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# How New Economic Ideas Changed the Danish Welfare State

The case of Neoliberal Ideas and highly Organised Social Democratic Interests

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## Abstract

The article argues that new economic ideas have exerted an independent causal effect on policy change in three major areas in the Danish welfare state; unemployment insurance, early retirement and taxation.

Thereby the Danish case bears resemblance to the paradigmatic shift from Keynesianism to monetarism in the UK. However, in the Danish case this paradigmatic shift did not coincide with a political shift to a right-wing government. This makes it possible to disentangle the intimate relationship between ideas and interests. It is argued that the Danish case provides one of the clearest examples of the independent causal effects of economic ideas because the Social Democrats pursued policies that compromised with the party's historically rooted positions and with the preferences of their electorate. Ideas and solutions did not come in one fixed package, however. But the new paradigm established some basic premises that were not up for discussion.

*Keywords: ideas, welfare reform, policy learning, policy paradigm, labour market policy*

## Introduction

The impact of ideas has become the topic of much scholarly interest, not least in comparative welfare state research. Increasingly, theories about ideas are used as an important supplement to

theories that explain welfare state change with increased exogenous problem pressure, shift in power resources (e.g. Korpi & Palme, 2003) or institutional feedback processes (e.g. Pierson, 1994, 2004; Skocpol, 1992). However, “ideas matter” studies have frequently been criticised for not being able to distinguish between the impact of ideas and other determinants of change, in particular interests (e.g. Blyth, 1997:236). In Peter Hall’s (1993) seminal contribution to the “ideas matter” tradition it is analysed how a shift in economic ideas – described as a shift in policy paradigm from Keynesianism to “monetarism” – influenced the Conservative Thatcher governments in the 1980s. However, Hall (1993) himself underlines that such paradigmatic changes involve major clashes between interests, and sceptics might argue that the redistributive effects of Thatcher’s monetarism coincided with the economic interests of a core group of the electorate of the Conservative party. From a “problem pressure” point of view, other sceptics might argue that the British economic situation by itself demanded radical change. In other words, both types of sceptics might argue that ideas were largely epiphenomenal.

The “ideas versus interest problem” also causes trouble for other studies in the field. For instance, a number of scholars have described how successful policy proposals need to be framed within the society’s cultural repertoire (e.g. Cox, 2001, Marx Ferree, 2003, Schmidt, 2002; Somers and Block, 2005). From this position it could be argued that Thatcherite neo-liberalism was possible because it could be linked to existing values within the British cultural repertoire (Beland, 2007). By the same token, it has been argued that in Scandinavia reform initiatives need to be framed within a Social Democratic discourse (Cox 2001). However, several studies have described how political actors can fit quite different policies to a particular cultural repertoire and sometimes even change the cultural repertoire itself (e.g. Snow et al. 1986: 469). Thereby “ideas matter” analyses again become an easy target for the interest argument. This also applies to the argument that the ability to impose reforms depends on the policy makers’ ability to build ‘coordinative’ and

‘communicative’ discourses (Schmidt, 2002, 2003). This would certainly not convince adherents of the power resources theory who suggest that it all boils down to interests (Korpi & Palme, 2003).

This article provides a response to such criticism by analysing a case where new ideas contributed to changes that 1) did not coincide with the (historically rooted) position of the political actors in charge and did not correspond with the preferences of their electorates and 2) did not coincide with a severe “objective” problem pressure that more or less obviously demanded retrenchment of the welfare state. Moreover, as the introduction of new ideas did not coincide with a change of government, Denmark provides a critical case where it is possible to isolate the effect of ideas and eliminate alternative explanations.

In the following, we first clarify the concept of ideas and describe how the Danish Social Democratic governments adopted a number of major reforms that were strongly influenced by new economic ideas but compromised with the party’s historically rooted preferences and with the preferences of the party’s core constituency as well as of potential voters. Next, it is described how these new economic ideas were introduced and how the new problem diagnoses were by no means a simple reflection of reality. The following sections describe how these new paradigms influenced Social Democratic labour market policy, early retirement policy and tax policy, respectively. The argument is *not* that these new ideas eliminated “ordinary” political conflicts about the distribution of economic resources. But the political struggles were fought in a context where the new paradigms established some basic premises that were not up for discussion.

