



Domestic Institutions and the Possibility of Social Democracy

Mark Blyth

Department of Political Science, Johns Hopkins University, Baltimore, MD 21218, USA.
E-mail: mark.blyth@jhu.edu

This paper examines the institutional context of social democracy. Social democracy is defined here as being composed of two specific goals, the reduction of inequality and the decommodification of labor, combined with a particular institutional means to achieve these goals. The first part of this paper discusses why these goals are so central to social democratic politics and details the institutions that realize these goals. It is argued that if what makes social democratic economic policies possible are specific institutions, then the ability to pursue social democratic policies in the 21st century is severely circumscribed. Specifically, political control of the institutions of domestic credit is seen as critically important for producing social democracy. Through a discussion of two cases of social democratic institutional failure: the United States and Sweden, the paper demonstrates that the absence of such domestic financial institutions means that even with the most optimistic will in the world, the best that social democrats can do, at least at the moment, is to serve as a palliative to neoliberalism. Furthermore, it is argued that if 'globalization' is to be seen to have any constraining effects upon the practices of such a politics, then such constraints are as much ideological as institutional, which makes policy change in the current era ever more unlikely.

Comparative European Politics (2005) 3, 379–407. doi:10.1057/palgrave.cep.6110062

Keywords: social democracy; financial institutions; Karl Polanyi; United States; Sweden; decommodification; inequality; neoliberalism; ideology

Introduction

This paper seeks to answer a very simple question, namely, what is required to have social democratic policies? By this I mean to draw attention to the institutional context within which it is possible to have social democratic economic policies. As election results in Europe during the 1990s laid plain, left parties may be in power all over Europe, but that does not automatically mean that left wing policies are being followed any meaningful sense. This however begs a prior question, namely, what are social democratic economic policies anyway? The triumph of 'supply-side social democracy,' 'New Labor,' 'New Democrats,' and 'New Social Democrats' over the 'old' politics and



policies gives us pause to consider exactly what social democratic economic policies are. After all, if social democratic policies can occupy a policy continuum ranging from the Swedish Wage Earner's Funds to the 'global competitiveness/flexible labor markets/public-private partnerships' of Tony Blair, one has to question exactly what we are talking about in the first instance.

Social democratic economic policies are not simply any policy to do with the economy that a social democratic party pursues. To see such policies as simply derivative of party labels is to make the term 'social democracy' meaningless. As a consequence, I argue here that in order to meaningfully address the *possibility* of social democracy in the 21st century, we have to say what social democracy is, and what it is not. Social democracy is defined here as being composed of two specific goals, the reduction of inequality and the decommodification of labor, and a particular institutional means to achieve these goals. That is, *social democracy is most meaningfully thought of as a set of institutions that makes a particular form of capitalism, and a specific set of institutional outputs, possible.*¹ The first part of this paper discusses why these goals are so central to social democratic politics and details what these institutions and outputs actually are.

Following this discussion of the institutional basis of social democratic economic policies, it is argued that to talk about pursuing social democratic economic policies in the current era is extremely problematic for one very simple reason. What makes social democratic economics possible are social democratic institutions. Therefore, if the institutions that make decommodification and inequality possible are absent, then the ability to pursue social democratic policies is severely circumscribed.² While this point has been made, and more recently unmade, regarding the changing international context of social democracy, for example, that bond markets pressures and inflation-sensitive investors now set the terms of public policy rather than governments, the same point has not been made strongly enough as regards the domestic context.³ In short, even if all global financial integration were halted today, social democracy would not be possible tomorrow. This is simply because the domestic institutions, which made social democracy possible are no longer on the scene. As such, while changed international conditions can constrain social democracy, they cannot account usefully for its breakdown. Given this, the key question becomes, what factors undermined these institutions and what common lessons can be gleaned from the comparative analysis of different cases?

In an effort to answer this question the next part of the paper lays out two cases of social democratic institutional failure. Appropriately, they were 'the first to go' and 'the last to go' namely, the United States and Sweden.⁴ Claiming the US as a social democracy is to swim against the current somewhat (Katznelson, 1989). Nonetheless, I shall seek to convince the reader that from the 1930s to the 1960s, the US was a social democratic regime.⁵



However, beginning in the 1950s with changes in the relationship between the Federal Reserve and the Treasury, and ending in the 1960s with the Kennedy tax cuts and Great Society programs, the United States ceased to be a social democratic state. The US state gave up on social democracy because the domestic monetary institutions that made such policies possible no longer existed. During the Kennedy–Johnson period the attempt by the state to extend the boundaries of its decommodificatory institutions paradoxically undermined its capacity to produce social democratic economic policies. Furthermore, the attempt to produce social democratic outcomes in this altered institutional environment in large part helped to discredit the very decommodificatory policies the state sought to develop.⁶

The Swedish case is juxtaposed to this to illustrate essentially the same dynamics in a ‘least likely’ case scenario, albeit in a wholly different international and domestic context.⁷ Sweden was very much the quintessential social democratic political economy and Sweden was also very much ‘the last to go.’ What ended Swedish social democracy was also the reformation of its domestic financial institutions. Once these were circumvented, the social democratic economic policies that were the outputs of the Swedish model were undermined. However, it is important to realize that these moves were not inevitable. Neither ‘globalization’ nor any other structural factor ‘made them do it.’ What made this possible was agency. In both Sweden and the US, politically motivated business interests and ideologically driven government policies pushed these institutions to collapse.⁸ However, what did become inevitable as a result of these developments was that the inability to practice social democratic economics. Regardless of decisions at the ballot box, the institutions to make this possible were simply no longer there.

This rather pessimistic analysis is interrogated in the conclusion and it is asked whether some Gramscian ‘optimism of the will’ is warranted in this respect? I argue in conclusion that the simple absence of the institutional basis of social democracy means that even with the most optimistic will in the world, the best that social democrats can do, at least at the moment, is to serve as a palliative to neoliberalism. Building upon this claim it is argued that if globalization is to be seen to have any constraining effects upon the practice of such politics, then such constraints are as much ideological as institutional, which makes policy change in the current era ever more unlikely.

What Social Democracy is, and What it is Not: Decommodification and Inequality

Returning to the original problematic of this inquiry, there are two quintessential policies that constitute the ends of social democracy. First is the decommodification of labor through the growth of welfare citizenship



as articulated by scholars such as Polanyi and Marshall.⁹ The second is the reduction of inequality through the redistribution of income and wealth.¹⁰ The decommodification of labor is best understood in relation to its antithesis, the conception of labor embodied in liberal economics. Liberal economics combines an individualist conception of welfare with a negative conception of liberty. Within such a framework it is held that no one can judge the utility of an individual better than the individual themselves (thereby closing the door on collective conceptions of welfare) and thus any action by the state to promote a collective conception of welfare is a violation of such individual rights, as well as being self-defeating.¹¹

It is important to remember that social democratic parties were brought into existence to combat the manifest bias of this doctrine. Such a vision of liberty and welfare ignores both the externalities of individual action and the volatility of markets. Moreover, liberal economic ideas pay little regard to distributionary effects.¹² For social democratic parties on the other hand, labor is no mere factor input in the productive process. Labor is instead seen as a social agent with positive rights. The right to combine, the right to health care, education, welfare compensations, etc., were seen by social democratic parties as prerequisites of economic growth and social peace. Consequently, social democratic parties must address these two failings of the classical liberal state. To put it bluntly, if you do this, then you are a social democratic party pursuing social democratic policies. If you do not, then you are not.¹³ To see why this is, consider a Polanyian analysis of the exigencies of the market system.¹⁴

Why Decommodification and Inequality? The Polanyian Problem

Polanyi argues that it was not until the 19th century that a fundamental condition of capitalism was met for the first time. That condition was the creation of a truly national wage–labor market.¹⁵ Labor was quite unlike other commodities however. As Polanyi argued, labor is a fictitious commodity. Unlike the price of potatoes, *the price of labor was of intrinsic interest to the laborer himself*. This laborer was also equipped with fists and regarded secular price movements, particularly downward movements, as far from simply being the expression of the optimal allocation of capital. As capitalism created disembedded markets with their attendant inequalities, the effect was to politicize labor by situating it in similar locales (thereby overcoming collective action problems), and engender consciousness of these inequalities.¹⁶ As the market system produces greater inequality over time as a correlate of commodification, labor combines and demands political representation and protection from the strictures of the market. As labor is increasingly commodified, labor increasingly demands policies to reverse, or at least limit, that commodification and the inequality associated with it.



