Michel-Pierre Chélini et Laurent Warlouzet (dir.)

CALMER LES PRIX
L'inflation en Europe dans les années 1970

SLOWING DOWN PRICES
European inflation in the 1970s

Une inflation massive a touché l'Europe après le choc pétrolier de 1973. Associée à une faible croissance et à la montée du chômage, elle a eu des conséquences majeures tant sur le plan social, en raison de conflits liés à l'indexation prix-salaires, que sur celui de la théorie économique, avec les controverses sur la courbe de Phillips et le monétarisme, et sur celui des politiques publiques, puisque la priorité a été donnée à la lutte contre l'inflation au détriment du plein emploi.

L'ouvrage revient sur ce phénomène dans une perspective historique large qui embrasse les pays d'Europe de l'Ouest, du Nord et de l'Est ainsi que les syndicats, les entreprises et les organisations internationales, en particulier la Communauté européenne et le GATT.

Following the oil shock of 1973, a massive wave of inflation spread throughout Europe. Combined with low growth and rising unemployment, it had major implications on the social front with conflicts linked to indexed wage-pricing, for economic theory with the controversies surrounding the Phillips curve and monetarism, and for public policy with the priority afforded to the fight against inflation at the expense of full employment.

This volume explores these upheavals through a broad historical lens, by examining countries in Western, Northern and Eastern Europe, as well as trade unions, businesses and international organizations, particularly the European Community and GATT.

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MISSION HISTORIQUE DE LA BANQUE DE FRANCE

sous la direction de
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Chapitre 5

Danish and Swedish responses to inflation in the 1970s and their repercussions in the 1980s

Jan Pedersen

Long-term price stability is a primary policy target for governments and central banks in Denmark and Sweden, even if they pursue this goal through different means: The Swedish *krona* (SEK) is under a managed float regime whereas the Danish *krone* (DKK) is pegged to the Euro. However, as the Golden Age ended, politicians and experts in Denmark and Sweden were reluctant to take inflation seriously. They were, of course, aware that steeply rising prices represent an open or latent threat to the smooth functioning of the economy. They could not help noticing that governments in leading European powers took action against inflation, but they were themselves less committed to this particular policy.[1]

Denmark and Sweden were both small open economies, highly dependent on exports. Their semi-corporatist political settings relied on class compromise.[2] One difference between the two countries, however, is worthy of note: the Swedish polity was sensitive - or rather, antagonistic - toward any significant rise

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1. Bengt Rydén (ed.), *Politik mot stagflation. Konjunkturrådets rapport 1977-78*, Stockholm, SNS - Studieförbundet Näringsliv och Samhälle, 1977, p. 12f; Det Økonomiske Råd, Formandskabet: *Dansk økonomi, april 1976*, Copenhagen, Statens trykningskontor, 1976, p. 13f.
2. Lars Magnusson, *Sveriges ekonomiska historia*, Stockholm, Studentlitteratur AB, 1996, p. 469; Jörgen Hermansson, Torsten Svensson and Per Ola Öberg, "Vad blev det av den svenska korporativismen?", *Politica*, 29 (4) 1997, p. 365-384; J. Blom-Hansen, "Still Corporatism in Scandinavia? A Survey of Recent Empirical Findings", *Scandinavian Political Studies*, 23 (3) 2000, pp. 157-181.

in unemployment. Among European countries, the active and successful efforts to guarantee jobs endowed Swedish development during the 1970s and 1980s with a unique quality.[3] In contrast, the majority of Danish leaders and most of the populace adapted quite easily.[4] Relatively little commotion arose as more and more people were either made redundant or – in the case of new entrants into the growing labour force – unable to secure a job in the first place.

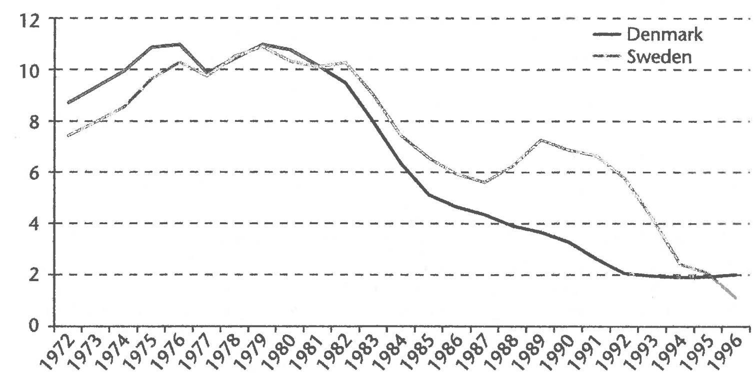
This chapter presents a complex set of historical events in a stylised fashion. First, it illustrates and briefly characterises the levels and fluctuation of inflation in Denmark and Sweden. The second section is a condensed narrative of policies and patterns of action at the governmental level. The third part deals with one particular aspect of the socio-political environment, namely the labour market and its regulation. This gives rise to speculation on how institutional preconditions determined the lines of policy that the governments pursued.

This account relies on a frequently observed triadic typology of successive approaches to solving economic problems during the period. Economist T.M. Andersen uses the following terms:[5] 1) "Bridging strategy": the crisis is regarded as being of relatively short duration, with little or no structural impact. Policy is consistent with a Keynesian worldview, prioritising support for aggregate demand until the arrival of a new self-sustaining economic upswing. 2) "Sheltering or adaptive strategy": a growing understanding of the depth of the crisis results in a change in priorities. Aggregate demand stimulus takes on a lesser role in favour of limiting deficits, and the direction of demand is deliberately "twisted" towards domestic production. 3) "Production or aggressive strategy": this represents, in broad terms, a shift towards supply-side economics, emphasising competitiveness for the sake of exports, leaning towards austerity, yet with a more optimistic, forward-looking emphasis on new technology embedded in new investment goods and a more highly qualified workforce.