### **Social Democratic welfare reforms in the 1990s: A case where ideas had a life on their own**

It is not an easy task to define ideas, but as a point of departure we can use Hall’s (1993: 279) definition of a paradigm as “a framework of ideas and standards that specifies not only the goals of policy and kind of instruments that can be used to attain them, but also the very *nature of the*

*problems* they are meant to be addressing” (Hall, 1993: 279). However, the paradigms described below are more policy specific than Hall’s notion of a total shift from Keynesianism to monetarism. In the first place, such a “global” shift did not take place in the Danish case – actually the Danish Social Democrats in the 1990s did not completely dismiss Keynesian fiscal policy, nor did subsequent Liberal-Conservative governments. Even more importantly, notions of Keynesianism and monetarism sometimes become so broad that they include ordinary ideological conflicts, or they may become so narrow that it ends up in technical distinctions between two economic schools which are often mixed up in practical economic policy. Therefore we focus more narrowly on problem definitions or ideas about “the nature of the problems” at the policy level. More specifically, in the field of unemployment policy and retirement policy we distinguish between what could be labelled a “business cycle paradigm” and a “structural unemployment paradigm” which are linked to policy makers’ perceptions of the nature of unemployment and what could be done about it. In the field of tax policy there are no equivalent labels, but certainly a shift towards a paradigm that much more strongly emphasizes the impact on labour supply and competitiveness.

Special attention is paid to causal beliefs which may be defined as “beliefs about cause-effect relationships which derive authority from the shared consensus of recognized elites, whether they be village elders or scientists at elite institutions” (Goldstein & Keohane, 1993: 10). The idea of a shared consensus is also highlighted in Hall’s description of a paradigm. According to Hall, a paradigm ‘is embedded in the very terminology through which policy-makers communicate about their work, and it is influential precisely because so much of it is taken for granted and unamenable to scrutiny as a whole’ (Hall, 1993: 279). Thus, in order to understand the influence from paradigm shift we should look for problem diagnoses and cause-effect beliefs that are taken for granted across policy elites representing different interests.

As to the dependent variable, the article will concentrate on the policy changes which the Social Democratic led governments carried out in the period from 1993 until they lost office to a Liberal-Conservative coalition in 2001. For eleven years prior to 1993, bourgeois governments had pursued quite strong cost-containment policies but made few institutional changes (Goul Andersen, 2000). The Social Democratic coalition governments, by contrast, allowed public consumption to increase at a much higher rate after 1993, but at the same time introduced significant institutional changes in the fields of unemployment insurance, early retirement, and tax policy. Most remarkably, they in most cases had to compromise not only with previous policy preferences but also with the immediate interests of significant groups among their electorate; nor did the policy changes have any appeal to potential “swing voters”. And at the same time, the economic problem pressure on the government was almost continuously reduced – from the mid-1990s, Denmark entered a long and almost uninterrupted period of prosperity.

In what came later to be described as a labour market reform in three stages 1993, 1995 and 1998, duration of unemployment benefits was gradually reduced, from about 8½ years to four years. At the same time the unemployed were confronted with ever more strict obligations for being available for the labour market so that strictness of eligibility changed from being among the most liberal to being among the strictest in Europe (Ministry of Finance, 1998, 2005:20-21; Hasselpflug, 2005). This indeed represented a shift from previous policy positions, and it is worth noticing that the same kind of reduction in duration period was blocked by the Swedish unions (Klitgaard, 2004). Furthermore, the harsher treatment of those unemployed was not very popular among the public which in the mid-1990s found job share arrangements much more attractive and effective (Goul Andersen, 1995a, Borre & Goul Andersen, 1997: 247-279).

In the field of early retirement, the Social Democratic government was even braver in breaking with the interests of the party’s voters. In 1998, the government changed the early

retirement allowance scheme – the “*efterløn*” – which was seen by many Social Democrats as the crown jewel among Social Democratic political attainments. This scheme, introduced in 1979, gave workers the opportunity to leave the labour market at the age of 60, typically with an allowance equal to maximum unemployment benefits. This scheme was extremely popular among Social Democratic voters - and among the electorate at large. In the 1998 election campaign where the government was on its heels, the prime minister had finally promised that the scheme would be maintained if the government was re-elected. In the 1998 reform, benefits for the 60-61 years old were cut by 9 per cent, and until the age of 62, there would also be a reduction for private pension savings over a certain minimum. Besides, contributions to unemployment insurance and early retirement allowance were separated and increased. The unions protested, and immediately after the political compromise over the early retirement allowance, support for Social Democrats in opinion polls was halved as compared to the election result nine months earlier (Goul Andersen, 1999).