Social democracy emerged then as a reaction to the market, with decommodification as its core strategy. The commodification and inequality produced by the market provoked a political and economic crisis which was resolved by the state through the construction of what we refer to as social democratic institutions. By accepting the reduction of inequality and the decommodification of labor as quintessential for capitalism's survival, Social democrats since the 1930s concluded that laissez-faire liberalism had had its day, and the market was now, once again, re-'embedded' in the social fabric of society through the deployment of a series of decommodificatory institutions.

So What Are Social Democratic Economic Institutions?

The comparison of Sweden and the United States suggests apples and oranges, or perhaps even fish and fowl, as comparative cases. Yet the analysis above suggests that despite having seemingly different institutions, both state projects were ultimately concerned with producing very similar economic outcomes. This claim can be made if something very important about social democratic institutions is accepted. That being, what matters are the content of institutional outputs, not the exact policy through which such outputs are obtained. So, for example, whether or not a state practiced deficit financing, or nationalization, or some other particular policy, is secondary to the fact that social democratic policy outcomes (decommodification and a reduction in inequality) were produced through a particular set of institutions. Like ethics, the true test of a party's policies lies in the consequences of actions, not its intentions.¹⁷ In short, although particular policies can vary, the type of institutions, particularly domestic financial institutions, that make this possible cannot.

As we shall see, the 'constrained Keynesianism' made possible by the American institutional environment relied upon tax cuts and monetary policy to produce these results, whereas the Swedes developed a broader set of decommodificatory institutions based upon supply-side credit subsidization. Despite these differences, both America's and Sweden's institutions were designed to do the same thing. That is, to increase consumption and investment, and thereby make possible the extraction of a taxable surplus that was used to decommodify labor and reduce inequality. By doing so consumption and growth were kept high enough that investment sufficient to promote these goals was forthcoming, thus creating a virtuous circle of growth. What this paper stresses in this regard however, is the centrality of institutions that control domestic credit and how central such institutions are for producing social democratic economic policies of inequality reduction and decommodification.¹⁸ Once a government loses control of the supply of credit,



the ability to produce social democratic policies downstream becomes far more difficult; a pattern confirmed in both our cases.

Building American Social Democracy

American social democracy, limited though it was, was constructed out of the need to save American capitalism from the Great Depression, which led in fits and starts to the building of a set of economic institutions known as the New Deal. Building the New Deal institutions of decommodification was especially problematic in the US case. Unlike Western European countries in this period, the US had few national economic institutions of any scope. Thus the New Deal was not just an attempt to build institutions to halt the slump, they were arguably the first modern project in 'state-building' the United States had ever undergone.

After stabilizing the banking system and closing the US economy to international financial flows in 1932 and 1933, Roosevelt's first attempt to build national economic institutions, the National Recovery Administration (NRA), marked the ascendance, not of a social democratic regime, but of quasi-corporatist and associational regime designed to create industry-specific cartels that would regulate prices by fixing them, rather than rely on the market.¹⁹ As such, the NRA was an attempt by the state to build a new institutional relationship with business, and to a lesser extent labor, on the basis of administering prices. Unfortunately, the result of all this effort to halt the depression was minimal. The problem of depression was neither industrial concentration nor monopoly rents, and as such, no amount of cartelization was going to solve the problem. Given the failure of this attempt to build an accommodation with business, the state turned to labor and took the first step towards building social democratic institutions (Blyth, 2002).

The US state had been traditionally very hostile to labor. However, beginning in 1934 the Department of Labor began to advocate minimum wages, health and safety reforms, extensive welfare benefits, and a variety of other decommodificatory measures. Similarly, the NRA itself helped labor organize themselves in so far as it brought labor into the discussions of business and government over the regulation of the NRA price codes, which of course included agreements over wages. However, it was congressional action which was to really re-energize the labor movement.

Despite the Congress of the 1930s having an institutional bias against labor, the extent of the depression and the Democratic avalanche of 1934 made pro-labor reform more possible than ever before, and a small pro-labor constituency headed by New York Senator Robert Wagner pioneered legislation, which transformed the institutional position of labor. Wagner's National Labor Relations Act (Wagner Act) 'encourage[d] the practice and



procedure of collective bargaining,' to protect 'the exercise of workers of full freedom of association... and... designation of the representatives of their own choosing.'²⁰ Furthermore, the Act specified that the right to strike was not to be interfered with, and perhaps most important, the act empowered a new national institution; the National Labor Relations Board (NRLB), which could compel employers to recognize unions. The new industrial union body, the Congress of Industrial Organizations, took advantage of the Wagner Act's provisions and grew rapidly.

The state solidified its alliance with these new industrial unions by passing the Social Security Act. The three parts of the Social Security Act, Old Age Assistance, Old Age Insurance, and Unemployment Insurance, also created national institutions of consumption maintenance that were each designed to decommodify industrial labor by treating it as more than a factor input to be laid off at the first sign of a downturn. While coverage was a function of contributions, the right to coverage was more or less automatic. Together then, as Plotke notes, 'by empowering workers and by re-drawing the boundaries as to who a representative agent with rights is [both on a micro level in the Social Security Act and on a macro level in the Wagner Act], and by excluding business from monopoly privileges over labor and over the use of violence, the Wagner Act [and the Social Security] collectively constituted *a new form of state* by changing the institutional relationship of business and labor' (David Plotke 'The Wagner Act, Again' *Studies in American Political Development* p... 148. My italics).

Despite business opposition to further decommodificatory programs, labor made impressive gains in membership and in its relative share of national income during the war. In this context, business sought to halt any further moves to create a more encompassing set of decommodificatory institutions after the war. In particular, business fought vigorously to restrict the scope of the 1946 Employment Act. Nonetheless the passage of this Act was significant as it mandated, even in its reduced form, that the government pursued 'maximum feasible employment' as the core goal of economic policy (Blyth, *Great Transformations...* pp. 79–84).

After the struggle over the full employment bill and a large strike wave in 1946–1947, business developed a relationship with labor which can only be described as corporatist.²¹ Although restrictions were pressed upon labor in the 1947 Taft-Hartley Act, there was no serious attempt by the state to return to *laissez faire*. In this environment a stable institutional equilibrium began to emerge. Given tight labor markets and high demand, labor, who had traditionally benefited from the pro-active support of New Deal institutions, began to argue that unions should be wholly responsible for contract enforcement, thus cutting out the state. Labor began to realize that in a period of relative prosperity the institutional supports of the state could easily



become institutional constraints. As such these newly secure unions began to prefer accommodation to confrontation (see Harris, 1982 and Goldfield, 1987).

Business on the other hand, while traditionally anti-statist and the main proponent of the free labor contract, began to change their perspective. Rather than seeing the state as a biased and unwelcome intervention, business began to see the advantage of the state as a break on labor. That is, by recognizing labor's core function of bargaining they could legitimately limit their activities in other areas.²² As such, a rough equilibrium of strategies was achieved. This institutional settlement provided a set of classic decommodificatory outputs; full employment, concertation, the reduction of wage inequality and stable national income shares. Arguably, by the 1950s, the US became, despite much business and labor hyperbole, as much of a social democratic state in terms of the outcomes it produced as the UK did in this period.²³

Making American Social Democracy Unworkable

During the 1950s, the American version of social democracy was quietly extended. The 1950 and 1954 amendments to the Social Security Acts brought 18 million new workers into decommodificatory institutions, and such institutions continued to grow under Eisenhower. In 1956 Disability Insurance was established and soon the extension of higher education and quasi-universal health care were seen as achievable and indeed desirable goals. However, beneath the surface institutional changes were taking place that would have serious consequences for the production of social democratic outcomes in the US. This first major change was the 1951 Federal Reserve-Treasury accords.

