, and pension rights for students.⁸²

Since the adoption of principles for the new system in 1994, subsequent decisions have been delayed several times, and the reform has yet to be fully implemented. After the change in government in October 1994, the SAP passed legislation for a one year delay in implementing the reform in order to gain more time to investigate the transition to the new

⁸²*Riksdag och Departement 22* (1994).

eligibility rules.⁸³ The SAP's intention was to present final legislation to the Riksdag in the Spring of 1995. Despite this delay, the new financing rules of the pension system took effect in January 1995, including the one percent individual pension contribution and the construction of the premium reserve system. The SAP could not agree on Spring legislation, and events in late 1995 further delayed full implementation. SAP Prime Minister Ingvar Carlsson announced he would step down in early 1996, and this led to several months of speculation about who would replace him. In any event, the change in leadership would require a special Social Democratic Party Congress during which the pension reform could easily become a major issue. The four bourgeois parties agreed to wait until after the SAP Congress, but issued stern warnings in the media about a possible SAP defection. In January, motions from the SAP rank and file began to flood into party headquarters. A total of 320 motions demanded that the pension reform be shelved and the previous system re-introduced.⁸⁴ As criticism swelled, one member of the working group stated that an SAP defection would be a "disaster (olycka) for Sweden" and that the Conservatives would never make a cross-party agreement with the SAP again.⁸⁵ The SAP leadership managed to resist the pressure from below, and the pension reform survived the scrutiny of the Congress. In its budget bill presented in September 1996, the SAP proposed a one year delay in the implementation of the eligibility rules of the new system, to January 1, 1999. The first pensions paid according to the new rules would also be

⁸³*Proposition 1994/95:100, bilaga 6.*

⁸⁴*Svenska Dagbladet*, January 9, 1996.

⁸⁵Margit Gennser (Conservative) in *Svenska Dagbladet*, January 10, 1996.

moved up one year, to 2001.⁸⁶ The motivation for this second delay was the need to adapt the social insurance administrative apparatus to the new eligibility rules.

Despite the delays in implementation, indications are that the reform will be adopted without major modifications in 1998. The issue of individual payroll contributions has already been resolved. Beginning in 1998, wage-earners contribute one half of program financing. This was accomplished by transferring the individual contributions to sickness insurance to the ATP system.⁸⁷ In terms of short term cuts, these are likely to remain in place with the exception of current reductions in pension payments achieved by downward adjustments in the base amount. It is reasonable to assume that the SAP will fulfill its pledge to restore pension payments to their full amount as soon as government finances improve. However, because they are already in place, reductions in pension payments may prove to be a tempting way for governments to cut expenditures further if the need arises.

Effects of the Reform

The pension reform is an extremely complex set of new rules, and sorting out the effects on future retirees is difficult. There is no doubt, however, that the new system is a major departure from existing pension policy. In particular, the switch from defined benefits to defined contributions in the ATP system is a radical change, and this will mean that the new system will have much less potential for "decommodification" than the old system. A study conducted by the National Insurance Board (Riksförsäkringsverket)

⁸⁶*Proposition 1996/97:1.*

⁸⁷Sickness insurance has been over-financed since the mid-1990s. See chapter four.

estimated that 2/3 of those studied would be losers in the new system, mainly TCO members and women.⁸⁸ The biggest losers are those who work 20 to 40 years before retirement. The biggest winners are those who work less than 20 years and receive the new higher guaranteed pension. In order to receive the same pension benefits under the new system as in the old, one must work at least 40 years. Still, this group, about 80% of the population, loses about 7-8 percent in pension value because of the new index rules. Women with little or no education fare the best, while women with higher education and fewer working years lose the most, about 17 percent. These calculations are based on a yearly economic growth rate of 1.5 percent. At higher rates of growth, pensions go up. Still, under the new system, at a yearly growth rate of 1.5%, pensions would be 12 percent lower. Only if growth is 2 percent will pensions remain about the same. In sum, the effects of the reform differ widely among social groups, but the overall impact is that of less decommodification. As Esping-Andersen argues, the extent to which pension systems promote decommodification depends on the degree to which actuarial principles are relaxed.⁸⁹ This means that decommodification is strengthened when the link between benefits and previous labor market performance is weak. Although the new system does not include reductions in nominal benefits, the switch to the lifetime earnings principle will have the effect of reducing benefits for many wage-earners.

⁸⁸SOU 1994:21 *Reformrat pensionssystem. Kostnader och individeffekter. Bilaga A*

⁸⁹Esping-Andersen, *The Three Worlds*.

Conclusion

In comparison with sickness insurance and unemployment insurance, old-age pensions represent a case of moderate retrenchment. Immediate cuts in benefit levels have not been as great as those implemented in unemployment insurance or sickness insurance, and the toughest cuts will be phased in over a period of many years. Moreover, some parts of the pension system have actually been improved, most notably the new guaranteed pension.

This chapter emphasizes the constraints of capital market integration, the role of the labor movement, and the impact of existing program structures to explain these outcomes. Integrated bond markets were a significant constraint on Swedish governments' fiscal policies. Politicians calculated that pension reform would improve Sweden's lagging standing on international bond markets. Meaningful reform was not possible without the explicit cooperation of the Social Democratic Party and the acquiescence of the Federation of Manual Workers (LO). Finally, the structure of existing pension policy narrowed the range of options for reform.

The timing of the reform is inexplicable without reference to the fiscal crisis which has pushed reform of the entire social insurance system onto the political agenda. Only when massive budget government budget deficits and projected shortfalls in the ATP funds were projected could politicians muster the political will to enact changes involving the imposition of significant pension losses on voters. Reform has also been motivated by the desire to improve Sweden's lagging standing in international capital markets. As one participant put it, "We have to show the market that we are prepared to make these

changes that mean that some people may have it a bit worse. Also so that interest rates do not become too high. Then we get lower investment and the whole economic system throughout the world is such that these judgements by market actors abroad matter and they have to be able to trust our ability to make these (social insurance) systems sustainable."⁹⁰ The structure of the financing system also meant that the basic pension system's "contribution" to the budget deficit was easy to identify, thereby increasing the perceived urgency of reform.

In contrast to sickness cash benefits, pension reform was not successfully linked to concerns about competitiveness in the policy debates which preceded reform. The Employers' Organization, the non-socialist parties, and many economists argued that the existing pension system created disincentives to savings and work and thereby contributed to Sweden's economic troubles. However, pension reform would influence labor supply and national savings only in the medium to long term. Thus, the perceived link between the pension system and national competitiveness was not nearly as strong as it was in the sickness insurance system.

The impact of EU membership has been greatest in pension policy. Eligibility rules for the basic pension were tightened in order to decrease the openness of that program to labor mobility in the EU. Additionally, the reformed ATP system is much more actuarial than the old system and thus less vulnerable to the effects of labor mobility in the EU. That this aspect of the ATP was never discussed must be considered in the context of low

⁹⁰Interview with Liberal Party member of the Social Insurance Parliamentary Committee, Stockholm, May 1994.

levels of public support for EU membership.

As in sickness insurance and unemployment insurance reform, the SAP has been the most important actor in the retrenchment process. Very little pension reform was achieved without the cooperation of the SAP. The SAP's willingness to cooperate in pension reform is explained by the importance of this particular program to the labor movement. Unlike unemployment insurance, the pension reform did not threaten the internal cohesion of the labor movement. Because not all union members would lose in the reformed ATP system, the reform divided the unions and made it impossible for the LO to block the SAP's reform plans.

Several other aspects of program structure account for the moderate success of retrenchment in pension policy. First, the ATP system is nearly mature and private pensions are relatively rare, making a radical departure from the system politically impossible. As one participant put it, "you can't make short term savings in a long term pension system, otherwise you don't have credibility." However, significant losses have been imposed on future beneficiaries with the switch to the lifetime earnings principle and changes in indexation rules. The most significant changes in the pension system will be phased in over two decades, so reductions in pension benefits will occur well into the future. The incremental nature of the reform's implementation no doubt also contributed to the defusion of opposition.

Second, the indexing formula provided opportunities for large savings in both current and future pension payments. By making benefits equal to contributions, politicians could claim that the new system was more fair, thereby defusing opposition

from those who would stand to lose in the new system. In this sense, the new benefit indexing formula provided a way for politicians to legitimize losses. Indexing rules also offered a quick way to achieve large reductions in current pension payments as part of the deficit reduction program.

Third, the complexity of the system created opportunities to compensate those negatively affected by the switch to the lifetime earnings principle. For example, the introduction of pension rights for studies and child care was a compensatory method for minimizing opposition to the switch to the reform. More important, the technical complexity of the existing and the reformed pension system was so great that many, if not most, citizens were unable to follow all of the political discussions concerning reform. The media's attempts to identify "winners" and "losers" in the reformed system only added to the confusion. Thus, many of the more technical aspects of the proposed reform such as the introduction of a life expectancy index and the replacement of the current inflation index with the economic adjustment index were shielded from criticism.

Fourth, unlike sickness and unemployment insurance, the pension system has a much greater long-term impact on wage-earners and public finances. This is so because pension policy involves much more extensive benefit commitments than sickness and unemployment insurance. Thus the need for a stable and predictable system is much greater in pension policy. Because of this, reform of the pension system has been characterized by the conscious attempts of the five parties backing the agreement to depoliticize the issue. All parties agreed on compromise at an early stage, and they have succeeded in minimizing the influence of powerful interests such as the LO. As one

participant put it, including the LO and TCO in the later negotiations "would have prevented a compromise. And these groups took part in previous studies, and besides everyone knows what they think."⁹¹ Another participant noted that the interest groups were excluded partly due to the "unstable political situation created by a minority coalition government as well as the recognition that when a reform has such wide-ranging impact, it should be stable and sustainable in spite of future political developments. This is unusual and is likely to be a sign of things to come."⁹²

Interest organizations such as LO and TCO have still been consulted, and given the close contact between the SAP and LO, LO's position is well-known to the SAP. But consultation has taken place outside the normal process, thereby limiting LO's influence. Additionally, the official comment period has been unusually short, forcing interested groups to rush to complete their comment statements. Despite this, in their comments, both LO and TCO vehemently objected to central aspects of the reform proposal, but few changes were made in response. But the short comment period and the rush to present legislation to the Spring 1994 Riksdag further limited the capacity of interest groups to block the reform process. In short, powerful interest groups were effectively neutralized. Even the Social Democrats acquiesced in this strategy. Excluding the interest groups from the negotiations prevented LO and TCO from sabotaging the process. This was the working group's intention. LO and TCO would wield more influence inside the

⁹¹Interview with Liberal Party member of the Social Insurance Parliamentary Committee, Stockholm, May 1994.

⁹²Interview with Social Democratic Party member of the Social Insurance Parliamentary Committee, Stockholm, May 1994.

negotiations than out. Had the interest groups been included in the negotiations, the SAP might not have been able to resist the pressure not to cut benefits. The whole process went quickly in order to minimize opposition to the final proposal and prevent it from becoming an election issue. The rush to make a decision was also based on the fact that the issue had been studied for several years. The final compromise was fairly fragile, and making a decision quickly would prevent internal party revolt, especially in the SAP. In sum, the process has been marked by the deliberate efforts of politicians to minimize veto points.

The Swedish case challenges some of the central arguments advanced in recent research concerning the politics of welfare state retrenchment. Pierson asserts that "once an extensive (pension) scheme is developed on a pay-as-you-go basis, it is very hard to introduce fundamental alterations"⁹³ because imposing losses on voters is an exceptionally difficult task for any government. As Pierson and Weaver put it, "the enormous blame generating potential of pension-cutting initiatives suggests that such initiatives will occur rarely if at all."⁹⁴ Events in Sweden demonstrate that far-reaching reform of a universal, comprehensive, and mature pension system is possible. Another argument found in the welfare state literature is the assertion that retrenchment is not in labor's interest. Implicit in the work of Stephens and Esping-Andersen is the argument that retrenchment spells trouble for the labor movement because it undermines the political support for universal

⁹³Pierson, *Dismantling the Welfare State?* p. 72.

⁹⁴Kent Weaver and Paul Pierson, "Imposing Losses in Pension Policy," in *Do Institutions Matter? Government Capabilities in the US and Abroad*, p. 115.

comprehensive programs.⁹⁵ Pension reform in Sweden demonstrates that this need not be the case. Even social democrats may choose to reduce benefits and alter the structure of eligibility rules which involve a recommodification of wage-earners in order to adjust the system to a new and harsher economic climate. When the public begins to doubt the credibility of the pension system, even tough cuts may lead to greater legitimacy and thus increased public support. Moreover, pension reform can be packaged in terms of fairness. As wage-earners faced skyrocketing unemployment and retrenchment in sickness and unemployment insurance, governments argued that pensioners had to shoulder part of the burden of austerity.

⁹⁵Gosta Esping-Andersen, *Politics Against Markets*; and John D. Stephens, *The Transition from Capitalism to Socialism* (Urbana: University of Illinois Press, 1979).

CHAPTER 6: OBDURATE POLICY LEGACIES:

UNEMPLOYMENT INSURANCE REFORM

In the retrenchment process, no policy area has provoked more controversy than unemployment insurance. Whereas the SAP and the unions have grudgingly accepted the necessity of reforming the pension and sickness insurance systems, overhauling the unemployment insurance system has proven to be highly contentious, partisan, and exceedingly difficult. Two features of the unemployment cash benefit system account for the extreme divisiveness of this policy area. First, unlike other income maintenance programs, unemployment insurance is not based on universal eligibility criteria. Rather, eligibility for most benefits is restricted to members of unemployment insurance funds administered by the trade unions. Second, in practice, unemployment benefits are of unlimited duration because of complex rules governing requalification through participation in active labor market policy measures. Until the recession hit in 1991, neither aspect of the unemployment insurance program warranted much criticism or policy action. As unemployment began to climb steeply in 1992, however, non-socialist critics focused on reforming these two central features of the system.

Since 1934, the unions have administered income-related unemployment benefits, and the labor movement was not about to concede this recruitment incentive. Above all, the LO and SAP have devoted considerable resources to ensuring that the system remains firmly in union hands. Both the SAP and LO fiercely opposed the bourgeois government's nationalization of cash benefits in 1993-94 and the SAP promptly reversed the legislation when it returned to office in October 1994. Labor movement unity was short-lived,

however. The issue of introducing an "outer parenthesis" (bortre parentes) or time limit on benefits has proven deeply divisive for the labor movement. SAP efforts to legislate a time limit on benefits were thwarted by LO opposition. Retaining union control of (unlimited) income-related benefits has not occurred without substantial costs, however. Between 1991 and 1997, governments of both left and right have slashed benefits, tightened qualifying rules, and frozen indexing.

In Sweden, unemployment insurance has never been a high profile welfare state program because of the overall structure and orientation of labor market policy. The cornerstone of Swedish labor market policy is the "work line" (arbetslinjen), the idea that policies should promote full labor market participation by all. An extensive state apparatus, the National Labor Market Board (Arbetsmarknadsstyrelsen, AMS), administers a series of active labor market policies aimed at the unemployed such as vocational training and public relief work in order to promote labor market mobility and hasten the return to the regular labor market. Given the predominance of active measures in Swedish labor market policy, cash benefits are intended as a seldom-used last resort. Rules governing cash benefits are not unimportant for active labor market policies, however. For most active labor market policies, eligibility and compensation levels are determined by the rules governing the cash benefit system.

Active labor market policy is generally considered to be one of the jewels in the crown of Swedish Social Democratic policy. Since it was initiated in the 1950s, active labor market policy has promoted labor force restructuring to meet industrial demand through retraining and public relief work. Moreover, until 1992 the policy has

successfully prevented the high levels of open unemployment prevalent on the European continent since the 1970s. Between the 1950s and 1990s, open unemployment never exceeded 3.5 percent while anywhere from 2 to 5 percent of the labor force was engaged in active labor market policies of some kind in any given year. Scharpf attributes Sweden's success at maintaining full employment during the world economic downturn of 1976-1982 to its institutional capacity for active labor market policy.¹

Because of the uncontested success of Swedish full employment policy until recently, there is little research on the structure and development of unemployment cash benefits; instead, investigators have focused on active labor market policies.² The few studies that examine the cash benefit system concentrate on the organizational incentives for union recruitment provided by the system and most ignore other aspects of the system, such as benefit levels, financing, and other eligibility rules.³ Thus, one important contribution of this study includes documenting these.

The importance of the insurance system to the labor movement is closely connected to union recruitment. Because the Swedish system is based on the Ghent model, wage earners face powerful incentives to join unions in order to qualify for income-related benefits as well as active labor market programs. The union monopoly on

¹Fritz W. Scharpf, *Crisis and Choice in European Social Democracy* (Ithaca: Cornell University Press, 1991).

²See, for example, Bo Rothstein, *The Social Democratic State* (Pittsburgh: University of Pittsburgh Press, 1995); Göran Therborn, *Why Some Peoples are More Unemployed Than Others* (London: Verso, 1986); and Scharpf, *Crisis and Choice*.

³Bo Rothstein, "Labor-market institutions and working-class strength," in Sven Steinmo, Kathleen Thelen and Frank Longstreth, eds., *Structuring Politics. Historical Institutionalism in Comparative Analysis* (Cambridge: Cambridge University Press). Hugh Heclö analyzes the emergence and development of unemployment insurance until the mid-1970s. See Hugh Heclö, *Modern Social Politics in Britain and Sweden*, (New Haven: Yale University Press, 1974), chapter three.

income-related benefits was precisely the feature of the system that provoked the criticism of the bourgeois government and led to full-scale confrontation with the labor movement. And this was the only feature of the system about which the SAP and LO were unwilling to compromise. As the retrenchment process unfolded, however, other aspects of the cash benefit system took on added significance. In particular, proposals to introduce a time limit on benefits have been a major source of division between the LO and SAP.

Like the other parts of the social insurance system, the unemployment insurance system was designed for an economic context that ceased to exist in 1991: stable economic growth and full employment. The deep recession of 1991-1993 was accompanied by very high levels of unemployment not experienced since the 1930s. These adverse developments turned the goals of Swedish labor market policy on its head. Even with widespread political support for increased resources, active labor market policies could not possibly absorb levels of total unemployment approaching 13 percent. Rather than preparing the unemployed for return to the regular labor market, active labor market policies increasingly functioned as a substitute for cash benefits or a means of re-qualifying for benefits that had formally expired. And as the number of unemployed increased, the non-universal character of the system attracted much criticism, especially in non-socialist circles. In contrast to the bourgeois coalitions that governed Sweden 1976-1982, the Bildt government openly challenged the union monopoly on income-related benefits. Moreover, the peculiar financing structure of the system led to unanticipated pressure on the already dire state of public finances. Because it was designed to be self-financing at an average level of open unemployment of 2-3 percent, soaring trust fund deficits in the

program required massive borrowing authorized by the government, and the state has been responsible for the interest payments on the accumulated debt (figure 6.1). As a result, although the SAP and LO have opposed changes in the administration of the system, the SAP in particular has proven more than willing to cut benefits in order to deal with the trust fund crisis and the specter of continued financing of high levels of open unemployment in the near future. In addition, benefit cuts would also result in savings for the state budget because compensation for most active labor market policies is equal to that provided by the insurance system. Thus, benefit reductions resulted not only in reduced costs for insurance, but also for labor market policy as a whole.

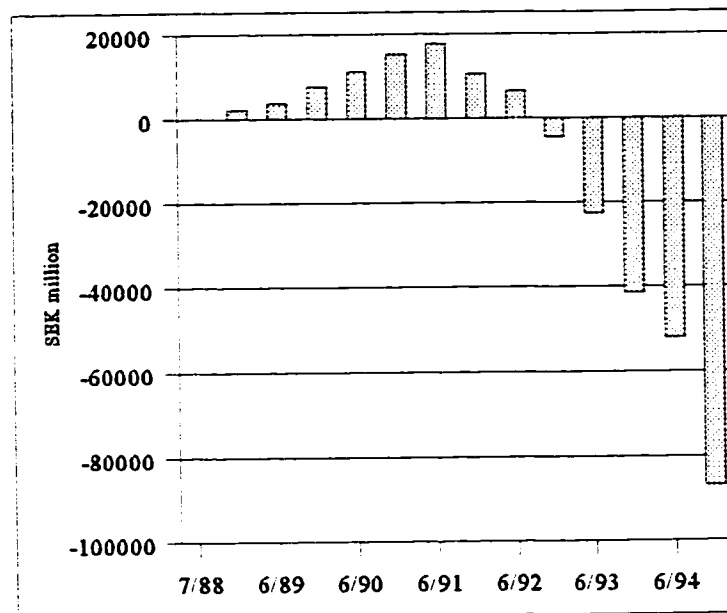


FIGURE 6.1: Financial Position of the Labor Market Fund 1988-1995.

Source: RRV, *Social Insurance Statistics. Facts* (Stockholm: RRV, various years).

The Bildt government's success in legislating substantial benefit cuts and payroll tax hikes was impeded by its minority coalition status. In order to pass its legislation, the Bildt government had to depend chiefly on the highly unreliable and unpredictable New Democracy Party. After several setbacks and retreats, the Bildt government introduced a benefit time limit and nationalized the unemployment insurance program. This ended the union monopoly on most cash benefits, but Bildt's success was short-lived. This legislation was reversed shortly by the SAP's return to power in 1994. However, even with the return to the union-administered system, the SAP kept the benefit reductions adopted by the Bildt government, and enacted substantial cuts of its own, much to the irritation of LO. Close collaboration between the SAP and the Center Party between 1995 and 1997 made this possible. In the end, LO prevailed on the issue of a benefit time limit, convincing the SAP to delay any action on this program feature until 2002. In sum, the Bildt government won the battle but lost the war. It succeeded in adopting large benefit cuts, but failed in its attempt to carry out lasting structural reform of the system, including the introduction of the benefit time limit and the end to the union monopoly on income-related benefits. The SAP implicitly accepted the Bildt government's benefit cuts by opting not to reverse them when the party returned to office in 1994.

