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JUKKA PEKKARINEN

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1. INTRODUCTION

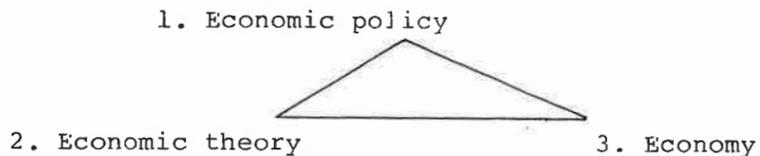
The relations between economic theory, economic policy and economy are a complex and controversial issue. It is particularly relevant for understanding the development of macroeconomics. It has rarely been discussed as an integrated whole. Yet many methodologically oriented studies of economic deal with parts of it.

The above relations can be approached, for instance, from the point of view of development of economic theory. In this they come close to the question which is the relative importance of the internal and external factors in the development of economics. Most economists would probably stress the role of factors external to science, i.e. changes in the economic environment, political and ideological factors etc. These are admitted to be crucial especially in the development of macroeconomics. Yet in the extensive literature which has applied the post-positivist theories of the growth of scientific knowledge to economics, the main emphasis has been on the factors internal to science or the community which exercises it. This follows the main thrust of the growth of knowledge literature in the philosophy of science. Limitations of this viewpoint may be reflected in the fact that the applications of this literature to macroeconomics, where the role of external factors cannot be neglected, are relatively few.

This paper will deal with the complex relations between theory, policy and environment from a particular point of view. Its starting point can be related to Figure 1. In the triangle of Figure 1, our main interest will be on the determinants of economic policy. More specifically, we shall be concerned with economic policy thinking and to a lesser extent with how it is

reflected in economic policy reactions. We shall not much deal with the actual effects of certain economic policy reactions on the economy.

Figure 1



In the search for explanation for the reactions in economic policy, attention will be given to the economic and political environment on the one hand and to economic theory on the other. Thus we shall allow for influence of poles 2 and 3 on pole 1 in Figure 1. Furthermore, economic policy thinking and economic theory will be looked at in interaction with one another so that between poles 1 and 2 influence runs in both directions. The influence of the economic environment (pole 3) on economic theory (pole 2) will also play a background role in our discussion.

This viewpoint is in a sense opposite to the conventional macroeconomic approach to economic policy. In the latter, the targets as well as the theoretical and factual knowledge available to policy makers are taken as given. The question is posed, how to choose the policy measures to affect the economy in the desired way. In a sense, the implicit causal relations run in Figure 1 unilaterally from poles 1 and pole 2 to pole 3. In the policy analysis, economic theory and the targets of economic policy are treated as independent.

The conventional macroeconomic view has also rivals which differ from it partly in a paradoxical way. It is most closely connected with Keynes and most of his Keynesian followers. In their view, economic policy is able to influence economic development. Furthermore, while the targets of benevolent policy makers are taken as given, economic policy is supposed to utilize available theoretical knowledge effectively. In their views of the behaviour of the economy and of the effects of various policy measures policy makers are in this sense dependent on economists. This dependence was stressed particularly by Keynes.

During the period of reasonable economic stability in the 1950's and 1960's many Keynesians in a self-complacent way claimed that Keynesian economics had solved the problem of macroeconomic management. But the turns in economic policy orientation of the leading capitalist economies during the last decade appeared as a puzzle to this view: Why is it that Keynesian economic policy maxims lose their credibility just at the same time as the crisis in capitalist economies became more acute and that monetarist and new classical prescriptions, ruling out an endogenous crisis, were adopted instead?

Frustration with the Keynesian policy maxims can be partly explained by the change in the economic environment, i.e. the fact that the economic problems of the 1970's were partly of a new kind outside of scope of the aggregative, demand-oriented Keynesian framework. Keynesianism became partly inappropriate. But still one may wonder why the change in the economic policy thinking was so sharp and deep-going especially at the theoretical level: Keynesian interventionism and policy optimism were now replaced by the approaches of Monetarists and New Classical economists which claim that macroeconomic policy cannot much but disturb a market economy, which evolves according to its own inherent laws.

This strong reaction indicates that combining policy intervention and market economy is controversial and that different schools of thought think in very different terms of it. Opposite views coexist. This facilitates sharp changes in the dominant view. But it can be argued that these changes in the theoretical hegemony are started by changes in the economic and ideological environment. If this is the case, the destiny of Keynesian economics itself shows that economic theory is not so independent as the Keynesians claim.

Monetarists differ from Keynesians also in their view of the relations between economic theory, economic policy and economy. Furthermore, in this they quite unexpectedly have an ally among the orthodox Marxists. Both schools namely are, although on different grounds, suspect of the Keynesian policy optimism and of the independent role it gives to economic theory. Furthermore, while it is well known that Marxists stress the role of economic and social conditions as well as of ideological factors in the development of science, it seems that also some Monetarists in the 'sociological' explanations for monetary policy have criticized the Keynesian economists' temptations to follow ruling interventionist ideologies in their scientific work (see, for instance, Johnson (1975)). In contrast to Keynes, both these approaches, which otherwise are very hostile to one another, tend to regard economists as subordinated to ideological forces. From a somewhat different point of view, the public choice theorists deny the independence of economic policy by treating politicians and bureaucrats as agents maximizing their own subjective utility function. Recently this view of economic policy has been propagated by Milton Friedman (1986).

Among economists, the Keynesians are policy optimists, emphasizing the malleability of the economy by macroeconomic management. But among social scientists there are much firmer adherents to economic interventionism than the Keynesian

economists. The latter are very well aware of that intervention can be made very difficult by economic and structural conditions which are subject to sudden changes and the implications of which are imperfectly known. They are also aware of the possible harmful microeconomic obstacles macroeconomic intervention may have. It seems that these considerations are left in the background by the group of politologists who are interested in corporatism and economic policy (c.f. Goldthorpe (1984)). In its simplest form, their interpretation of economic development and economic policy comes near to the view according to which only class relations and other types of political constellations determine economic policy which in turn counts for the differences in the development of different economies. The countries which have had a high degree of social consensus have managed the economic crisis of the last decade relatively well. Reading these interpretations of economic policy one feels that role of supply shocks, external dependence and other structural factors, strongly emphasized by Keynesians, is totally neglected so that economic policy becomes highly 'voluntarized' indeed.¹ Recalling the triangle in Figure 1, it also seems that this type of a politologic approach also assumes away any influence of economic theory on economic policy: the required theoretical knowledge is available to all while the problem in the choice of economic policy strategy is how the different class interests are balanced. Consequently economic policy becomes the dominant pole in the triangle.

¹But one has to notice that there exists also an economists' interpretation of corporatism. E.g. in the influential work of Bruno & Sachs (1985, Ch. 10) it is argued that corporatism works for more flexible real wages which in turn smoothen adjustment during supply shocks.

It thus seems that there exist sharply conflicting views of the relationship between economic theory, economic policy and economic environment. These different views are also biased in the sense that they put the emphasis exclusively on one particular factor which is seen to play the causally determining role, on Keynesian economic theory, on the given laws of development of the economic environment or on class relations as the case might be.

In this paper we shall argue that the relation between economic policy and economic theory is different in different countries and in different periods of time. These differences reflect different economic, ideological and political environments. Furthermore, instead of adopting either of the above sharply conflicting views of the relation between economic theory and economic policy, we shall maintain that there exists mutual interaction between them. Influence runs in both directions between poles 1 and 2 in Figure 1. Economic theory is partly an exogenous factor which influences economic policy thinking but at the same time it reflects certain economic and social environment and plays an apologetic role justifying given policy stance. This interaction differs in different economic environments. Consequently it has to be analyzed in historical terms. In some circumstances, the autonomous influence of economic theory may be decisive while in others it may just passively reflect the existing policy thinking and the economic and ideological background factors backing it.