Social democratic economic policy largely depends upon restricted capital movements internationally and an easy money doctrine domestically.²⁴ That is, independent central banks such as the Federal Reserve present a problem for other social democratic institutions in that by focusing upon price stability and the value of the currency, they can often work at counterpoint to an expansionist fiscal policy. As such, social democratic outcomes are best produced under *dependent* central banks and *restricted* capital movements. Unfortunately, playing such an accommodatory role undermined the autonomy of the Federal Reserve in its traditional role as the guardian of the currency. At its most basic, being 'independent' meant that whatever Congress decided to do in pursuit of the goals of the Employment Act, the Federal Reserve could obviate by holding money tight.²⁵

The reason the relationship between these institutions became contested during the war was that, at this time, the Federal Reserve was under the domination of the Treasury. The rationale for this arrangement lay in the need for cheap credit to finance the war. The Treasury wanted federal debt to be attractive to bond-holders. Consequently, rates were pegged such that



regardless of the volume of bonds issued, the return to those bonds would be guaranteed since the Fed was the designated buyer of last resort, thus creating an easy money framework. As a result of the distorting effect such a policy was having on the creation of domestic credit in the post-war period, after a brief struggle, the Fed regained its independence (see Stein, 1996 and Collins, 1981). However, the consequence of this institutional separation was not to be felt until a decade later when the Kennedy and Johnson administrations attempted to extend social democratic institutions in the 1960s.

The Importance of Institutions: The Democrats Come to Power

When the Democrats came to power in 1960 the institutional context within which social democracy could be pursued had changed markedly. As a result of the reestablished institutional independence of the Fed and its focus on monetary stability and the dollar deficit, monetary policy was to prove no ally in expansion.²⁶ The strategy formulated to overcome this dilemma was developed by Walter Heller, James Tobin, and others at the Council for Economic Advisors (CEA). The CEA felt that the key to recovery lay in changing business' expectations as to the role of government such that an expansionary strategy would be seen as both possible and desirable. In order to do this Kennedy's CEA decided that some public re-education was required on the nature of modern economics and throughout 1962, this is what the state sought to do. A particularly important example of this was Kennedy's speech to the 1962 Yale commencement. In this speech, which was written largely by CEA chair Walter Heller, Kennedy sought to argue that the reason that the economy was not producing as many jobs as possible was simply because business was caught in the thrall of economic myths which have no basis in reality. (*The Public Papers of John F. Kennedy*, 11th June 1962 pp. 470–475). Kennedy sought to examine 'myth and reality in our national economy...[because]...in recent months, the dialog...between business and government... has been clogged by illusion and platitude and fails to reflect the true realities of contemporary American society' (Kennedy, *Public Papers* ...p. 471).

In this speech, Kennedy struck some key social democratic themes. Kennedy suggested that the 'problem' of the increasing size of the government is a myth because only 'big' government can provide those 'goods,' from agricultural stability to scientific research and development, which the private market cannot. Kennedy also sought to dispute 'the myth that deficits create inflation and budget surpluses prevent it,' and then turned to the issue of confidence in the economy and suggested, in the manner of Keynes, that 'the problems of fiscal and monetary policies in the 1960s...demand subtle challenges *for which technical answers, not political answers, must be provided*' (Kennedy, *Public Papers* ...p. 474, my italics). Indeed, Kennedy argued, *such answers have*



already been found in Western Europe where ‘governments, [are] prepared to face technical problems without ideological preconceptions, [and] can coordinate the elements of a national economy and bring about growth and prosperity — a decade of it’ (Kennedy, *Public Papers* ...p. 475).

By stressing the technical and scientific nature of economic management, the state sought to change business’ preconceptions concerning the appropriate role of the state, and indeed the very workings of the economy. The problem with this strategy was that business refused to listen. Business’s deafness on this issue was caused by relations between the state and business that were, from the beginning of the Kennedy period, downright hostile. This hostility came from two sources; the conflict with the steel industry over the implementation of wage and price guideposts in 1962, and the reaction of business to tax reform proposals a year later.

Guideposts for the Deaf

The inflationary control valves in the Kennedy–Heller model were a set of wage and price guideposts, the idea being that increases in wages and prices would be tied to productivity increases. Unfortunately for the state, business was intensely hostile to the idea of guideposts, arguing that they set limits on profits and hence reinvestment. The guideposts were tested when US Steel announced on April 10th 1962 a rise in the price of steel of \$6 per ton, a 3.5 percent increase and a full percentage point above what the productivity guidelines stated. As steel was considered a core industry and wage setting in steel set the pattern elsewhere in the economy, a rise here in price would almost certainly set of claims elsewhere in the economy.²⁷

Kennedy eventually faced down steel companies by a variety of tactics ranging from threatening to place defense orders with companies which did not raise prices to FBI investigations of steel executives. However, when US steel capitulated, the business community as a whole revolted.²⁸ Consequently, the prospects of a rapprochement with business, the reason behind the original attempt at re-education, seemed further away than ever. In this situation of unbridled hostility, the overtures of the CEA regarding the re-education of business into ‘myths’ and the political neutrality of modern economic management fell on deaf ears.

In such a charged environment education into the finer points of social democratic economics was proving pointless, and bribery seemed the better part of illumination. Basically, a strategy evolved between Heller at the CEA and Dillon at the Treasury to promote growth through the fiscal stimulus of a tax cut. However, the tax cut would be packaged in such a way that it would be ideologically palatable to business, thus helping to repair the damage of the past year. Rather than seek to convince business of the logic of the ‘new



economics,' the state now sought to 'dupe' business into supporting a Keynesian stimulus under the guise of a classical tax cut. In short, 'Kennedy...dressed up liberal demand-side Keynesian economics in conservative supply-side clothing and enrolled thousands of the nation's largest businessmen in a profitable association with Democrats, who were planning to use general affluence to improve national economic prospects and their own political prospects (McQuaid, 1990).'

The Revenue Act of 1962 was an attempt to build this 'profitable association.' The main part of the Act was an Investment Tax Credit (ITC) set at 15 percent on capital outlays exceeding a firm's depreciation allowance. The basic idea was that the ITC would encourage greater investment, which would lead to a greater rate of growth.²⁹ Yet despite this huge giveaway, business mobilized *against* the ITC arguing that 'the ITC allowed the government excessive control over private investment decisions' (Martin *Shifting the Burden...* p. 61). By allowing business to paint the ITC as an interventionist policy, the rationale for tax cuts as stimulating investment became ever more difficult. Consequently, in late 1962 the rationale for tax cuts was altered, and in a widely noted speech to the Economic Club of New York in December 1962 the 'new' rationale for tax reduction was deployed for the first time.

Back to the Future

In this speech Kennedy made a series of claims that pleased his business audience immensely. Kennedy noted that the dynamism of the American economy was unique in the modern world. Placing this in a historical context, Kennedy argued that '*interrupted* during the decade of the 1930s, the vigorous expansion of our economy was resumed in 1940 and continued for 15 years thereafter. It demonstrated for all to see the power of freedom and the *efficiency of free institutions...*[which has produced]...the economic health of this nation.'³⁰ Kennedy further argued that in order to aid economic growth 'the most significant kind of federal action possible is to cut the fetters which hold back private spending' (Kennedy 'Speech to the Economic Club...' p. 877, my italics). Kennedy acknowledged there were other ways of boosting growth such as increasing Federal expenditures, 'but such a course would soon demoralize both the government and our economy' (Kennedy 'Speech to the Economic Club...' p. 877). Consequently, the 'best means of strengthening demand is to...reduce the *deterrents* to private initiative, which are imposed by our tax system...In short...the Federal government's role is not to rush into a program of...public expenditures, but to *expand the incentives* for private expenditures' (Kennedy 'Speech to the Economic Club...' p. 877, my italics). In order to do this the most effective policy is to cut '[c]orporate tax rates...to



increase the availability of investment capital' (Kennedy 'Speech to the Economic Club...' p. 878). By doing so 'profit margins will be improved and both the *incentive to invest and the supply of internal funds for investment* will be increased' (Kennedy 'Speech to the Economic Club...' p. 878, my italics). The problem with such a strategy, as it has been traditionally conceived, is that 'what concerns most Americans is...the deficit in our Federal budget' (Kennedy 'Speech to the Economic Club...' p. 879). However, such a concern is misplaced because 'the paradoxical truth that tax rates are too high today and tax revenues are too low...[means that]...*the soundest way to raise revenues in the long run is to cut the rates now*' (Kennedy 'Speech to the Economic Club...' p. 879, my italics).