3. Hans Tson Söderström (ed.), *Sverige vid vändpunkten. Konjunkturrådets rapport 1991*, Stockholm, SNS – Studieförbundet Näringsliv och Samhälle, 1991, p. 62f.
4. Henrik Christoffersen, *Danmarks økonomiske historie efter 1960*, Aarhus, Systime, 1999, p. 97.
5. Torben M. Andersen, "Macroeconomic Strategies towards Internal and External Balance in the Nordic Countries", *Scandinavian Journal of Economics*, 92 (2), 1990, p. 179.

The figure below illustrates patterns of inflation in the two countries, underlining broader trends and shifts. By using moving averages, the most sudden changes are smoothed away but are nevertheless easily summed up on a one-by-one basis.

Graph 1 – **Inflation, 5 years' moving average, 1972-1996 (%)**



Source: The World Economic Outlook (WEO) Database September 1999, International Monetary Fund, http://www.imf.org/external/pubs/ft/weo/1999/02/data/, accessed 19/09/2016.

In 1974, the Danish inflation rate increased by 5.6 percentage points (15.1% compared with 9.5% in 1973) due to OPEC I. Sweden also felt a significant shock, though on a lesser scale, with an increase of 3.2 percentage points (9.9% compared with 6.7%). Both countries were dependent on foreign oil for their energy supplies, but Sweden likely benefited from the broader supply base provided by its hydroelectric plants in addition to several nuclear power stations.

Between 1979 and 1980, with the new external shock of OPEC II, the relationship was inverted, as the relative increase in inflation was more modest in the Danish case. This time, the Swedish rate of inflation grew disproportionately from 7.2% in 1979 to 13.7% in 1980. However, the former of these values was quite low for the period, so, volatility aside, the smoothed curve in the figure offers a fair picture of a rather similar pattern over these years.

Finally, the remarkable discrepancy from the end of the 1980s through to the beginning of the 1990s had its centre of gravity in 1990, when Swedish inflation rebounded to a level last seen a decade earlier, whereas the Danish course continued more regularly downwards. The subsequent cooling off of Sweden's economy triggered a major financial crisis. Its solution had a significant impact on economic governance and performance, in rough terms putting an end to Swedish exceptionalism.[6]

Table 1 – **Implicit price indices based on GDP, year to year percentage change, average values over four periods**

	1960-1973	1973-1979	1979-1989	1989-1997
Denmark	7.0	10.2	6.4	2.0
Sweden	4.9	10.6	8.0	3.5
EU 15*	4.7	9.4	6.5	3.7

* Germany, France, Italy, UK, Austria, Belgium, Finland, Greece, Ireland, Luxembourg, NL, Portugal, Spain, Sweden, Denmark.
Source: OECD, Historical Statistics 1960-1997 (1999), Table 8.1, http://www.oecd-ilibrary.org/docserver/download/3099083e.pdf?expires=1474290940&id=id&accname=ocid195427&checksum=54486265BB0D827567FB7C7524D153B9, accessed 19/09/2016.

Measured against the EU 15 (cf. table), Denmark had an alarmingly high rate of inflation over the last decade of the Golden Age. During OPEC I and the subsequent years of recovery, both Denmark and Sweden were above average. From 1979 through to 1989, encompassing OPEC II and the move towards a low-inflation regime, Denmark was on the mark whereas Sweden lay significantly above the rate, leading up to the aforementioned crisis at the close of the decade. Subsequently, Sweden achieved, for better or worse, extremely low inflation figures. A stagnant or deflating price level at the end of the century hints at a growth crisis,[7] but it should be noted that Sweden has fared better than almost any other Western European state during the recent economic downturn and its aftermath.[8]

6. Lennart Schön, *En modern svensk ekonomisk historia. Tillväxt och omvandling under två sekel*, Stockholm, SNS – Studieförbundet Näringsliv och Samhälle, 2000, p. 506f.
7. Cf. Assar Lindbeck, "The Swedish Experiment", *Journal of Economic Literature*, 35 (3), 1997, p. 1273-1319, here pp. 1284-1286.
8. The Swedish economy, "North star. Unlike much of the rest of Europe, Sweden is roaring ahead", *The Economist*, 9 June 2011; OECD Economic Surveys: Sweden 2015, p. 10, http://www.oecd-ilibrary.org/economics/oecd-economic-surveys-sweden-2015_eco_surveys-swe-2015-en, retrieved 08/12/2015.

Intuitively, the smoothed curves in the figure indicate that, after a period of creeping inflation in Denmark, the two countries shared the general problem of seriously accelerated price increases. Inflation was, however, tamed through policies of austerity and new monetary regimes. The Swedish trajectory for undertaking this correction was special and out of sync with the majority of states, but price stability eventually became the gospel of economic policy in Scandinavia and elsewhere.

Government policies against inflation

Overview (I): Denmark

By the start of the 1970s, the Danish economy was approaching a state of overheating.[9] As late as 1973, immediately before the oil shock, production was running at near full capacity. Inflation, notoriously above the general European level, was stimulated by a series of factors, some of which were external in nature.[10]

In the midst of prosperity, opportunities were scarce for lowering these pressures through robust income policy. Fiscal policy, on the other hand, had undoubtedly been too lax for too long, perhaps because the political leadership did not want to risk voter dissatisfaction in the run-up to the all-important referendum on EEC membership on 2 October 1972. Soon after this, the Social Democratic government, now under a new leader, had no choice but to confront the interconnected problems of inflation and a growing current account deficit.

The government introduced and maintained fiscal prudence even as the price hike in oil occurred. At the start of the crisis, anxiety concerned inflation, whereas unemployment was more of an afterthought. During this period university economists experimented with prognostic models. Foremost among these researchers were the three independent academics who headed the Economic Council, a deliberative body. In public discourse, they were dubbed "the Sages". According to their forecast, unemployment would indeed increase. The subtext was that there was no way out. Increased energy expenditure for all trading partners

9. Balder Asmussen, "Nyt syn på Anker Jørgensens økonomiske politik", *Historisk Tidsskrift*, 110 (2), 2010, pp. 432-492, here p. 442.
10. Niels Thygesen, "Nyere synspunkter på inflationens årsager", *Nationaløkonomisk Tidsskrift*, 113 (3), 1975, pp. 230-248, here pp. 230-237.

would make inroads into demand for Danish goods, regardless of domestic policy. This message was not quite as trivial as it may sound. The Sages' nervous observation of the figures from spring to winter 1974 later became legend among economists: the pertinent question was, would unemployment rise significantly? The trustworthiness of the Sages depended on it![11] This anecdote emphasises the fact that the unemployment problem presented itself as a genuine novelty. When the forecast proved true, fiscal policy loosened once again.