The influence of economic environment on economic policy thinking and on its interaction with economic theory will be indicated by certain country cases. In particular, it will be argued that the kind of economic policy approach supported by the mainstream Keynesianism, i.e. the Neoclassical Synthesis, in fact reflects the economic and ideological conditions prevalent in certain large capitalist economies, United States and UK in particular. The economic environment has been

different in small export-oriented economies. This has led to different types of economic policy and to do different kinds of interaction between it and economic theory. But there are differences in the economic policies of the small economies as well. These will be demonstrated by concentrating on differences between Sweden and Finland. While Swedish economic policy represents further development of Keynesianism, the Finnish approach to economic policy has never adopted it. The relation between economic theory and economic policy thinking also turns out to be different in these two countries.'

The paper will proceed as follows. In Chapter 2 we shall present a more systematic conceptual framework in which to analyze the interaction between economic theory and economic policy. In chapter 3 it will be shortly indicated how the contents and emphasis of Neoclassical synthesis in fact reflect certain historical conditions in major capitalist countries and how Keynesianism there combines several different ideological, structural and economic dimensions of a policy intervention. In small countries, these dimensions are more distinct. This allows one to reach a more nuanced picture of the role of Keynesianism in economic policy. This is done in Chapters 4 and 5 where economic policy in Sweden and respectively in Finland is discussed. Chapter 6 summarizes the paper.

2. THE CONCEPTUAL FRAMEWORK

It is our starting point that economic theory and economic policy thinking do not come to the same thing but, quite to the contrary, the varying relations between them form an interesting subject for study. We shall proceed on the assumption that there are two intellectual communities, the one oriented towards theorizing, the other towards policy making, which share the same subject, problems of economic policy, but which approach it in different manner. They conceive of the

which approach it in different manner. They conceive of the targets, constraints, instruments and evaluatory criteria of economic policy in different ways. These two intellectual communities have also different social attributes; the one is a scientific community, the other more diffuse consisting of policy makers, interest groups, the press and the public interested in economic policy.

To allow for this difference in approaches, we shall distinguish between two different models, the theory model and the policy model, which are used by the scientific community and the practical policy makers respectively. These two kinds of models pose the targets, constraints, instruments and criteria of evaluation of economic policy in different ways. But there is certain correspondence between them. The degree of this is different in different conditions. Furthermore, at each point of time these two models interact and influence the development over time of one another. This interaction is also historically and institutionally conditioned. It is influenced by the economic environment. In certain conditions, the influence of the theory model on the policy model may be strong. In others, it may only constitute one way of rationalizing the policy measures implied by an independent policy model.

Our main line of argument will thus emphasize that the relationship between the theory model and the policy model is historically and institutionally specific. But this does not rule out that there are certain general tendencies in this relationship. These general tendencies which also will be reflected in our country cases below, can be summarized as follows:

1. The theory model has become more and more universal in the course of development of economic theory; nowadays it is to a large extent common stuff to every country. Against this,

national peculiarities are much more common in the case of the policy model. These have persisted despite the theory models' tendency to universalize. We can speak of specific national policy models. The thinking patterns reflecting certain national economic policy model also tend to be nation-wide in the sense that they are shared by all parts of the economic policy debate. The national policy model puts forward the issues which are tackled by the Left as well as by the Right, by employees as well as by employers etc. As the policy models differ from one country to another, this implies that, for instance, the political Left and the trade union movement conceive of their goals and strategies in different ways in different countries.

2. Implicit in what has been said above is that the policy model, while nationally specific, also tends to be stagnant and resistant to change. This may reflect the fact that its intellectual sources and its premisses are unclear. Moreover, the persistence of a given policy model is strengthened by the fact that each group can rationalize its adherence to it in its own specific way. Thus the policy models are sustained by several 'satellite' models through which it is communicated to different interest groups.

But if national policy model were totally unresponsive to changes in the economic environment, its possibilities to survive would be decreased. Thus a successful policy model has to be able to cope at least to some extent with changes in its environment. There may occur gradual development of the policy model. In what follows we shall not be concerned with the question how this takes place in different cases.

3. The national peculiarity of the policy model and the universality of the theory model build up a source of tension between them. We shall indicate later on how these tensions play themselves out in different circumstances. As a

generalization, one can put forward the thesis that, loosely speaking, under 'normal conditions' where the existing course of economic and social development is not questioned, it is the policy model which dominates and the theory model plays a passive role. The basic orientation of economic policy follows the policy model. The main role of economists is to provide technical assistance and to rationalize the existing policy line in economic terms. In this they can utilize the theory model as a technical weaponry so that it is used as a source of legitimization for the policy model. The requirements of policy relevance determine the aspects of the theory model capable of communicating with the policy model.

But in contrast to normal conditions, during periods of economic and social crisis the policy model may be put under question. Doubts concerning its validity are raised. Provided that it is capable of offering an alternative conceived as relevant, the theory model may in these conditions strongly affect economic policy thinking. Thus as economic crisis opens up an opportunity for the theory model to intervene.

One may notice in our account of the relationship between the theory model and the policy model certain analogy to Kuhn's well-known propositions on the development of scientific theories. In both accounts, changes are regarded to occur discontinuously. In our story, however, there are two different model spheres and the factors working for period of normal science and crisis affect these both in their own ways. This account gives more emphasis to the external social and economic forces in the development of social science, as they condition the normal and crisis state of the policy model. It also allows e.g. for a kind of cyclical development where a policy model once passed may return under suitable social and economic conditions. This cycle in the development of economic policy thinking is often referred to.

3 THE DEVELOPMENT OF THE MAINSTREAM KEYNESIAN MODEL

Before going in more detail in our Nordic country cases in later chapters we shall in a broad outline indicate how the interaction between the policy model and the theory model has been reflected in the development of Keynesian economics. It turns out that this interaction has followed the general scheme we have indicated above: initially the Keynesian theoretical revolution had a strong impact on economic policy thinking, but gradually its role became more passive. During the economic crisis of the last ten years or so, this in turn opened the way for a new, i.e. Monetarist, theoretical revolution capable of influencing the policy model.

In this chapter our focus will be on the development of the Keynesian theory model and we shall only in general terms indicate the policy views and the economic environment which have shaped it. The latter have reflected the conditions in major capitalist economies, in the United States and United Kingdom in particular. These conditions will deliberately be presented as a sharp contrast to the case of the small economies to be discussed later.

The Keynesian theory model has developed through different stages. In Keynes' own work, it was greatly different from its Keynesian variants, which themselves are different in emphasis, the Neoclassical Synthesis being the dominant one. Finally, in its latest phase the Keynesian theory model has been compelled to respond to the Monetarist challenge. This has influenced its emphasis. In what follows the discussion will be limited to some aspects of Keynes' own work and to the development of the Neoclassical Synthesis.

Keynes' own emphasis reflected his interpretation of the economic problems of 1930's. The diagnosis of the General Theory is based on excess saving hypothesis. Lack of effective

demand is conceived as the main economic problem. To get rid of it, expenditure has to be increased. It is of secondary importance in which way this happens. The supply side does not play a role in the analysis. The problem of inflation is also left in the background. The historical and institutional conditions of the 1930's are furthermore reflected by the fact that the external constraint does not appear as any serious obstacle to expansion in Keynes' writings in the 1930's.

A more subjective element in Keynes' diagnosis, intimately connected with his interpretation of the British economic problem in the interwar period, is his emphasis on the high level and downward stickiness of the long term rate of interest as the central factor curtailing the effective demand. In accordance with his view of a tendency to a chronic stagnation, Keynes was advocating a permanently low level of interest.