What is remarkable about this speech is how such a representation of the how the economy worked could ever be seen serving social democratic goals since it effectively delegitimated state action in the production of those goals beyond the cutting of taxes. Kennedy called Heller after he delivered the speech at the Economic club and declared 'I gave them straight Keynes and Heller, and they loved it.'³¹ Unfortunately, 'business loved it' precisely because the decommodificatory economics hidden within the neo-classical wrapping was totally invisible. Business heard only a return to orthodoxy with a state agenda limited to cutting taxes. As Arthur Schlesinger remarked at the time, 'this [policy] might lead some to think that we are abandoning the democratic faith in the support of demand and are instead trying to fight the stagnation on the trickle down theory' (Arthur Schlesinger Jr quoted in Martin *Shifting the Burden...* p. 67). The problem for the state was that while they did not think this was what they were doing, business certainly did. Business it seemed, had not realized that they were being duped. The results of this self-delusion by the state were to prove profound.

The (Not-So) Great Society

The second and final nail in the coffin of American social democracy was Johnson's Great Society Programs. The Great Society programs were an attempt to solidify and expand the American version of social democracy through an extension of decommodificatory institutions. Unfortunately, the Great Society utterly failed for two reasons. First, the institutional logics of the Great Society and the New Deal were completely different. The institutions of the New Deal were demand-side, contributory, and decommodificatory. The institutions of the Great Society were, supply-side, non-contributory, and commodificatory. In fact, their sole purpose was to commodify lumpen-labor. The war on poverty and the programs that it spawned certainly focused upon the reduction of poverty. This however was not the same thing as the reduction of inequality, which is at the core of a decommodificatory order.³² Indeed,



these programs were based upon a singularly liberal assumption, that by freeing individuals from the 'fetters' of market access, poverty would be eliminated since all persons could now share in the growth that tax cuts would bring about. Just as Heller forgot to tell business that they were being duped, the state itself seemed to forget that classical arguments were rhetorical cover, rather than actual public policy.

Second, the targeted constituencies of the Great Society were those left outside of the core New Deal institutions. Yet those inside the decommodificatory institutions were expected to pick up the tab to pay for its extension. Like the tax cuts which preceded it, the Great Society programs were not organically related to the decommodificatory institutions of the 1930s and 1940s. Instead the Great Society programs worked not as a progressive extension of the New Deal institutions, but at counterpoint to them.³³

The problem with these new institutions was that they entailed a consumption loss for those *not* benefiting from the programs. They necessitated a transfer of rents from those 'inside' the original New Deal institutions to those 'outside' of them. Given that the income tax system's redistributory scope had been reduced by the Kennedy tax cuts, the Great Society had to be funded from general taxation. Specifically, most of the benefits were financed through rises in social security taxes, which again meant that those inside the New Deal institutions were being taxed to pay for transfers to those outside of them in the most regressive manner possible.³⁴ Therefore, unlike the institutions of the New Deal, under the Great Society institutions the link between contributions and benefits, the signature of American decommodification and redistribution, was broken. In particular, the Great Society programs quickly became identified by those inside the New Deal institutions as being the exclusive province of immigrants, blacks, urban rioters, and the 'undeserving' poor. As Kevin Phillips perceptively remarked at the time 'The Democratic party fell victim to the ideological impetus of a liberalism which had carried it beyond taxing the few for the benefit of the many [the New Deal] to programs taxing the many for the benefit of the few [the Great Society].' (Kelvin Phillips, *The Emerging Republican Majority*, quoted in Berman, 1994).

The end result of these 'innovations' was the end of American social democracy. With the institutional equilibrium of the 1950s becoming increasingly unstable in the face of these changes, the state had practically no policy instruments to redress the balance. Having given up on active fiscal management due to the independence of the Fed, having abandoned stimulatory consumption focused tax-cuts for supply side tax-cuts, and having grafted new non-decommodificatory institutions onto old decommodificatory institutions, the state effectively reformed its capacity to reform out of existence. To paraphrase Barrington Moore, 'no institutions of social democracy, no social democracy.'



Building Swedish Social Democracy

Swedish social democracy was also constructed in response to the Great Depression. However, the construction of Swedish decommodificatory institutions was quite straightforward in comparison to that of the US. Emerging out of discussions among Social Democratic Party (SAP) deputies, a Committee on Unemployment set was up by the coalition government in 1927 to examine the deep economic crisis of the period.³⁵ The Committee reports were distinctly unorthodox and dealt with issues such as the 'new' (counter-cyclical) business cycle theories, wage formation, unemployment, etc. In power since September 1932, the SAP enthusiastically accepted these new ideas and government embraced the analysis of the committee. The new state argued that it, 'should be given a totally different role than it had before in order to stabilize employment on a high level' (Bergstrom, 1992).

What enabled this version of reflationary policy to be accepted by business was its unique focus on policy goals other than simply getting the economy out of a low equilibrium trap. First, the state resolved to take the stability of the price level as a given and promote the expansion of the economy as a whole, rather than simply attempt to reduce unemployment. Second, inflationary pressures were given a central place, and the state resolved to ensure business confidence by committing to balance budgets over the business cycle rather than over a given financial year. As such, the share of wealth controlled by the government would remain unchanged in real terms, and those of business and labor were to grow in lockstep with one another.³⁶

In order to achieve this, the state had to make the outcomes of these new institutional arrangements positive sum for all parties. The solution was to foster growth through the success of top corporations inside a system of taxation that was redistributive, but which encouraged productivity increases and investment. As Steinmo notes, 'tax reform in favor of larger corporations proved to be the glue that made the historic compromise stick (Steinmo, 1988).' Those largest corporations were given tax concessions predicated upon the growth of their own enterprises. In return the unions got a commitment not to use 'scab' labor or mass lockouts, and crucially, institutional autonomy in its wage negotiations with business's titular association, the Swedish Employers Association (SAF) (see Blyth, *Great Transformations...* pp. 115–118).

The state's trade off with labor was made in the form of an equally firm commitment to full employment. Rather than being merely a political goal, full employment was seen as being desirable on efficiency grounds in that a full utilization of resources facilitates other policy goals. By stressing the *necessity* of full-employment rather than its desirability, the state brokered a deal with business and labor based upon two inviolable principles. First, that full employment is a prerequisite of other policies, and as such becomes the



primary policy goal of the state. Second, that while the market economy should be regulated to produce socially optimal outcomes, private ownership should be held as sacrosanct.

Therefore, by not challenging that most fundamental element of capitalist relations, ownership, and narrating this through the medium of a new set of economic ideas that promoted to the overall goals of welfare and equality, and by predicating all this on a positive sum relationship between all parties, the Swedes developed a conception of the economy and a set of institutions of distribution which served to consolidate social democratic economics within a capitalist open economy framework. In the post-war period these institutions were progressively extended in what became known as the ‘Rehn-Meidner’ model of economic management.