The willingness of both bourgeois and Social Democratic governments to attempt retrenchment in unemployment insurance is explained largely by the fiscal crisis of the state in the wake of the recession of 1991-1993. However, large program and government budget deficits were a necessary, but not sufficient condition for substantial

retrenchment. Recent research demonstrates that seemingly powerful economic constraints do not necessarily lead to welfare state cutbacks.⁴ Groups representing the interests of business must be able to translate increased resources into political influence, and this occurs only if governments are both able to construct a parliamentary coalition in favor of cutbacks and willing to withstand the electoral risks of retrenchment. However, retrenchment can take on vastly different forms, and it is here that the feedback effects of existing policies enter the analysis. As Pierson argues, existing policies provide the “raw material” for retrenchment initiatives; political actors form their policy preferences in relation to the program structures already in place.⁵ Broadly defined policy preferences are not always translatable into viable retrenchment strategies, however; existing policies shape the alternatives available for achieving retrenchment. Available retrenchment alternatives, in turn, shape the coalition possibilities available to proponents of reform.

Given its long-standing commitment to healthy public finances and economic growth, the SAP leadership not surprisingly advocated retrenchment in unemployment cash benefits early on. Simply put, the SAP was willing to cooperate in imposing significant losses on its core constituencies in order to improve public finances and the overall health of the economy. Although the process has been contentious, the SAP has drawn on its organizational resources to overcome rank and file opposition within the party and the unions. LO has been more oppositional in its stand on unemployment

⁴Kurt Weyland, “How Much Political Power do Economic Forces Have? Conflict Over Social Insurance Reform in Brazil” *Journal of Public Policy* 16:1 (1996). Weyland focuses on the limited impact of international financial institutions and other economic interests.

⁵Paul Pierson, *Dismantling the Welfare State? Reagan, Thatcher, and the Politics of Retrenchment*, (Cambridge: Cambridge University Press, 1994).

insurance vis a vis the SAP, and the SAP has chosen to cooperate more with the LO on unemployment insurance cuts than it has in both pension and sickness insurance reform. This is not to say that all is well within the labor movement; support for the SAP fell dramatically in public opinion polls in 1996 and 1997, and in the 1998 election, the party scored its worst defeat since the 1920s.

To understand the unemployment insurance retrenchment, we need to examine five issues in greater detail. First, the next section reviews the historical development of unemployment insurance legislation, providing the backdrop for the reforms launched in the 1990s. Second, the chapter discusses the central program structures of the unemployment insurance system, including eligibility, financing, and compensation levels. These first two aspects set the stage for the way that existing policies structure retrenchment options. Third, the chapter analyzes the Bildt government's retrenchment initiatives as well as those of Social Democratic government in power since 1994. Finally, the chapter concludes with a discussion of the most important factors influencing retrenchment outcomes in unemployment insurance.

Historical Development and Structure

In contrast to other social insurance programs, the unions rather than the state, administer the income-related unemployment insurance system.⁶ In principle, the system is voluntary and it is supervised by the National Labor Market Board (AMS).⁷ In addition, a flat-rate state-run cash unemployment assistance program (kontant arbetsmarknadsstödet,

⁶40 recognized unemployment funds are financed through state funds and individual contributions.

⁷Until AMS was set up in 1948 the National Board of Social Affairs (Socialstyrelse) oversaw the union funds.

KAS) provides benefits for those who are not members of the union funds, or who are not eligible for them such as part time workers and the self-employed. KAS benefits are not particularly high compared to those provided by the union funds, so workers still face powerful incentives to join unions and thereby qualify for income-related benefits. The bifurcation of unemployment cash assistance into two very different programs is the outgrowth of reconciling the principle of universal social protection with a system that buttresses the power of the unions. In 1991, about 80% of the labor force was a member of a union fund.

The development of unemployment insurance has been closely related to the development of labor market policy and the public employment offices (*arbetsförmedling*). The first union fund was established in 1893 and provided benefits financed solely by member contributions. As the number of union funds increased, Parliament considered a number of bills concerning state involvement in unemployment benefit provision. Beginning with the first discussions in Parliament, the most controversial issue has been whether state financed insurance should be voluntary or obligatory. In 1933, Parliament adopted legislation authorizing state grants to unemployment insurance funds administered by the unions. At the same time, the rules governing eligibility, fees, compensation, etc., were formalized in legislation, and local public employment offices were introduced to register the unemployed. The 1933 legislation was not without controversy, however. Then, as in the 1990s, the non-universal structure of the system was the source of significant criticism.

The issue of voluntary union funds versus some sort of obligatory system has never

really been settled. If anything, the stable economic growth and low unemployment of the postwar period obviated serious discussions of changing the administration of the system. A series of official commissions of inquiry in the 1940s, 1960s, and 1970s proposed a switch to a universal system, but each time the proposals failed in the wake of union protests. As a result, reforms have focused on the improvement of union-administered benefits and the introduction of flat-rate benefits for those not eligible for the union funds.

Major reform of the union-administered insurance system took place in 1941 and 1973. In 1941 and 1973, benefits were improved significantly, and in 1973, Parliament approved the introduction of state-sponsored cash unemployment assistance (KAS) for those not eligible for union benefits, mostly new entrants to the labor market and those not members of the union funds. The 1973 legislation was intended to be a provisional arrangement until the details of the switch to an obligatory system could be worked out. Benefits were flat rate and much lower than the average benefit provided by the union funds. Thus, the unions retained the strong selective incentive to join. The 1973 legislation also increased benefits provided by the union funds, and both KAS and union benefits were made taxable.⁸ Current eligibility rules date from the 1973 reform.⁹ Participation in labor market education programs (arbetsmarknadsutbildning) was viewed as the equivalent of regular work for the purposes of qualification. This change expanded the list of labor market programs that earned the unemployed the right to re-qualification.

⁸Benefits for the union funds were extended from 150 to 300 days and to 450 days for those over age 55. KAS benefits were paid out for 150 days.

⁹The "work condition" (arbetsvillkor) requires five months of work during the twelve month period prior to the onset of unemployment. The same work condition applied to KAS.

In the 1980s, the list of active labor market programs eligible for re-qualification was expanded further, and in 1987 a formal guarantee against losing benefits was introduced. Now, participation in all labor market programs guaranteed the unemployed person the right to a new benefit period.

Even after the current system was introduced in 1974, the SAP government appointed an official commission of inquiry to propose an improved, universal system. At the time, LO and TCO were among the interest groups pressing for the appointment of such a commission. The report presented in May 1978 proposed the merger of KAS and the union funds into a single, obligatory system with the union funds as the organizational foundation. However, the proposals did not result in legislation. Two other parliamentary commissions in the 1970s investigated the incorporation of the unemployment insurance into a general social insurance but these proposals also failed. Thus, since 1974, the cash benefit system has remained more or less unchanged except for modest benefit improvements and a reformed financing structure in 1988.¹⁰ The last major improvement in benefits occurred in 1988 when Parliament abolished the five remaining qualifying days.¹¹

In sum, the development of unemployment benefits between 1934 and 1991 has been marked by the steady expansion and improvement of benefits (table 6.1). Despite criticisms of the union's monopoly on income-related benefits and the opinions of several

¹⁰Instead of state grants to the funds, now employer payroll taxes (arbetsmarknadsavgift) were introduced so that now the system was financed with employer fees and member fees paid directly to the new labor market fund. State funds continued to finance KAS.

¹¹Qualifying days had been in place since the state began subsidizing the union funds in 1934.

official commissions, the LO and the SAP successfully prevented every attempt to change this feature of the system. Until 1991, steady economic growth and low unemployment obviated the perception of any urgent need for reform. There is no clearer indication of the role of policy feedback in the unemployment insurance system than the role of the unions in administering the funds. Because the union funds provided strong selective incentives to members, the unions and the SAP benefitted from increasing membership.

TABLE 6.1: The Development of Unemployment Benefits 1892-1991

1892	Typesetters establish the first union fund.
1935	The state provides grants to the union funds. Benefits available to those who have paid dues for 52 weeks. Benefits last for 120 days.
1941	Benefits are raised
1953	Benefits are raised
1956	Self-employed and part-time workers gain the right to benefits.
1964	The maximum benefit period is extended to 150 days or 30 weeks
1974	The maximum benefit period is extended to 300 or 450 days for those over 55. Flat-rate benefits (KAS) are introduced for those not qualifying for union funds. KAS benefit limit is 150 days.
1981	Benefits are raised
1985	Right to wages paid by the state for those laid off.
1987	Guarantee against losing benefits; participation in all labor market programs qualifies for new benefit period.
1989	Benefits raised to 90 percent. Benefits indexed to wage developments. Waiting days are abolished.

Program Structure in 1990

This section address the features of program structure relevant for explaining retrenchment outcomes. 1990 is used as the baseline in this section because this is the year in which benefits were most generous, and these were the program structures politicians confronted as they attempted to formulate and enact retrenchment policies. That the unions dominated the administration of cash benefits was one of two central sources of division among political actors. The SAP and unions lined up in support of the existing system, while the bourgeois parties and employers organizations pressed for an end to the union monopoly. The rules governing re-qualification for benefits was a second source of division. At first, the lines of division among political actors resembled the issue of union administration of benefits, with the SAP and LO favoring the existing rules, and the bourgeois parties and employers organizations supporting the introduction of a benefit time limit. As the costs of benefits increased (table 6.2), however, the SAP shifted course and advocated the introduction of a time limit in 1995. With this change in preferences, the issue of re-qualification rules drove a wedge through the labor movement, pitting the SAP against the LO. After a protracted struggle, the LO prevailed and the SAP delayed implementation of a benefit time limit. In addition to these two central program features, other aspects of program structure also were the source of heated disagreement among political actors, including the complex set of rules governing eligibility, financing, and compensation levels.

TABLE 6.2. Unemployment Compensation and State Grants, 1984-1994

year	number of recipients	total number of benefit days			benefits paid	state grants
	1,000s	1,000s	per member of union fund	per recipient	millions of SEK	millions of SEK
1984	340		not available	not available	5,863	5,587
1985	331	23,826	7	72	6,067	5,795
1986	336	24,466	7	73	6,760	6,426
1987	340	24,461	7	71	7,455	7,077
1988	318	20,298	6	64	6,713	6,313
1989	274	16,588	5	60	5,982	5,534
1990	262	16,806	5	62	6,556	6,053
1991	360	26,916	7.5	75	11,986	11,437
1992	564	50,840	13.6	89	24,071	22,880
1993	770	76,987	20.4	100	36,631	35,404
1994	857	79,163	21	92	36,286	36,286
1995						

Source: RRV, *Social Insurance Statistics*.

Inclusiveness As noted, the two-tiered structure of cash benefits for the unemployed has been a significant departure from universal, obligatory social insurance. Until 1974, only union members were eligible for cash benefits. After 1974, anyone with a close connection to the labor market was covered by flat-rate benefits provided by the state, while only union members qualified for income-related benefits. The superiority of income

related benefits from the union funds provided powerful incentives for wage earners to join unions, and the labor movement has jealously guarded this advantage. The dominance of the union funds was the single most important program feature affecting the politics of retrenchment. For the bourgeois parties, breaking the union monopoly was a way to tame the unions and reduce labor power. The non-universal structure of the program also made the SAP vulnerable to charges that the system was unfair, especially when compared to the universal structure of other social insurance programs. As unemployment rates increased, this aspect of the system became especially prominent in the debate about how the system should be reformed.

Despite the non-universal structure of the system, most wage earners were covered by either union-administered benefits or state-sponsored flat-rate benefits, so the population covered by both programs was still quite extensive. As the costs of providing cash benefits during a period of high unemployment increased, policymakers intent on cutting costs had no choice but to focus on this nearly universal system of benefits.

Financing Retrenchment advocates faced a financing structure in unemployment benefits very different from that of other social insurance programs. The unemployment funds administered by the unions are financed by a mix of employee and employer contributions deposited in an ear-marked fund, the labor market fund (*arbetsmarknadsfond*), an account in the National Debt Office (*Riksgäldskontoret*).¹² Since the financing reform in 1989, the fund was intended to be self-financing at an open unemployment rate of about three

¹²The fund also pays for education allowances for labor market education for union fund members and allowances for wages paid during layoffs, and a few other things.

percent.¹³ State funds would cover any temporary shortfalls, but the account was supposed to be balanced in the long run. In 1991, employers paid 2.12% of payroll¹⁴ while wage earners paid a fixed membership fee every month that varied across union funds. Member fees were quite low, however, compared to employer payroll taxes. Member fees finance the administrative costs of the union funds as well as payments by the funds to the labor market fund. In contrast to the union funds, KAS was financed from general state revenues until 1989. State revenues also finance active labor market programs, but expenditure is limited to the appropriations approved by parliament in the yearly budget process. In contrast, expenditure on cash benefits was unlimited in practice because of the structure of financing.

No sooner had the new system been introduced than soaring unemployment rates placed overwhelming pressure on the system of trust fund financing. As open unemployment strained the capacity of the system and deficits in the labor market fund began to increase dramatically, temporary state funding proved insufficient for financing costs. The surplus in the labor market fund in both 1989 and 1990 was transformed into soaring deficits beginning in the second half of 1992. To address this problem, the state authorized the labor market fund to obtain a variable credit at the National Debt Office in 1992. The dire state of central government finances made regular transfers of funds an impossibility. The deficit in the labor market fund is not visible in the state budget but it

¹³The post-1989 system was introduced so that frequent adjustments in employer payroll taxes would not be required.

¹⁴Employer fees were reduced in the early 1990s because of the good position of the funds and earlier years of low unemployment.

burdens the state nonetheless because the state pays the interest and guarantees the loan.

The deficit in the labor market fund was widely reported in the media, heightening awareness of the precarious financial position of the unemployment insurance system.

Eligibility One set of general rules governs eligibility to both flat rate cash assistance and the benefits administered by the union funds: benefits are available to those who are able to work, have registered at an employment office, and are willing to accept suitable work. The employment offices (arbetsförmedlingen) serve the purpose of establishing whether recipients meet the eligibility requirements concerning the willingness to work. In addition, 12 months membership in a union fund (the membership requirement, or medlemsvillkor) as well as 75 days of work within a four month period (the work requirement, or arbetsvillkor), are required for income related benefits.¹⁵

Eligibility rules take on a second aspect of importance in that they also apply to most of the labor market programs administered by the National Labor Market Board. If an unemployed person risks losing benefits, s/he may request assignment to one of several labor market programs such as labor market education or a public relief job (beredskapsarbete). Participants are paid the same level of compensation they are eligible for in KAS or the union funds. Four months of participation in labor market programs sufficed for qualifying for a new period of cash benefits. This peculiar mix of eligibility rules began to have unanticipated effects after the onset of the recession in 1991. Although formal eligibility rules provide rather strict limits on the duration of benefits, benefits could continue indefinitely in practice because of the rules governing

¹⁵Those who are 64 or work less than 17 hours per week are not eligible for the union funds.

requalification.

In the past, labor market education and public relief work were part of an overall strategy to get the unemployed person back into the labor market as quickly as possible. With the labor market offering few job vacancies, active labor market measures became chiefly a means of re-qualification. Critics called this aspect of the system the “endless carousel” (den eviga rundgången) of rotating between cash benefits and participation in labor market programs. In the past, this aspect of the system was never seriously questioned, but it could only work under conditions of low long-term unemployment. Prior to 1991, Sweden never had a serious long-term unemployment problem so rotating between cash benefits and labor market programs never resulted in the “endless carousel” of benefits that attracted so much criticism when unemployment began its steep rise in 1991.

Benefits and indexing In 1990, the union funds provided benefits equal to 90% of qualifying income up to a maximum of 564 kronor per day.¹⁶ Compensation was limited to 300 days for those under 55 years of age and to 450 days for those above 55. This level of compensation is low compared to other social insurance programs because of the construction of the benefit ceiling and index mechanism. The ceiling for unemployment benefits corresponds to 5.5 base amounts, compared to 7.5 base amounts in other programs such as sickness insurance and parental insurance. The lower benefit ceiling no doubt reflects the fact that unemployment has historically been a problem for blue collar

¹⁶This corresponds to a ceiling of 5.5 base amounts, although the base amount does not formally govern benefits.

workers, rather than more highly paid white collar workers. When unemployment began to afflict even white collar workers, the lower benefit ceiling became a target for criticism from TCO in particular.

Unlike sickness insurance and pensions, unemployment cash benefits are not indexed to inflation through the use of the base amount. Until 1990, there was no formal index mechanism; Parliament simply adjusted the maximum daily benefit level every year. Since 1990, the yearly increase in the maximum daily benefit is linked to the development of the wages for industrial workers. In practice, the new index has proven fairly amenable to adjustment, and this created opportunities for major savings; the government could simply reduce or freeze benefits with little problem. Waiting days had been in place since 1934, but were finally abolished in 1989.

As noted, benefit calculations apply not only to cash benefits, but also to the compensation paid in most labor market programs. Thus, benefit cuts have a double effect: they reduce not only cash benefits paid by the labor market fund, but also labor market outlays financed with general revenues. With an open unemployment rate of 8.5 percent of the labor force in 1996, and an additional 4.5 percent participating in labor market programs, nearly 13 percent of the labor force is affected by any adjustment in benefit levels or eligibility.

Retrenchment measures focused on all aspects of unemployment insurance program structure. Because of the dramatic rise in unemployment and the ensuing deficits in the labor market fund and pressure on the state budget, politicians have left no aspect of the program untouched. In order to cut costs, individual payroll taxes have been raised,

benefit levels cut, indexing frozen, and qualifying rules tightened. Politicians have made use of both highly visible cuts, such as reductions in nominal benefits and the introduction of waiting days, and less visible retrenchment techniques such as tightening eligibility and freezing indexation of benefits. However, the most contentious issue has concerned the overall organization of the system, even though ending the union monopoly on income related benefits would not result in financial savings for the state or the labor market fund. This issue concerned first and foremost union power resources, and it was a question on which the labor movement would not compromise.

Bourgeois Minority Coalition Government 1991-1994

In contrast to the bourgeois governments that ruled Sweden between 1976 and 1982, the coalition government that took office in October 1991 was dominated by the Conservative Party.¹⁷ Whereas the bourgeois governments of 1976-1982 never challenged the union monopoly on income related benefits or attempted cuts in cash benefits, the Bildt government was intent on reforming the excesses of social democratic welfare policy, and high on their agenda was the reorganization of unemployment insurance. In particular, the Bildt government planned to increase individual contributions to the insurance system and end the union monopoly on income-related benefits. When they took office, the bourgeois coalition parties had no explicit plans to cut benefit levels, but cost overruns soon made this a policy imperative for the Bildt government. As discussed in chapter three, however, the new bourgeois government faced both internal divisions and

¹⁷The three bourgeois governments that ruled Sweden 1976-1982 were dominated by the Center Party and the Liberal Party.

parliamentary obstacles to its reform intentions. As a minority government, the Conservative led coalition would either have to seek the support of the New Democracy Party, or try to cooperate with the SAP. Given their determination to end the union monopoly, the government could hardly expect the support of the SAP. For this issue, the Bildt government gambled on the cooperation of New Democracy. Because of the rapidly deteriorating fiscal situation, the SAP was more willing to compromise on the issue of benefit cuts, but refused to do so as long as the government persisted in its attempt to nationalize the system. The unstable parliamentary situation would plague the Bildt government throughout its entire tenure in office and complicate its reform agenda.

The organization of the policymaking process itself added to the difficulties of the Bildt government. Whereas benefit cuts could be presented as part of the yearly budget bill or other legislation, major reforms, such as the nationalization of the unemployment insurance system, typically involve a much longer policy cycle. Before legislation can be drafted, the government must appoint a commission to investigate the issue and make reform proposals, and interest groups must be permitted to comment on the report. With a fairly short mandate period (three years), a quick and decisive end to the union monopoly would be extremely difficult. Despite these potential obstacles, the Bildt government settled on a strategy of frequent benefit and financing adjustments at the same time that it pursued long-term structural reform. New Democracy proved willing to cooperate at first, but its increasing intransigence and internal problems toward the end of the mandate period complicated the Bildt government's plans for structural reform.

Cutting Costs and Ending the Union Monopoly

Shortly after taking office, the Bildt government quickly moved to double the individual contributions to the union unemployment insurance funds, for an annual savings of SEK 600 million.¹⁸ With the support of New Democracy, parliament ratified the legislation, and the higher fees took effect January 1, 1992.¹⁹ Despite the magnitude of the increase, the individual fees remained rather small. Nevertheless, this was a first step in dealing with rising costs in the insurance system and shifting a higher proportion of financing to wage earners. In the budget bill of January 1992,²⁰ the government followed up on this reform tack by proposing two additional increases through 1993.²¹ By early 1992, open unemployment had climbed to about five, and the government wanted wage earners to bear most of the increased costs of the program, rather than raising employer payroll taxes.

In February 1992, the Bildt government followed up on its promise to initiate structural reform of the unemployment insurance system. Gerhard Larsson was appointed to head the investigation with the help of several experts.²² The choice of a “one-man commission” was part of a deliberate strategy to minimize the influence of the labor movement on the commission’s work. Interest groups, including the LO and TCO, were

¹⁸*Proposition 1991/92: 38.*

¹⁹Individual fees were raised from 35 to 70 percent of the daily average income related cash benefits for each union fund. With the fee hike, union members would pay .25 percent of wages in membership fees.

²⁰*Proposition 1991/92: 100.*

²¹The government wanted to raise the fee to 210 percent by 1993, triple the 1992 level and six times the 1991 level.