To go to still more subjective elements, it can be asked to what an extent Keynes' ideological views, the "pre-suppositions of Harvey Road", are reflected in his views. Recalling Keynes' famous phrase of politicians as the slaves of some defunct economist, one can argue that, to speak in our own terms, to Keynes it was the theory model which influenced the policy model, not the other way round. Furthermore, the development of the theory model was in economists' hands so that in this way they in Keynes' view got a crucial role in shaping economic policy. To put it strongly, Keynes represented a kind of elitist-liberalist interventionism, according to which the intellectual elites were to renew economic policy. Successful policy reforms were more results of their persuasion than of political struggle of the masses. This marks a difference between Keynes' view and the Left. Keynes opted for a kind of benevolent social engineering practiced by a technocratic elite.

The influence of Keynes' ideas on economic policy thinking was favoured by certain economic, ideological and institutional circumstances which were most characteristic to major 'mature' capitalist countries, like the UK and the United States. The emphasis on effective demand was legitimized not only by the economic slump of the 1930's but also by the fact that these countries had passed their industrialization process and possessed a relatively settled production structure which was not disturbed by the war. Moreover, these countries were relatively closed in the specific sense that domestic demand occupied a decisive share of the markets of each production branch. The balance of payments problem and inflation appeared only later as obstacles to demand management. Ideologically, these countries had a strong laissez faire tradition and the Socialist ideology was never strong. According to the dominant view, the State had to stay outside the economy. In this ideological environment, the Keynesian hydraulics of demand management was more acceptable than direct intervention in production.

As regards the development the Neoclassical Synthesis, it seems that part of the ideological, structural and economic preconceptions of Keynes were preserved by it, while certain parts were put under a pressure to change by postwar economic development.

Among those features that have remained largely unchanged is the elitist and technocratic view of economic policy. Thus the independent role of economic theory in economic policy has been preserved.

The Neoclassical Synthesis shares also Keynes' policy optimism. But one can indicate many areas where the interventionism of the Neoclassical Synthesis differs in its contents from Keynes:

either it does not go as far, represents a change in emphasis or tries to tackle such economic or institutional constraints which were omitted by Keynes.

As an example of delusion of Keynes' program let us notice his claim for a "somewhat comprehensive socialization of investment" which does not play any role in the Neoclassical Synthesis. This delusion has been heavily criticized by the left-wing Keynesians.

Changes in emphasis can in turn be found in the tools of demand management, although the general emphasis on the hydraulics of demand has remained. In the post-war period, the Neoclassical Synthesis has gradually moved away from its original exclusive reliance on fiscal tools and monetary policy has occupied a more prominent role. In this, Keynes' claim for persistently low rates of interest has also been given up. The rediscovery of monetary policy by the Neoclassical Synthesis can also be interpreted as an attempt to meet the Monetarist challenge.

Finally, inflation and external constraint represent new constraints to demand management the Neoclassical Synthesis cannot have overlooked. Throughout the postwar period, these constraints have performed as major obstacles to demand management. Their omission was interpreted as a weakness of the original Keynesian theory model. The Neoclassical Synthesis has had great difficulties to overcome these weaknesses. Thus the economic conditions, which originally were favourable to the Keynesian theory model, turned against it. The Keynesian theory model lose its initiative role in its relation to the policy model. This disharmony opened the way to a new theoretical approach. This opportunity was utilized by the Monetarist counterattack.

During the last ten years, Monetarism in its various versions has occupied the previous active role of Keynesianism in economic policy debate. As a theory model, it now poses the questions to which Keynesians also have to response. And as far as the influence on the policy model is concerned, it seems that Monetarists now have the same positions as Keynes and his early followers. They have been able to influence the policy model which, together with the Keynesian theory model, was put under a crisis as a result of the economic turbulence of the 1970's.

In general the evolvement of the dominant theory model from the aftermath of Keynes' General Theory through Neoclassical Synthesis to Monetarism conforms our theses concerning the relationship between the theory model and the policy model. While the prevailing policy views were in crisis, the early Keynesians were able to exercise strong influence on the new orientation of economic policy during and after the Second World War. But during the same process the Keynesian theory model begun to accomodate itself to certain economic and ideological preconditions of the old policy model. In the Neoclassical Synthesis, this accomodation went further. Gradually the theory model lose its initiative role. It performed more like a technical adviser which reacted on the issues raised by the policy model. In the new economic circumstances, its ability to explain and foresee new policy problems, like inflation and balance of payments, deteriorated. The policy model backed by the Keynesian views was led in a crisis. This opened the way for the Monetarist counterattack. With its new approach, Monetarism in turn occupied a more active role in shaping the policy model.

4. THE INTERACTION BETWEEN THEORY MODEL AND POLICY MODEL IN SWEDEN

Introductory

We have described the policy view implicit in the mainstream Keynesian theory model as a kind of elitist interventionism that emphasizes the role of technocrats in economic policy and heavily relies on demand management. The influence of this theory model on actual economic policy was favoured by certain economic and ideological circumstances which were most characteristic to major mature capitalist economies.

But many of these circumstances which favoured the mainstream Keynesian policy approach did not apply to small European economies of the Nordic type. First, their economic structure and degree of development was inappropriate. They were heavily dependent on foreign trade in the specific sense that in addition to the high share of exports in the GDP, their exports were concentrated in certain branches, which in many cases were cyclically sensitive industries, like raw materials processing or investment goods industries. Consequently the dominant cyclical impulses came from exports and aggravated the balance of payments constraint on domestic demand. Attainment of a good export performance, connected to the process of industrialization which still continued, gave investment a high priority in economic policy. They drew attention away from demand to the supply side. Managing changes in external economic circumstances appeared as the strategic national economic issue in the small open economies.

Second, these economic conditions were interwoven with certain ideological and political constellations which also disfavoured Keynesianism. As a reflection of concentrated export industries, exporters formed an active and coherent interest group which stressed the competitiveness of exports and was

less interested in domestic demand. Their status was enhanced by the priority given in economic policy to industrialization and investment. Related to this, the supply orientation of economic policy made the role of the State different from the outside controller of the hydraulics of effective demand. Intervention was to take place on the supply side, i.e. more 'inside the economy': the State was supposed to be a manager, not only a buyer. This supply orientation was strengthened by the fact that in the small Nordic countries the laissez faire doctrine had never played such an ideological role as in the Anglo-saxon world. They also had a strong socialist tradition.

These economic, ideological and ideological circumstances make it understandable that the economic policy models of these countries came to differ from the mainstream Keynesian model we have described above. But the universalist tendencies dominant in economic theory have had as a consequence that the Neoclassical Synthesis has become also in these countries to the dominant theory model. One could consequently expect to find considerable tension between theory and policy models. In fact this tension can be discerned. But again reflecting different economic, political and ideological circumstances in different countries, this tension has got different expressions. In what follows, we shall shortly present two variations, Sweden and Finland. In the former, the tension resulted in further development of Keynesianism; in the latter in a persistent lack of dialogue between theory and policy models.

Comparison of Sweden and Finland also provides an example of the national specificity of the policy models. Despite the fact that the economic and ideological background factors have been rather similar, the Swedish and Finnish policy models differ strongly from one another. In fact, from the point of view of Keynesianism, they appear as two extremes. While the Swedish model represents further development of Keynesianism over the

borders of the Neoclassical Synthesis, the Finnish model has never adopted it. Thus the question is raised which factors, political, economic or others, explain these differences in the policy models.

The Swedish Model

Sweden's success in the early application and further development of Keynesianism in economic policy is so well-known that there is no need to repeat it here (c.f. Lindbeck 1975) and from a somewhat different angle Crouch (1979), Meidner (1976) and Higgins-Apple-Wright (1981) and Esping-Andersen (1985)). But certain remarks on this standard description are in order. In particular we shall emphasize the Swedish model as a further development of Keynesianism.