Extending Swedish Social Democracy

The Rehn–Meidner model had three main elements. First, fiscal policy was to be restrictive rather than countercyclical so that demand was kept at a manageable level. Traditionally, excessive demand was seen as a function of too high wages. Rehn argued instead that the problem lay in too high profits.³⁷ As such, keeping profit levels down would encourage employers to be resistant to inflationary wage claims.³⁸ Moreover, capping profit levels through taxation would also have the beneficial effect of transferring private into public savings. These would then be loaned to business at below market rates and used to stimulate the economy in a cyclical downturn. Thus cheap investment funds and taxes together could be provided as the means of tying business into these institutions, while an easy money policy could be followed that was not contingent upon the external balance.³⁹

Despite profit capping, wages still had to be controlled. In order to defeat this problem the second element of the model was introduced, a solidarity wage. The unions through their central confederation (LO) would operate a centralized wage determination policy, which stressed the principle of ‘equal pay for equal work’ across sectors. This policy was designed to force inefficient firms to either increase productivity or go bankrupt, while at the same time further redistributive policy goals.⁴⁰ This ‘solidarity wage’ not only contributed to social equality, it also promoted demand constriction and industrial reorganization by encouraging low productivity firms to either ‘shape up’ or ‘go under.’ The third element of the model, an ‘active labor market’ policy, was designed to make profit capping and the solidarity wage effective by promoting labor mobility through supply-side training, relocation, and investment programs. The point of doing so was to encourage further industrial adjustment and employment maintenance as two sides of the same coin.⁴¹ The institutions of Rehn–Meidner became the institutional centerpiece of the Swedish social democratic state.



Making Swedish Social Democracy Unworkable

Problems with the positive sum politics of Rehn–Meidner began to appear in the 1960s. However, such problems were manageable with the contemporary political machinery. Indeed, the Swedish economy performed well in comparative perspective even during the recessionary period of 1976–1982 until around 1985 with, on the surface, more of the same policies (Bosworth and Rivlin, 1986). Sweden survived the oil shocks of the 1970s better than most, and by 1985 seemed to have successfully negotiated what they termed, well before Tony Blair popularized the term, a ‘third way’ between the deflation and unemployment of Thatcher and Reagan and the inflation and capital flight of the French left. However, just as we saw in the US case, the way the Swedes did this ultimately undermined the very institutions they were trying to save.

In order to avoid both unemployment and inflation, the state sought a solution by increasing the growth of GDP. Such growth would have to be export led and consequently the current account would have to be stabilized. The centerpiece of this strategy was a 16 percent devaluation coming in the wake of a 10 percent devaluation in 1981. At first this policy succeeded remarkably well, and that was the beginning of its problems. Exports rose 10.7 percent in 1983 and 6.5 percent in 1985. Investment grew in 1984–1985 at an average of 16.2 percent. By 1985 the growth in government expenditure had been all but halted, the deficit had declined to a mere 2 percent of GDP and unemployment had fallen back to 2.9 percent.⁴² However, it soon seemed to be the case that the devaluation was too large. Thus the devaluation ‘overshot’ its target and made the economy vulnerable to inflation since imports became relatively more expensive. The problems soon to follow did not lie at an economic level alone however, or to be more accurate, they had political determinants as well as economic effects.

The SAP maintained that while the goals of social democracy remained the same, full employment, greater equality, etc., the very different institutional means employed by the state to achieve these goals, as instantiated in the Swedish version of the third way, implied an effort to restructure the distribution of costs between labor and business. Specifically, what changed most dramatically was how the SAP viewed redistribution as a policy goal (Walters, 1985). Rather than the absolute level of resources being seen to count with distributions being relatively equal, the focus shifted instead to a redistribution of any given level. This change was necessary because the third way devaluation was intended to shift inputs from consumption to investment — from labor to business. As Walters argues, ‘the third way hinged on a strategic redistribution; a long-term rise in profit levels, in order to provide for investment at the expense of wages. Such a shift in resources could not be



justified as equitable, only as economically necessary' (Walters 'Distributing Decline...' p. 362). This shift in the meaning of redistribution was crucial. It constituted an attempt by the state to unilaterally redefine the content of the social democracy away from the decommodificatory combination of efficiency and equity towards a neo-classical view of efficiency and cost control as primary, with equity as a secondary consideration. Unfortunately, this was a combination at totally odds with the logic of existing institutions.

The Swedish third way, as an attempt to resuscitate Rehn–Meidner was almost too successful. As inefficient firms are pushed out of the market and business is further concentrated, the majority of workers end up being employed in leading sectors. Yet because the solidarity wage equalizes income differentials between sectors, some of the major unions in LO, for example, the engineering workers, were in fact being asked to subsidize workers who were not in their respective constituencies. Inter-union conflicts over wages were bound to result and weaken labor. In such a situation, when the state is seen to be abrogating its commitment to equality and universalism through its new 'distribution policy,' when the burden of the solidarity wages plus increased import costs falls all the more heavily on the unions, and when business is reaping profits from what is perceived as a zero-sum rather than a positive sum redistribution, the unions themselves started to turn against the third way.⁴³ As Martin argues, '[t]he higher inflationary impact meant that the real-income cut suffered by most of the population, and the redistribution from labor to business, was larger than necessary, making the burden of securing agreements by organized claimants...larger than it had to be' (Andrew Martin 'Macroeconomic Policy...' p. 10).

By 1985, in response to the redistributionary effects of the devaluation, inflation was increasing at 8.2 percent per year with real wages increasing at 12 percent per year.⁴⁴ The competitive effects of the 1982 devaluation were being undercut and industrial unrest was increasing. Record industry profits were met with calls for wage restraint as the old conception of equal (re)-distribution had been challenged from within. Furthermore, the redistribution from labor to business was not reaping the investment divided it was supposed to. In the face of a simultaneous combination of large profits, high inflation, declining wages, and declining investment, all of which could be related to the 'third way,' the institutions of social democracy were becoming increasingly irrelevant to the problems they had to face. GDP growth was falling to 1.6 percent for 1986 yet wage drift was accelerating to almost 8.6 percent. The net effect of all this was to push to breaking point the institutions, which nourished and reconstituted Swedish social democracy since the 1950s. Yet, what finally broke these institutions was the state's decision to deregulate domestic credit markets. Just as occurred in the US case, when the state lost control over monetary policy, interest rates, and the credit subsidization/solidarity wage/



profit capping institutions, which made Swedish social democracy possible, it became impossible.

The Importance of Domestic Financial Institutions — Again

Under the institutions of Rehn–Meidner, monetary policy largely consisted of keeping interest rates low and avoiding overheating through credit controls. Growing external imbalances in the late 1960s called for a tightening of credit market regulations at the same time as the expansion of the welfare state demanded greater liquidity for housing construction. Consequently, ‘bank portfolios were increasingly concentrated in fixed interest and government bonds at the expense of regular loans to households (Englund, 1990).’ Such loans led to the creation of a so-called ‘gray market’ of finance companies outside of the regulations to facilitate consumer borrowing. In the 1980s this market grew rapidly, and in vogue with the call for deregulation elsewhere, Swedish financial interests began to agitate for a deregulation of these markets (Blyth *Great Transformations...* pp. 223–227).

Doing so presented the SAP with both a cost, that monetary policy would be harder to control, and a benefit, that deficits would be easier to finance. Given the perceived short run costs of the third-way, the Finance Ministry and the central bank enthusiastically embraced the deregulatory impulse. The state began to issue new securities to take advantage of their new credit position and pump the deficit while the new private finance houses began to pump more and more liquidity into the economy. Rather than regulate and offset these imbalances the government instead abolished the bond holding requirements for banks in 1983 thus adding to credit market liquidity. Soon afterwards the restrictions on the foreign purchases of shares were lifted. In May 1985 the Riksbank abolished interest rate regulation and then in November 1985 in the so-called ‘November revolution’ occurred when the Riksbank abolished limits on loan ceilings.⁴⁵

Klaus Eklund, one of the main supporters of deregulation in the finance ministry referred to the existing regime as ‘Swiss cheese, with more holes than cheese.’⁴⁶ Given that the efficiency of the old regulations was being undermined by the ‘gray market,’ the best thing to do Eklund argued, was to let ‘good money drive out bad’ and let the market decide.⁴⁷ The possibility that such a scenario would create a situation of profligate loans and a credit bubble was expected to be obviated by a device called the ‘ranttetrappan’ or ‘interest rate ladder’ that would automatically increase interest rates in line with a greater volume of transactions occurring at the central bank. The ‘ranttetrappan’ however proved to be totally ineffective as a tool of monetary management.