²²The commission was a one man operation with only a few experts lending their assistance. The experts were drawn from the labor market parties including LO, but they only offered expertise and were not permitted to take part in negotiations.

specifically excluded from the commission, except as experts. In contrast to the pension reform process, a parliamentary commission including the SAP and Left Party was also ruled out in order to prevent the SAP from derailing the government's plan to nationalize the system. The main instructions from the government were to fashion an obligatory system to replace the union-dominated system currently in place. In addition, Larsson was instructed to propose a system which would be financed by the labor market partners and responsive to different levels of unemployment. The SAP reacted sharply to the appointment of the Larsson Commission and the contents of the government's directive and promised to oppose any proposal to nationalize the system. In sum, the Bildt government chose a confrontational strategy vis a vis the labor movement. The government staked its strategy on the insulation of the commission from labor influence, hoping that New Democracy would support the resulting legislation. This constituted a significant departure from the standard operating procedures associated with major policy reforms during the twentieth century.

As Larsson began his investigation, the currency crisis of autumn 1992 allowed the SAP to win a reprieve from the possibility of a new, obligatory unemployment insurance system. The top level negotiations between the four government coalition parties and the SAP resulted in two crisis packages designed to stabilize the economy and stem the flight of capital from Swedish kronor into foreign currencies. As a condition for its cooperation, however, the SAP demanded that the government suspend its plans to nationalize the system and further increase individual fees. As a result, the crisis packages contained substantial cuts in sickness insurance and pensions, but not in unemployment benefits.

Additionally, the bourgeois government announced that the unemployment insurance system would not be nationalized, at least for the time being. However, the agreement was interpreted in different ways by both the government and the SAP, and the Larsson Commission continued its work.

The dramatic deterioration of public finances and rising unemployment in 1992 provided the backdrop to substantial benefit cuts suggested by the government in its January 1993 budget bill.²³ The Bildt government proposed a decrease in compensation from 90% to 80% and the introduction of five waiting days.²⁴ In addition, flat rate benefits would be reduced to SEK 198 per day. These cuts were projected to save approximately SEK 6.0 billion per year.²⁵ At the time, the labor market fund showed a large deficit and all predictions pointed to steep increases in the fund deficit. At this point, the SAP was unwilling to consider any cuts in unemployment benefits and refused to cooperate with the government. In their budget motion, the SAP specifically rejected cuts in the unemployment insurance system. Because of its minority status and the opposition of both the SAP and Left Party to the cuts, the Bildt government turned to New Democracy for support. New Democracy's cooperation would be difficult to obtain, and their preferences concerning the legislation were still not clear. The SAP tried to capitalize on the unstable parliamentary situation by negotiating with the government coalition parties in the parliamentary labor market committee, offering to accept the

²³*Proposition 1992/93: 100.* The maximum daily benefit was set at SEK 564.

²⁴*Proposition 1992/93: 150, bilaga 8.*

²⁵This figure is taken from *Riksdag och Departement 13* (1993).

introduction of waiting days if benefit levels remained unchanged.²⁶ In contrast to the government's proposal, the SAP wanted to spread the costs to all workers rather than just on the unemployed.²⁷ In early April, New Democracy agreed to support the legislation in committee, and the legislation was passed by parliament.²⁸ Individual fees to the union funds were also raised. The passage of the budget bill had extra significance for the Bildt government: until New Democracy's conversion, there was widespread speculation that the government would fall because of the unstable parliamentary situation.²⁹

In addition to reducing benefits from 90 to 80 percent, the maximum daily benefit was cut from SEK 598 to SEK 564 per day. In effect, this was a 5.5 percent increase in the income ceiling. KAS was also reduced by 5.5 percent, and indexing was suspended. In effect, benefits were de-indexed and cut from two sides. This strategy was made possible by the peculiar indexing mechanism used in the system.

In February, the government issued a second directive to the unemployment insurance investigation. As the deficit increased in the labor market fund, the government directed the Larsson Commission to propose a system that would be self-financing at all levels of unemployment so that the state would not have to borrow to cover deficits in the system. By the end of fiscal year 1993/94, the deficit in the system was projected to reach SEK 40 billion.

²⁶The SAP also proposed to increase both individual and employer payroll taxes in order to finance unchanged benefit levels.

²⁷*Riksdag och departement* 13 (1993).

²⁸*Arbetsmarknadsutskottets betänkande 1992/93: 11 and 19.*

²⁹The survival of the Bildt government was unclear at the time because of the shifting allegiance of New Democracy. After having voted with the government on partial pension cuts in committee, the party reversed itself in the parliamentary vote. Even though the party did not take the opportunity to fell the government, it stated clearly that this was a possibility on the unemployment insurance issue.

As the economy continued to deteriorate, critics of existing labor market policy entered the public debate about the causes of Sweden's economic difficulties. In particular, critics charged that labor market policy contributed to the inflexibility of the labor market, thereby hindering economic growth and competitiveness. Even after the cuts approved by parliament, many economists argued that benefits were still too high to promote the desired level of labor market flexibility. Moreover, these critics claimed that the level of current benefits provided few incentives for the unemployed to actively seek work.

One of the more prominent examples of this type of criticism came from the Lindbeck Commission, appointed in the aftermath of the 1992 currency crisis to make recommendations for political and economic institutional reforms. Headed by the economist Assar Lindbeck and staffed mostly by economists, the commission presented its report in March 1993.³⁰ Coming in the midst of soaring unemployment and deteriorating public finances, the Lindbeck Commission report attracted much attention in the public debate and added fuel to the government's structural reform plans for the unemployment insurance system. Specifically, the commission recommended sharp benefit reductions, a switch to cheaper labor market programs, and hikes in both employer and individual fees. The commission also proposed the end of the union monopoly on income-related benefits, arguing that union involvement was unnecessary and prevented universal access to benefits. The Lindbeck Commission was one of the first prominent studies to explicitly link the structure of unemployment insurance with economic performance in general and

³⁰*SOU 1993: 16, Nya villkor för ekonomi och politik.*

labor market flexibility in particular. On the basis of their analysis, the commission members argued that unemployment insurance reform was one of several measures necessary for the recovery of the economy.

In the immediate aftermath of these devastating criticisms of existing labor market policy, the Larsson Commission presented its final report. The guiding principle of report was to combine flat rate cash assistance and the voluntary union funds into a single obligatory system. In addition, Larsson proposed reduced benefits, increased payroll taxes, and a definite time limit on benefits.³¹ According the proposal, the possibility of rotating between compensation and participation in state-sponsored jobs programs, and back again, would be eliminated. The Larsson Commission also proposed an increase in individual contributions (1% in 1994 and 2% in 1995) which would replace the fees currently paid to the union funds. Workers could still remain dues-paying members of the union funds, but this would be in addition to the fees paid to the state. Thus, the costs for remaining the union funds would be raised considerably, thereby reducing the incentive for wage-earners to belong to unions. These were radical and controversial proposals.

The publication of the Larsson Commission report sparked criticism not only from the labor movement, but also from the municipalities. The SAP and LO objected to just about everything contained in the Larsson reform proposal, particularly the creation of a state run unemployment fund. The SAP and LO charged that the move was a deliberate

³¹A two tiered system would provide an obligatory basic benefit level of 60% of qualifying income, and workers could complement this with voluntary insurance providing up to 80% of qualifying income. The length of the benefit period would be cut from 300 to 200 days or 450 to 300 for older workers. The system would be financed entirely by the labor market parties.

attempt to weaken the unions, and the SAP immediately promised to reverse any resulting legislation if returned to office in 1994. Complaints from the municipalities resulted from the fear that curtailing the benefit period would lead to soaring costs as the long-term unemployed turned to means-tested social assistance (socialbidrag) when their benefits ran out. With the municipalities already strapped for resources because of a tax freeze imposed by the national government in 1991, representatives from the municipalities claimed that increased social assistance costs would lead to cutbacks in services provided by the municipalities, such as day care and care of the elderly.

The labor movement's criticism was hardly unexpected; SAP's and LO's position on the matter was well known to both the Bildt government and the Larsson Commission. As in the pension reform process, interest groups were excluded from the commission's work except for the participation of some experts. Larsson conceded that even in his discussions with the experts there was no general agreement about how to reform the system. Because of the differences in opinion, the resulting reform proposal is largely the work of Larsson, although it has been influenced somewhat by the participating experts.³² Nevertheless, the experts rejected the proposal in its entirety and complained of the rushed methods and their inability to monitor the commission's work. That the Larsson Commission continued its work in the midst of severe criticism of both its proposals and its working style is highly unusual for a Swedish investigatory commission.

Despite these massive criticisms, the government parties now began internal negotiations on the Larsson report and by October, they had agreed on the outlines of the

³²SOU 1993:52 *Ersättning vid arbetslöshet*, pp. 13-14.

new system. The government's strategy was to present the reform legislation in two steps. First, the government would seek passage of financing rules as well as the principles for further reform in the Autumn session of Parliament. Second, the government planned to present detailed legislation on program rules in the Spring of 1994. The two-step strategy was designed to deal immediately with the huge deficit in the labor market fund, and to buy some extra time for the more controversial parts of the reform.

Because their reform plans proposed to end the union monopoly on income related benefits, cooperation by the SAP or Left Party was unthinkable. By default, the government would have to negotiate with New Democracy. This would not be an easy task even though New Democracy had previously declared its support for the government's reform intentions.

The government presented its bill to parliament on October 25, 1993 as part of a large package of budget consolidation measures. Consistent with the Larsson Commission proposals, the overall direction of the reform was to change both the financing and administrative structure of the system. In terms of financing, the government wanted to increase individual contributions to a level equal to that currently paid by employers, about two percent. This way, wage earners and employers would finance equal proportions with the state covering any temporary shortfalls. Individual fees would begin January 1994 and increase to two percent in 1995. The contribution would be tax deductible and replace the fee currently paid to the union funds. Moreover, union members would be required to pay twice for their insurance. This was intended to radically alter the incentives affecting union membership. As planned, the new insurance

system would be obligatory for all wage-earners. For those not eligible for the union funds and to increase freedom of choice, a new state fund would be introduced, probably administered by the National Insurance Board (Riksförsäkringsverket, RFV). The new unemployment insurance fund would provide both income-related benefits and flat rate benefits.³³ In sum, Larsson's proposal to introduce an obligatory basic system and a voluntary supplementary income-replacement program was scrapped.

The governing parties disagreed on several issues right up to the last minute. One thorny question concerned the maximum level of benefits as well as the ceiling under which contributions are paid. The coalition parties settled on a benefit ceiling of 5.5 base amounts with a maximum daily benefit of SEK 564, or about 80 percent of qualifying income. Minimum benefits would be raised somewhat, to SEK 4,500 per month. However, because of the growing deficit in the labor market fund, contributions would be paid up to 7.5 base amounts. This financing formula was intended to be transitional, however. As soon as the deficit in the labor market fund decreased, the ceiling for contributions would be lowered so that benefits are more actuarial. As in the past, employers would continue to pay contributions on total payroll.

In several other crucial aspects, the legislation also departed from Larsson's reform proposal. In response to massive criticism, the government softened its proposal for introducing a time limit on benefits:³⁴ the 300 day limit remained, but the rules for qualifying for a new period of benefits would be sharpened. In the bill, re-qualification by

³³*Proposition 1993/94: 80.*

³⁴The Larsson Commission proposed the reduction of maximum benefits from 300 to 200 days and the elimination of re-qualification through participation in public labor market programs.

taking part in labor market education or public relief work, would result in only 150 days of benefits, rather than a full benefit period. Benefits would terminate for those still unemployed after this second period of benefits. In addition, the bill included tougher rules governing the work condition: in the new system, five months of work within a twelve month period would be required. The new system is based on a calculation of unemployment of 5 percent.³⁵ Despite the modest improvement in benefits, the entire reform would increase revenues by SEK 8.5 billion when fully implemented.

The introduction of the reform legislation sparked a new round of criticism from the SAP and unions. Besides their obvious opposition to an obligatory system, the SAP and unions focused their objections on the proposal to introduce a time limit on benefits. Even though the government had softened this aspect of the legislation, the SAP still charged that this would result in many unemployed losing their benefits. The municipalities would have to pick up the slack with means-tested social assistance (socialbidrag). And if the municipalities have to increase expenditures for social assistance, then cutbacks in education and elder care would result. The SAP called the reform a “de-insurance bomb (utförsäkringsbomb).”³⁶ To support these objections, LO conducted a study of the effects of the bill and concluded that the reform would cause a social assistance shock to the tune of SEK 11 billion per year for the municipalities as a result of the benefit time limit.³⁷

In their motions concerning the bill, all three opposition parties (Left Party, SAP,

³⁵*Dagens Nyheter*, October 13, 1993.

³⁶*Dagens Nyheter*, October 27, 1993.

³⁷*Dagens Nyheter*, November 12, 1993.

and New Democracy) rejected the proposed changes in unemployment insurance. The Left Party and the SAP opposed the bill in its entirety and proposed keeping the current insurance system. Ingela Thalén, the SAP chairperson of the parliamentary labor market committee, called the bill “pure provocation” and repeated the SAP's promise to reverse the legislation if returned to power in the next election. Again, the SAP criticized the introduction of a non-union unemployment fund, calling it "unnecessary" and part of a deliberate strategy to weaken the unions. Thalén even conceded that the current structure was very significant for membership recruitment.³⁸

The opposition of New Democracy must have come as a bitter disappointment to the government. In their motion, New Democracy criticized the new fees and proposed moving funds from sickness insurance to the unemployment insurance system in order to cover the deficit in the labor market fund. New Democracy also recommended that the resulting shortfall in sickness insurance be financed with cuts in parental insurance. New Democracy's intransigence concerning the bill reflected the party's desire to directly influence the contents of the legislation. Excluded from the coalition government's negotiations on the bill, New Democracy's only remaining avenue for influence was to try to negotiate with the government parties in parliamentary committee. Clearly, the Bildt government had taken New Democracy's support for granted because of the party's earlier support for its unemployment insurance policy.

Hemmed in from the left, the Bildt government had no choice but to attempt to negotiate with New Democracy in committee. Gaining support from New Democracy

³⁸*Dagens Nyheter*, November 15, 1998.

proved more difficult than anticipated for the government, however. In the Spring, New Democracy had agreed to the principle of new individual fees as part of the budget consolidation, but by November they had taken back their pledge. As the committee deadline neared, the parliamentary group leaders of the coalition parties met with New Democracy's leader Ian Wachtmeister to negotiate the legislation. In return for New Democracy's support, the government raised the minimum benefit level from SEK 198 to 245 per day. However, a majority in the committee (Left Party, SAP, and New Democracy) refused to take action on a bill of principles containing benefit limits and other rule changes. Instead, the committee recommended that the government present legislation on these issues in the Spring. Thus, the other details would have to wait, including the qualifying rules, the work condition, and the length of benefits. Clearly, New Democracy was holding out for yet another round of negotiations with the government in the Spring.

By securing New Democracy's support for the legislation, the government overcame its most difficult obstacle in the Autumn session of parliament. For one thing, the new financing rules for unemployment insurance benefits provided the largest part of the government's deficit reduction program. Second, the government faced the threat of a parliamentary crisis: if the legislation did not pass, the government would either have had to withdraw the bill or face a vote of no confidence.

The budget bill in January 1994 contained no new proposals for unemployment insurance. However, the bill reiterated the government's rationale for the overall direction of unemployment insurance policy and touted the importance of the reforms launched

since 1991. For example, the budget bill praised the introduction of individual contributions as a vital step in making the costs of insurance more visible for wage earners. The government also tried to put a positive spin on its benefit cuts, calling them a method of strengthening incentives for the unemployed to seek and accept a job as well as for those already employed to moderate their wage demands so that unemployment does not increase.³⁹ In anticipation of the upcoming legislative proposals for further reform, the budget bill also pointed to international research studies showing that the length of the benefit period was an important factor influencing long term unemployment. This provided an additional rationale for the government's plans to ending the re-qualification "carousel."

The government would still have to negotiate with New Democracy in order to pass the legislation to be presented in March. As events in the previous Autumn demonstrated, New Democracy would not be an easy target for support. That the government could not take New Democracy for granted was illustrated yet again in January when New Democracy indicated publicly that it would like to influence the proposed rules concerning the time limit on benefits as a condition for its support.⁴⁰

In the parliamentary budget debate in late January, the SAP again harshly criticized the government's policy on unemployment insurance. However, in their shadow budget, the SAP accepted the reduced benefit levels adopted the previous year, much to the irritation of LO. As a result of this SAP policy statement, open conflict soon emerged

³⁹*Proposition 1993/94: 100*, p. 61.

⁴⁰*Dagens Nyheter*, January 11, 1994

between the SAP and LO. At first, LO leader Bertil Jonsson and LO economist P.O. Edin accepted the SAP's position on lower benefits, but quickly changed their minds when the LO governing board (styrelse) adopted a resolution declaring that benefits should be raised to 90 percent and financed by increased taxes on private pension insurance. As *Dagens Nyheter* put it, now the LO was on a "collision course" with the SAP.⁴¹

At the same time, a working group had been set up by the SAP party executive (partistyrelse) and the SAP parliamentary group (partigrupp) in order to come up with a unified policy on unemployment insurance.⁴² Because of the deterioration of state finances and the soaring deficits in the labor market fund, the SAP accepted the necessity of cost-cutting within the unemployment insurance system. The question was how to present a cost-cutting alternative to the government's legislation that might appeal both to the core of the labor movement as well as to New Democracy. Among the possibilities investigated were keeping the 80 percent benefit level but raising the ceiling from 5.5 to 7.5 base amounts or introducing two levels of benefits: lower benefits for cash assistance and higher benefits for those with public relief jobs or labor market education allowances.⁴³

By early March, however, the government was in retreat. The coalition parties were widely criticized even by their own constituents, and the issue threatened to turn explosive in an election year. Both the Center Party and the Christian Democrats voiced concerns about tightening eligibility or limiting the length of benefits. Moreover, cutting

⁴¹*Dagens Nyheter*, February 2, 1994.

⁴²The working group included members of the party executive, TCO and LO.

⁴³*Dagens Nyheter*, February 2, 1994

benefits would play right into the SAP's hands with a general election only five months away. Although the Conservatives and Liberals advocated a limit on both benefit days and benefit periods, they backed away from the deep cuts proposed in the Fall. Another source of disagreement concerned subsidies to the union funds in order to achieve neutrality between the state and union funds. In spite of these disagreements, Liberal Party leader Bengt Westerberg announced in March that the government should still present the bill before the election but allow the second benefit period to be longer than 150 days.⁴⁴ In the end, however, the government shelved provisions for reducing the number of benefit days and it softened the limit on the number of benefit periods. In response to criticisms of these two program features, the government decided to appoint to a parliamentary commission to investigate these issues.⁴⁵ In this way, the sensitive question of benefit length would be buried in a commission during the election campaign. The government now re-directed its strategy toward achieving the end of the union monopoly on income related benefits.

The government presented its legislation to the Riksdag on March 30, 1994.⁴⁶ Although there were no proposed reductions in benefit levels, the bill sought to decrease costs by tightening up qualifying conditions and restricting benefits to part time workers.⁴⁷ In terms of benefits, the most important departure from existing policy was the suggestion

⁴⁴*Dagens Nyheter*, March 13, 1994

⁴⁵A parliamentary committee had already been set up at the end of 1993 on the role, scope and direction of labor market policy. This committee would now be charged with the additional task of researching ways to stimulate the unemployed to seek new employment.

⁴⁶*Proposition 1993/94: 209*

⁴⁷The bill proposed the elimination of cash benefits for those working part time.

to terminate benefits after two benefit periods. This provision would end the “carousel” between participation in labor market programs and receipt of cash benefits which meant that benefits could continue indefinitely. The benefit time limit would take effect through the introduction of two different work conditions, one for initial qualification and one for re-qualification.⁴⁸ The major change proposed was the end of eligibility after two benefit periods of 300 days.⁴⁹ Participation in labor market programs would no longer count toward re-qualification. The end to the union monopoly on income related benefits would be achieved through the establishment of an insurance fund separate from the unions. Union funds would continue to exist, but as noted, the costs of membership would be higher. The state fund would have a competitive advantage versus the union funds in that wage earners would pay no extra membership fee while those remaining in the union run funds would continue to pay membership fees. The government counted on the support of New Democracy for passage. When the bill was introduced, Minister of Labor Börje Holmlund emphasized that the new system would strengthen the work line and break the current trend toward rotating between active labor market measures and cash benefits without any real progress toward joining the labor market.⁵⁰

By May, internal disagreement persisted among the government parties. For example, several members of the Liberal Party presented their own motions for changes in

⁴⁸The “general work condition,” requires 75 hours of work per month for at least five months during the previous year in order to qualify for the initial period of benefits. In order to qualify for a second period of benefits, one must meet the general condition or the so called “specific work condition” of having worked at least 65 hours per month for ten months.

⁴⁹Those over 55 would have 450 day benefit periods.

⁵⁰*Riksdag och departement* 15 (1994).

the bill.⁵¹ At the same time, the SAP and Left Party and the unions amassed all of their resources to fight the legislation. Committee action on the bill in parliament threatened to derail the process entirely because of the unpredictability of New Democracy. The first committee report (AU 18)⁵² presented to parliament was referred back to committee before a vote could be taken. In the second committee report (AU 26), a majority led by the SAP (including New Democracy and the Left Party) prevailed and recommended that the government withdraw the bill. The government looked certain to go down in defeat when the bill was put before the whole parliament for a vote. By this time, however, some members of New Democracy had decided to abstain, and in the end a majority supporting the proposal of the government parties in the committee prevailed. Thus, on June 11, 1994 the last day of the spring parliament, the reform was passed.