Another motive for easing off fiscally was that voters were fed up with the tax rises required by public sector growth. In the breakthrough election of 1973, a recently established populist anti-tax party had won a considerable number of seats in Parliament, as had a number of other minor parties, all of which expressed popular discontent in their own way. The old "responsible" parties now hesitated and eventually, in 1975, gave up counterbalancing a series of tax cuts with reductions in expenditure.[12]

Eventually, some anti-inflationary measures did come into force. Restraint was imposed on wages and salaries through intervention in industrial conflicts and later through temporary suspension of wage indexing. As a concession to workers' dissatisfaction and in order to communicate that the target was inflation rather than ordinary people's income, the government also imposed temporary limits on prices and profits. The income policy noted here did not quell excess inflation at first. In fact, results were rather disappointing but did improve after 1979.[13]

In the meantime, not only was inflation high, but public expenditure and payment deficits were moving from bad to worse. Put in relative terms, external net debt doubled to 23% of GDP at market prices in 1979 from an already high level of 11% before OPEC I. Total public expenditure had been drifting regularly upwards for a long time, yet it was only with the onset of the crisis that central government debt exploded. Revenues became

11. Anders Ølgaard, *Den syngende vismand*, Copenhagen, Nyt Juridisk Forlag, 2008, p. 280.
12. Balder Asmussen, "Nyt syn på Anker Jørgensens økonomiske politik", *op. cit.*, pp. 447-451.
13. Henrik Christoffersen, *Danmarks økonomiske historie efter 1960*, *op. cit.*, p. 161; Det Økonomiske Råd, Formandskabet, *Dansk økonomi, november 1978*, Copenhagen, Direktoratet for statens indkøb, 1978, p. 84f; idem: *Dansk økonomi, maj 1982*, Copenhagen, Direktoratet for statens indkøb, 1982, p. 38.

insufficient as unemployment reduced tax sources while expenditure honouring claims for transfer income, among other things, was increasing. As late as 1975, liabilities seemed manageable; in 1979 gross central government debt amounted to almost 25% of GDP, two fifths of which was owed to foreign creditors. Figures related to local authorities were more stable and modest.[14] The public deficit, together with low private savings, lay at the root of the swelling of foreign credit. Unlike nowadays, foreign debt was at that time considered a far greater problem than public debt – all the more so as the capability of servicing sovereign debt was normally undisputed. The public deficit, seen as a whole, was largely considered an account to be settled between the state and its citizens.[15]

Increasingly, leading Danish government officials and politicians focused on the current account deficit. They realised that even though the trough of the mid-1970s was now in the past, real prosperity could prove to be a long time coming, all the more so because major economic powers had little intention of taking action – either individual or concerted – to restore growth through Keynesian stimulus.[16] Bridging policy was out; adaptation to a perhaps permanently crisis-ridden situation was in. The so-called twist policy distinguished itself by not just addressing one imbalance to the possible detriment of others; it worked by transforming private expenditure, with its large component of demand for foreign goods, into public expenditure. The remedy was to collect more taxes and use the revenue to employ more people in socially useful domestic jobs. A lesser share would be spent on imported goods and private savings if the marginal tax revenues were redistributed as operational public expenditure before entering private circulation.

Restricting inflation was incorporated into this new policy style, if only abstractly. Instead of increasing aggregate demand and thereby stimulating inflation, demand remained at the same level.

14. Figures based on *Statistisk tiårsoversigt 1980* [Statistical Ten-Year Review 1980] from Statistics Denmark.
15. Maurice Obstfeld, "Does the Current Account Still Matter?", *The American Economic Review*, 102 (3), 2012, pp. 1-23, here p. 2f; Niels Kærgaard, "[Obituary of] Svend Aage Hansen 4. April 1919 – 5. september 2009", *Nationaløkonomisk Tidsskrift*, 150 (1), 2012, pp. 1-20, here p. 8.
16. Det Økonomiske Råd and Formandskabet, *Dansk økonomi, maj 1977*, Copenhagen, Direktoratet for statens indkøb, 1977, pp. 26-31.

The trick was to redirect some share of it towards purposes that would bring about jobs, and thus, by implication, new growth. The effect in real terms was small at first but considerable over the period 1979-1982.[17]

One possible means of making inflation tolerable - if only on a temporary basis - was currency devaluation. Denmark, as member of the EC "Snake" and later the EMS, had committed itself to exchange rate stability. Nevertheless, the government took advantage on several occasions of the possibility for minor downward adjustments within the European system, in practice vis-à-vis the Deutschmark.

On other occasions, Denmark was affected by adjustments made on the initiative of others. An EMS adjustment in 1982 reset the Danish overall exchange rate to its 1973 level when rates of inflation are taken into account.[18] Already in 1980, however, the effective exchange rate of the krone, regardless of development in prices, was on a par with that at the start of the 1970s, after a cycle of appreciation followed by depreciation. The effective exchange rate continued downwards for another couple of years.[19]

In 1982, the chair of the Economic Council ("the Sages") hinted at the availability of the devaluation option, going beyond the limits of the "Snake". Practically all other parties that possessed some voice or authority in the matter promptly called them to order.[20] Whether this was due to disapprobation of the idea or fear of spoiling a surprise effect is hard to say; motives may have differed. The government chose to anticipate eventualities by proclaiming the steady exchange rate a dogma to be obeyed indefinitely, which has actually remained the case up until the present day.