Given the bottled up demand for credit, the situation among banks and finance houses became similar to a multi-player Prisoner’s Dilemma. The



rational thing to do was to loan first and get the good debt. However, in doing so the banks' exposure to credit risk, given the lack of regulations, increased, which made the imperative of getting the good loans to cover the bad all the more important (Jaffee, 1994, 81–82). Rather than the 'ranttetrappan' regulating a slowly increasing volume of loans related to the state of the real economy, the banks fell over each other to give money away as fast as possible and a classic speculative bubble was built up. Given that in an inflationary environment real interest rates fall and the cost of borrowing becomes cheaper, the demand for ever more credit became self-fulfilling as inflation led to demands for credit, which led to further inflation. Unfortunately, because exchange controls had not been lifted this money could not go anywhere else to find a return to repay the loans. As such, all asset prices began to inflate, and in particular, commercial real estate prices skyrocketed.⁴⁸

As the demand for loans increased and assets were sought to collateralize those loans, asset prices were bid up ever higher, thus raising the demand for loans again. However, those loans were secured against these very same assets, so in order to service the debt the asset prices had to continue to rise. As Jaffee notes in such a situation 'the perceived real rate of interest on real estate loans falls even further as investors extrapolate the high current rates of asset appreciation into the future. This leads to...a self-fulfilling cumulative expansion' (Jaffee, 1994, 78). In this environment, it actually became rational for debtors to borrow against inflated assets to pay the loans that had bought the assets in the first place. Meanwhile, it became rational for banks to loan more and more since the decline in real interest rates meant that the banks' returns on assets was falling at an accelerating rate (see Jaffee 'The Swedish Real Estate Crisis...' p. 83).

As with all short run credit booms, the short-term performance of the economy seemed to be very good. By 1989 unemployment fell to 1.4 percent.⁴⁹ However, there was also a crunch just around the corner. As Martin notes, 'the extremely sharp rise in borrowing following the deregulation of the credit market...clearly signaled the breakdown of the third way' (Martin 'Macroeconomic Policy...' p. 20). In the face of this speculative boom, whatever influence over prices and credit formation the institutions of the old order once had were totally obviated. With unemployment at 1.4 percent and an underfunded tax reform in 1990 simply adding fuel to the fire, calls for wage restraint fell on deaf ears and the boom continued. Unfortunately, like all booms, it was followed by a slump.

Between 1991 and 1996 the Swedish economy went through its largest deflation since the 1930s. At the same time as the tax reforms were being implemented the finance company Nyckeln 'suspended payments following major losses on real estate loans...Soon thereafter, the banks began to suffer



major losses themselves' (Dwight M. Jaffee 'The Swedish Real Estate Crisis...' p. 88). Once Nyckeln collapsed, the banks attempted to call in their debts. By calling in loans and increasing interest rates the banks began a general deflation from a very exposed position. This led to 'a general collapse of real estate prices and construction activity' (Dwight M. Jaffee 'The Swedish Real Estate Crisis...' p. 78). By the end of 1993 the total cost of bailing-out these financial institutions was to prove to be 74 Billion Skr (Dwight M. Jaffee 'The Swedish Real Estate Crisis...' p. 89). This downturn also created massive unemployment which rose to over 12 percent in 1992.

This of course created greater pressure on the state in the form of increased transfer payments and hence a burgeoning deficit. However, a slump of such magnitude, which would never have been possible if policy had been formulated to maintain, rather than to compromise the Rehn–Meidner institutions, totally overwhelmed domestic monetary institutions. The budget deficit ballooned to 12 percent of GDP on top of the state's now much heavier debt burden. In this new context, business and the bourgeois parties regrouped, arguing that the policies of deregulation and redistribution were not the problem, which they were in that they worked at counterpoint to existing economic institutions, but that social democratic institutions themselves were the cause of the slump (Blyth, 2001). Paralyzed by the demands placed upon them and obviated by the inability to control the credit system, the institutions of the Swedish model became redundant and Swedish social democracy, in terms of the ability to decommodify labor and reduce inequality, likewise ceased to be a possibility. Globalization had little to do with it — the failure of domestic level regulatory institutions did.

Conclusion: What do the American and Swedish Experiences Tell us about the Possibility of Social Democracy?

I argue that the comparison of these two seeming disparate episodes points to some interesting conclusions. First, despite the very different means of achieving it, both states' domestic economic institutions were fundamentally concerned with producing social democratic outputs, namely; decommodification, labor market concertation, a reduction of wage inequality, and stable national income shares. Similarly, what destroyed the ability of states to provide these goods were domestic political decisions that undermined the institutional arrangements that 'made social democracy work.' In both cases it was domestic choices over credit markets that undermined these institutional outputs. Interestingly then, one of usual suspects invoked to explain the end of such institutional orders — globalization — is conspicuous by its absence. In the case of Sweden, globalization, it seems, had little, and in the case of the US, nothing to do with it (Blyth, 2001).



In both cases a vital institutional component in the production of social democracy was the link between the state and the monetary authority. Once the state loses control of the institutions of monetary policy and credit creation, the ability to produce social democracy is severely circumscribed. Thus for the United States, the separation of the Fed and the Treasury in 1951 inadvertently had the effect of pushing the state towards tax cuts, which had the effect of narrowing the state's room for maneuver ever further. This itself led to the state's attempt to broaden its institutions under the auspices of the Great Society program. However, given the lack of institutional financial means to promote the ends of the Great Society, these programs were financed regressively and based in new institutions that worked at counterpoint to the institutions of the New Deal period. It was here then, not in 1971 with the closing of the gold window, nor in 1980 with the election of Reagan, that American's limited social democracy, and any possibility of social democratic economic policies, ended. Quite simply, the American state reformed its ability to reform out of existence long before the words 'competitiveness' or 'globalization' were ever uttered.

In Sweden a similar pattern emerges. Organized business interests in the 1980s, as we saw in the US in the 1960s, argued for the undermining of state control of credit. In the Swedish case this produced a massive boom and bust in domestic property markets that was used by business and the political parties of the right as a rationale for dismantling the Swedish model. What both these cases show, once again, is the centrality of domestic institutions over international conditions. Having survived the inflation of the 1970s, and the deflation of the 1980s, the argument that 'globalization ended the Swedish model' in the 1990s becomes highly suspect.

First of all, it is temporally wrong. The deregulation of the credit markets that exacerbated the steering problems of the state following the 'third way' devaluation in the 1982 did more to dismantle the institutions of Rehn–Meidner and decommmodification than any amount of bond raiding and currency dumping in the 1990s. Second, this bond raiding and currency dumping was itself a direct function of the deregulation of domestic credit markets. Once the state, *by design*, lost control of investment and credit, Rehn–Meinder's focus on profit capping and solidarity wages was bypassed by the speculation and easy credit of the boom. The bust that followed from these previous policy choices effectively finished the job. The key lesson once again, is that once domestic social democratic institutions are undermined, then social democracy cannot be practiced. A new 'Bretton Woods' could be erected tomorrow, but that would merely treat the symptoms, not the disease.⁵⁰

As such, is any 'optimism of the spirit' warranted? Is there any real possibility of meaningful social democracy in a post-EMU Europe? By focusing upon domestic institutional failure rather than international constraints, what this analysis suggests is that optimism of the will, shorn of



domestic institutional foundations, may be less than useful. Those institutions that promote decommodification and the reduction of inequality evolved as specific responses to a crisis now long past. Short of a cataclysm such as another Great Depression it is highly unlikely that any government could force through a legislative program that could promote these goals.