The completion of the second step in unemployment reform was calculated to have a neutral impact on program finances. Costs associated with increasing eligibility would increase spending by SEK 3 billion per year while the longer term effects of tougher rules would cancel this out. However, since the individual payroll tax adopted in December would generate SEK seven billion in extra revenues in 1994 and SEK 14 billion in 1995, the financial effect of both steps in the reform amounted to a savings of SEK 4 billion in 1994 and SEK 11 billion in 1995. However, it was not the financial aspect of the reform that was most divisive. While the SAP did not necessarily oppose savings in a system

⁵¹*Dagens Nyheter*, May 10, 1994

⁵²The committee report reflected a majority in favor of the legislation, including New Democracy. Ratification by the full parliament should have been automatic, but in the meantime New Democracy had changed its mind and requested that the labor market committee consider the bill again.

running huge deficits, they would not countenance a departure from union-administered income related benefits. The SAP specifically promised to reverse the legislation if returned to office in September 1994. Since 1993, the SAP had been leading the government parties in the opinion polls, and they scored their best election result since 1970 when voters went to the polls in September 1994. During the election campaign, however, the SAP made no promises to increase benefit levels in unemployment insurance or any other income maintenance program. Indeed, the SAP asked the voters for an "open mandate" to take the steps necessary to reduce budget deficits and stabilize accumulated state debt.

Social Democratic Retrenchment 1994-1997

Soon after it took office in October 1994,⁵³ the new SAP government quickly moved to restore the old union-based system. There is no clearer indication of the substantial role that the SAP plays in the retrenchment process than this; SAP cooperation is essential for long-term retrenchment. The SAP government claimed that only a few people were excluded from benefits under the old system; in short, there was simply no rationale for a state-run insurance fund. Reversing the legislation would be fairly easy; the SAP could count on the support of the Left Party in order to achieve a majority in parliament.

However, the new government faced a two-sided budget deficit problem. State

⁵³The September 1994 election resulted in the exit of New Democracy from the Riksdag, and the re-entry of the Green Party. The Greens had been elected to the Riksdag for the first time between 1988 and 1991, but they failed to gain enough votes to continue in the Riksdag between 1991 and 1994. Aside from these changes, the party constellation in the Riksdag remained the same.

finances continued to deteriorate, and the deficit in the labor market fund remained abysmal. Thus, with the return to the old system, the SAP would still have to make cuts in the insurance system. The SAP strategy was to first restore what the Bildt government had taken away, namely the union monopoly.⁵⁴ This "reversal strategy" (återställarstrategi) dominated the Autumn session of parliament. However, along with the reversal of legislation enacted by the bourgeois government, the SAP imposed further losses on the unemployed through several adjustments to program rules governing eligibility and benefits. Between 1994 and 1997, the SAP's overall strategy was to tighten eligibility rules, retain the waiting days, reduce benefit levels and increase individual contributions. In many ways, the Bildt government had done the hard work for the SAP already by initiating the process of cutting benefits substantially. The SAP could abolish the legislation it found unacceptable, but keep the cuts already in place. On top of this, the SAP looked for further savings in what was becoming a hugely expensive program. The SAP pursued this strategy even though the LO consistently pushed for a return to 90 percent benefit levels and more generous qualifying rules. SAP strategy concerning benefit cuts was motivated above all by the dire state of public finances and the dramatically rising costs of unemployment benefits.

The SAP presented its first legislation concerning unemployment insurance to parliament on October 27, 1994.⁵⁵ With the return to the old system, the SAP proposed

⁵⁴The SAP also used this strategy in several other policy areas: they abolished the care allowance; abolished certain changes in the health care system; and re-established some of the employment security provisions abolished by the Bildt government. The latter issue is not addressed in this dissertation.

⁵⁵*Proposition 1994/95: 99.*

two losses for the unemployed. First, the SAP proposed to tighten the work condition;⁵⁶ second, the SAP wanted to restrict benefits for part time workers.⁵⁷ The first change would affect mainly youths and immigrants with shorter and more unstable employment histories. About 200,000 are part time unemployed, so this provision promised to have an even bigger impact than the tougher work condition.⁵⁸ These changes were projected to decrease costs by SEK 2.6 billion per year. In addition to these changes, the SAP proposed the appointment of an official commission of inquiry to investigate further reforms of the unemployment insurance system in light of the rising costs of financing benefits at high levels of unemployment. The return to the old system also meant the re-introduction of liberal qualifying rules; the "endless carousel" was back in operation.

In the parliamentary labor market committee, the SAP gained the support of the Left Party for its legislation.⁵⁹ However, negotiations with the Left Party resulted in one important change: rules limiting part time benefits were scrapped.⁶⁰ The return to the old system also meant a return to the old financing rules and the elimination of individual payroll taxes for unemployment benefits. However, the SAP capitalized on the individual fees introduced by the Bildt government; the fees would not be abolished, rather, they

⁵⁶The SAP proposed a work condition of five months of work (at least 80 hours per month) in the twelve month period preceding unemployment. The Bildt work condition only required 75 hours of work per month during the required five months.

⁵⁷Before 1993, part time workers could qualify for benefits "up to full time." The SAP proposed to limit benefits for part time workers to one benefit period (300/450 days). After this, part time workers would not be entitled to benefits for the time they do not work.

⁵⁸In the pre 1994 system there was no limit to the amount of time one could work part time and then supplement with cash benefits.

⁵⁹As a minority government the SAP need the support of one other party in order to pass its legislation.

⁶⁰*Arbetsmarknadsutskottets betänkande 1994/95:5*

would be shifted to sickness insurance.⁶¹ This way, the government could claim that "production" was paying the costs for unemployment. Still, with the new rules, compensation to the unemployed decreased by SEK 2.5 billion, largely as a result of the tougher qualifying rules.⁶² Predictably, the bourgeois parties opposed the legislation and called for the maintenance of the system introduced the previous summer.⁶³

In the budget bill presented in January 1995, the SAP proposed several additional changes in the unemployment insurance system. At the same time, the budget bill contained an important shift in the SAP's overall view of the unemployment insurance system: the SAP now emphasized that the system should be a temporary adjustment insurance (omställningsförsäkring).⁶⁴ In other words, the SAP now emphasized that benefits could not continue indefinitely; benefits should be a temporary means of support while jobless workers seek new employment. Specifically, the SAP proposed restrictions on cash benefits for those under the age of twenty, as well as the elimination of the labor market fund as the organizational basis for financing. Instead, the SAP proposed that cash benefits be financed via the regular state budget. Steeply rising deficits in the labor market fund rendered the method of fund financing meaningless at high levels of unemployment. Moreover, huge deficits attracted too much attention to the "unfinanced" costs of cash benefits, and this was surely an issue the SAP wished to avoid. The switch to financing

⁶¹Employers get a reduction in sickness insurance fee but a corresponding raise in labor market fee, so the total fees remain unchanged.

⁶²The switch back to the old rules was scheduled to be completed by June 30, 1996.

⁶³The Green Party also opposed the legislation.

⁶⁴This means that the insurance should be a temporary means of adjustment for the unemployed. Rather than function as a long term source of income, the insurance should promote the speedy return of the unemployed to the regular labor market.

cash benefits from general revenues would avoid this problem and permit the SAP to pursue savings in the program not quite as drastic as those that would have been required in order to restore balance to the labor market fund. By abolishing the labor market fund, the SAP would put an end to recurring trust fund crises (table).

Whereas the Left Party was prepared to support the switch in financing, it refused to go along with restrictions on benefits to youths.⁶⁵ This marked the end of collaboration between the SAP and Left Party. The labor market fund was abolished June 30, 1995 with an accumulated deficit of SEK 87 billion.

In early March, the SAP's plans to issue a directive to the commission on labor market policy⁶⁶ set up by the Bildt government the previous year were leaked to the media. In particular, word that the SAP was considering an income-related unemployment insurance fund independent of the unions did not please LO. LO leader Bertil Jonsson demanded that Minister of Labor Anders Sundström distance himself from the directive. In the wake of these protests, Sundström cancelled the directive.⁶⁷

Despite this setback, the SAP followed up on its new policy emphasis on the unemployment cash benefit system as a temporary adjustment insurance when it issued a second directive to the labor market commission. The government's new directive to the labor market commission was that the unemployed shall have both the *right* and the *obligation* to try to find a new job. Although the directive avoided mention of a non-

⁶⁵*Arbetsmarknadsutskottets betänkande 1994/95 :11.*

⁶⁶The Bildt government had set up the commission as part of the reform passed in June 1994. The commission was charged with investigating the issues too controversial to be included in the legislation ending the union monopoly.

⁶⁷*Affärsvärlden*, March 6, 1995.

union unemployment insurance fund, it nonetheless marked a decisive turning point in SAP policy concerning the unemployment benefit system. Now, more emphasis would be placed on altering the incentives faced by the unemployed. In short, the unemployed would face stronger pressure to find and accept a job on the regular labor market as quickly as possible.

By Spring, the SAP alliance with the Left Party had broken up over the issue of further cuts in social insurance spending. Instead, the SAP began cooperating with the Center Party. The April supplementary budget bill⁶⁸ marks the beginning of this new parliamentary coalition. In terms of unemployment insurance, the SAP and Center Party agreed on a further reduction of unemployment insurance to 75 percent of qualifying income beginning January 1, 1996.⁶⁹ The new coalition also agreed on reductions in benefits to the part-time unemployed.⁷⁰ These changes would reduce unemployment benefit costs by SEK 2.5 billion per year. The legislation also promised that the commission studying reform would also investigate the issue of part time unemployment. In addition, the bill contained tougher qualifying rules as well as stricter rules for qualifying for benefits after voluntarily leaving a job. The bill also promised additional cuts in the Fall, and it sailed through parliament with the support of the Center Party.

In early Summer, the government formally appointed a commission to examine the unemployment insurance system. The commission was a one-person operation headed by Birgitta Isaksson-Perez. The government directed the commission to clarify the

⁶⁸*Proposition 1994/95:150.*

⁶⁹KAS would go down from 245 to 230 kronor per day.

⁷⁰Part time unemployed would no longer be able to qualify for benefits for time not worked.

obligations of the unemployed in terms of making themselves available to the labor market as well as to investigate the issue of restricting benefits to youths. To reinforce this new orientation, the commission took the name “Commission on Unemployment and Adjustment (Utredning om ersättning vid arbetslöshet och omställning, ARBOM)” emphasizing that the new system should be an adjustment insurance; it should provide income security but also obligate the unemployed to find a job as quickly as possible. In particular, the commission was instructed to study how the length of the benefit period as well as the mechanisms for qualifying for a new benefit period affect the motivation to seek work or acquire new training.⁷¹ The final report would be due in late September 1996. The appointment of the ARBOM Commission meant that now two separate commissions were working on unemployment insurance reform. As discussed later in this chapter, however, the ARBOM Commission dominated the investigatory process.

The next action on unemployment insurance occurred in the Autumn 1995 session of parliament. In its Economic Growth Bill (Tillväxtproposition)⁷² presented on November 6, 1995 the government proposed further losses for the unemployed. Again, the dire state of public finances provided the SAP’s rationale for additional cuts, and reduced benefits were proposed as part of a comprehensive deficit reduction package. Cuts mainly took the form of tougher eligibility rules. Starting in January 1996, only “regular work” would qualify for the initial period of benefits. Part time workers would

⁷¹Among other things, the directive suggested that the commission look into restricting part time benefits, reforming the rules for seasonally unemployed, and providing for better coordination between sickness insurance and unemployment insurance.

⁷²*Proposition 1995/96:25.*

lose supplementary benefits if permanently employed part time. Those who decline a job offered by the state employment offices will face stiffer penalties in the form of longer periods without compensation. These changes would result in yearly savings of SEK 1.3 billion. The bill also contained additional instructions to the ongoing ARBOM Commission to propose a time limit on benefits. For the first time, the SAP announced its support for this controversial principle. Again, the cuts sailed through parliament on December 19 with the support of the Center Party.⁷³

In early 1996, the first information about the work of the ARBOM Commission was announced. In January, the secretary in the commission, Patrick Joyce, announced that a benefit limit of four years would probably be proposed. At the same time, the social democratic members of the (separate) labor market commission were considering several possibilities for reform, including a system of graduated benefits.⁷⁴ When this idea was made public, the LO leaders immediately attacked the proposal. After this backlash, the social democratic members of the commission decided that the issue was too difficult and pushed the question over to the ARBOM Commission.⁷⁵ From now on, the ARBOM Commission would play the leading role in investigating unemployment insurance reform while the labor market commission would concentrate on other aspects of labor market policy.

⁷³The Green Party also supported the legislation.

⁷⁴Such a proposal might include higher benefits during the first year of unemployment, i.e. 90 percent, 75 percent in the second year, and 60 percent in the third year.

⁷⁵*Svenska Dagbladet*, Jan 17 1996. Two commissions were working at the same time.

The SAP extra party congress held March 15-17 1996⁷⁶ promised to be a tough confrontation between the LO and SAP on the issue of unemployment insurance benefits. Before the congress, the party leadership presented its main policy proposals (riktlinjer) to the party executive (verkställande utskott), including a raise to 80 percent in sickness and unemployment insurance benefits. The new SAP Prime Minister, Göran Persson announced that he had been convinced by LO chief Bertil Jonsson that benefits in social insurance could be raised to 80 percent in 1998 without harming government finances. Clearly, this concession to the LO leadership was part of an overall strategy on the part of the SAP to maintain party cohesion and mend the fences with LO after so many benefit cuts.⁷⁷ LO was pleased by this announcement since they had pushed this persistently, but Persson said that the benefit improvements would have to be financed by other changes in the rules for both systems. In short, Persson announced that costs for unemployment benefits would not be permitted to rise. Because of their continued close cooperation with the SAP in the Riksdag, the Center Party was informed of the plans before the congress. Despite the promise of higher benefits, Persson would not be specific about what the rule changes would be.⁷⁸ Despite LO's apparent victory on the issue of higher benefits, it nevertheless accepted the principle of a time limit on benefits. Up to this point, the LO had consistently refused to support this principle. However, the LO was not content to concede the issue to the SAP, and the LO began promoting the idea that those who lose

⁷⁶The SAP normally holds a congress every four years. The extra party congress was held in order to formally elect Göran Persson as Party Leader after Ingvar Carlsson (Party Leader 1986-1997) announced his retirement.

⁷⁷*Svenska Dagbladet*, February 6, 1996.

⁷⁸*Svenska Dagbladet*, January 21, 1996.

benefits should be employed in local public works projects financed by the state through decreases in subsidies to companies. Thus, on the surface, LO seemed to be sticking to its traditional line in terms of benefit levels. At the same time, however, LO's support of the principle of a time limit on benefits was a major departure from its previous policy orientation.

In late February, the labor market policy commission was nearly finished with its work. Before the final report was presented on March 5, 1996, however, several members of the commission reported their dissatisfaction to the media. Members from both LO and SAF were highly critical of the commission's work, charging that several of the proposals lacked adequate analysis. LO's representative in the commission was most critical of the report's proposal to include a time limit (*bortre parentes*) in the unemployment insurance system.⁷⁹ Other experts in the commission, including those from LO and TCO, complained that the committee's work was hindered by the lack of interest among the politicians in the committee and by the actions of Labor Minister Anders Sundström. The TCO representative accused the Labor Minister and the government of repeatedly making decisions affecting the work of the commission without consultation.⁸⁰ Another member criticized the large role played by AMS in the commission.⁸¹ After nearly two years of work, then, the labor market commission produced very little in terms concrete reform

⁷⁹*Svenska Dagbladet* March 1, 1996.

⁸⁰One problem was that the committee was appointed under the Bildt government as a concession after all of the criticism of the new unemployment insurance legislation, in particular the time limit on benefits. When the new government took office, some of the members changed and the directions to the committee also changed. The committee then began to play a more peripheral role when for example, a commission to study the unemployment insurance system was appointed. *Svenska Dagbladet*, March 21, 1996.

⁸¹*Svenska Dagbladet*, February 29, 1996.

proposals for the unemployment insurance system.

In March, the SAP government again began to seriously discuss the possibility of an independent unemployment insurance fund, separate from the unions. With ten percent of the labor force ineligible for union-administered income-related benefits, the SAP was particularly vulnerable to criticisms about the fairness of the system. The main principles for a new system would be presented in the labor market policy bill (sysselsättningsproposition) on May 29. The final details would wait until the Autumn session of parliament, but the government wanted to present its intentions in the Spring. At the time, the ARBOM Commission was still working on proposals, and these would come in the summer. The chair of the ARBOM Commission, Birgitta Isaksson-Perez had been in contact with the Ministry of Labor as well as the government and had presented several alternatives, and the government was leaning toward the introduction of one independent insurance fund. By creating an independent alternative to the union funds, the government was responding to critics demanding an alternative to the union monopoly. The labor market bill would also contain a time limit on benefits. The government took pains to say that a limit on benefits would not mean increased costs for municipalities. However, no concrete proposals were made about who or what will take over when benefits run out.⁸²

These announcements set the stage for a major confrontation between the SAP and LO. In effect, the SAP was now proposing changes very similar to those adopted by the Bildt government in 1994: the end to the union monopoly and the time limit on benefits.

⁸²*Dagens Nyheter*, March 22, 1996.

Although the SAP could rely on the Center Party for support in the Riksdag, convincing the LO to accept these changes would prove extremely difficult.

To balance these additional cuts, the SAP was ready to propose increases in unemployment benefits.⁸³ In the Spring Economic Policy Bill (ekonomiska vårproposition)⁸⁴ (April 15) supported by the Center Party, the government formally proposed raising benefit levels to 80 percent of qualifying income in 1998. Increased costs for higher benefits would be financed by other cuts in the program. The cuts would be announced in the Spring Employment Bill (sysselsättningsproposition).

In April, the preliminary proposals for the new unemployment system were published by the ARBOM Commission with final proposals due in the Fall. According to the reform sketch, the new system would consist of two parts, an obligatory basic insurance and a voluntary income related insurance. By letting the union funds administer both parts, the commission calculated that both the SAP and unions would accept the proposal.⁸⁵ The basic part would consist of a flat rate benefits high enough to prevent the unemployed from having to rely on means-tested social assistance, but still low enough to provide an incentive to seek work. The income-related part of the system would provide benefits roughly equal to those currently available. The proposed state-run insurance fund would be introduced mostly for youth and immigrants. A time limit on benefits would be set at three and a half years, thus ending the “carousel,” resulting in substantial savings.⁸⁶

⁸³The same bill promised to also raise sickness and parental insurance benefits by the same amount.

⁸⁴*Proposition 1995/96:150.*

⁸⁵SOU 1996:51 *Grundläggande drag i en ny arbetslöshetsförsäkring-alternativ och förslag.*

⁸⁶Three and a half years was chosen because this allows the unemployed to wait for improved conditions on the labor market at the same time that they have some incentive to find a job.

In response to continued complaints from LO about current and proposed cutbacks, Labor Minister Margareta Winberg⁸⁷ promised to listen closely to LO before final legislation was formulated.

On May 29, motions presented by the opposition parties in response to the Spring Economic Policy bill demanded quicker action on unemployment than the government proposed. On May 30, the parliament voted to hold an extra session in July to deal with the employment instead of waiting until the Fall. So the employment bill, including concrete proposals, was tabled on June 1, and it contained provisions limiting unemployment benefits to three years. The bill emphasized that the benefits should be temporary and not a permanent means of support. Participation in labor market programs would count as part of the three year limit; in other words, participation in labor market programs would no longer be equated with regular employment for the purposes of eligibility. However, the government offered no guidance about what would happen to those unemployed for longer than three years. Rules for initial qualification were also sharpened in order to finance the raise to 80 percent.⁸⁸

On July 12, the full Riksdag considered the finance committee's report on the employment bill.⁸⁹ Parliament approved the raise in benefits scheduled for 1998, the time limit on benefits, and tougher qualifying rules, but the legislation was modified in several aspects: waiting days were increased from five to six in order to help finance the raise in

⁸⁷The previous Labor Minister, Anders Sundström, was re-assigned to the Ministry of Industry after Göran Persson took over as party leader and prime minister.

⁸⁸*Proposition 1995/96: 207 and 222.* Workers must have had regular work for nine months during the twelve months prior to unemployment and must have worked at least 80 hours per month.

⁸⁹*Proposition 1995/96:207 and 222.*

benefits. Changes would take effect January 1, 1997.

The passage of the employment bill marked a major change in social democratic policy concerning unemployment benefits, particularly the introduction of a time limit on benefits. The new rules would almost certainly result in many unemployed persons losing benefits. Youths and immigrants will have a hard time because of the requirement to work nine months; seasonal workers will lose benefits; and benefits are limited to three years. A study conducted by AMS predicted that up to 30,000 would lose cash benefits when the new rules take effect. This would mean dramatically higher costs for the municipalities. Already their costs doubled for social assistance since the early 1990s. In 1995 social assistance was SEK 11 billion.⁹⁰ The government also announced its intention to propose indexing changes which would further reduce benefits. Not surprisingly, LO reacted sharply to these changes. However, given the magnitude of the changes, it is surprising that there was not more vocal criticism of the legislation.

Even in the wake of these rather tough cuts in the system, the SAP continued its investigation of further savings. During the summer, the government sent up several trial balloons to LO to see what they would accept, for example the de-indexation of benefits. LO rejected this. Another idea was to raise individual fees to the union funds. The Metalworkers Union in particular rejected this idea and suggested raising income taxes instead so that pensioners pay part of the increased costs of unemployment.

⁹⁰*Metallarbetaren*, August 7, 1996.