Overall, during the years of high inflation rates, Denmark pursued an active though not radical devaluation policy in order to

17. Peter Nannestad, *Danish Design or British Disease? Danish Economic Policy 1974-1979 in Comparative Perspective*, Aarhus, Aarhus University Press, 1991, pp. 169-172; Det Økonomiske Råd, Formandskabet, *Dansk økonomi, maj 1982*, Copenhagen, Direktoratet for statens indkøb, 1982, pp. 63-76.

18. Johan A. Lybeck, *Devalveringar. Ett inslag i de nordiska ländernas stabiliseringspolitik*, Stockholm, Liber, 1985, p. 45, p. 83f.

19. Richard Mikkelsen, *Dansk pengehistorie*, Vol. 4, *1960-1990*, Copenhagen, Danmarks Nationalbank, 1993, pp. 179-183; Johan A. Lybeck, *Devalveringar, op. cit.*, p. 157f.

20. Det Økonomiske Råd, Formandskabet, *Dansk økonomi, oktober 1982*, Copenhagen, Direktoratet for statens indkøb, 1982, pp. IX-XVI, pp. 55-62.

compensate for failing competitiveness. Multilaterally agreed adjustment within the EMS framework was considered an adequate forum for safeguarding national interests through negotiation, but unilateral discretionary action was off limits.

When OPEC II caused inflation to accelerate again by 1979, the Danish response was one of resignation. The political latitude of Anker Jørgensen, the Social Democratic head of government since October 1972 - with the exception of a spell of one year of centre-right government - was limited following a decade of attempts to subdue the crisis. The attempts were many, encompassing a variety of measures, and they were often worthy, yet they frequently met with animosity from within the Social Democrats' own camp as they negatively affected disposable real income. In 1982, after negotiations regarding the public deficit ended in stalemate, the Social Democratic leader surrendered power to a centre-right coalition led by Poul Schlüter of the Conservative Party. Few expected it to last long, but the new government showed resolve not only by pledging full allegiance to the principle of holding the exchange rate stable but also through a firm and precisely targeted income policy. The national wage indexing system, a clear source of inflation, had already been restricted under the previous government; now, it was immediately suspended. A few years later, it was abolished altogether by law. Furthermore, the government set a rigid costing framework for labour contracts within the public sector even before negotiations had begun.

Government efforts were aided by the international recovery following OPEC II's downswing combined with the new international low-inflation regime. Prices moved more slowly upwards, unemployment went down, and the domestic budget balance improved. The foreign payments deficit persisted though, and by the end of the decade, as workers had grown accustomed to the situation and felt the time was ripe for a more offensive attitude, cost pressure built up once again. Consistent with a new awareness of inflation as a core problem, the government responded with fiscal austerity. Not only was general expenditure curbed, but household disposable income was also held in check by various means, notably by reducing tax allowances.

Effectively, this policy was one of contraction. Unemployment again went up, this time to a level not seen since the 1930s, and the public budget situation worsened as unemployed individuals paid fewer taxes and demanded more social welfare payments.[21] Inflation was subdued to a sustainable level, in line with other Western European countries. Danish politicians were not monetarists who believed in unhindered market freedom but they consistently tolerated some rise in unemployment whenever it was necessary to put a brake on inflation, whether as an intermediate means of balancing accounts or, ultimately, as the key to achieving long-term stability.

Overview (II): Sweden

Sweden stumbled into recession in the start of the 1970s. Over the previous decade, inflation had been moderate, and deficits caused no alarm. However, tight monetary policy from 1970 to 1972 had unintentionally provoked local stagnation at an early date, and OPEC I now collided with the rebound. One analyst sarcastically remarked that Sweden had skipped not just the international recession but also the subsequent upswing.[22] Be that as it may, the oil price hike presented the same problem in Sweden as in many other countries: inflation and declining demand went hand in hand. Faced with the dilemma that while supporting demand might stimulate inflation, failure to do so was likely to create unemployment, the Swedish government opted for the former. An expansive bridging policy dominated the first years of crisis.[23]

One specific counter-inflationary tool was introduced; or rather, an old tool was modified to fit the current situation. Prices in Sweden had been under intense public scrutiny since the 1950s. This policing of market behaviour may have had a regulating effect solely by making latent monopoly abusers restrain themselves in advance, but active regulation was common as well.

Earlier provisions, however, were mostly set up to authorise the correction of anomalies in accordance with specific conditions and procedures. A new law on price regulation, effective as of July 1973, augmented the possibility of using discretionary price

21. Henrik Christoffersen, *Danmarks økonomiske historie, op. cit.*, pp. 161-170; Hanne Rasmussen, Mogens Rüdiger, *Danmarks historie*, Vol. 8, *Tiden efter 1945*, Copenhagen, Gyldendal, 1990, pp. 360-365.
22. Bengt Rydén (ed.), *Politik mot stagflation, op. cit.*, p. 14.
23. Johannes Lindvall, "The Politics of Purpose: Swedish Economic Policy after the Golden Age", *Comparative Politics*, 38 (3), 2006, pp. 253-272, here p. 260f.

regulation in economic policy. From then on, until 1987, price control was a commonly used instrument, including longer and shorter spells of general price stops in 1981, 1982, 1983, 1984, 1985, and 1987. Several OECD countries attempted price control in the first half of the 1970s but gave up on the project. In other words, Sweden was an exception. The effects of comprehensive price control are unclear, but one could suspect that it would increase volatility rather than keep inflation lower than it would otherwise have been. Likewise, it may have exerted only minor influence on anticipated inflation – an important parameter governing the behaviour of economic agents.[24]

Regardless of nominal prices, the cost level of employers was building up in the middle of the 1970s. The basic idea of the two Haga Agreements, named after the distinguished state manor at which talks took place in 1974 and again in 1975, was to substitute income tax cuts for wage rises. However, the Social Democratic government did not succeed in assuming effective leadership in these tripartite negotiations. One problem resistant to a central solution was wage drift. Furthermore, the government significantly raised payroll taxes in order to support booming state expenditure. Thus, the general cost of labour grew by a startling 40% over just a very few years. This burden on industry tended to increase unemployment; however, the general expansionary policy and discretionary efforts, such as subsidised stock building as well as support for participation in education, training, and leaves of absence, counterbalanced this tendency. In addition, various labour-intensive industrial sectors, such as shipbuilding, mining, and pulp and paper, were directly subsidised.[25]