In the first place, the Swedish Social Democrats thought of aggregate demand management as the reform of the first stage which should maintain full employment and thus contribute to political power and resources for further development of social welfare. In Sweden the Keynesian policy prescriptions were generalized early on so that in addition to aggregate demand, supply structure and inflation were tackled, and, in fact, in combination.

Around the time of the Second World War, the policy model and the theory model developed hand in hand. It is an open question which part played the more active role in this development. It has been argued that at least in the 1930's new thinking had a strong social appeal independent of economists' writings (c.f. Myrdal (1982)) and that later on, as further developments of the Swedish model were proposed by the Social Democrats, economists normally opposed them (Bergström (1977)). But on the other hand, Swedish economists were closely involved in the economic policy debate in the 1930's and many of the new

proposals were nevertheless formulated by economists close to the labour movement. There was fruitful interaction between economists and politicians which, however, later disappeared.

Secondly, in contrast to mainstream Keynesianism, new economic policy in Sweden was not meant to be an elitist, enlightened technocracy practised by civil servants. It was from the beginning conceived as a way of broadening economic democracy and of creating a method to control social conflict through economic policy. Apart from the Social Democratic Party, the trade union movement has been actively involved in the further development of the Swedish model. In fact the most central new stages concerning anti-inflationary policy and the workers' investment funds have been suggested by it. Thus the Swedish model has been based on broad mobilization, and it has left trade unions degree of freedom to operate in their members' interests. Consequently, incomes policy has not become a fighting issue in Sweden as it has done in countries where narrow Keynesianism has been applied. In fact government control over wage negotiations has not been used, as the methods to control wage inflation have been devised between trade unions and employers' organizations.

Thirdly, the Swedish model is not without contradictions or weak points. Thus for instance it is not clear how the control of imported inflation based on the Scandinavian model (c.f. Edgren-Faxen-Odhner (1969)) will work in conditions of a rapid and a variable rate of world inflation and of unstable exchange rates. At least the experience of the 1970's is not satisfactory in this respect.

Ambiguities are also involved on the supply side of the Swedish model, as originally described by Gösta Rehn (LO, 1951). It stresses rapid structural change, flexibility and technical progress in industry as the means to maintain its competitiveness in the world market and combat demand

inflation. As an indirect means of contributing to the industry's renewal capacity, the wage screw and profit squeeze are traditionally given a prominent rôle, at least in principle. These should sweep out inefficient enterprises unable to pay wages comparable to the leading branches of the open sector. Active manpower policy, control of credit flows and taxation should provide the instruments to alleviate employment problems inherent in the profit squeeze and to enhance the creation of new enterprises to replace the old and inefficient ones.

These measures are, however, indirect in nature in the sense that they do not involve, for example, direct State intervention in production. In fact state-owned enterprises have not played a significant rôle in Sweden except for the quite recent past. Apart from its indirect nature, this kind of supply control involves an ambiguity in its attitude to income distribution and profits. Is not the profit squeeze, at least in the short run, a contractive factor which may lead to de-industrialization? It seems that this ambiguity was not sufficiently dealt with in the development of the Swedish model and that in the 1970's the threat of de-industrialization appeared as an obstacle to the model. This threat was made more dramatic by the slow-down in international trade. The formerly dynamic Swedish export sector now seemed to consist of crisis branches.

As a further potential weak spot in the Swedish economic policy model one can take up the balance of payments. It is not at all clear how this should be dealt with in this model. Perhaps it has been by accident or by certain structural characteristics of the Swedish economy and not by any particular virtue of the Swedish economic policy that Swedish exports and imports have normally been quite closely synchronized so that serious balance of payments problems have been rare. Indeed it is during more serious balance of payments problems, like at the

end of the 1940's, towards the end of the 1960's and during the last few years that Swedish model has come under stress. In these conditions the Swedish Government has been inclined to adopt either traditional stop-go measures to maintain the external balance or the beggar-thy-neighbour policy to increase the room to manoeuvre through big devaluations. These have in turn strained relations between the Social-Democratic government and the trade unions, a central pillar of the Swedish model.

By and large, recent changes in external conditions of the Swedish economy as well as in the policy orientation of Swedish governments have been so great that the whole existence of the old Swedish model can be questioned. This issue will be dealt with in the concluding chapter.

We have argued that a given policy model tends to be a nation-wide frame of reference. It seems that also in Sweden all the participants in the economic policy debate are more or less anchored to the same national model, although the model was implemented by the Social Democrats and in fact it has had a particularly strong connotation with their objectives. The last non-socialist government in Sweden was not ready to give up the Swedish model; it simply reduced it to more narrow Keynesian lines. By international comparison it is indeed remarkable that the Swedish bourgeois government maintained practically full employment despite the fact that certain structural problems in industry were more serious in Sweden than in many other countries that were ready to give up the full employment goal. It was then left to the present Social Democratic government to launch measures, like a large devaluation and a squeeze on real wage costs, that do not follow the old Swedish model.

Our final comment on the Swedish model concerns the development of the relation between the theory model and the policy model. As it was mentioned above, there was a strong interaction

between economists and policy-makers in Sweden originally when the new economic policy was launched. But gradually this interaction evaporated. Economists turned to foreign influences and the theoretical background of the policy model was left stagnant. In fact by the 1970's it seemed that majority of Swedish economists had become highly critical of it. Thus the Swedish case also broadly conforms our theses concerning the relation between the theory model and the policy model. Economic crisis opened the way for the former's influence on the latter, which however become more independent in the course of time.

5. THE FINNISH MODEL

Introductory

The remaining part of our paper will be devoted to the analysis of the Finnish case, which we consider particularly interesting and salient from our point of view. The Finnish policy model can namely be considered as an extreme non-Keynesian case. It has been quite narrow and one-sided in its exclusive emphasis on cost and supply factors. As a consequence of this and of the instability of the raw materials intensive foreign sector, the Finnish economy has been one of the most unstable among the OECD-countries. Yet at the same time its long-run growth performance has been good.

The Finnish model also provides a good example of a situation in which the interaction between the theory model and the policy model is almost totally absent. The economic science taught and discussed in Finland has, for the most part, closely followed the mainstream of international developments. Since the 1930s, new economic theorizing that has later been labelled as Keynesian revolution was noticed in Finnish economic science. We must emphasize, however, the Swedish and

Scandinavian connections: The Stockholm School was read before Keynes and it was only after the war that Keynes' name began to dominate economists' discussions. By the end of the 1950s, Finnish economics was already firmly based on Keynesian lines of thought. The idea of compensatory fiscal policy had already been established before the war, mainly through the influence of Swedish writers such as Lindahl and Myrdal, and the theoretical innovations brought about by Keynes', e.g. the multiplier theory, merely strengthened its position as a generally accepted line of thought. The special characteristics of the Finnish economy were, however, often mentioned as obstacles to these principles, although they were not analysed in any systematic theoretical framework. Thus the policy model was insulated from the theory model.

The Finnish Policy Model

As noticed in the beginning of chapter 4, the background to the Finnish model - a small and open economy under a process of structural change, and an economic discipline conducted along Stockholman-Keynesian lines - was not very different from Sweden. According to this line of thought, one would expect to find a policy model somewhat similar to that of Sweden, where Keynesian ideas would be prominent but where some attention would also be paid to problems of supply. The traditionally close cultural ties between Sweden and Finland should have made it still more likely. What emerged after the war, however, was a policy model that had little to do with any kind of Keynesianism.

The Finnish policy model has been rather one-sided in its emphasis on supply, cost and competitiveness factors. It has never been analyzed and worked out in a systematic way, but the study of various documents and economic policy discussion

Thus, the Finnish policy model has had little contact with post-war economic science and it is a peculiar fact that Finnish economists have not felt this discrepancy as a fruitful motive to analyze. The Finnish policy model has been somewhat opaque and has never been clearly spelled out either by economists or by policy-makers. It has been part of the national culture and as such it has shown remarkable continuity even during political upheavals which have been sharp. Essentially, the model stems from the interwar era and has made little progress since then. The Finnish case provides an extreme example of the continuity of the policy model and its independence of theoretical developments.