In the September 1996 budget bill,⁹¹ the government made good on its pledge to raise benefits to 80 percent on January 1, 1998. The improvement was calculated to cost SEK 1.4 billion per year, but would be financed by other savings in the program, so the financial effect is neutral. A bill containing details would come later in the fall. The budget bill⁹² emphasized the earlier switch to seeing the insurance as an temporary adjustment insurance (omställningsförsäkring) with the introduction of the time limit and tougher qualifying rules.⁹³ In addition, the government pledged to present additional legislation in Spring 1997 based on the final proposals of the ARBOM Commission.

The ARBOM Commission delivered its final report in early October,⁹⁴ and it mostly adhered to the principles announced in March. The basic ideas behind the proposal were to merge the daily cash benefit (KAS) with the union funds, increase the minimum level of compensation, and limit the right to benefits to 600 days. Moreover, the new system is designed to be stable in the long term, independent of economic swings. Initially, the new system would cost more than the current system, but by the year 2000, the new system would be cheaper.

The Commission adhered to the basic structure of the current system in that the new insurance was proposed to consist of two parts. An obligatory system with a fixed level of compensation would provide 6,500 kronor per month.⁹⁵ In addition, a voluntary

⁹¹As a result of reforms passed the previous Spring, the budget process was streamlined. The September 1996 budget bill was the first under the new system. The budget year is now the same as the calendar year, and the introduction of expenditure ceilings is intended to increase the financial discipline in the budget process.

⁹²*Proposition 1996/97: 1.*

⁹³Another switch was to now call the recipients "(job) seekers" instead of "insured" persons.

⁹⁴During the thirteen months the ARBOM Commission worked, the government dealt with seven bills about unemployment insurance.

⁹⁵This amount (295 per day) is still higher than the minimum provided by KAS (230).

system would provide about 80 percent of lost income.⁹⁶ The report recommended raising the income ceiling later since many wage earners would have income above this ceiling. The highest level of daily benefits would be raised to 590 kronor and then indexed afterward to the average wage increase in the labor market.

In order to finance these benefit improvements, the Commission proposed higher individual contributions⁹⁷ and stricter qualifying rules. Stricter qualifying rules were calculated to have an additional effect: preventing the system from becoming a permanent source of income for those outside the ordinary labor market.⁹⁸ One of the goals of the reform is to make the labor force more flexible, so it should encourage wage earners to move or acquire more training. The right to benefits is limited to 600 days, divided into three periods of 200 days. In order to qualify for a new period of 200 days, wage earners would have to work for six months or participate in a labor market program such as re-training or public relief work. Part time workers would retain the right to supplement part time work with cash benefits. The Commission set the benefit time limit at four years; beyond this, one must qualify all over again.

The proposal also provided protection for those who lose their benefits after four years. After this, one can get the basic insurance for 200 more days. For those over 58, this extra protection lasts until retirement age.⁹⁹ How the extra protection for those who

⁹⁶The highest level of compensation in the voluntary system would be SEK 13,000 per month, or 80 percent of SEK 16,250.

⁹⁷About SEK 25 per month.

⁹⁸The work requirement would be 75 hours per month for nine months during a twelve month qualifying period.

⁹⁹SOU 1996: 150 *En allmän och sammanhållen arbetslöshetsförsäkring*.

lose benefits will be formed would have to be investigated further and legislation presented in 1997. Self-employed can also qualify after one year, compared with two years in the old system.

The ARBOM report was sent out for comment until December 1, and the government promised legislation in March 1997. However, interest groups did not wait until they formulated their written comments before they voiced their concerns about the commission's proposals. SAF considered the establishment of the new state unemployment insurance fund as only a marginal improvement of a flawed system and repeated its desire for an obligatory system separate from the unions. SAF also criticized the proposed financing structure, arguing instead for the state, unions, and employers to pay equal shares of the financing.¹⁰⁰ In several respects, TCO was positive toward the proposal, since, unlike LO, it had long advocated a universal system. However, the publication of the ARBOM report also provided an opportunity for TCO to criticize the government's legislation from the previous summer. TCO's chief of staff called the report's proposals an improvement over some of the recent benefit cuts but took the opportunity to demand a delay in the implementation of the tougher rules adopted in July.¹⁰¹ In particular, TCO criticized the recent changes and the report for not leading to a "real" universal insurance, arguing that the tougher qualifying rules resulted in less access to benefits. TCO also focused its criticism on the ARBOM report itself, vehemently criticizing the introduction of a time limit on benefits as well as the proposed income

¹⁰⁰SAF, *Pressmeddelande*, October 10, 1996.

¹⁰¹These were scheduled for January 1, 1997.

ceiling. Although the ARBOM Commission proposed an increase in the ceiling, TCO complained that it was not high enough to provide adequate income security for its members. Because maximum benefits have been unchanged since 1993, half of all TCO members are above the ceiling so their actual replacement rate is lower than for those within the ceiling.¹⁰² Only those earning less than 15,500 per month would benefit from the higher benefits proposed by the commission.

Despite these criticisms, the SAP could claim that the proposed reform would provide better benefits than the current system. At the same time, however, the SAP now had the opinion of an official commission of inquiry on its side concerning the role of the unemployment insurance system as a source of temporary cash benefits while the unemployed person looks for another job. Moreover, the commission delivered on its instructions to make qualifying rules more strict.

Despite this momentum, the issues of limited benefits and strict qualifying rules continued to plague the government. In particular, the new work condition attracted much negative attention from the unions because it would mean that about one fifth of those currently receiving benefits would lose benefits after the new year. In addition, TCO pressed for new discussions of alternative forms of financing the system. TCO announced that it could accept the principle of higher individual fees only if more people became eligible for benefits. TCO accused the SAP of caving in to the preferences of the Center Party on this issue since Center has long advocated flat rate benefits supplemented with

¹⁰²TCO, *TCO om ARBOM-utredningen*. Pressmeddelande, October 10, 1996.

voluntary insurance.¹⁰³

In their official comment statements, both the LO and TCO followed up on their earlier criticisms of the ARBOM Commission report. TCO directed its harshest criticism toward the tougher qualifying rules, restricted benefits for university students,¹⁰⁴ and the time limit on benefits. TCO argued that the proposed system would hit its members particularly hard; many TCO members have income above the ceiling for which they receive no benefits, and many work part time. Two out of three TCO members have income above the benefit ceiling and would not profit from the proposed increase in benefits.¹⁰⁵ To address this problem, TCO argued for an increase in the income ceiling, equal to that governing sickness insurance. On the issue of qualifying rules, TCO reiterated its earlier criticism of the current and proposed rule changes, arguing that many wage earners, including TCO part time workers, would lose their benefits. While not opposed to the principle of limited benefits, TCO announced that it could only accept the time limit if there are better measures for those who risk losing benefits. However, TCO agreed with the emphasis on the system as an adjustment system and not a permanent means of support.¹⁰⁶

In the midst of this ongoing criticism, parliament was set to address the budget bill for 1997. Although the budget bill contained no new cuts in unemployment insurance, Social Democratic and Center Party members in the parliamentary labor market committee

¹⁰³TCO, *Pressmeddelande* October 23, 1996.

¹⁰⁴The new study rules mean that the right to study and get benefits at the same time is limited.

¹⁰⁵Many TCO members do not even get 70 percent of wages because of the ceiling.

¹⁰⁶TCO remiss to SOU 1996:150. November 11, 1996.

used the committee's decision power to delay implementation of the rule changes adopted the previous summer.¹⁰⁷ Specifically, the committee voted to cancel the legislation concerning qualifying income calculations and to delay the new tougher qualifying rules for unemployment insurance, including the time limit on benefits, both scheduled for implementation on January 1, 1997. The committee vote to reverse the previous summer's legislation resulted from decisions made in both the SAP and Center Party's parliamentary groups. Because the delay would increase costs, the Riksdag approved an extra appropriation to the unemployment insurance system to cover the shortfall. The committee's rationale for delaying implementation was to give the government more time to come up with an integrated proposal in the Spring. Despite the decision to delay the cuts, the committee emphasized that this was not an agreement to stop them altogether. The parliamentary finance committee followed the lead of the labor market committee and agreed that the new rules should be delayed. However, both committees agreed on the retention of the new time limit on benefits.

In the wake of these setbacks and continued criticism from the unions, the SAP initiated negotiations on the upcoming legislation with both the LO and the Center Party in January 1997. Minister of Labor Margareta Winberg carried out parallel talks with Wanja Lunby-Wedin of LO and Elving Andersson and Anders Ljunggren of the Center Party. The negotiators accepted the ARBOM Commission's proposal to combine the union funds with flat rate benefits, so discussion centered on three central issues: the work condition, the level of benefits, and the time limit on benefits. In February, the SAP, LO and Center

¹⁰⁷*Finansutskotts betänkande 1995/96:15; Arbetsmarknadsutskotts betänkande 1996/97:7.*

Party agreed on the principles for the new system: an increase in benefits to 80 percent of qualifying income in October 1997¹⁰⁸ and modifications in both the time limit and work condition. The time limit remains, but only in principle. The negotiators agreed to appoint a parliamentary commission to iron out the final proposals on the time limit, as well as the issue of how to handle benefits for part time workers. This move effectively prevents the implementation of a time limit for five years. Compared to the rules in effect at the time, the agreement included stricter rules governing the work condition, but the proposed rules are less stringent than those adopted the previous summer and delayed by parliament in December.¹⁰⁹ The negotiators also agreed on less restrictive eligibility rules for part time workers and university students, a revised formula for calculating qualifying income,¹¹⁰ and the introduction of a non-union insurance fund that would nevertheless be administered by the three main union confederations, LO, TCO, and SACO. The agreement is fully financed with a hike in member fees of about 20 kronor per month. The government presented its bill to parliament on March 14, 1997¹¹¹ and it passed easily with the support of the Center Party.

Negotiations concerning improved benefits and strict qualifying rules were relatively trouble-free compared to the issue of the benefit time limit. The time limit has

¹⁰⁸The ceiling will rise to SEK 580 per day, or SEK 12,800 per month, an increase of SEK 400 per month compared to the current rules. Flat rate benefits also increase to SEK 240 per day.

¹⁰⁹The proposed work condition is six months of work during the previous twelve months, compared to the current requirement of five months. The previous Summer, the SAP and Center Party agreed to increase the number of months of required work to nine, but as noted, Parliament prevented this from taking effect in January 1997.

¹¹⁰Qualifying income will be the income during the months the unemployed person earned his right to benefits.

¹¹¹*Proposition 1996/97: 107.*

been the source of the most division between the SAP and LO, and in the end, the LO prevailed in preventing the benefit time limit from reaching the implementation stage, effectively overturning the SAP-Center Party decision from the summer of 1996. Since the time limit first became a goal of reform during the bourgeois government's tenure in 1993, LO has consistently opposed it and argued that such a limit could not be considered without a specific plan for providing income support for those who lose unemployment insurance benefits. Shifting the costs to the municipalities through increased social assistance spending was not an option. With the latest legislation, the reprieve would last until 2002 at the earliest.¹¹²

It is tempting to interpret the February 1997 agreement as a return to SAP-LO cooperation on major social policy issues. Such a conclusion is unwarranted, however, because the agreement merely postpones any decision on the deeply divisive issue of a benefit time limit. In fact, the agreement was formulated such that each of the three parties to the negotiations could claim that they got what they wanted concerning the time limit on benefits. The SAP and LO could claim that the time limit was off the table for the time being; no unemployed wage earners would lose benefits for at least five years and by that time, alternative means of compensation for those without benefits were promised to be in place. The Center Party was not particularly enthusiastic about delaying the introduction of the time limit, but consented to the agreement when LO and SAP supported a statement of principle that the reformed system would be a temporary

¹¹²Because of the time required for a commission to investigate reform, the earliest date a parliamentary decision on a benefit time limit could take place is 1999, and with the new rules, the limit could only take effect in 2002 at the earliest.

adjustment insurance. In effect, the SAP and LO were having it both ways: they agreed on the time limit in principle, but could delay its content and implementation for five years. Clearly, both the LO and SAP calculated that during these five years, improvements in the labor market would obviate the need for such a drastic measure.

TCO was notable for its exclusion from the negotiations on the new insurance system, and the agreement did little to address TCOs concerns about the low level of the income ceiling and the increase in member contributions for TCO members. TCO complained about its exclusion from the negotiation process and accused the SAP of ignoring its concerns. The bourgeois parties also criticized the agreement. The Liberals responded critically to the news that the time limit would not be introduced. And the Conservatives accused the SAP of caving in to the LO.¹¹³ SAF's executive director Göran Tunhammer responded to the news of the agreement by saying that once again the government had put the problem off to the future. Tunhammer reserved his harshest criticism for the cancellation of the planned benefit time limit as well as high costs of the program. SAF argued that the fee hike was insufficient.¹¹⁴

Conclusion

Between 1991 and 1997, both bourgeois and Social Democratic governments have imposed significant losses on the unemployed as well as on the union members and/or taxpayers who finance their benefits (table 6.3). Retrenchment has occurred not via large-scale radical reform, but through an extended incremental process of cutbacks.

¹¹³*GöteborgsPosten*, February 12, 1997.

¹¹⁴SAF PM February 12, 1997.

Policymakers have reduced nominal benefits, tightened eligibility, increased payroll taxes and individual contributions, and frozen benefit indexing. As in pension policy and sickness insurance, unemployment benefit policy outcomes confirm Pierson's argument that universal programs are not invulnerable to significant retrenchment. Despite these cuts, the unemployment insurance system experienced the least retrenchment relative to the pension system and the sickness insurance system.

Given the spectacular increase in program costs between 1991 and 1997, it is surprising that benefits were not cut even more. The method of trust fund financing attracted attention to the huge deficits in the system, and should have created opportunities for policymakers to legislate deep cuts in benefits. This was not the case, however. In contrast to retrenchment initiatives in pensions and sickness insurance, policymakers abandoned the principle of program self-financing. In 1992, ear-marked payroll taxes and individual contributions ceased to cover program expenditures; by the time this method of financing was abandoned in 1995, it covered only one third of program costs. That governments continued to permit extraordinary financing of unemployment benefits demonstrates the enduring political support for the program. This aspect of the reform process demonstrates that even in the wake of serious trust fund crises in individual programs, policymakers still have choices about how to respond. In short, although program structures influence the setting of political agendas, outcomes are not pre-determined. That the SAP abolished the trust fund feature of the unemployment insurance system demonstrates that the party leadership understood the negative effects of trust fund deficits on program durability.

TABLE 6.3: Major Changes in Unemployment Cash Benefits, 1990-1998

Reform and year enacted	Impact	Implementation	Parties Supporting
Bildt government 1991-1994			
1991 Increase in membership fees for union funds	Savings of SEK 600 million per year	yes	Li + Ce + CD + Co + ND
1993 Five waiting days introduced Benefits cut from 90% to 80% Indexing suspended	Savings of SEK 6.0 billion per year	yes	Li + Ce + CD + Co + ND
1994 Nationalization of UI Introduction of employee contribution Stricter qualifying rules Benefits limited to 600 days	Savings of SEK 8.5 billion per year	no	Li + Ce + CD + Co + ND
SAP government 1994-1998			
1994 Return to pre-1994 rules, except: Stricter qualifying rules New financing rules	Savings of SEK 2.5 billion per year	yes	LP + SAP
1995 Benefits cut from 80% to 75% Restrictions on part-time benefits	Savings of SEK 2.5 billion per year	yes	SAP + Ce
1995 Eligibility rules tightened	Savings of SEK 1.3 billion per year	yes	SAP + Ce
1996 Benefit time limit introduced Eligibility rules tightened	Savings of SEK 500 million per year	no	SAP + Ce
1997 Raise in benefits to 80% Eligibility rules tightened Increased indiv. contribution Benefit time limit delayed until 2002	Financially neutral	yes	SAP + Ce

Several other aspects of program structure explain the durability of the unemployment insurance system. The issue of administration was especially important. Although benefit cuts were controversial, this issue was not nearly as divisive as the

question of whether the state or the unions should administer the system. The Bildt government fought hard to end the union monopoly on income-related benefits only to see its reform overturned within a few months when the Social Democrats returned to power. The issue of state vs. union administration of benefits had little to do with budget savings and everything to do with union power. By nationalizing the system, the Bildt government hoped to weaken one of the most important bases of union power: recruitment through the union unemployment insurance funds. Unable to secure SAP cooperation, the Bildt government chose confrontation, playing right into the hands of the SAP in an election year. Whereas the SAP was willing to cooperate on benefit cuts, it was entirely unwilling to accept the nationalization of income-related benefits. The LO was not about to accept this outcome either. More than in any other welfare state policy area, the LO mobilized its resources to ensure that the benefit funds remained firmly in union hands. This is a particularly strong piece of evidence illustrating the importance of policy legacies in welfare state politics.

Retrenchment outcomes in unemployment insurance demonstrate very clearly the continued political importance of the labor movement in welfare state politics. Although the program has been cut substantially, retrenchment has occurred more or less on labor's terms. The inability of the Bildt government to end the union monopoly for more than a few months is clear evidence of this. This is not to say that labor is united in its preferences concerning unemployment benefits. As the discussion in this chapter shows, several issues continue to divide the SAP and the LO. Although the SAP and LO negotiated an agreement on what is likely to be one of the last steps in the reform cycle,

they delayed discussion on the issue of limiting the duration of benefits. Clearly, both sides are waiting for an improvement in the labor market to reduce the salience of this issue. Nevertheless, the analysis shows that when the SAP and LO join forces, retrenchment is very unlikely.

That the SAP and LO mobilized considerable resources to ensure that the unemployment funds remain under union administration is explained by the importance of this policy area to the labor movement. More so than the pension and sickness cash benefit system, the union-administered unemployment funds contributed substantially to the resources of both the Social Democratic Party and the LO. Neither the SAP nor the LO was willing to relinquish this arrangement. With benefit cuts already causing friction between the SAP and LO, the SAP was loathe to risk further confrontation. Because the issue of administration had little to do with program costs, the SAP also risked little in terms of financial effects on the budget by defending the union monopoly.

One segment of the labor movement which has clearly been disadvantaged in the retrenchment process is TCO. Prior to the recession of 1991-1994, TCO members were not among those usually hit by unemployment, and unemployment benefits were not tailored to their needs or expectations. The relatively low income ceiling for benefits is one indication of the historical irrelevance of unemployment benefits for white collar workers. The recent recession dramatically altered this picture, however, and for the first time, many TCO members faced unemployment. In the wake of these developments, TCO pushed for benefit changes that would assist newly unemployed TCO members, but with only limited success. Moreover, TCO was excluded from the 1997 negotiations between

LO and the SAP which resulted in legislation presented to parliament in March. In sum, TCO has been the biggest loser in the retrenchment process. Unless unemployment ceases to be a problem for TCO members in the near future, unemployment policy is likely to contribute to the erosion of the blue collar-white collar coalition supporting Social Democratic welfare state policy.

CHAPTER 7: CONCLUSION

This chapter summarizes the findings of the case studies and discusses their implications for future research in two areas: welfare state retrenchment and the relative influence of domestic and international variables on domestic policy processes. This study argues that retrenchment was most successful in the case of sickness insurance and work injury insurance and least successful in unemployment insurance. Old-age pensions constitute a case of moderate retrenchment. To support these conclusions, this section provides several sets of indicators for estimating the degree of retrenchment across policy sectors.

Considering the high level of scholarly interest in retrenchment processes, there are surprisingly few studies which actually attempt to measure the magnitude of retrenchment. Pierson, for example, provides guidelines for measuring retrenchment, but does not apply these systematically in his case studies of retrenchment in the USA and Britain.¹ However, the welfare state literature does point to two methods of estimating retrenchment; the first is based on the use of expenditure and revenue data while the second is based on the construction of an index of decommodification. The former approach would track program spending changes over time in order to estimate the financial value of social welfare cutbacks, while the latter approach would compare changes in decommodification levels over time. Because of the difficulty of constructing a decommodification index, this

¹Paul Pierson, *Dismantling the Welfare State? Reagan, Thatcher, and the Politics of Retrenchment* (Cambridge: Cambridge University Press, 1994).

chapter relies on indices derived from revenue and expenditure data.²

Estimating the degree of retrenchment which occurred between 1990 and 1998 will necessarily yield only very crude measurements of retrenchment. The aim here is not to arrive at a precise measure of retrenchment, but rather, to provide a rough approximation of retrenchment which can be used to compare the degree of change across programs. The indicators used in this section rely on two dimensions of policy design: program benefits and program financing.³ As argued throughout this study, focusing on retrenchment solely in terms of benefit reductions provides an incomplete picture of retrenchment politics. For example, benefits may remain constant at the same time that the burden of financing benefits is shifted from employers to wage-earners, or from employers to the state. Thus, there are two types of information necessary for estimating retrenchment: changes in program spending over time and changes in the distribution of program financing between employers, wage-earners, and the state.

²On the concept of decommodification, see chapter three. The foremost practitioner of the “decommodification approach” to measurement is Gøsta Esping-Andersen. Esping-Andersen constructs an index for measuring decommodification based on data from 18 welfare states. Although Esping-Andersen’s indexing method is useful for identifying distinct regimes of welfare statism, it is ill-suited to the task of measuring retrenchment in specific policy areas, unless retrenchment has been radical. Esping-Andersen’s index formula permits the classification of program features only in terms of high, medium, and low decommodification. Even though the index includes several different program characteristics, it cannot capture important changes in program rules which may not warrant a change in score from, for example, high to medium decommodification. In other words, even after accounting for program changes, the cases examined in this study would probably still achieve decommodification scores similar to those assigned by Esping-Andersen based on 1980 data. Finally, Esping-Andersen’s index underplays or ignores two aspects of program structure: financing and administration. Thus, we need some measurement method which takes into account greater differentiation in program structures as well as changes which do not constitute radical retrenchment. Gøsta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton: Princeton University Press, 1990).