Government power was transferred to the centre-right in October 1976. How much difference this made is open to debate. During the preceding electoral period, there had been a parity of votes between the Social Democrats and their supporters in the small Euro-Communist Party on the one hand and the opposition on the other, necessitating either compromise or decision by drawing lots, a procedure authorised by the Constitution if voting

24. Lars Jonung, *Inflation och ekonomisk politik i Sverige*, Lund, Dialogos, 1989, p. 138, 149ff.
25. Bengt Rydén (ed.), *Politik mot stagflation, op. cit.*, p. 81f; Jonung, *Inflation och ekonomisk politik i Sverige, op. cit.*, p. 14ff; Lars Magnusson, *Sveriges ekonomiska historia, op. cit.*, p. 475f.

resulted in a tie. Apparently, the consensus on crisis policy was not greatly affected by the election, although out of necessity some novelties emerged. Cost pressure eroded the otherwise-ingrained competitiveness of Swedish industry, which had possessed a particularly strong record on export markets. The ensuing loss of market share reduced the inflow of foreign currency, imperiling the balance of payments, although even then, pressure was less than in the other Nordic countries. The threat from a growing foreign debt burden was enhanced by the fact that the state now financed part of its deficit through foreign loans in order not to crowd out productive investment. Gross external debt measured against GNP rose from 12.7% in 1972 to 21.2% in 1977.[26] Between the same two years, the balance of payments' current account relative to GDP went from slightly positive (0.6%) to clearly negative (-3.5%). Foreign owners' share of sovereign debt shifted abruptly from 0.3% in 1976 to 9.4% in 1977.[27] Together with savings, investment was already reeling.[28] In order to cope with the situation, Sweden left the European "Snake" currency arrangement in 1976. A series of devaluations followed, by 3% in October 1976, by 6% in April 1977, and by 10% in August 1977.[29] The year 1977 also saw a change from expansive bridging to a contractive adaptation policy. This involved higher VAT and tighter money. This was necessary, the government claimed, if devaluation was to be of any use. Balances would be set straight, and Sweden would no longer live beyond its means.[30]

The devaluations may have altered expectations of both industry and workers in the long term, thus negatively influencing their behaviour. In the short term, however, the devaluations helped correct the situation by restoring the strong performance of Swedish exporters.

26. http://www.reinhartandrogoff.com/data/browse-by-topic/topics/9/, retrieved 25/09/2013.
27. Figures based on *Statistisk årsbok för Sverige* [Statistical Abstract of Sweden], Statistics Sweden, relevant years.
28. Bengt Rydén (ed.), *Ut ur krisen? Den nya ekonomiska politikens möjligheter och risker. Konjunkturrådets rapport 1982-1983*, Stockholm, SNS - Studieförbundet Näringsliv och Samhälle, 1982, pp. 35-38.
29. Johan A. Lybeck, *Devalveringar, op. cit.*, p. 21f; Bengt Rydén (ed.), *Ut ur krisen? Den nya ekonomiska politikens möjligheter och risker. Konjunkturrådets rapport 1982-1983, op. cit.*, p. 19.
30. Bengt Rydén (ed.), *Mot nya förlorade år? Konjunkturrådets rapport 1979-1980*, Stockholm, SNS - Studieförbundet Näringsliv och Samhälle, 1979, p. 16f.

Miraculously, one is tempted to say, the trick worked twice, perhaps even better the second time. The backlash of OPEC II hit so much harder because none of the underlying structural and institutional problems of the economy had actually been solved. Prior to the 1982 elections, centre-right candidates had promised austerity. Perhaps they anticipated losing the election and saw a tactical advantage in sharpening their profile of responsibility, but this was not necessarily the case. In fact, over the previous few years, the government had introduced budget cuts, thus moving further away from bridging policy and towards adaptation. Public deficit figures had now exceeded safety limits; tax rises could no longer save the day. In 1981, still under centre-right rule, a devaluation of 11% took place.

The following year, the Social Democrats were reinstated in their traditional role as the party of government. Their victory built on a vision of a "Third Way" following neither the courses of draconian Thatcherism nor those of Mitterrand's first years as president, with shorter working hours and more direct state governance.[31] Pragmatism carried the day. The Social Democratic government's most important initiative in 1982 was a new devaluation of no less than 16%. This was so drastic a figure that it allowed the all-important Swedish exporters to remain competitive for an extended period while also creating space for toleration of a level of inflation that was significantly above the European average, cf. table and figure.

Economic prospects looked reasonable enough for much of the 1980s. Monetary and financial institutions were liberalised, permitting Swedish firms to gain easier access to credit and act more flexibly in a world market that was approaching the new paradigm of globalisation.[32] Only the Swedish labour market remained entrenched in the old ways of seeing and doing things. A high level of economic activity at the end of the decade translated into higher inflation and, consequently, new cost pressure and imbalances. Attempts by the government to put on the brakes clashed with the new liberal setup in the financial sector, which was no longer the preserve of financial high fliers alone; ordinary citizens were now significantly involved in loan transactions, typically facilitated by tax breaks on payment of interest. The bursting of

31. Lars Magnusson, *Sveriges ekonomiska historia, op. cit.*, p. 478.
32. Lennart Schön, *En modern svensk ekonomisk historia, op. cit.*, pp. 514-516.

a speculative bubble in housing, together with spill-over effects from the German reunification, provoked a banking crisis that could only be solved through massive state intervention.[33] As of 19 November 1992, the krone was left to float. This implied one final massive *de facto* devaluation taking place gradually over the next few months; subsequently, inflation ceased to be a central mechanism in the working of the economy, and the exchange rate became more stable, though still flexible. Full employment as a principle that overruled all other considerations was abandoned.[34]

To sum up, Danish political leaders accepted, without openly stating as much, a substantial level of unemployment as an auxiliary to keeping inflation and the balance of payment deficit in check. Their favoured active instrument against inflation was income policy. Fiscal policy played an important role in general stabilisation policy. As a complement, exchange rate policy was used measuredly within a multilateral system of exchange rate management.