Yet is such a critique not misplaced? For during the 1990s, and increasingly today, it is held that the ‘new social democracy’ embraced by Blair, Schroeder, *et al.*, is still social democracy in that it promotes high employment and growth. While superficially pleasing, such a response is rather weak for several reasons. First of all, *liberals, neo or otherwise, do not promote low employment and stagnation*. Consequently, there is nothing particularly social democratic about arguing for jobs and growth. It is the distribution which matters and the new ‘supply-side social democrats’ are all but silent on this question.⁵¹

Second, and perhaps more significantly, over the past decade, a profound ideological change has taken place among these new social democrats such that the basic assumptions of neoclassical economics (the NAIRU, the efficient markets hypothesis, the fundamental theorem of welfare economics, rational expectations) have become inculcated as ‘fundamental economic truths’ rather than political positions (See in this regard Colin Hay ‘Normalising and Necessitating? The Role of Rationalist Assumptions in the Genealogy of Neoliberalism’ in Denzau and Roy (2005)). Such an ideological change is particularly important for two reasons. As John Eatwell has argued, accepting such maxims as policy nostrums means that contemporary politicians accept ‘a picture of economic efficiency being dependent upon free markets for goods, labor and finance, and a minimalist state. Market liberalization is...beneficial because it involves the removal of market distortions, which are *by definition* inefficient’ (Eatwell, 1997).

Yet such a perspective tends to forget that social democracy was constructed precisely because of the externalities generated by complete factor markets and a minimalist state; especially the distributional externalities such institutions generate. Unless such mal-distributions no longer pertain, then adherence to such policy norms can only result in a distributional myopia. As Robin Varghese warns us about such ideational adoptions, ‘one should be wary of importing with this methodology the attendant premises of a narrow wing of economics that by definition rules positive state action economically pathological. One need not be a Foucauldian...[or]...a Marxist to realize that “neoclassical” is not a synonym for “correct”, “true”, or “transcendentally appropriate.”’⁵³

Given the combination of institutional changes and ideational challenges, the current constraining effects of the global economy, in terms of the actual material pressures brought to bear on mature welfare states, may be less important in explaining outcomes than the pressure brought to bear by how politicians *perceive* these global pressures. This is not to suggest that ever



increasing globalization is not a constraint on welfare states at all; far from it. Globalization's constraining effects are doubtless far stronger today than they were a decade ago, but even within such constraints analysts have found that there is still substantially more 'room to move' than even the pessimists of a decade ago would have believed; and yet social democrats *choose* not to move (Compare Milner and Keohane (1996) with Mosley *Global Capital and National Governments...* and Hay (2004)). Social democracy may have been made impossible because of the failure of domestic institutions rather than the 'brute facts' of globalization. However, this analysis also suggests that how political actors think about globalization, rather than any 'brute facts' of the situation, may be the most constraining factor of all regarding an optimistic future.⁵⁵ In the discussions of contemporary social democrats, these facts, along with decommodification and inequality, are often forgotten.

Notes

- 1 This is not to define an economic regime tautologically, in terms of its outputs via a certain 'necessary' set of institutions. Rather, it is to posit that specific policy outputs (decommodification and inequality) have certain institutional prerequisites. This is not to impart functional necessity to these institutions however. Rather, it merely proposes that certain policy outcomes are more or less possible depending on the institutional context.
- 2 This explanation is not intended as a refutation of other perspectives that focus upon party alignments, congressional vetoes, or class power. Rather, it is intended as a mid-range compliment to such more macro-perspectives that shows how domestic institutions intersect the politics of parties, vetoes and classes. For such alternatives see Sundquist (1973), Katznelson and Geiger (1993) and Hicks (1999).
- 3 For arguments stressing the primacy of international constraints see, among others, Pontusson and Swenson (1996), Linbeck *et al.* (1994). For those contesting such primacy, see Hirst and Thompson (1999), Swank (2002), Mosely (2002).
- 4 For a supportive argument claiming common essentials along a continuum of possibilities, rather than categorical differences regarding different types of welfare states see Hicks and Kenworthy (2003). In their view liberal and social democratic states both appear as 'progressive liberal' states in opposition to more moribund 'traditional conservative' welfare states. Where I depart from Hicks and Kenworthy is where they see socialism as a form of progressive liberalism. As Esping Andersen notes, such a position, though logically sound, does not explain the historical dynamics that either blended socialism into liberalism or made liberalism more socialist, which of course varied geographically and temporally. Such a position runs the risk of giving an inevitable and/or evolutionary cast to a set of contingent struggles over discrete institutions, as the analysis here attempts to show. See Andersen (2003).
- 5 That is, if the key determinants of social democratic economics are seen to be decommodification and the reduction of inequality.
- 6 As such, the ability to practice social democratic economic policies ended in 1968, not as is commonly dated, in 1978, with the monetarist turn at the Federal Reserve.
- 7 That is to say, if in different time periods, and facing different international pressures, the same result pertains because of similar domestic factors, the case for those factors being important is strengthened.



- 8 See Blyth (2002) for a discussion of the motivations business, labor and state agents during periods of institutional upheaval.
- 9 See Polanyi (1944) and Marshall (1950), although Polanyi's naturalistic yearning for premarket society is often held as evidence that he was not a social democrat, the thrust of his ideas have been very influential amongst those who were. See the critique of Polanyi offered by Lacher (1999).
- 10 This is not to underplay the concentration of wealth that societies such as Sweden actively encouraged in the name of promoting large-scale investment. However, given the prevailing tax regime, wealth inequality mattered less than income inequality for obviating the 'sharp edges' of the market system in Sweden and elsewhere during the so-called 'Golden age.'
- 11 This line of thought runs from Ricardo to Hayek to Nozick.
- 12 Hence the well-known lacunae in welfare economics that when Bill Gates walks into a bar the average income of the patrons increases a hundredfold.
- 13 Seen in this light, the notion of a 'third way' as a coherent alternative to neoliberalism becomes ever more suspect (see Giddens, 2000).
- 14 For such an analysis see Andersen (1985).
- 15 For an exchange concerning the acuity of a Polanyian understanding of labor markets and commodity labor as an historically recent development see Blyth, (2004).
- 16 Interestingly, it is only in the twentieth century that the notion that the market does not intrinsically produce distributional asymmetries has come to be the norm. Interestingly 18th and 19th century political economists were much more open concerning the distributionary effects of markets. Compare Smith (1993).
- 17 Let me be clear what I mean here. Keynesianism, the economic rationale of social democracy, does not equal, nor is it equivalent to, deficit financing. Keynesian economics was fundamentally concerned with the structuring of investment and consumption expectations through participation in political and economic institutions such that growth was achieved in return for labor peace and stable profit shares. Consequently, even though the US and Sweden had very different institutions and policies during the Keynesian era, they were still Keynesian states since the institutions that made capitalism possible were intended to stabilize expectations and produce social democratic outcomes such as full-employment and growth. Therefore if one identifies Keynesianism as the present or absence of deficit financing, then one is really missing the wood for the trees.
- 18 For trends in income inequality cross nationally the Luxembourg Income Study is the benchmark <http://www.lis.org>. For trends in the United States see the work of the University of Texas Inequality project <http://www.UTIP.org>. For trends in the United States in Income and Wealth inequality and their rise since the 1970s see Wolff (1996).
- 19 The basis of the NRA, the National Industrial Recovery Act, was little more than a cartel agreement. In essence, if the problem of depression was seen as a problem of concentrated industrial structure preventing prices clearing, then the natural ally of the state in turning this situation around is business since only (oligopolistic) business can really do anything about prices and quantities (see Himmelberg, 1976; Hawley, 1969).
- 20 National Labor Relations Act July 5th 1935 (1936).
- 21 In fact the 'liberal corporatist' model of Katzenstein fits the American political economy in this period remarkably well. see (Katzenstein, 1985).
- 22 For a discussion of the evolution of business and labor attitudes in the immediate post-war era see Harris *The Right to Manage* pp. 105–129 and Vatter (1985).
- 23 To make such a claim is not to ignore the important exceptions in racial politics (civil rights) and health care. However, if one looks at marginal tax rates, wage compression, and income distribution, then the US looks little different from Europe in this period. As well as the sources listed in footnote 18, see Goldin and Margo (1992).