³As argued throughout this study, the issue of who administers social welfare programs is potentially as important as who benefits and who finances. However, because of the difficulty of constructing quantitative indicators for changes in administration, this issue is not considered in this section.

Figure 7.1 presents aggregate expenditure data and program expenditure data for the period 1980 to 1998 as a percentage of GDP. As the figure shows, total public spending on social insurance peaked at 21 percent of GDP in 1994 and declined to 17 percent of GDP by 1998. Other “small states in world markets” experienced similar reductions in social security spending (see figure 7.2) but the trend is particularly strong in Sweden.

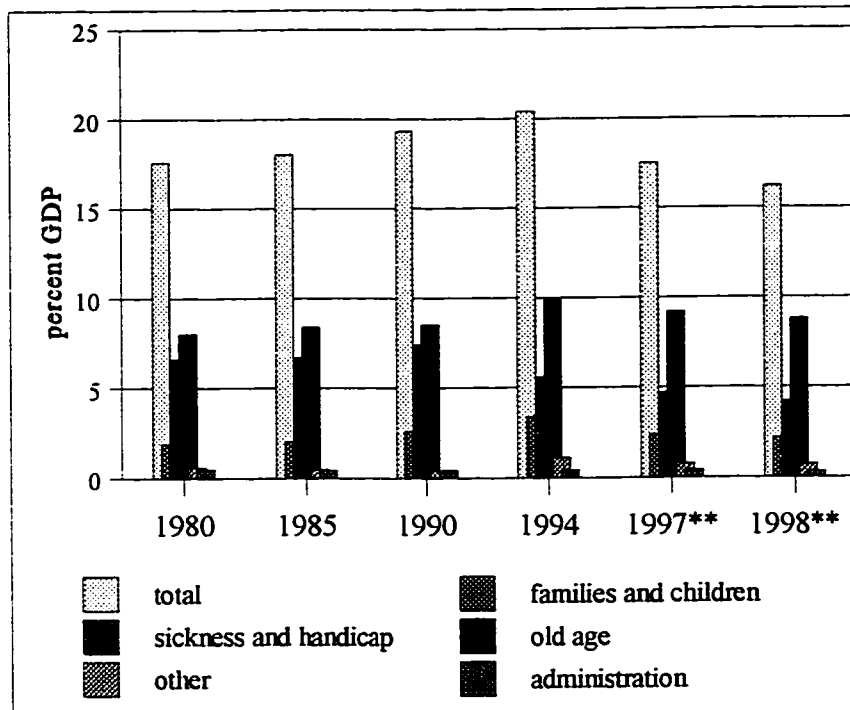


FIGURE 7.1: Social Insurance Expenditure as Percent of GDP*

Source: Ministry of Finance, *The Swedish Budget*, various years.

Notes: *does not include unemployment insurance

**forecast

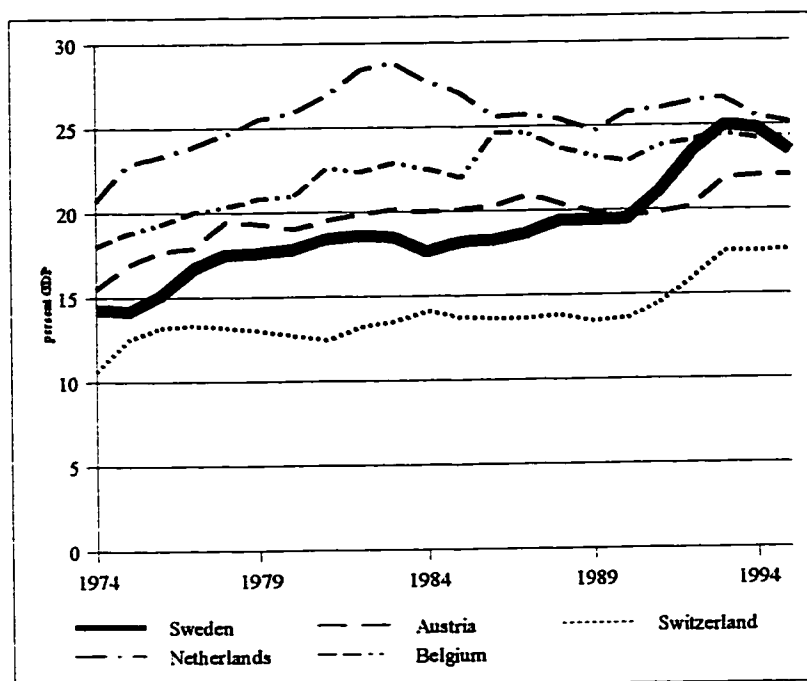


FIGURE 7.2: Social Insurance Expenditure in Sweden, the Netherlands, Austria, Switzerland, and Belgium 1974-1995. Source: OECD, *Historical Statistics*.

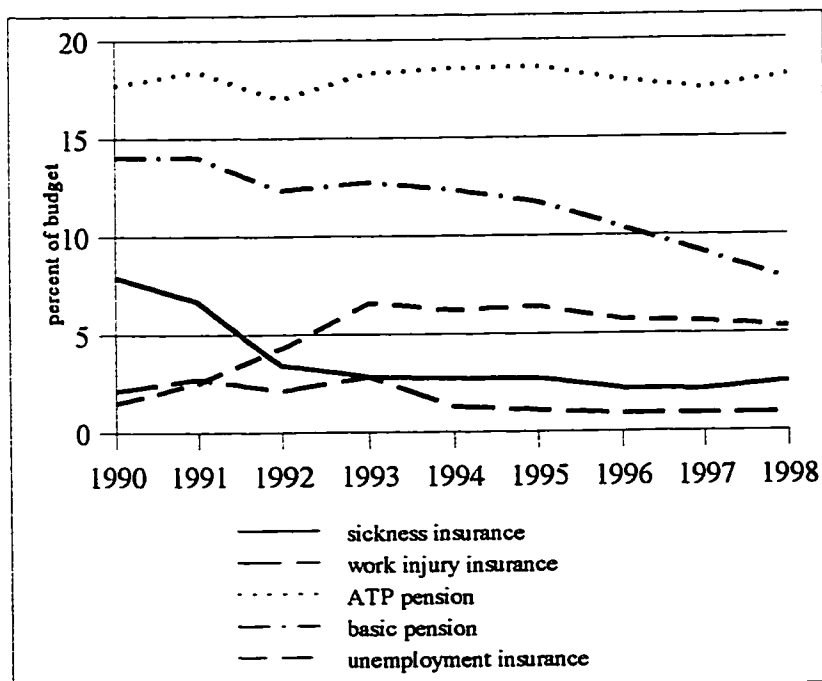


FIGURE 7.3: Program Spending as Percent of Government Spending 1990-1998

Source: SCB, *Statistisk årsbok för Sverige*; and Ministry of Finance, *The Swedish Budget*, various years.

Despite the overall reduction in social insurance expenditure, there was considerable variation in the extent to which specific programs were cut. As figure 7.3 shows, the sickness insurance system, the basic pension scheme, and work injury insurance experienced sharp declines in expenditure calculated as a percentage of total government spending between 1990 and 1998. In contrast, ATP pension spending remained fairly constant, and unemployment insurance spending rose dramatically. Table 7.1 and Figure 7.4 show the percentage change over time in program spending as a share of the government budget. As pictured, unemployment insurance spending increased by 253%, while sickness insurance registered the greatest cut in budget share, 68%.

TABLE 7.1: Percent Change in Program Spending 1990 and 1998

	1990	1998	percent change
sickness insurance	7.90	2.50	-68.00
work injury insurance	2.10	0.90	-57.00
ATP pension	17.70	18.10	+2.20
basic pension	14.00	7.70	-45.00
unemployment insurance	1.50	5.30	+253.00

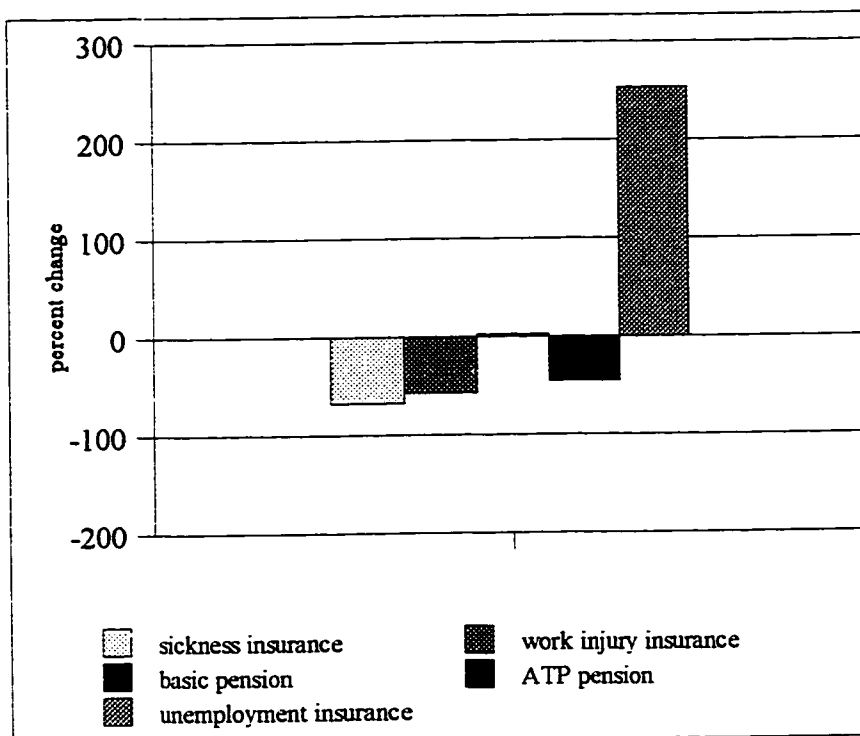


FIGURE 7.4: Percent Change in Program Spending as Percent of Government Spending 1990-1998

Source: Ministry of Finance, *The Swedish Budget*, various years.

Table 7.2 and Figure 7.5 present an estimate of the magnitude of retrenchment in financial terms across policy sectors for the period 1990 to 1998.⁴ In terms of the absolute magnitude of retrenchment, the basic pension system and the sickness insurance system experienced the highest degree of retrenchment, with unemployment insurance undergoing substantial spending increases.

⁴Figures were calculated according to the following method: the 1990 percentage share of government spending for each program was multiplied by the amount of the government budget in 1998 to arrive at an estimation of program spending as if no retrenchment had occurred. The actual program spending amount for 1998 was then subtracted from the "no retrenchment" 1998 number in order to arrive at the estimation of program spending increases or decreases.

TABLE 7.2: Estimated Financial Value of Retrenchment 1998. SEK millions.

	1990 actual spending	1998 with "no retrenchment"	1998 actual spending	approx. cut/increase
sickness insurance	34,983	54,826	17,119	-37,707
work injury insurance	9,389	14,574	6,051	-8,523
ATP pension	77,406	122,838	125,300	+2,462
basic pension	60,982	97,160	53,403	-43,757
unemployment insurance	6,556	10,410	36,443	+26,033

Source: Ministry of Finance, *The Swedish Budget*, various years.

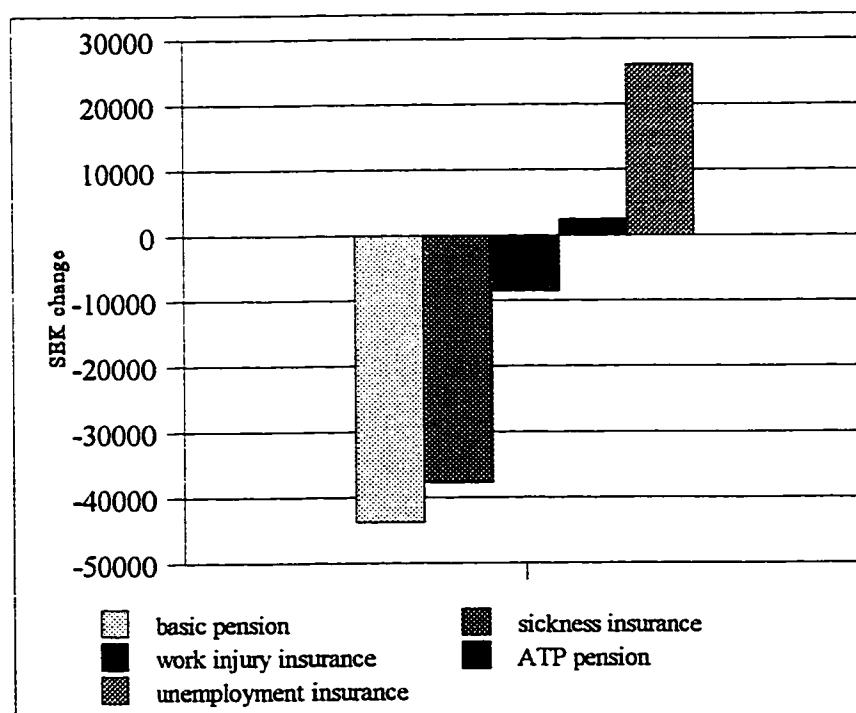


FIGURE 7.5: Difference in Program Spending, 1990-1998.

Source: RRV, *Social Insurance Statistics. Facts*. (Stockholm: RRV, various years); Ministry of Finance, *The Swedish Budget*, various years.

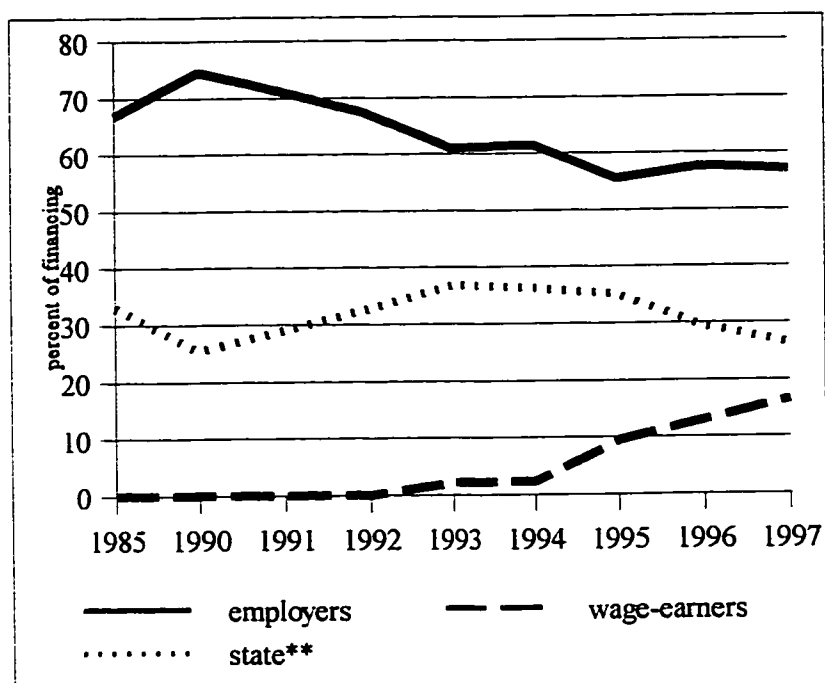


FIGURE 7.6: Social Insurance Financing*

Source: RRV, *Social Insurance facts*.

note: *includes partial pension.

**may include fund income.

The indicators of retrenchment in program spending lead to the following two sets of rankings, one based on the percentage of change in actual spending, and the other based on the estimated absolute financial magnitude of retrenchment. As table 7.3 shows, retrenchment outcomes in terms of spending cuts strongly support the qualitative findings of this study: retrenchment was greatest in sickness and work injury insurance and least successful in unemployment insurance. Although the magnitude of financial savings was greatest in the basic pension system, this is partly due to the transfer of disability pensions from the basic pension scheme to the sickness insurance system in 1998. Thus, the data

probably overstate the estimated savings achieved in the basic pension system.⁵

TABLE 7.3: Retrenchment Rankings* for Spending Cuts.

	percent change	rank	absolute change in SEK millions	rank
sickness insurance	-68	1	-37,707	2
work injury insurance	-57	2	-8,523	3
basic pension	-45	3	-43,757	1
ATP pension	2.2	4	2,462	4
unemployment insurance	253	5	26,033	5

Note: Programs are ranked relative to each other, not against a measurement standard. 1 represents the greatest retrenchment, while 5 indicates the least retrenchment.

Turning to the issue of financing, the overall trend is toward lower levels of financing provided by employers and the state with a concomitant increase in the share of program costs financed by wage-earner contributions. As figure 7.6 shows, the employers' share of social insurance financing peaked in 1990 at 76 percent and declined to 58 percent by 1997. At the same time, wage-earner contributions increased from zero to 18 percent of program costs, and the state's share of financing dropped from 32 percent in 1990 to 28 percent in 1997.

Changes in the distribution of financing differed significantly across policy sectors, however. Figures 7.7, 7.8, and 7.9 illustrate changes in the distribution of financing between the state, employers, and wage-earners in three of the policy areas examined in

⁵See chapter five.

this study, the sickness insurance system, the ATP pension system, and the basic pension system.⁶ As discussed in the case study chapters, substantial increases in wage-earner contributions to the sickness insurance system facilitated a substantial shift in the distribution of financing in the ATP pension system (see figures 7.7 and 7.8). Overall, individual program data confirm the general trend in financing shown in figure 7.6.

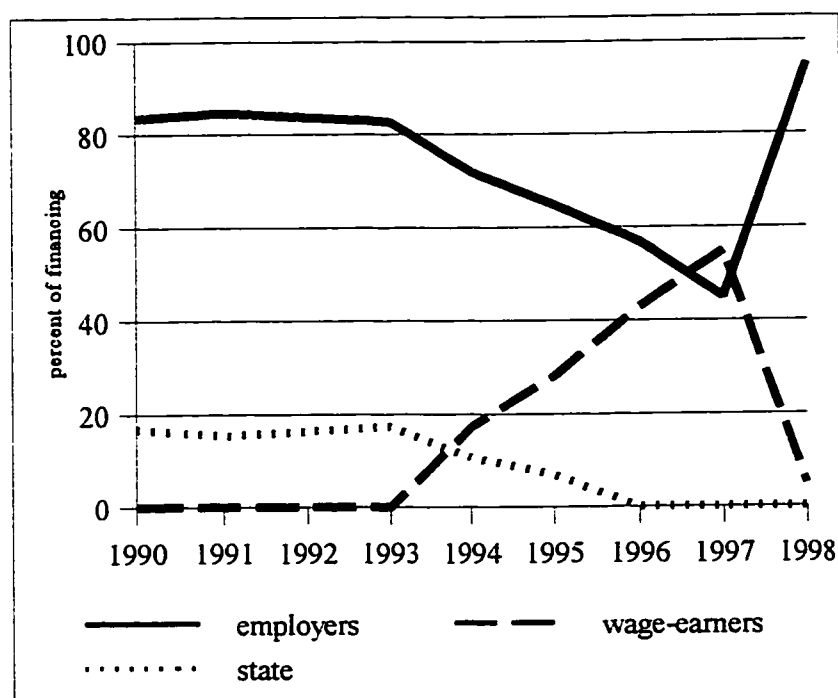


FIGURE 7.7: Sickness Insurance Financing.

Source: RRV, *Social Insurance facts*; SCB, *Statistisk årsbok för Sverige*.

⁶Comparable data for unemployment insurance and work injury insurance were not available so figures for these two programs are not included here.

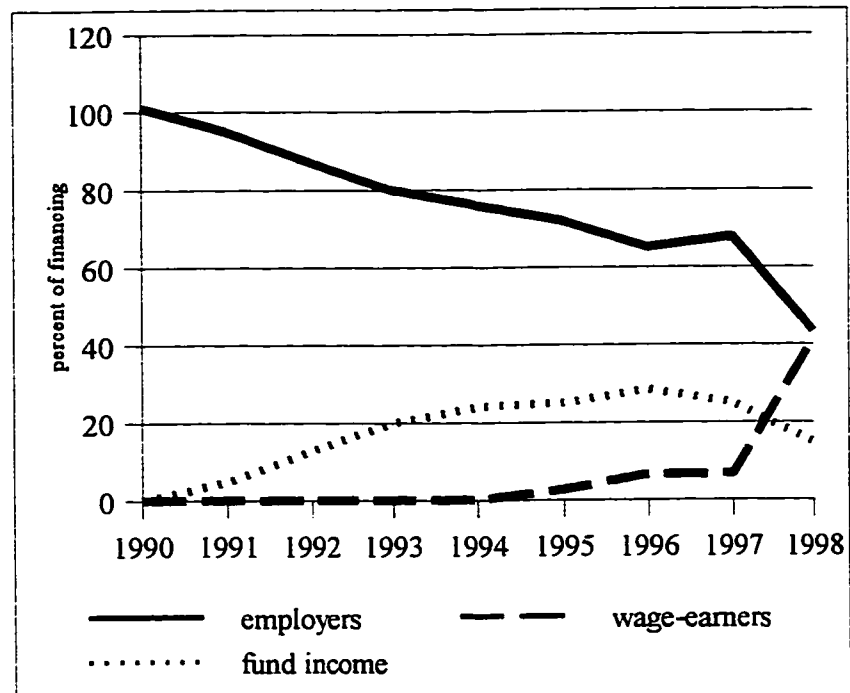


FIGURE 7.8: ATP Pension Financing

Source: RRV, *Social Insurance facts*; and Ministry of Finance, *The Swedish Budget*, various years.