Sweden, on the other hand, repeatedly carried out independent, significant devaluations; i.e., although inflation was allowed to develop, it occurred in a state of semi-insulation, or put differently, the economy was being protectively hedged in. By allowing exporters to uphold normal selling prices on international markets and at the same time adjust to rising domestic prices – thanks to more and more favourable exchange rates for the foreign denominated proceeds of exports – high levels of employment and international competitiveness could co-exist. Income policy was applied more passively and less aggressively than in Denmark. As in Denmark, fiscal policy moved in different directions with differing degrees of intensity depending on the context but tending generally towards greater strictness.

The importance of labour market institutions in combating inflation (I): Sweden

The Swedish case appears more clear-cut than the Danish one. There is widespread agreement that a peculiar Swedish model existed, informed by a set of ideological notions and economic

33. O. Emre Ergungor, *On the Resolution of Financial Crises: The Swedish Experience*, Policy Discussion Paper no. 21, Federal Reserve Bank of Cleveland 2007.
34. Assar Lindbeck, "The Swedish Experiment", *op. cit.*, p. 1304f.

guidelines for the regulation of interaction between industry, workers, and the public sector.[35] The model was neither an official blueprint nor ever rigorously applied. There is little doubt though that it possessed discursive force and may be taken to represent the *Zeitgeist*.

The Rehn-Meidner model,[36] elaborated at the end of the 1940s by – symptomatically – two economists from LO, the Swedish trade union federation, conceived of the national economy as being split into two sectors: one exposed to foreign competition and the other not. The exposed sector ought to set the limit for the extent to which wages could rise. If the productive sector benefited from particularly high productivity gains as might be anticipated, the derived extra funds for adding to wages should be shared across the sectoral divide. This was the so-called solidaristic wage policy, which implied equitable distribution between individual industries and across qualification levels of workers. Prices for the exposed sector were set on the international marketplace whereas other prices were cost based, passing rises in wages and salaries on to consumers (and taxpayers, in the case of public services). Hence the need to keep a close eye on actual prices, as noted above.

Ideally, wage rates were set centrally through independent agreements between industry and trade unions, free from state intervention. The core of the historical class compromise lay herein: trade unions committed themselves to restraint in order not to compromise the competitiveness of the exposed sector, which served as the primary engine of the economy and provided the essential link to the international economy. Some wage drift was unavoidable. In one sense, this was a disturbing element, but it was also integral to the mechanism: wage pressure would set a limit on profits that motivated employers to cut back on wage expenditure through innovation and rationalisation. This in turn would pave the way for further improvements in income. Through adequate fiscal policy, the state prevented open or latent overheating – or the opposite – of the economy.

35. Erik Lundberg, "The Rise and Fall of the Swedish Model", *Journal of Economic Literature*, 23 (1), 1985, pp. 1-36.
36. For an extended discussion, see Lennart Erixon, "The Rehn-Meidner Model in Sweden: Its Rise, Challenges and Survival", *Journal of Economic Issues*, 44 (3), 2010, pp. 677-715.

Whether termed a model or an ideology, these thoughts were designed to show how Swedish citizens could improve their standards of living and social equity year on year while simultaneously maintaining international competitiveness. Sweden displayed very respectable growth rates from 1950-1973 even though the country had ranked at the very top of the league during the preceding period; on account of this, some convergence-based loss of steam was to be expected.[37] However, from some point in the 1960s, the model began to show signs of fatigue.

Swedish industry, in spite of its enormous strength and capability, did not renew itself at the same rate as it had done earlier in the century. Some industries, particularly shipbuilding and textiles and clothing, went into structural decline.[38] The base remained strong, but classical industry as a whole faced difficulties in translating its strategic economic position into political influence and social acceptance. As services, not least public services, expanded, industry's relative weight diminished in terms of direct stakeholders within the population. Health workers, social workers, teachers, and students used their weight to further their own agendas. More and more people, for instance, became concerned about pollution and the working environment. Undoubtedly, the focus on growth and higher material consumption had triggered real welfare problems, yet dissatisfaction was probably also due to the social surplus and emancipatory aspirations generated precisely by growth, equity, and welfare. Part of this picture was a radicalisation of workers.

The Swedish model thus remained in force, but the mechanisms that were meant to provide economic equilibrium and social satisfaction had been disturbed. Specifically, it was next to impossible to establish consensus concerning procedures for dampening inflation. On the contrary, the new socio-economic contradictions tended to enhance inflation: the new grand coalition of public service workers was little inclined to accept caution and thrift in fiscal policy. Greater diversity in social composition and new movements and ideologies meant more volatility in voting patterns. Faced with a perfidious electorate even responsible

37. Jan Pedersen, *Danmarks økonomiske historie 1910-1960*, Copenhagen, Multivers, 2010, tables 2.2.1 and 2.2.2, based on data from Angus Maddison: *Monitoring the World Economy: 1820-1992*, OECD 1995, table D-1.

38. Lennart Schön, *En modern svensk ekonomisk historia, op. cit.*, p. 477.

politicians might hesitate to proceed with disagreeable measures as the political cycle turned and election day was approaching, a phenomenon known as time inconsistency in, for instance, economic policy.[39] Perhaps worst of all, concord among workers began to break down as the blue-collar section lost its hegemony. Instead of a collective commitment to historical compromise with industry, various factions were now on guard against one another, speculating about gaining compensation for absolute and relative losses that had been suffered for one reason or another during the turmoil of crisis.[40]

Neither Social Democratic nor Conservative governments had the necessary courage or opportunity to override the principle of an autonomous system for settling national contracts and instead impose statutory *ad hoc* solutions, not to mention a coherent state-led income policy. Such a venture would indeed have been risky, as it could have undermined workers' faith in a Social Democratic government, thus promoting rank and file militancy; or from the opposite perspective, it could have reversed the electoral fortunes of a centre-right government, postponing the demise of Social Democratic hegemony indefinitely.