- 24 Unless you are Germany. But Germany is such an anomaly in welfare state studies in so many ways the fact that the Bundesbank has historically had a tight money but pro-decommodificatory stance financed by an under valued exchange rate serves more as the classic exception that proves the rule.
- 25 Which is exactly what happened in the United States from 1978 to 1983.
- 26 Moreover, the constrained position of the dollar internationally meant that the Democrats preferred policy mix of a loose monetary policy and a tight fiscal policy was ruled out.
- 27 What made this particularly difficult was that the state had been orchestrating a non-inflationary pact between the United Steelworkers of America and US Steel since January 1962, and the Steelworkers had agreed in good faith to a mere ten cents per wage packet increase. As *The Economist* argued 'the steel companies had welcomed the administration's help in bringing the steel workers to the bargaining table to negotiate a new contract well in advance of the expiration of the old one, and in pressing them to moderate their demands. But as soon as the contract was signed, [US Steel] broke what everyone had presumed...was [its] side of the bargain.' *The Economist* 'The United States versus United States Steel,' April 21 1962, p. 223.
- 28 The comments of ex-President of the Coca Cola Company William Robinson to ex-President Eisenhower in the aftermath of the Steel debacle are illustrative. 'Dear General Ike, [h]ere we go again, back down that road to the babel of dissension, friction, acrimony and class warfare that brought us close to ruin in the thirties and renewed itself in the latter stages of the Truman regime...What now for our free enterprise system....when [the state] denies the right of a business to price its goods.' William Robinson to Eisenhower, April 13th 1962, Box 4, William Robinson Papers, Eisenhower Library, quoted in McQuaid (1982).
- 29 The bribery aspect was apparent in that some Congressional Democrats thought the ITC an embarrassing giveaway to business. Indeed, the 1962 tax reform did ultimately add approximately between \$1.8 billion per year to business' bottom line. Rowen *Free Enterprisers...* pp. 46-47 (see also Martin, 1991).
- 30 In making this claim Kennedy painted a picture of the economy as free and self-regulating, rather than sclerotic and unstable, which in effect implied that the regulatory institutions of the New deal period were in fact unnecessary obstacles to growth. John F. Kennedy 'Speech to the Economic Club of New York' *Public Papers* vol. 2, p. 876, my italics.
- 31 Quoted in Heller *New Dimensions of Political Economy...* p. 35.
- 32 Great Society programs were designed to reduce poverty by focusing on supply-side features of the labor market. Practically all of the major policy initiatives of the Great Society; the Job Corps, Upward Bound, Head Start, the Manpower Development and Training Act, school lunch programs, Medicaid, legal services, etc. were all intended to facilitate labor market access to minority groups.
- 33 For a similar argument concerning the logic of the Great Society and its place in the overall logic of the post-war settlement (see Katznelson, 1989).
- 34 As Robert Kuttner notes in '1965, employees paid a tax of 3.625 percent on income up to \$4,800.00 for a maximum social security tax of \$174. By 1980, the tax rate had rise to 6.18 percent and the wage based had sky rocketed to \$25,900.00, for a maximum of \$1,558.00.' Robert Kuttner *The Revolt of the Haves: Tax Rebellions and Hard Times* (New York: Simon and Schuster 1980) p. 212. Moreover because of the lack of progressivity of social security taxes, those in the lower income brackets were being taxed to subsidize those in the 'even lower' income brackets. As Ferguson and Rogers note, between 1965 and 1975, 'as a percentage of federal receipts...social security taxes and contributions increased from 19 percent to 30.3 percent' (see Ferguson and Rogers, 1986).
- 35 Members of the committee included Dag Hammarskjold, Erik Lindhal, Gunnar Myrdal and Bertin Ohlin. My account of the work of the Committee on Unemployment is drawn from Eskil



- Wadensjö 'The Committee on Unemployment and the Stockholm School' Swedish Institute for Social Research, Stockholm University, Occasional Papers Series, Reprint, No. 314, May 1991.
- 36 As Meidner said of the SAP in this period 'its ideology was to maintain the market economy, to counter short-sighted fluctuations through anti-cyclical policies, and to neutralize its negative effects through fiscal policies. The rallying cry was full employment, economic growth, fair division of national income, and social security.' Meidner (1980).
- 37 'Full employment and the certainty that it will be permanently maintained, must also tend to result in high profits and thereby give rise to fierce competition for the labor with the help of which profits are to be gained. This would lead to a rise in wages which increase purchasing power, thus leading to further rises in prices, increasing profits still more.' Rehn (1952).
- 38 Whereas a policy of general reflation would simply produce inflated profits and wage drift. Wage drift is the difference between centrally negotiated and actually obtained wages.
- 39 Unlike the US, the Swedish state had full control of interest rates and monetary policy by having strong external financial controls and a highly *dependent* central bank.
- 40 Unlike the US, the Swedish state had full control of interest rates and monetary policy by having strong external financial controls and a highly *dependent* central bank.
- 41 As Meidner was later to say 'labor market policy was to be used to as a means to remove hindrances for a market economy of the type that the classical economic theorists dreamed of. The element of planning in this quasi-liberal ideology was reduced to the method for eliminating these hindrances. When the economy was freed from this it was thought that it could function according to the rules of the market and so do even better than in a consistently non-interventionist society.' Meidner (1984) quoted in *The Political Theory of Swedish Social Democracy: Through the Welfare State to Socialism* (Oxford: Oxford University Press 1990) p. 208
- 42 Figures from Fraser (1987).
- 43 As a measure of this in the period 1981–1984, growth in private consumption as a percentage of GDP growth was 0.7%. In the period 1985–1988 this trend catapulted to rate of increase of 85.5% In the first period exports constituted 62.8% of GDP growth. In the second period this shifted, given the growth of private consumption (read imports) to a fall of –45.8%. Part of the reason for this dramatic decline lies in the perverse advantages of real estate investment in a speculative bubble which effected the economy from 1985 until 1990. These figures are from Henrickson (1990) table 1 p. 46, quoted in Martin (1996).
- 44 Figures from *The Economist*, March 9th 1985 p. 117.
- 45 This account in part draws on Svensson (1996).
- 46 Klaus Eklund Interview with author, June 16th 1997.
- 47 Klaus Eklund Interview with author, June 16th 1997.
- 48 By 1990 at the peak of the speculative cycle Stockholm's office space was second ranked second in the world. See Bank of International Settlements *Annual Report* 1994.
- 49 On the effects of deregulation (see Calmfors, 1993); Torsten Svensson *November-revolutionen...* On the tax reforms of the 1980's (see Steinmo, 1993).
- 50 As suggested earlier, this perspective on the centrality of domestic institutions both compliments and challenges other perspectives. While it shares some similarities with Ton Noterman's explanation of macroeconomic regime change, it differs on the causes of the shift (endemic inflation and deflation versus political control of key credit institutions). Similarly, while the attitude of business elites and their alliances with the state is a central focus for both this study and the work of Peter Swenson, this study sees elite attitudes as a function of conjunctural politics rather than specific assets (see Notermans, 2000; Swenson, 2003).
- 51 The British case is instructive in this regard. One can point to the considerable 'redistribution by stealth' that has taken place under New Labour in the form of tax increases, negative income tax credits targeted on the poor such as child and working persons tax credits. However, rather than constituting 'left politics by other means' these policies are problematic along two fronts.



First of all, such redistributions have not reversed the income inequality trends of the past two decades. As Andrew Shephard put it, 'Since Labor came to power the GINI coefficient has increased once more... Income inequality over the past two years (2000–2002) has been higher than in any other period covered by our data (1979–2002).' Secondly, Labour's tax increases, which have been largely concentrated on fuel, cigarettes, alcohol etc. are disproportionately paid for by the very people who are being redistributed to, which is probably why the government's own recent surveys of inequality find at best, 'no consistent trend since the start of the 1990s' in income inequality (see Shephard, 2003; Lakin, 2004).

52 Varghese (2001).

53 On the importance of globalization as an ideational limit on policy see Rosamond (2003).

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