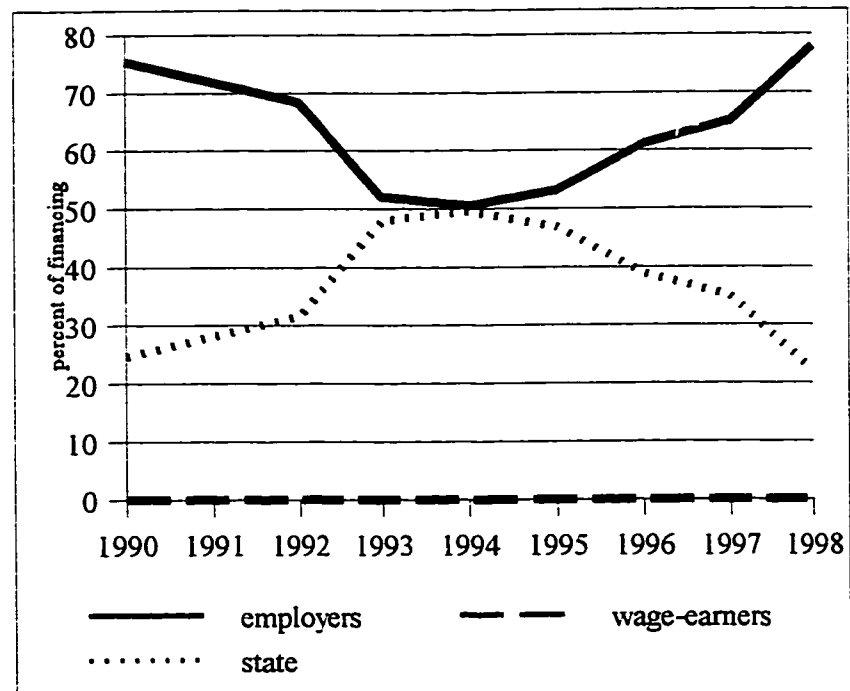


FIGURE 7.9: Basic Pension Financing.

Source: RRV, *Social Insurance facts*; and Ministry of Finance, *The Swedish Budget*, various years.

The five programs can also be ranked according to the degree of retrenchment which has occurred through changes in program financing rules. Table 7.4 summarizes the distribution of financing between the state, employers, and wage-earners for 1990 and 1998 for all five programs analyzed in this study. Changes in the employers' share of financing is then used as an indicator of financing retrenchment.⁷ As the results indicate, retrenchment rankings are very different in terms of financing rules compared to retrenchment in program spending. Because of the substantial switch in the distribution of financing in the ATP pension system, this program receives the highest retrenchment ranking, with sickness insurance ranked last. However, these results obscure the changes that took place between 1990 and 1998, including the large decrease in employer financing of the sickness insurance system until 1997.

⁷Esping-Andersen argues that decommodification increases when wage-earners do not contribute to the financing of income maintenance programs. Thus, to the extent that wage-earners pay payroll contributions or income taxes which finance program costs via the state's share of financing, the employers' share of financing should provide the best approximation of retrenchment.

TABLE 7.4: Percentage Distribution of Program Financing 1990 and 1998.

	1990			1998			% change in employer share of financing	rank
	employ- ers	wage- earners	state*	employ- ers	wage- earners	state*		
sickness insurance	84.0	0.0	16.0	95.0	5.0	0.0	+13	5
work injury insurance	100.0	0.0	0.0	100.0	0.0	0.0	0.0	2
basic pension	75.4	0.0	25.6	78.0	0.0	22.0	+3.4	3
ATP pension	101.0	0.0	0.0	43.5	41.5	15.0	-57.0	1
unemploy- ment insurance	92.0	8.0	0.0	100.0	0.0	0.0	+8.7	4

note: *For the ATP system, the state's share is the same as financing provided by fund income.

The data presented in this section yielded three sets of retrenchment rankings according to changes in expenditure and financing rules. Adding all three scores produces overall retrenchment rankings which support this study's conclusions concerning the extent of retrenchment in specific policy sectors. As table 7.5 shows, retrenchment rankings are highest for sickness insurance, work injury insurance, and the basic pension system. As noted, 1998 spending and financing levels probably overestimate the degree of retrenchment in the basic pension system. Thus, even though the basic pension system is ranked as a case of high retrenchment, it does not contradict this study's finding.

TABLE 7.5: Retrenchment Rankings*

	spending rank (table 7.3)	financing rank (table 7.4)	sum of rankings	overall rank
sickness insurance	1 + 2	5	8	1
work injury insurance	2 + 3	2	7	
basic pension	3 + 1	3	7	
ATP pension	4 + 4	1	9	2
unemployment insurance	5 + 5	4	14	3

Note: *Lower numbers indicate increasing levels of retrenchment.

The findings presented in the previous section are broadly consistent with recent research concerning the causes and extent of welfare state retrenchment in Sweden and elsewhere. In two recent studies, Huber and Stephens attempt to quantify retrenchment by analyzing expenditure and benefit level data in 18 OECD countries in order to assess the degree to which social welfare programs have been rolled back. Huber and Stephens find that old-age pensions were the most resistant to retrenchment in Sweden, with unemployment insurance and sickness insurance experiencing moderate cuts. Although the results of this study demonstrate a somewhat different variation in outcomes, this is probably due to two differences concerning data. First, Huber and Stephens' data extend only to 1994 so their results may underestimate the degree of retrenchment in, for example, sickness insurance. Second, Huber and Stephens' reliance on aggregate expenditure data means that their analysis does not reveal what only detailed case studies demonstrate, namely, that there may be significant retrenchment occurring even in the

absence of spending cuts.⁸

The preceding exercise in estimating the extent of retrenchment in three distinct policy areas raises the following question: to what extent are these fundamental changes? Few would argue that the cases of retrenchment analyzed in this study constitute radical departures from the social democratic welfare state regime. All three social insurance systems are still based on universal eligibility and provide relatively good benefits. Nevertheless, considering the supposed difficulties of imposing losses on large segments of the electorate, the results are striking. The pension and sickness insurance system were subject to partial privatization, and all three programs provide benefits which are significantly less decommodifying than they were in 1990. Thus, 1998 program structures represent a substantial, but not radical departure from pre-existing policies.

Comparing Retrenchment Outcomes The Impact of Internationalization

The literature on internationalization and globalization offers little insight into the ways in which capital mobility generates pressures for specific domestic policy changes, especially in the welfare state. The current state of the field is characterized by the polarization of viewpoints into two camps. One group of scholars argues that internationalization generates very little in the way of reform pressures, while a second group asserts that capital mobility renders certain left-wing economic and social policies

⁸John D. Stephens, Evelyne Huber, and Leonard Ray, "The Welfare State in Hard Times," in Herbert Kitschelt, Peter Lange, Gary Marks, and John D. Stephens, eds., *Continuity and Change in Contemporary Capitalism* (Cambridge: Cambridge University Press, forthcoming); and Evelyne Huber and John D. Stephens, "The Politics of the Welfare State After the Golden Age: Quantitative Evidence," Paper presented at the 1997 Annual Meeting of the American Political Science Association, Washington, D.C., August 28-31, 1997.

obsolete.⁹ This study takes a somewhat different approach by specifying the causal mechanisms which link international economic processes to pressures for change in specific policy areas.

As I argue in chapter one, the processes of productive capital mobility, financial capital mobility, and Europeanization influence social insurance programs in different ways. Program structure is the critical variable through which international economic processes are channeled into political preferences for change. For “small states in world markets” like Sweden, maintaining the competitiveness of the export sector is the key to generating economic growth and employment. Depending on their structure, specific programs provide critical information to political actors about the relationship between the welfare state and competitiveness.

The extent to which program design influences political actors’ perceptions about the cost, use, and supply of labor in the export sector has important implications for social insurance politics. Because labor costs are the largest component of operating costs, the cost and use of labor are likely to figure prominently in debates about how to regain market shares under conditions of declining competitiveness. This is so because reducing labor costs is the quickest way to reduce export prices and thereby regain market shares. It is here that program structures enter the picture. To the extent that the operational and financing features of specific social insurance programs are linked to concerns about declining competitiveness, the pressure for retrenchment is likely to increase. This argument is supported by the evidence presented in chapters three, four, and five.

⁹See footnote six in chapter two.

One aspect of policy design, financing structure, was the target of fierce criticism by export industry. Until 1991, all four of the programs analyzed in this study were characterized by the exclusive reliance on employer payroll taxes to finance program costs. Taken together, these four programs accounted for nearly 87% of employer payroll taxes in 1990. Thus, all four programs contributed significantly to non-wage labor costs. The employers organizations seized on this issue, arguing that the level of these charges harmed competitiveness. Although employers criticized both individual program contributions and the overall level of employer contributions, employers focused most of their criticism on the latter.¹⁰ Policymakers across the political spectrum responded with substantial reductions in the overall level of employer contributions, mainly by transferring the costs to wage earners in the form of individual payroll taxes. This was clearly a concession to the employers, although the employers did not get the level of reductions they demanded. Still, by 1998, employers paid 33.03% of payroll in contributions, a reduction of 15% from 1990 levels (38.97% of payroll).

A second aspect of program structure which was specifically singled out as detrimental to competitiveness was the impact of sickness and work injury benefit rules on the use of labor as a factor of production. As argued in chapter 5, cuts in sickness and work injury insurance were earliest and deepest precisely because of the strong impact that these two programs had on the productive conditions of export industry. Employers claimed that rising sickness absence rates created a drag on labor productivity. Lacking

¹⁰In other contexts the employers did criticize the financing structure of specific social insurance programs because of the weak link between contributions and benefits. However, this criticism had little to do with non-wage labor costs and more to do with concerns about the overall tax burden.

any credible alternative explanation for the effects of sickness absence and the causes of low productivity, the SAP and unions tacitly accepted this criticism and agreed to reform. The credible threat by export firms to relocate production abroad no doubt intensified the pressures created by information feedback from specific program structures.

Program financing structure also mediates the relationship between financial capital mobility and policy preferences about specific social insurance programs. Because integrated bond markets tend to punish governments running large budget deficits, the information provided to policymakers via financing structures is likely to influence policy preferences in important ways. All four programs were designed to operate either as actually existing trust funds or fictitious trust funds, creating a trust fund driven politics. As program deficits increased, the state stepped in with extraordinary financing. I will return to the issue of trust fund politics below, but the essential point here is that, except for the ATP system, the contribution of each program to the budget deficit was easy to trace. Rising budget deficits and capital outflows led to high real interest rates, heightening the vulnerability of these programs to retrenchment. It is important to emphasize that negative bond market reactions to overall government fiscal policy *increased* the trust fund driven vulnerability of these programs.

The impact of EU membership was greatest in pension retrenchment and negligible in unemployment insurance, with sickness and work injury insurance showing moderate impact. Two aspects of program structure account for this outcome: the structure of financing and the vulnerability or “openness” of program rules to beneficiary mobility. Both of these effects of EU membership have little to do with specific EU policies;

instead, they follow from negative integration in the EU, or the impact of the internal market on take-up rates and benefit financing rules.

The shift to strict residence rules for basic pension eligibility is the clearest case of the impact of negative integration in the EU. Although this rule change would no doubt impose losses on many residents, it was enacted with little opposition precisely because the vulnerability of the basic pension system to beneficiary mobility was so clear cut. Because the basic pension system provided an acceptable flat-rate minimum income to all residents over 65, the threat of even a small number of persons moving to Sweden to claim benefits was enough to generate support for tightened eligibility rules.

The impact of negative integration on the ATP system, sickness insurance, and the work injury insurance system is more difficult to estimate. Although the employers and non-socialist parties warned that EU membership would require drastic reductions in the tax burden, especially employer contributions, this argument had little impact on actual policy deliberations. It is tempting to interpret the trend toward recommodification in the ATP system, sickness insurance and work injury insurance as part of an attempt by policymakers to reduce the openness of these programs to beneficiary mobility. Because programs which provide “earned” benefits are more resistant to beneficiary mobility than more decommodifying programs, the retrenchment outcomes in the ATP system, sickness insurance and work injury insurance can be said to support the hypothesis that EU membership results in social insurance recommodification, even if intentions cannot be

confirmed with empirical evidence.¹¹ Given the continued unpopularity of EU membership in Sweden, it is not surprising that this potential impact of EU membership was not discussed in official policy deliberations.

These arguments about the impact of international economic processes on domestic social policy choices raise a number of implications for future research. First, the analysis suggests that program structure is a crucial variable mediating the impact of international economic variables on domestic policy preferences. Because the general pressures of internationalization are fairly well-understood, future research would benefit from attention to the relative vulnerability or durability of different types of social insurance policy designs. Two dimensions of program structure are likely to determine the extent to which social insurance programs are vulnerable to the forces of internationalization: financing arrangements and labor productivity effects. The arguments and evidence presented in this study suggest that social insurance programs financed exclusively or mostly by employer payroll taxes are vulnerable to retrenchment because of their contribution to non-wage labor costs. Thus, social insurance schemes financed by general revenues or individual payroll taxes should be more resistant to pressures for change arising from capital mobility and increased competition. Similarly, social insurance programs which rely on deficit-prone trust fund financing are likely to be susceptible to pressures for reform arising from the impact of financial capital mobility on national fiscal policy. Policy designs which provide for self-financing and preclude the emergence of

¹¹Stephan Leibfried and Paul Pierson, eds., *European Social Policy. Between Fragmentation and Integration* (Washington, D.C.: Brookings, 1995).

program deficits should thus be more adaptable to financial capital mobility pressures.

The impact of policy design on labor productivity is also likely to influence the extent to which internationalization triggers demands for retrenchment. Generous benefit rules affecting the use of labor as a factor of production are viable only as long as productivity is rising and firms can maintain competitive export prices. This suggests that a certain degree of recommodification is inevitable in social insurance programs providing paid absence from work, unless governments, firms, and/or unions can find ways to reduce absenteeism without resorting to benefit cuts. This argument appears to be borne out by recent sickness insurance retrenchment efforts in Germany and the Netherlands.¹²

The analysis presented in this study points to a second implication for research about the effects of internationalization: the impact of negative integration within the EU. Most research on the impact of EU membership on welfare state policies focuses on the prospects for “Social Europe.” However, it appears likely that EU membership will influence welfare state policies much more through the de facto effects of market integration than through proactive policies adopted at the EU level. Although many scholars have highlighted the ways in which the Maastricht convergence criteria reduce the scope for domestic economic policy autonomy, few arguments have been advanced about the interaction of negative integration and national social policy designs.

A third implication arising from the present study is the need for more attention to the interrelationships between national wage bargaining arrangements and social welfare

¹²See, for example, Jelle Visser and Anton Hemerijck, *'A Dutch Miracle' Job Growth, Welfare Reform and Corporatism in the Netherlands* (Amsterdam: Amsterdam University Press, 1997).

policies. As argued in chapter 1 and demonstrated in the cases studies, social policy retrenchment becomes a default strategy for promoting external adjustment when centralized wage bargaining fails to keep wages in line with competitiveness. For large, institutional welfare states such as those found in Scandinavia and some continental European states, the interdependence between industrial relations and welfare state regimes is likely to be a major factor influencing whether or not pressures for retrenchment arise in the first place.

Fourth, research concerning the impact of internationalization on domestic politics would benefit from more careful attention to the ways in which domestic economic structure mediate the influence of capital mobility. The most important aspect of economic structure is likely to be the structure of business. Economies characterized by the dominance of large multinational firms should be far more vulnerable to the effects of productive capital mobility than economies characterized by the preponderance of small firms with close ties to the domestic economy. In other words, the structure of business will influence the extent to which capital exit is a credible threat.

Finally, untangling the relationship between domestic and international influences on domestic policymaking requires closer attention to actual political decisionmaking processes in individual states. Cross-national studies relying on aggregate data are not likely to reveal very much about the causal mechanisms linking internationalization and domestic policy choices because such studies preclude close analysis of the perceptions of political actors responding to internationalization. A process tracing approach is best suited to such an undertaking because it permits the researcher to identify whether and to

what extent political actors actually seem to be responding to distinct processes such as capital mobility and Europeanization. Careful analysis of individual cases of retrenchment will contribute to settling the theoretical controversy concerning the extent to which internationalization affects domestic politics.

The arguments advanced in this study imply that there is still considerable scope for ambitious welfare state goals. However, as argued throughout, internationalization does create specific types of reform pressures, depending on program structure. Still, these pressures did not determine outcomes. Politics still matters and politicians do have choices about how to respond to internationalization.

Organized Interests: the Continued Importance of the Labor Movement in Welfare State Politics

As Pierson argues, the political costs of retrenchment are very high.¹³ Even in the presence of large budget deficits and capital outflows, policymakers intent on reducing the size and scope of public social insurance programs face considerable obstacles arising from the general unpopularity of program cuts. Moreover, even when economic constraints are formidable, retrenchment is not automatic.¹⁴ In other words, economic constraints are a proximate rather than immediate cause of retrenchment. Political actors must be able to capitalize on economic constraints and use them as a resource for mobilizing support for unpopular retrenchment initiatives.

This study argues that the political importance of organized labor in retrenchment politics depends on interest group structure. Pierson has shown that the development of

¹³Pierson, *Dismantling the Welfare State?*

¹⁴Kurt Weyland, "How Much Impact Do Economic Forces Have?" *Journal of Public Policy* 16: 1 (1996).

welfare state policies influences the structure of interest group formation and strength.¹⁵ As argued in chapter two, however, Pierson's conclusion about the declining importance of organized labor in retrenchment politics is largely based on his selection of two countries characterized by segmented, pluralist, interest group structure. This study takes Pierson's central insight about interest groups as mobilizers of opposition to retrenchment in a different direction. By choosing a case in which interest group structure is characterized by solidaristic, centralized, encompassing organizations, I have tried to make the case for bringing labor back in to the study of retrenchment.

As chapters three, four, and five demonstrate, the labor movement has been the principal actor in the retrenchment process. However, this finding does not imply the vindication of the labor power resources approach to welfare state development. As the case studies show, the labor movement was the pivotal actor in the retrenchment process, decisively influencing the form that retrenchment would take. But labor was often internally divided, with successful retrenchment coming only after the Social Democratic Party more or less imposed its will on the LO. This was the case in pension and sickness insurance reform. This is not to say that the LO had no influence in pension and sickness insurance reform. On the contrary, LO interests were informally represented because of the regular links between the party and the LO. Thus, LO opposition to pension and sickness insurance reform, when it occurred, must be interpreted as symbolic protests to changes that the LO leadership deemed inevitable and necessary. On the other hand, when the party and unions were united in their opposition, as they were concerning

¹⁵Pierson, *Dismantling the Welfare State?*

unemployment insurance, retrenchment was unsuccessful.

Understanding why the SAP and LO agreed to retrenchment in pensions and sickness insurance and opposed it in unemployment insurance requires attention to the ways in which different policy areas matter in different ways to the labor movement. Simply put, the SAP and LO mobilized all of their resources to ensure that the unemployment insurance remained firmly under union administration because of the importance of this program to the internal cohesion and organizational strength of the labor movement. In contrast, the SAP and unions were willing to cooperate in the partial privatization of the ATP pension system and the sickness insurance system because of the lower political salience of these two policy areas to the labor movement. Whereas the union-administered unemployment insurance system offered an important selective incentive to union members and thereby encouraged union recruitment, the issue of public versus private administration of the pension and sickness insurance system was not nearly as salient to labor. This is not to say that the SAP and unions welcomed partial privatization in the pension and sickness insurance system. Rather, the party and unions were simply not willing to expend the political resources necessary to keep both systems completely public. In other words, partial privatization of pension and sickness insurance were a necessary evil for both the SAP and LO.

Most research on social welfare retrenchment assumes that interest groups affected by proposed cutbacks will always oppose retrenchment. As argued in chapter two, this will not always be the case. Under what conditions, then, will interest groups accept policies which will hurt their members? In other words, when will interest groups act in

an “other regarding” rather than “self-regarding” manner? This question is crucial for explaining why the labor movement accepted the necessity of retrenchment in Sweden. The emergence of a veritable fiscal crisis of the state can hardly be overemphasized in accounting for the labor movement’s cooperation in retrenchment. As Schwartz argues, fiscal soundness is the “hidden precondition” for the social democratic welfare state.¹⁶ Social democratic and union leaders realized that unsustainable budget deficits undermined the fiscal foundations of the welfare state. To the extent that labor leaders wanted to maintain the system in its current form, deficit reduction was a top priority. Rising deficits would siphon resources from social welfare spending. With a tax burden among the highest in the OECD, there was little scope for covering debt payments with increased taxes. In short, bringing the deficit down trumped concerns about maintaining benefit levels. The flight of productive and financial capital from the country exacerbated the urgency of this task.

In fact, Swedish Social Democratic governments had a long history of fiscal rectitude. It was not until the early 1980s that a Social Democratic government had to grapple with high deficits and debt burdens which were accumulated from six years of non-socialist rule (1976-1982). In 1982 and again beginning with the recession of the 1990s, fiscal soundness was a top priority.

Labor’s cooperation in retrenchment must also be considered in light of their concerns about maintaining export competitiveness. Although the party was more willing

¹⁶Herman Schwartz, “Social Democracy going Down or Down Under: Institutions, Internationalized Capital, and Indebted States,” *Comparative Politics* 30: 3, (April 1998).

to accept retrenchment than the LO, both groups were well aware of the putative effects of the social insurance system on the productive conditions of firms. The twin shocks of capital flight and falling domestic production shifted the terms of the retrenchment debate in capital's favor. Swedish capital did not get everything it wanted concerning social insurance reform, but it came closest in sickness insurance and, to a lesser extent, in the pension system. The Swedish Employers Organization had long argued for the introduction of individual risks and an employers period in the sickness insurance system in order to reduce absenteeism. Similarly, the Employers pushed for the introduction of actuarial principles and a premium reserve in the pension system. However, Employers' demands for radical reform of the unemployment insurance system met with little success.

That the labor movement acquiesced to many of the employers' demands for reform demonstrates the importance of organized capital in Swedish politics. The credible threat of exit strengthened the bargaining position of organized capital. However, capital was also able to press its demands on the government because it is highly organized and generally able to present a unified position on social policy issues.