The continuity of the Finnish policy model in part reflects the strong position of bureaucracy in Finnish policy making. Traditionally cabinets have been very short lived and as they have either been backed by a minority in the Parliament or consisted of internally weak coalitions, the role of the bureaucracy has been enhanced. The Finnish case provides an extreme example of the continuity of the policy model and its independence of theoretical developments.

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

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

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

Furthermore, the war had meant in Finland - as in many other countries - a more extensive governmental intervention in, and regulation of, the economy. Extensive rationing and planning were applied during the war and also after the war the rôle of the State was strategic in the resettlement of the Carelian refugees and the organization of production to pay for the war reparations to the Soviet Union. The development of the productive structure and the fostering of necessary investment were seen as the main economic policy goals at that time. State-owned companies were established, and the metal industry,

which has since then become an important export industry, was born mainly through State sponsoring to cover the war reparations. The interventionist programme was thus concentrated on the supply side.

Fiscal policy

In spite of this new economic and political situation, there was no upheaval in the policy model which remained firmly anti-Keynesian, as has been pointed out previously. This anti-Keynesian character of the model is most clearly borne out by the study of fiscal policy, the area in which Keynesianism generally has had its greatest impact.

Finnish fiscal policy has continuously relied on the principle of sound finance. What is more, the State has been, until recently, a net saver, i.e. the budget surplus has been positive throughout. This is a result of the endeavour to balance the budget without loan financing but including the State's own financial investments as current expenditures. The State has thus fostered savings, 'room' for investment and growth. In the same spirit, emphasis has been given to the need to enhance the competitiveness of industry by curtailing its costs through fiscal measures. Loan financing has been avoided, and the crowding-out effects of fiscal policy have been underlined - although the argumentation has been far from consistent. One can, however, discern a line of argument in accordance with the old British Treasury View: every penny loaned by the State diminishes private economic activity by the same amount. In general, stabilizational aspects have been omitted in Finnish fiscal policy. Given the target of a balanced budget, only some selective measures have usually been allowed to care e.g. for cyclical unemployment.

The dominant reaction in Finnish budgetary policy has thus been to adjust expenditure to fit the estimated revenue. This has resulted in a procyclical reaction, which is well borne out by a full employment surplus calculation outlined in figure 2. The continuous line shows the hypothetical budget surplus that would have been achieved without cyclical variations in State revenue.¹ It can be interpreted as the discretionary reaction of fiscal policy. The dotted line shows the real GDP:s deviation from trend, thus indicating the cyclical phase. (Both variables as % of GDP).

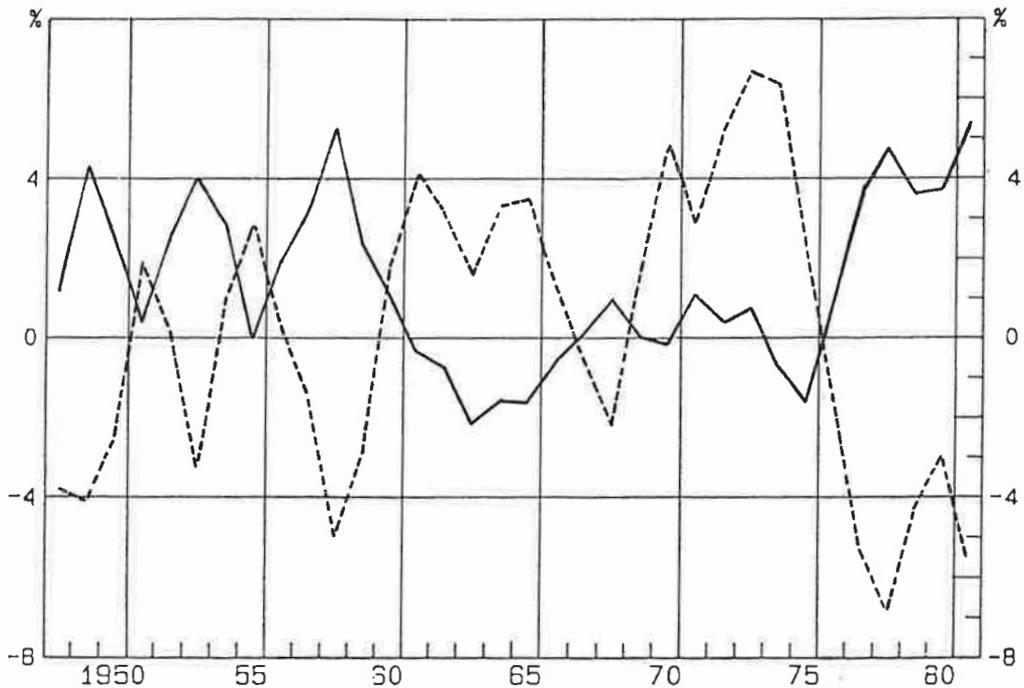
Especially in the fifties, fiscal policy reaction is very clear and systematic: in a period of depression, the discretionary measures have been contractive and vice versa during an upswing. And although unemployment has been identified as a problem, it has been tackled using selective measures, while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

Interestingly enough, this model of fiscal policy has never been systematically defined and articulated and so the arguments used to defend any of its elements are often contradictory. Thus, for example, the discussion concerning government borrowing shows a line of thought very similar to

¹Strictly speaking, this is not a full employment surplus, since we have calculated the hypothetical budget surplus that would have come out had the economy remained on long-run trend, not at full employment. Essentially, this should yield the same results, since we are interested in the fiscal policy reaction and not in the level of the surpluses. To put it succinctly, we have estimated hypothetical state revenues without cyclical fluctuations, taking into account that in that case the income distribution, the share of imports in total supply and the price development would have been different, too. Taxes were disaggregated into direct taxes for consumers, direct taxes for the corporations and indirect taxes and separate functions were estimated for each item. The volume of State expenditures was not altered, but expenditures were of course adjusted to fit the hypothetical price index. The outline of a somewhat similar

Figure 2

Hypothetical discrete budget surplus (continuous line) and GDP deviation from trend (dotted line) as share of GDP in Finland 1948-1981.



the quantity theory of money, while the effects of taxation have often been seen through some kind of cost-push inflation theory. Similarly, the endeavour to achieve balanced budgets annually has been motivated along differing lines of reasoning; on the one hand the crowding-out effect of State expenditure has been emphasized, while on the other hand one can discern something of a political attempt to limit the growth of the public sector. It also seems that there is certain selectivity

bias in the traditional Finnish analysis of fiscal policy, i.e. the structure of the budget has been emphasized at the cost at its overall balance.

The central bank and the Finnish business cycle

A central institutional aspect of the Finnish policy model is a strong and independent monetary authority, the Bank of Finland. The Bank of Finland has secured the continuity of the model at the political and institutional level. It has also controlled fiscal policy and opposed the growth of State expenditure, hampering attempts to implement more countercyclical budgeting. This has been made possible by the fact that in Finland the facilities for government borrowing from the public have remained underdeveloped. Neither has the central bank financed public expenditure directly. As a result, the State has largely been seen as an economic agent comparable to any private one, operating under a budget constraint often of a much more severe kind than that of other agents. During the past two decades the prominent rôle of the Bank of Finland has been further enhanced by the fact that it determines the exchange rate policy which has become an important part of the policy model.

The cyclical reactions of Finnish monetary policy are revealed by Figure 3. As a rough indicator of monetary policy it presents the relative deviations from its own exponential trend of H^* , which is the optimal central bank debt of commercial banks and summarizes the influence of the central bank on the terms of central bank borrowing, traditionally the central weapon of monetary policy in Finland.¹ (The greater H^* is, the easier

¹ H^* is an indicator of monetary policy which the central bank can control most immediately. But there are many intervening variables which condition its influence on actual credit flows and aggregate demand. Thus it indicates the immediate monetary thrust, not its final effects.