The alternative - the devaluation policy - compensated for the immediate damage of inflation and helped the country to emerge from the prolonged crisis in reasonable shape, in spite of shaky growth performance. It provided time to adapt to a new, more global, and less regulated economic regime. There was, however, a severe outburst of inflation and financial instability after most other comparable countries had become settled within the new paradigm.

The importance of labour market institutions in combating inflation (II): Denmark

Creaking in the joints though it was, Sweden had its model. In Denmark, the environment for political decision-making was more

39. Lars Jonung, *Inflation och ekonomisk politik, op. cit.*, p. 23.

40. Hans Tson Söderström, "Villkoren för 80-talets avtalförhandlingar", first published 1980, here quoted from Erik Lundberg, Bengt Rydén (eds.), *Ekonomisk politik i förvandling*, Stockholm, SNS - Studieförbundet Näringsliv och Samhälle, 1985, pp. 181-197, here p. 182, 187, 189f; Alice M. Rivlin (ed.), *Brookingsrapporten. Den svenska ekonomins framtidsutsikter*, Stockholm, SNS - Studieförbundet Näringsliv och Samhälle, 1987, p. 67f, p. 101.

turbulent and anarchistic and worked over shorter time periods. Paradoxically, politicians from opposing sides did not fundamentally differ in their perceptions of and approaches to economic policy. During the inflationary period, they frequently sought compromise in *ad hoc* solutions, seeking to patch up the economy here and there so that no imbalance went completely out of control. Over the years from 1974-1980, this occurred 13 times.[41]

However, neither the Social Democratic Party nor any other collective agent possessed the hegemony required to handle the crisis according to a known and dependable pattern - indeed, there was no preconceived grand scheme for maintaining a balanced economy.

From the middle of the 1970s, Danish elite politicians and technocrats learned with relative ease that not only would the earlier *ad hoc* problem solving need to yield to more determined, better targeted policies, it would also require austerity and the abandonment of a number of well-earned rights and optimistic expectations. Nevertheless, the Kingdom of Denmark - and that of the labour movement - was divided against itself; as such, this process took both time and a great deal of political turmoil, including the abrupt fall of the Social Democratic Party from its privileged position as the "natural" party of government.

The epicentre of strife was located in the institutions and organisations of the labour market. Once again, a paradox seems to be at work: labour relations were characterised by long-standing, rock-solid traditions of settling disputes through talks instead of through open conflict. This tradition was embedded in an elaborate set of smoothly functioning institutions.

General issues were settled between the central organisations, which nevertheless left much to be decided at the level of different branches of trade, for instance the transport, construction, and metal industries. For large portions of the labour market, the vital issue of wage rates was determined by local bargaining. This permitted the market mechanism to work its magic in terms of labour mobility, and it promoted class collaboration under the thinking that techno-economic efficiency secured jobs and yielded reasonable wages.

41. Søren Borchsenius, "SV-regeringens forudsætninger og forløb", *Historisk Tidsskrift*, 104 (1), 2004, p. 122-16, herep. 124; Hanne Rasmussen, Mogens Rüdiger: *Danmarks historie, op. cit.*, p. 480f.

One may speculate that since these institutions had formerly served as pillars of the economy and as vehicles for resolving social conflict, it was little wonder that they became objects of expectation even in times of crisis. In 1976, 1977 and 1978, the independent academics ("the Sages") who chaired the advisory Economic Council increasingly recommended income policy as a tool for alleviating cost pressure in firms and lessening demand for imported goods.[42] Workers ought to show restraint in the face of inflation and foreign payments deficit.

This was not a completely new idea. On various occasions during previous decades, the government had raised outlines of new labour contracts to the status of law or had statutorily prolonged existing contracts with minor modifications as an attempt to respond adequately to current macroeconomic challenges - or simply to avoid the inconvenient, enervating effect of a major labour dispute. Trade unions were not altogether against the philosophy underlying a more systematic - and consensual - approach to overall solutions including state-sponsored contracts. Their leaders were well aware that if wage levels jeopardised economic stability, it was within the power of the state to absorb excess demand through fiscal policy, making relentless collective pursuit of higher wages and other benefits pointless. On the other hand, workers were - rightfully - concerned that a possible sacrifice on their part might not trigger similar contributions from other groups, thereby shifting income shares to their disadvantage.[43] Overall, income policy was an option, but it was a problematic one, capable of arousing tensions along various fault lines. The pattern of new social diversity and latent radicalisation applied in Denmark as well as in Sweden. Trade unions were bound to defend the specific interests of their members even when they realised the general adequacy of warding off cost-push inflation.[44]

Although, then, income policy was the word of the day, it proved a difficult word to live by. Nevertheless, throughout the latter part of the 1970s, the government closely monitored the centralised portion of contractual negotiations. This was not

42. Det Økonomiske Råd, Formandskabet, *Dansk økonomi, april 1976*, Copenhagen, 1976, pp. 82-85; *Dansk økonomi, november 1976*, Copenhagen, 1976, pp. 78-80; *Dansk økonomi, december 1977*, Copenhagen, 1977, pp. 70-72; *Dansk økonomi, maj 1978*, Copenhagen, 1978, pp. 19-21.
43. *Ibid.* (1978), p. 9, pp. 81-84.
44. Peter Nannestad, *Danish Design or British Disease?, op. cit.*, p. 175f.

unusual in itself, given the highly institutionalised setup, which included mandatory conciliation and other rule-bound procedures stipulated by law. The new component was that on three consecutive occasions (1975, 1977, and 1979), the state intervened and ultimately determined the outcome. The first and the second of these three instances were more or less of the same nature as were the manifold series of political initiatives aimed at a patchwork redressing of imbalances. Some of these also targeted the labour market and income formation.[45]

In 1978, however, things were different. Experience from the previous years indicated that local bargaining undermined the effort, embodied in state interventions, to dampen upward development in wages. On the one hand, local bargaining was a cornerstone of the labour market system; on the other hand, the situation endowed it with a new problematic functionality. It absorbed some of the pressure that state interventions incurred on the system's legitimacy, yet it also neutralised the effect of intervention. Politicians and trade union leaders thus shared an interest in setting a new agenda.[46]

Based on a common wish to improve the economic situation, the Social Democrats and the major centre-right party agreed in 1978 to form a coalition government. Its programme included regular tripartite talks in preparation for the 1979 contract renewal. Trade union leaders accepted the idea. Presumably, judging by subsequent events, they did so in order to escape the squeeze from, on the one hand, unilateral government interventions and, on the other, leftist rank and file militants who denounced the impotence of the, as it were, Social Democratic union leaders.