The arguments and evidence presented in this study thus confirm recent research about the importance of divisions within labor movements and the role of organized capital in domestic politics.¹⁷

The Role of Institutions

Recent research in the field of historical institutionalism emphasizes the strategic

¹⁷See, especially, Jonas Pontusson, *The Limits of Social Democracy. Investment Politics in Sweden* (Ithaca: Cornell University Press, 1992).

context within which political struggles are played out. Institutions provide the “rules of the game” for political interactions, channeling decision-making in more or less predictable ways.¹⁸ Several aspects of Swedish institutional structure are important for explaining the varied fates of the pension, sickness insurance, and unemployment insurance systems. First, Swedish political institutions concentrate power in the executive, although the proportional representation electoral system leads to the representation of 5-8 parties in parliament. As argued in chapter 2, the combination of proportional representation and the historical fragmentation of the non-socialist bloc into several competing parties created a context in which the SAP emerged as the pivotal party in the retrenchment process. As discussed above, the SAP had different priorities concerning the four social insurance programs, but once the SAP positioned itself in favor of retrenchment in a specific program, the party’s task was to attempt to minimize the number of veto points it would face. Given the likelihood that at least one of the non-socialist parties would support retrenchment, passage in parliament was assured.

Two potential veto points threatened to derail the SAP’s retrenchment efforts: opposition from the LO, and opposition from within the party itself. That the SAP was usually able to overcome this opposition points to the importance of a second aspect of institutional structure: the internal organization of political parties. As Heclo and Madsen argue, the SAP possesses an enormous capacity to overcome divisions within the party

¹⁸Ellen Immergut, *Health Politics. Interests and Institutions in Western Europe*(Cambridge: Cambridge University Press, 1992).

and between the party and the unions.¹⁹ The SAP leadership was not always able to block opposition from the LO or from status quo supporters within the party. However, the party leadership succeeded more often than it failed. That the SAP joined the LO in defense of union administered unemployment insurance benefits no doubt contributed to the LO's passive acceptance of retrenchment in other areas.

The preceding discussion highlights the importance of a third aspect of institutional structure which influenced retrenchment outcomes: the structure of interest intermediation. As argued throughout this study, the peak organizations of labor, the LO and the TCO, were the principal defenders of the social insurance status quo. Because the Social Democratic Party and the union federations dominated the long period of welfare state development, client groups autonomous and separate from the labor movement did not emerge as they did in other countries. Where such client groups existed, as was the case with the pensioners organizations, they wielded little political clout. Instead, the unions and the SAP have been the critical actors representing the interests of welfare state client groups.

Besides the regular consultation between the SAP and LO, the corporatist system of policymaking in Sweden meant that negotiations between the political parties and interest groups usually took place in the official commissions of inquiry which researched and formulated policy proposals. Additionally, interest groups had the opportunity to voice their opinions about proposed legislation through the remiss, or official comment

¹⁹Hugh Hecló and Henrik Madsen, *Policy and Politics in Sweden. Principled Pragmatism* (Philadelphia: Temple University Press, 1987).

period. In the past, this arrangement served the purpose of integrating relevant interest groups into the decision-making process and incorporating their opinions into policy proposals. The process also served as a platform for compromise, ensuring broad support for final proposals.

In all four cases of retrenchment studied here, there has been a significant departure from the decision-making norms embedded in the investigatory and remiss processes. The political parties consciously excluded interest groups from the commission which negotiated the pension reform, and in the other three policy areas, several one-person commissions produced proposals that failed to result in legislation. Even the commissions that included interest groups produced proposals which had little influence on legislative outcomes. In short, the investigatory process was important only in the case of pension retrenchment, and this is explained by the nature of that particular policy area. Because the pension system affects such a large segment of the population far into the future, reform could hardly be negotiated on an ad hoc, incremental basis. Once the main political parties committed to reform, the commission of inquiry served as a forum for negotiating a broad compromise without interference from interest groups.

Program Structures and Retrenchment Strategies

The arguments and evidence presented in this study confirm Pierson's claims about the importance of existing program structures on retrenchment politics. Five aspects of policy design were particularly important factors influencing retrenchment strategies and the likelihood of success. First, "lock-in effects" played a critical role in pension retrenchment but were relatively inconsequential in sickness and unemployment insurance.

Lock-in effects, or the sunk costs of previous policy choices, seriously constrain retrenchment options. Because of the overwhelming dominance of the public pension system in the retirement planning of most Swedes, a radical privatization of the existing system was virtually impossible. In contrast, the sickness and unemployment insurance systems displayed little in the way of lock-in effects. Because sickness and unemployment were risks which were either non-existent or of short duration for large segments of the labor force, the design of these two systems had negligible impact on the planning decisions of individual wage earners. Even the scaled back systems of income support for sickness and unemployment would still provide an acceptable, albeit lower, standard of living.

The long term importance of the pension system also provided opportunities for the incremental implementation of benefit reductions. The most significant changes in the pension system will be phased in over two decades, so benefit cuts will occur well into the future. The incremental nature of the reform's implementation no doubt contributed to the defusion of opposition.

The availability of private alternatives to public programs was also an important influence on retrenchment strategies and outcomes. In none of the three cases was there a fully functioning private market to insure the risk in question. However, the sickness insurance and pension systems provided opportunities for partial privatization. Because of the relative rarity of private pension schemes, radical privatization was impossible. However, the emergence of a fully functioning capital market in the 1980s created opportunities for partial privatization under public supervision. The introduction of a

premium reserve system in the reformed pension system will radically decrease the role of the publicly administered AP funds in generating national savings and create a very large number of privately managed pension funds. Partial privatization of sickness insurance was even easier to implement. The introduction of statutory sick pay provided by employers did not require the existence of a private sickness insurance market since firms would simply take over the responsibility for paying the first two weeks of sickness absence. The Employers Organization had advocated such a reform for several years, not only because it was argued to bring down sickness absences, but also because of the ease with which this responsibility could be transferred to firms.

Indexing rules proved to be a powerful retrenchment tool and were used extensively in all four cases analyzed in this study. Changes in indexing rules provided huge temporary savings in the pension system, and the introduction of a new benefit calculation index based on lifetime earnings is likely to generate large savings far into the future. The pension reform also included two other changes in indexing rules which will play a crucial role in keeping the future pension system in balance: the life expectancy adjustment and the economic adjustment index. As detailed in chapter 3, both indexes allow for reductions in pension benefits if life expectancy rises or if economic growth falls below the threshold required to keep revenues and expenditures in balance. In the sickness insurance system, policymakers reduced the generosity of the index used to calculate qualifying income, resulting in major savings. The ad hoc nature of annual cost of living adjustments in the unemployment insurance system meant that politicians were well-positioned to keep increases below the level of price increases.

Finally, financing arrangements also figured prominently in the retrenchment process. Trust fund financing arrangements characterized all of the social insurance programs analyzed in this study and heightened their vulnerability to retrenchment when program deficits emerged. As Pierson argues, “Trust-fund crises reshape the political debate in ways that facilitate cutbacks. The threat of financial shortages prevents program supporters from keeping cutbacks off the agenda and allows retrenchment advocates to argue that reductions are necessary to save the programs.”²⁰ In all three cases of retrenchment, trust fund crises strengthened the hand of reform advocates. The presence of very large government budget deficits made extraordinary financing by the state impossible and program deficits were widely reported in the media. The case of unemployment insurance reveals the limits of this type of argument, however. Although program deficits were huge, the SAP engineered the abolition of trust-fund financing in order to insulate the program from criticism. Now the state finances unemployment benefits, and programs deficits are much harder to track. That the SAP government arranged for extraordinary financing of unemployment benefits demonstrates the enduring political support for this program and its importance to the labor movement.

Strategies of Obfuscation, Division, and Compensation

Pierson argues that policy inheritances channel retrenchment strategies in specific ways. When facing the difficult task of retrenchment, existing program designs influence whether it is possible for governments to defuse opposition to benefit cuts by using strategies of obfuscation, compensation, or division. The analysis presented in this study

²⁰Pierson, *Dismantling the Welfare State?* p. 174.

provides only partial confirmation of this argument. Although the pension retrenchment process provided ample opportunities for all three strategies, unemployment insurance and sickness insurance reform reveal their limits.

The complexity of the existing pension system created opportunities for several types of obfuscation strategies, centering mainly on the introduction of new indexing rules. Two new indexes will replace the old index which protected the value of pension benefits from price increases: the economic adjustment index and the life expectancy index. Because each index depends on economic and demographic trends which are very difficult to predict, it is almost impossible to forecast exactly how they will affect the future value of pension payments. Similarly, the new lifetime earnings benefit formula includes provisions that grant pension rights for the care of small children and time spent in higher education. Compared to the old benefit formula (best 15 of 30 years), it is very difficult to forecast the future pension benefits of many wage earners. The confusion in the media about the potential winners and losers in the new system is evidence of this complexity.

The rules of the reformed pension system promise to provide benefits equal to or better than those of the old system for several segments of the labor movement, particularly pink and blue collar workers. Thus, the new system attracted support from several LO unions at the same time that it prompted fierce criticism from the white collar unions. Because the reformed pension system divided the labor movement, it was nearly impossible for the white collar unions to mobilize the support of other unions for its opposition to the proposal.

In contrast, strategies of obfuscation, compensation, and division played only a

small role in sickness, work injury, and unemployment insurance reform. Nominal benefit cuts and the introduction of waiting days were highly visible and hotly contested. The strategy of obfuscation was important only in terms of changing the calculation of qualifying income in the sickness insurance system, and this particular retrenchment tool was not significant in terms of cost savings. Finally, strategies of compensation played little role in all three programs.

The preceding review of the role of organized interests, political institutions and policy legacies has several implications for future research. First, this study's focus on the ability of the Social Democratic Party to overcome internal opposition to its retrenchment efforts points to the importance of studying party organization. Because retrenchment requires political leaders to defuse or block opposition, doing so within one's own party is likely to be every bit as important as blocking opposition from interest groups. Pierson's analysis of retrenchment under Margaret Thatcher is replete with examples of the prime minister retreating in the face of opposition from her own party.²¹ In contrast, the Swedish Social Democrats appear at times to be remarkably capable of selling their retrenchment agenda to the party rank and file and the unions.

Second, the analysis in this study also suggests that contrary to Pierson's claims, policy learning may be an important type of policy feedback affecting retrenchment outcomes. Policy learning clearly played an important role in pension and sickness insurance retrenchment while it had almost no impact in unemployment insurance cutbacks. The absence of a policy debate and expert consensus on program weaknesses

²¹Ibid.

helps to explain the resilience of unemployment insurance. That pension and sickness insurance program deficiencies were so extensively studied and so widely disseminated probably helps to explain the relative vulnerability of that program to retrenchment.²²

Finally, the analysis supports recent research findings about the importance of politically defined “need” in accounting for the relative success of governments in cutting public spending.²³ Clearly, the dramatic deterioration of public finances creates a large “policy window.” In retrenchment politics, “need” may also be related to policy learning about possible program deficiencies. To the extent that politicians can successfully argue that retrenchment contributes to the solution of national problems like declining competitiveness and fiscal imbalance, retrenchment may be more likely.

The Future of Social Democracy in Sweden

Both Social Democratic and bourgeois governments have pursued retrenchment in the social insurance system in order to achieve immediate budget relief, and they have focused on structural reform of the social insurance system in order to make it self-financing and thereby resistant to future economic and demographic shocks. In this respect, the desire to make social insurance programs self-financing reflects the goal of *protecting* the welfare state. For the bourgeois parties, the economic crisis provided the strategic opportunity to challenge social democratic hegemony in social insurance policy and advocate changes only recently considered politically impossible. For the SAP, retrenchment has been both a painful necessity brought on by the severe economic crisis

²²Visser and Hemerijck make this argument about the Netherlands. See ‘*A Dutch Miracle?*’

²³Fiona Ross, “Cutting expenditures in advanced industrial democracies: The importance of avoiding blame,” *Governance* 10: 2 (April 1997).

and an opportunity to preserve the basic structure and scope of the social insurance system by correcting its perceived weaknesses. The price of reform, however, is that the social insurance system is less generous and redistributive. Given the enormous prestige the SAP has invested in the social insurance system, a fiscally solvent system resistant to future shocks was clearly preferable to the specter of a possibly much worse fate later on.

The recent election in Sweden resulted in a dramatic setback for the Social Democratic Party and a surge in support for the Left Party. The outcome demonstrates the very real electoral risks arising from retrenchment policies. The Social Democrats remain in power, but they must rely on the Left Party and the Green Party for support in parliament.

The Social Democratic policy agenda of the past several years suggests that the party is taking several steps to insulate the economy from the effects of internationalization. Central government finances are in surplus and the SAP has announced its intention to continue running surpluses of about 2%. The SAP government has also embarked on a plan to encourage the development of small firms. Given the party's disastrous experience with budget deficits and capital flight, both strategies appear to be clear responses to internationalization. Now that the scaled down social insurance system is more resistant to the pressures of internationalization, the Swedish political economy is likely to be much more flexible in responding to shifts in the world economy in the future.

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I. EDUCATION

1998: Doctor of Philosophy in Political Science, University of Washington.
Dissertation: "The Welfare State in the Global Economy. The Politics of Social Insurance Retrenchment in Sweden 1990-1998."

Advisors: Prof. John T.S. Keeler (chair), Prof. Leslie Eliason,
and Prof. Christine Ingebritsen.

1990: M.A. in Scandinavian Area Studies, University of Washington.
Major Field: Scandinavian Politics and Society.

1985: B.A. in Foreign Affairs, University of Virginia.

II. FELLOWSHIPS AND AWARDS

1994-95; 1995-96: FLAS Fellowship in Swedish for Dissertation Research and Writing, University of Washington.

1993-1994: American Scandinavian Foundation Fellowship for Field Research in Sweden.

1993: Roth-Thomson Foundation Fellowship for Field Research in Sweden.

1990: J. Allen Smith Fellowship, Political Science Department, University of Washington.

III. LANGUAGES

Swedish: Near-native proficiency.
German: Very good knowledge.
Danish and Norwegian: Reading knowledge.
French: reading knowledge.

IV. PUBLICATIONS

1. Article on Sweden for the *1997 Collier's Encyclopedia Year Book*.
2. Article on Sweden for the *1996 Collier's Encyclopedia Year Book*.
3. Article on Sweden for the *1995 Collier's Encyclopedia Year Book*.
4. Review of Justin Greenwood, Juergen R. Grote, and Karsten Ronit, eds., *Organized Interests and the European Community* (London: Sage, 1992), in *European Community Studies Newsletter*, Volume VIII, No. 2 Spring/Summer 1995.
5. "Internationalizing the Swedish Welfare State," in *Proceedings of the 12th Annual Graduate Student Conference at the Institute on Western Europe, Columbia University, March 30-April 1, 1995*.

V. PRESENTATIONS

1. "Organized Labor, Policy Feedback, and Retrenchment in Swedish Pension and Unemployment Insurance," to be presented at Eleventh International Conference of Europeanists, Baltimore, February 26-March 1, 1998. A revised version was presented at the Annual Meetings of the Society for the Advancement of Scandinavian Studies, Tempe, Arizona, April 30-May 2, 1998.
2. "Pension Reform in Sweden," presented at a workshop on "Testing the Social Fabric: the Future of Social Policy in Europe, University of Washington, Seattle, January 17-18, 1997.
3. "Social Insurance Reform in Sweden: Domestic and International Sources of Change," presented at a graduate student workshop on the "Distributive Dimensions of Political Economy: European Politics in the High Unemployment Age," Center for European Studies, Harvard University, March 1-2, 1996. A revised version was presented at the Annual Meeting of the Society for the Advancement of Scandinavian Studies, Williamsburg, VA, May 1996.
4. "Leftist Government and Business Confidence: The Swedish Case," presented at the Tenth International Conference of Europeanists, Chicago, March 14-16, 1996. Co-authored with Steven G. Snow.

5. "Internationalizing the Welfare State: Swedish Policy Choices Since 1982," Annual Graduate Student Conference on Western Europe, Columbia University, New York, March 1995.
6. "The Internationalization of the Swedish Welfare State," Annual Conference of the International Studies Association-West, Seattle, WA, October 1994.

VI. TEACHING EXPERIENCE

University of Washington, Graduate School of Public Affairs:

1998: Lecturer
Comparative Administrative Systems (Pb Af/SIS 551)

University of Washington, Political Science Department:

1994-1997: Pre-Doctoral Teaching Associate
Independent Courses: Politics in Scandinavia (Pol S 437); taught in Swedish and English; and Introduction to International Relations (Pol S 203).
TA Courses: Introduction to Political Economy (SIS 401), Introduction to International Relations (Pol S 203), and Introduction to Politics (Pol S 101).

1990-1993: Teaching Assistant for Introduction to International Relations (Pol S 203), Western Europe in World Affairs (Pol S 347), and American Foreign Policy (Pol S 321).

University of Washington, Scandinavian Department:

Summer 1996, 1998, and 1989/90: Teaching Assistant for first year-Swedish.

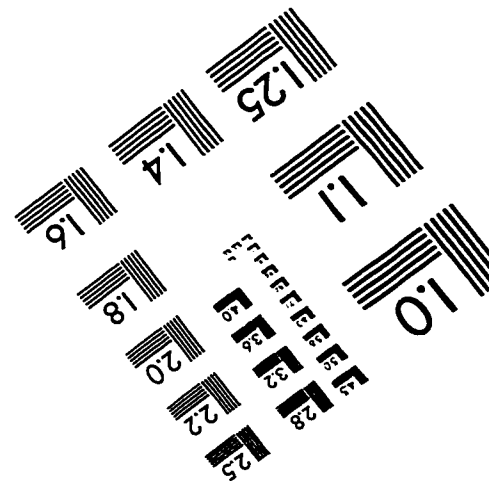
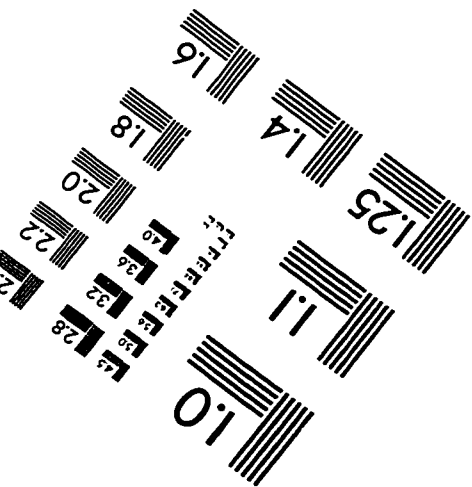
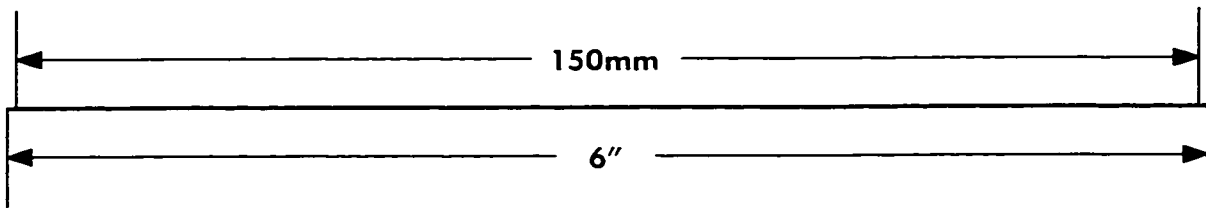
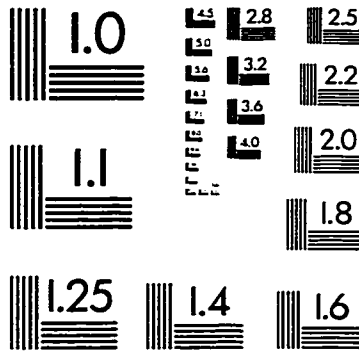
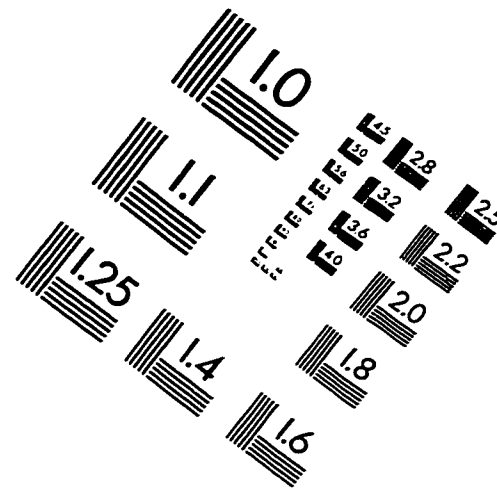
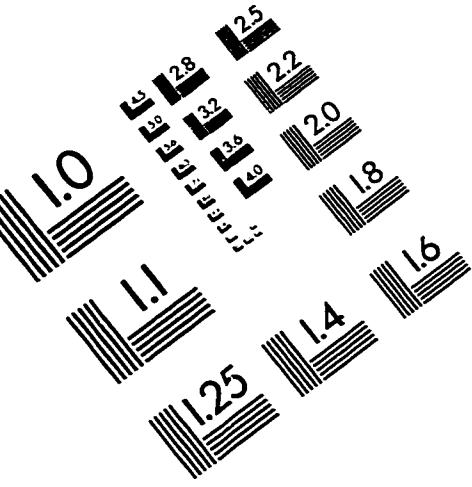
Green River Community College/City of Auburn:

1990-1993: Instructor of Swedish for Senior Citizens.

VII. RESEARCH EXPERIENCE

1991: Research Assistant to Profs. Donald Matthews and Henry Valen, Political Science Department, University of Washington. Compiled and analyzed abstracts of Norwegian political party manifestos for the 1985 election.

IMAGE EVALUATION TEST TARGET (QA-3)



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