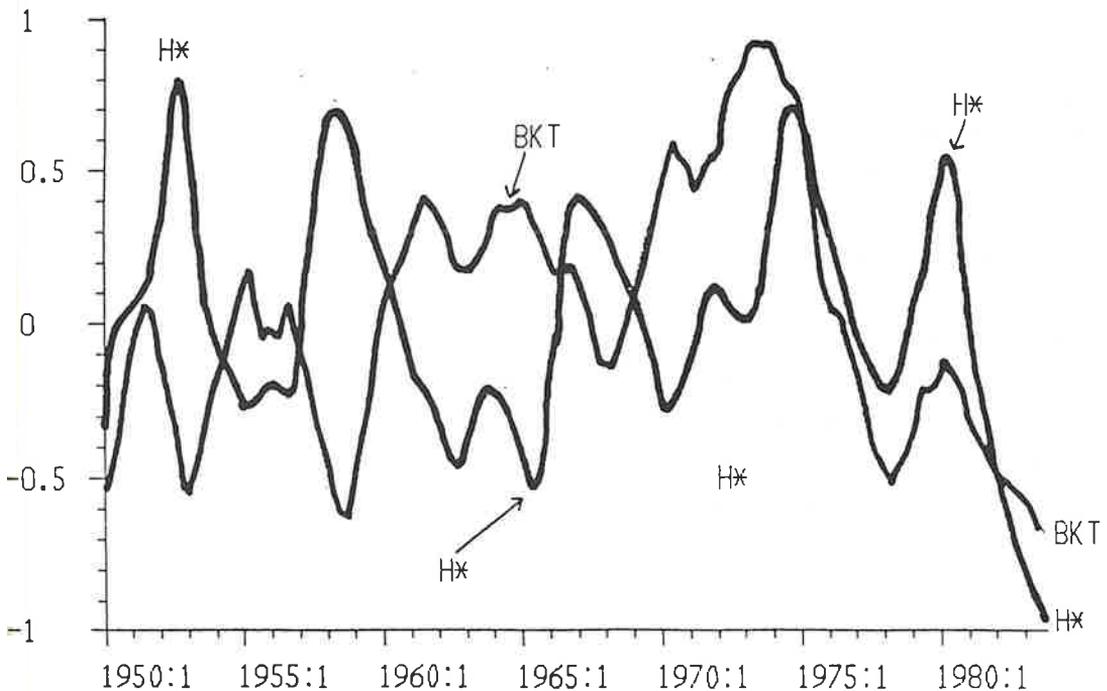
monetary policy.) The deviation of GDP from its trend appears as a cyclical indicator.

Figure 3 shows that particularly from the mid 1960's onwards the reactions of monetary policy have been procyclical. The story from 1950's and early 1960's is not such simple. The indicator of Figure 3 seems to behave mainly countercyclically. Yet closer investigation of monetary developments would show that as a whole credit flows have behaved procyclically. The measures of the central bank have been too late and too small to affect the behaviour of the banks. It also seems that the central bank has been influenced by the state of foreign exchange reserves in its measures, which often has led to procyclical reactions.

Exchange rate policy is a further policy area which has been crucial in Finland and where the central bank has also played an active role. There have occurred big devaluations of the Finnish markka at roughly 10-years intervals, typically towards the end of a deep slump and a period of high unemployment, like in 1957, 1967 and 1977-8. Devaluations have shifted the distribution of income in favour of profits, and by curtailing private consumption, they may have been contractionary in the short run, when exports have again picked up leading to a recovering economy, incomes policies have been used to maintain this income distribution, thus laying foundation for an investment boom. Gradually, however, wage inflation has eroded the changes in income distribution and competitiveness. This paves the way for a new devaluation. In this way successive devaluations have increased the instability of the economy; during export depressions big devaluations have curtailed domestic consumption and their expansionary effects have been felt as investment booms during export booms.

Figure 3

Indicator of easiness of monetary policy (H^*) and GDP deviation from trend (BKT) in Finland 1950-1983.



In the Finnish discussion these developments are known as a devaluation cycle.¹ It is depicted by Figure 4, which shows a rather regular 10-years cycle of the functional distribution of income and of relative unemployment, an indicator of activity in Finland in international comparison. In the figure, devaluations have been marked by D. As it can be seen, they have occurred at times of exceptionally low profitability and high unemployment.

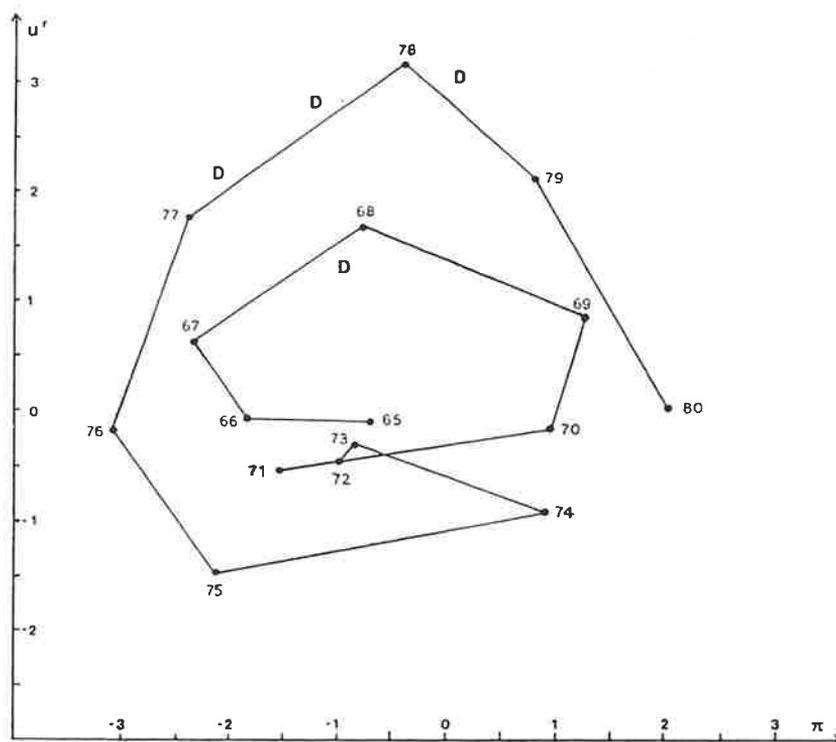
¹The term is due to Korkman (1978). A short critical analysis of the debate is to be found in Pekkarinen and Sauramo (1985).

Typically the slump preceding a devaluation has been characterized by very tight fiscal and monetary policy (cf Figures 2 and 3). On the other hand the policy stance has been made more expansive during the consequent boom. There is indeed reason to interpret the Finnish devaluation cycle as a 'Kaleckian' political business cycle where periods of deflationary policy have been used to room space for a succesful devaluation to squeeze out the required capital accumulation by shifting the distribution of income in favour of profits. This kind of a combination of devaluation policy and procyclical monetary and fiscal policies has unquestionably increased the instability of the economy. In fact, in the post-war period, the Finnish economy has been among the most unstable ones in the OECD area. But through its emphasis on investments, this policy line may have accelerated the long run growth and structural change of the economy. It is an open issue whether this has been the case. Let it only be noted that the Finnish economy, while unstable, has grown relatively rapidly and has also underwent very rapid structural change during 1950's and 1960's.

After all the above story is not meant to describe the Finnish policy model, while un-Keynesian, as wholly unsuccessful. There might be a trade-off between instability and growth the pay-offs of which should be assessed in order to make such a judgment. Furthermore, in an open export dependent economy which is curtailed by the balance of payments constraint, the room for Keynesian policies is in any case restricted. We shall come back to this at the end of the chapter where the recent developments in Sweden and Finland are discussed.