A complicated sequence of alliance formation and rejection, public pronouncements, and internal intrigues followed. Among the central subjects of this process was so-called economic democracy. This theme was much in vogue during the period and complemented the ideological currents of the time. However, it meant different things to different people. Even employers and

45. Jesper Due and Jørgen Steen Madsen, *Overenskomstsystemets sammenbrud*, Copenhagen, Akademisk Forlag, 1980, p. 92.

46. Jesper Due and Jørgen Steen Madsen, *Fra storkonflikt til barselsfond. Den danske model under afvikling eller fornyelse*, Copenhagen, DJØF Forlag, Jurist- og Økonomforbundet, 2006, p. 80.

Conservatives embraced the concept, at least nominally; their favoured model was local, in-firm co-investment by workers, paid for out of the existing wage sum. Some academic economists, including non-leftist ones, saw capital funds owned by wage earners as a possible means of curbing consumption and stimulating investment.[47] The version of economic democracy cherished by central trade union leaders included massive capital funds governed by them alone. The idea had been promoted for some years without gaining many followers on either side of the centre – or even in the centre itself, for that matter.

Now, however, this served as an expedient means of making strong claims on what was presented as a fair and just *quid pro quo* tripartite settlement: wage restraint in exchange for economic democracy.[48] The proposition was far removed from the more business-like idea behind the proposed talks, i.e. to achieve contracts that were acceptable to workers and at the same time accommodated general economic policy measures. Union leaders and their active supporters within the Social Democratic Party used this and other differences to obstruct talks – true tripartite dialogue never materialised – and to drive a wedge between the party leadership and its centre-right coalition partner. There can hardly be any doubt that trade union leadership would readily have accepted an income policy scheme in exchange for genuine concessions regarding economic democracy. But because there was so little prospect of this happening their claim may be interpreted more as a tactical device. Ultimately then, by the middle of March 1979, the government once again unilaterally decided on the issue of contract settlement. However, as a reflection of the display of power by the unions during this course of events, the settlement contained important concessions to workers. In September of the same year, the government coalition was dissolved, having failed to achieve a coherent and concerted answer to the economic woes facing the country.[49]

For the trade unions, this amounted to a tactical victory but hardly constituted strategic progress since the Social Democratic

47. Thomas Clausen, *Fra ØD til OD og ud. En politisk og økonomisk analyse af debatten om økonomisk demokrati mellem 1969 og 1987*, unpublished MA-thesis, University of Copenhagen, 2010, pp. 48-53.

48. Det Økonomiske Råd, Formandskabet: *Dansk økonomi, maj 1978*, p. 9.

49. Søren Borchsenius, "SV-regeringens forudsætninger og forløb", *op. cit.*, pp. 150-157.

government later saw itself obliged to throw in the towel after a period of near paralysis. One advantageous development did occur however: during the 1980s and 1990s, the opposing parties of the labour market found new, somewhat more decentralised, ways of settling their affairs without government meddling. They were able to move on by building on recent negative experience and because the socio-economic tide as a whole was turning. A new supply-side orientation and increasing international competition encouraged collaboration.[50]

Conclusion

During the battle against inflation in the 1970s, Danish politicians, with the Social Democrats in the seat of government for the majority of the period, managed to keep the economy afloat by means of *ad hoc* initiatives in different directions. Compared to the previous period, relative performance in limiting inflation was somewhat better but far from fully successful. The fulcrum of addressing the inflationary problem – potentially using the same lever for solving problems of economic balances as well – consisted of income policy and labour market policy. One major attempt at establishing a national compromise to this effect was made in 1978/79. This fell through, however, due to a lack of unity within the labour movement. The Conservative-led centre-right government of the 1980s implemented a more consistent policy, successfully bringing the rate of inflation in line with that of Denmark's EU partners but at the cost of a further increase in the already significant level of unemployment.

While the Danes regarded unemployment as collateral damage, the Swedes prioritised full employment. In both cases, the labour market and its inherited structural features shaped the outcome, though they did so in different ways. In Sweden, there was stronger integration between the state, organisations, and market institutions, even if disintegration set in when the model was subject to stress. Continuous devaluation served as an emergency solution. In Denmark, labour organisations were more autonomous in their mutual relationships and vis-à-vis society as a whole. This hindered a corporatist solution at the moment of crisis. On the other hand, it may have facilitated the general adaptation to the new

50. Jesper Due and Jørgen Steen Madsen, *Fra storkonflikt til barselsfond, op. cit.*, p. 84.

economic regime, which emerged for both countries on the other side of the inflationary crisis.

From that time on, Scandinavian countries were set on a course towards less equity, weaker labour mobilisation, and greater disparity between net winners and net losers – insiders and outsiders. It was not – not yet anyway – a defeat for labour, the social base of which nonetheless became more divided. Thus, the inflationary period and its immediate aftermath did not simply represent a cyclical episode that appeared, vanished, and now lies in the past. It was a game-changer. Recession and inflation – an unexpected combination – challenged the smooth functioning of the economy and, ultimately, social stability. The crisis escalated as no stable and trustworthy compromise for sharing the cost of redressing economic imbalances presented itself. One should not regard this failure as *prima causa* of the restructuring we associate with globalisation; the roots of the latter run both deeper and wider. Nevertheless, the inflation of the 1970s exists in this context. The subsequent shift towards supply-side policies, largely endorsed even by labour after mobilisation had petered out, was among the first important steps in this new direction.

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