Figure 4.

The Finnish devaluation cycle projected on unemployment and profits.



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

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

Source: Korkman (1981)

Further explanations

To explain non-Keynesian Finnish policy model, a variety of factors must be taken into account. The structural aspects of the Finnish economy, heavy dependence on a one-sided export sector etc., have already been discussed earlier in this paper. At the political level, there have been surprisingly few contradictions and divergences of opinion about the basic policy line. This is in accordance with our thesis that a national policy model possesses some degree of hegemony over political demarcation lines. The post-war years and the fifties could have meant an upheaval in the policy model, but in the end the Left did not use its strengthened position to pave the way for a new kind of economic policy. What is particularly interesting and important is that the Finnish Social Democratic movement never integrated a Keynesian stabilization policy into its strategic goals. Neither did the Left question the authoritative position of the central bank, which at the level of institutions reflects the bourgeois idea of two separate economic and political spheres of a capitalist society.

The societal-theoretical conception of the Finnish policy model thus seems to lie near the Classical economies. On the one hand, there is an apolitical monetary authority which safeguards the state of the currency as a basis for the functioning of the system, while, on the other hand, there is the State which operates within the rules dictated by the economy and which is not able to threaten the authority of the central bank. In this way, the political and the economic spheres are totally separate.

The narrowness of the Left's scope for interventionist action can be further explained by a general 'tightness' of the political climate after the war. The Right was afraid of the Soviet Union and distrusted any significant reforms. It must also be remembered that in the inter-war years political

hegemony had been solidly bourgeois and this meant that they could take very significant retreating steps without, however, really putting into question the basic location of economic power. On the other hand, the parties of the Left did not develop a comprehensive and consistent economic policy strategy. Neither did Keynesian ideas find very fertile ground in the other main governing party, the Agrarian Centre, both because of the general discrepancy of the agrarian ideology and Keynesianism, and also because of the fact that a great part of Centre Party supporters have a common interest with the export oriented forest industry. Thus, at the political level, criticism of the policy model has been scarce and unsystematic, coming mainly from the trade unions and some leftist and populist circles.

The extremely deep rift between theory model and the policy model in Finland remains, to some extent, a mystery. Dialogue between the policy model relying on pre-Keynesian modes of thought and economic science conducted along Keynesian lines has generally remained very weak. In the fifties, and again during the seventies, there was some academic criticism of economic policy, but this did not have much effect. On the whole the policy model, although never explicitly spelled out, has been strong compared with the theory model. In fact the Finnish case provides an extreme example of the gap between the two models.

It seems that the policy model has been able, on the other hand, to gather from the theoretical discussion the elements that it has needed to legitimize itself. This has become all the more apparent with the current state of economic science. The crisis of Keynesianism has created in the international macrotheoretic discussion new tools for conceptualization and analysis which the Finnish policy model has been able to 'utilize for its own reproduction and elaboration. The critics of Keynesianism have stressed supply side factors and issues

related to growth and competitiveness. They mistrust the use of fiscal policy to stabilize the economy and emphasize the independence of monetary policy. These are traditional aspects of the Finnish policy model, too.

The Finnish policy model becomes more understandable also when it is seen against the background of the general intellectual tradition in Finland. The weakness of the laissez-faire tradition and the openness of the economy have, quite naturally, created an intellectual climate in which a national problem of economic growth through good export performance was identified. This is especially obvious in Finland which is a young nation and in which the influence of the German Historical School was strong at the beginning of the century, both in economics as well as more generally in the way in which social problems were tackled. Other aspects of Finnish intellectual history relevant to the understanding of economic policy are, first, a kind of determinism, and secondly, the way the rôle and nature of the State has been conceived. Economic development has been regarded as being somehow predetermined and consequently economic policy as something that must adapt itself to 'realities', mostly dictated by the competitiveness and the profitability of the export industry.

The general attitude toward the State operating in a capitalist economy is also very interesting. As was mentioned earlier, in the Keynesian tradition the State is conceived as being outside the economy, as a benevolent decision-maker who has the use of able economists. In Finland, according to a metaphor that has sometimes been used, the State operates rather 'within' the economy, obeying its constraints, and is not an outside regulator. One could see this as conflicting with the fact that the laissez-faire tradition has been weak in Finland. However, we feel that somehow these factors go hand in hand. Here we could try to distinguish two theoretical conceptions of capitalist society. On the one hand we have the Anglo-Saxon

laissez-faire tradition in which mainstream Keynesianism has also operated. According to this tradition, market economy is something that constitutes itself. The State, from the very beginning, is 'outside' it - and it is precisely from this external position that it can again intervene in the economy. On the other hand, we have the 'Finnish' tradition, in which the State is something that operates 'within' the economy, on the economy's own terms, obeying to constraints imposed by it and strengthening its inherent tendencies. It is a historical fact that in Finland the State has from the beginning of capitalism been fostering growth and industrialization, thus playing a more active rôle than just providing the basic legal framework for laissez-faire capitalism.

Looking at the history of economic theory, one can perhaps draw a parallel to the German Historical School again: in German Historism, the State was also 'part' of the economy, and this corresponds to the fact that also in Germany the State, from the beginning of capitalism, actively sponsored industrialization and monopolization. The metaphor 'State within the economy' has also been used in German theoretical discussion.

Recent changes: Sweden and Finland on crossroads

Finally we shall point out some recent changes in the Finnish policy model and link them to changes in the external economic environment. This also leads to an interesting comparison between Finland and Sweden, where changes seem to point to different directions.

When the Finnish policy model was discussed above, it was mentioned that it has been able to adopt certain elements from theoretical developments without changing its main approach. In fact it seems that since late 1970's the Finnish policy model has to a certain extent adopted even the idea of Keynesian

fiscal policy which it earlier wholly rejected. The public sector deficit has been to some extent used as a countercyclical weapon. This comes out from Table 1 which presents for some countries the calculations of OECD Secretariat on the discretionary (i.e. structural) and automatic (cyclical) components of changes in the public sector deficit.

Comparison of the third column in Table 1 reveals that in the 1980's discretionary changes in the Finnish fiscal policy have been relatively big, in fact bigger than the much proclaimed changes in the U.S. fiscal policy. And although changes in automatic stabilizers and structural deficits seem to go often in different directions, one could with some qualifications for timing etc. argue that these changes in the Finnish fiscal policy have largely been countercyclical in character. Thus there is a big change to negative direction in 1982, which was a year of recession and to positive direction during the upswing in 1984.

Table 1: Cyclical and structural changes in general government financial balances

As a percentage of nominal GNP/GDP

		Change in actual balance	Change in built-in stabilizer	Change in structural budget balance
United States	1981	+ 0,3	+ 0,6	+ 0,9
	1982	- 2,8	- 1,9	- 0,9
	1983	- 0,3	+ 0,4	- 0,7
	1984	+ 0,7	+ 1,4	- 0,7
	1985	- 0,5	- 0,5	- 0,3
	1986	+ 0,1	0	+ 0,1
Average of major six (excluding United States)	1981	- 0,5	- 0,7	+ 0,2
	1982	- 0,2	- 0,7	+ 0,5
	1983	- 0,1	- 0,5	+ 0,3
	1984	+ 0,3	0	+ 0,3
	1985	+ 0,4	+ 0,1	+ 0,3
	1986	+ 0,4	0	+ 0,4
Sweden	1981	- 1,1	- 1,7	+ 0,6
	1982	- 1,2	- 0,8	- 0,3
	1983	+ 1,0	+ 0,4	+ 0,6
	1984	+ 1,8	+ 1,0	+ 0,8
	1985	+ 0,9	+ 0,4	+ 0,5
	1986	+ 0,5	- 1,0	+ 1,5
Finland	1981	+ 1,0	- 0,5	+ 1,5
	1982	- 1,7	+ 0,1	- 1,8
	1983	- 1,2	+ 0,1	- 1,2
	1984	+ 1,8	+ 0,1	+ 1,7
	1985	+ 0,4	+ 0,5	- 0,1
	1986	- 1,0	+ 0,3	- 0,7

Source: OECD Economic Outlook

Closer inspection of the recent Finnish fiscal policy would show that in their contents the fiscal policy measures have been in accordance with the traditional Finnish policy model in the sense that taxation has mainly been used as an indirect way to decrease the production costs and thus enhance competitiveness. Thus, compared with other Nordic countries, increase in the share of taxes has been modest in Finland.

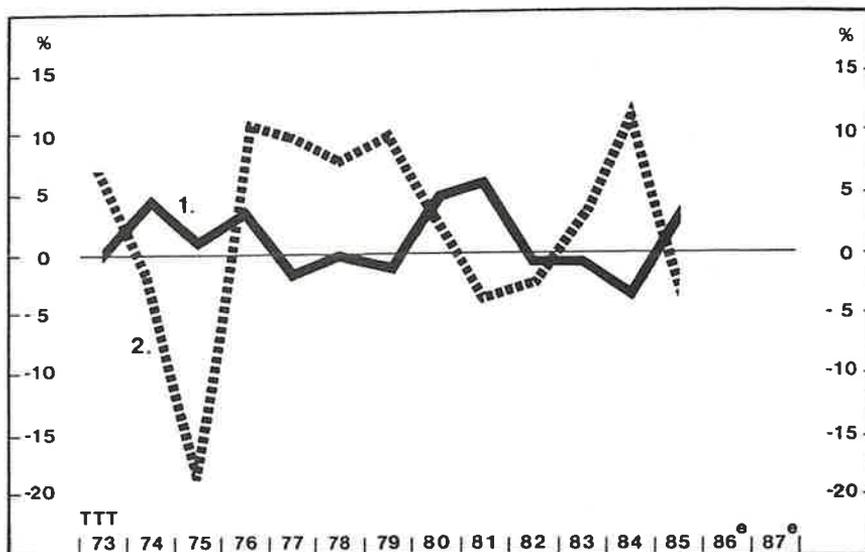
While the Finnish model has adopted elements of Keynesianism, the Swedish model has changed in the opposite direction. This, too, may be partly reflected in the modest changes in the third column of Table 1 in the Swedish case. During the last few years, both fiscal and monetary policies have been tight quite regardless of the cyclical situation. At the same time, production costs and competitiveness have been given the highest priority in economic policy. In fact, referring to these developments, one could speak about certain 'Finlandization' of the Swedish model!

Without going into detail, it can be argued that it is changes in the underlying external equilibrium which mainly count for these changes in the two policy models. Since 1970's the Swedish current account deteriorated chronically, except during the very recent past. Furthermore, as result of the first oil crisis Sweden had a big structural deficit in the public sector which encapsulated the fiscal policy.

At the same time, the underlying factors in the Finnish current account, which earlier was unstable and in a chronic deficit, have been stabilized. Perhaps the most important single factor in this has been that due to the fact that Finland imports her oil from the Soviet Union the oil crises have hit the Finnish economy differently from other oil importers. Finland's trade with the Soviet Union is namely bilateral in character so that the increased oil bill has been paid by increased exports of industrial goods to the Soviet Union. This has resulted in a kind of synchronization between Finnish exports to Western and Soviet markets respectively. This comes out from Figure 5. When exports to the West have been slackened due to the contractionary effects of the oil crises there, Soviet exports have boomed. On average growth of total exports has been relatively stable.

Figure 5

Contributions of Eastern (1) Western (2) exports to the growth of total Finnish export volume 1973-1985.



Steady growth of exports in turn has contributed to a kind of a virtuous cycle: unshocked by balance of payments crises, fiscal and monetary policies have had a stabilizatory stance which in turn has facilitated stable growth of domestic demand, thus stable imports and balanced current account. And this at the same time when Sweden and other oil-importing industrial countries met serious balance of payments difficulties.

The recent, although opposite, changes in Finnish and Swedish policy models both indicate how sensitive the policy models of small open economies may be to changes in external conditions. These changes were favourable to Finland in the late 1970's and early 1980's and softened the hard-line Finnish policy model considerably. But according to the interpretation above, this may have occurred only due to good luck. The difficulties, and the old hard model, may wait just around the corner.

6. CONCLUSIONS

We have been concerned with the relationship between economic theory and economic policy. Economists usually identify the difficulties of economic policy with imperfect foresight, ignorance of certain key relationships and with conflicting policy objectives, while the communication problem between economic theory and economic policy has been pushed into the background. Without denying the importance of the factors mentioned first, this communication problem has been emphasized in this paper. We have argued that economists using their theoretical framework and the actual economic policy debate in each country conceive of the problems, targets, constraints and instruments of economic policy in different ways. We employed the terms economic theory model and economic policy model to indicate these different ways of thinking of economic policy.

We also argued that economic-structural, historical, political and cultural factors shape the relation between the theory model and the policy model in a specific way in each country. We laid down some propositions concerning this relation and claimed that our country cases supported them. Originally the Keynesian ideas fertilized the policy models of various countries, and e.g. in Sweden the active interaction between economic theory and policy led to further development of the policy model towards a kind of progressive Keynesianism. But the interaction between the policy model and the theory model evaporated over time, the policy model became stagnant and was led to a crisis by the stagflation of 1970's. Finland again provides an example where no dialogue between the Keynesian theory model and the national policy model ever occurred.

Our country studies indicate that despite the ongoing integration of the policy-oriented economic theory around the Neoclassical Synthesis, the character of the economic policy

debate, or the policy model, clearly differs from one country to another. From this point of view, the Finnish policy model offers a particularly interesting example.

It also turned out that to a certain extent it is possible to account for the differences in the national policy models in terms of the factors relating to the economic and political structure in each country. In our mind, these explain why in the Nordic countries there has been more emphasis on the problems of supply and why the control of social conflicts inherent in the Swedish model integrated the problem of inflation within the model. Yet such factors leave unexplained the sharp contrast between the Swedish and Finnish models. We have to conclude that some deeper differences in the politics and culture of these countries are involved here.

We also provided evidence of how the country-specific policy model tends to determine the economic policy thinking of all participants of the policy debate from the Right to the Left. This seems to be more or less the general case.

Our investigations are also in accordance with the view that in settled normal economic and social conditions the influence of the theory model on the policy model tends to be minor at the level of the basic policy paradigm. It is during an economic and social crisis that a relevant theory model, deviating from previously accepted truths, may have the greatest influence on economic policy thinking. The rise of Keynesianism provides an example of this.

Our cases indicate that basically the policy model is stubborn and resists change. It can live quite unchanged over great economic, political and cultural upheavals. This is exemplified by the Finnish policy model, which stems from the inter-war

period despite the fact that the Finnish economy and society have since then experienced one of the most violent structural changes in the Western world.

International economic developments during the last ten years have put the policy models of various countries under change. We made some observations concerning the recent changes in the Finnish and Swedish policy models respectively. It turned out that to some extent these two models are at crossroads. While the Finnish model has adopted certain elements of Keynesianism, and in particular has given more emphasis to internal stabilization than before, the Swedish model shows some symptoms of 'Finlandization'. In particular it has given more emphasis to costs and competitiveness than before. These recent developments may reflect the dominant influence of changes in external economic conditions on the policy models of small open economies. These changes in different directions in Sweden and Finland at the end of 1970's and early 1980's. In the former case they became more difficult while they were eased in Finland. These changes, and the consequent changes in the policy models, may however be temporary.

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