Finally, the Social Democratic government lowered marginal taxes in the 1993 tax reform. According to the plan, effective marginal tax rates should be reduced by 7.1, 9.2 and 6.5 percentage points, respectively, for lower, medium and higher incomes. In practice, however, the reduction was not fully realized for lower and medium incomes because of increasing municipal taxes; at this point, the higher incomes were protected by a total tax ceiling. The reduction of marginal taxes were financed mainly by “green taxes” (on water, electricity, petrol etc.), by lower deductions for interest payments, and by a few other instances of “broadening the tax base” (Larsen & Goul Andersen, 2004: 152-155). In addition, some “dynamic effects” (from expected impact on labour supply) were included. There was a deficit, however, as a temporary tax relief was intended to “kick-start” the economy. This lowering of marginal taxes differed significantly from the party’s previous proposal in 1989, and it was hardly intended to satisfy voters’ preferences. In the 1990 election, the bourgeois government nearly lost office after an election campaign on a proposal to

lower income taxes for middle-income groups (*without* any concomitant savings that had any impact on ordinary citizens or on the welfare state). By opposing the proposal, the Social Democratic party increased its support from 29.8 per cent to 37.0 per cent (Bille, Nielsen & Sauerberg, 1992). Voters did not like the Social Democratic 1993 tax reform either. The reform was technically complicated and poorly understood, but even though there was considerable sympathy for “green taxes” – at least in the beginning (Goul Andersen, 1999) – the tax reform as a whole was certainly not welcomed by the electorate (Goul Andersen, 1995a, 2005).

Looking across these three policy areas, we observe quite significant changes in Social Democratic policy preferences which cannot be explained from a vote-seeking model of party behaviour. On the other hand, it is easy to point out a possible connection between changing preferences and new economic ideas. In order to establish the causal link, we shall follow Hall’s idea of “process tracing”. The idea is that the causal link can be demonstrated through a “thick description” of how new ideas came into place, how they became dominant, and how they influenced concrete policy initiatives: in our case unemployment insurance, early retirement and taxes. The main empirical material is policy relevant documents, which is supplemented with personal interviews with the key actors.<sup>1</sup>

Before turning to this “process tracing”, however, it is useful to briefly discuss two alternative explanations of the actions taken by the Social Democrats. First, it might be argued that the government was simply forced by exogenous problem pressures to adopt such reforms; one could call it the “exogenous pressure” argument. Social Democratic decision makers themselves would undoubtedly claim that they only did what was ‘necessary’. However, what is perceived as ‘necessary’ depends very much on the diagnoses of the problems, and on the concomitant cause-effect beliefs of actors. The high level of unemployment in the early 1990s was seen as a major problem and obviously constituted an economic challenge. But as pointed out below, it was by no



means self-evident that the Danish labour market was severely troubled by structural problems. Furthermore, the economic situation could hardly be regarded as unsustainable (Goul Andersen, 1997). As judged by comparative standards, problem pressure was quite modest. Denmark was blessed with high labour force participation rates, also among the elderly, by increasing full-time employment rates, by low levels of long-term unemployment, by high fertility rates, by inexpensive public pensions and health care - and even by low life expectancy. All these factors made the short-term and long-term fiscal pressures more modest than in most other European welfare states (Goul Andersen, 2000, 2002). Arguably, Denmark could have avoided a shortening of duration of unemployment benefits (as in Sweden at the time); the early retirement scheme could have remained unchanged (as retirement age was anyway comparatively high), and aggregate employment figures did not indicate that marginal tax rates had to be lowered. This is not to argue for or against possible beneficial impacts, but to underline that problem pressure is not a convincing candidate as a key driving force behind the reforms.

A second alternative line of reasoning could be that even though the Social Democrats were not vote-seeking they might still have been office-seeking. The argument is supported by the fact that the Social Democratic governments throughout the period had to rely on a small coalition partner, the (social liberal) Radical Liberal Party. This party in fact strongly endorsed the new economic ideas. Especially in the case of the early retirement reform, the Social Democrats faced internal pressure from the coalition partner. However, interviews indicate that the leading Social Democratic ministers were in most instances in agreement with the coalition partner.<sup>2</sup> Moreover, there is nothing to indicate that the reforms were popular among swing voters. As far as swing voters are concerned, it was important for the Social Democrats to create and maintain an image of economic responsibility, but this was more a matter of keeping budgets and maintaining macroeconomic stability. This was by no means immediately related to labour market, retirement

and tax reforms. Finally it should be mentioned that apart from the 1993 tax reform and the 1993 labour market reform, the policy changes were adopted in compromises with the Liberal and/or Conservative opposition parties. However, the government was not without alternatives: throughout the period there was a (workable) centre-left majority in Parliament, and substantial parts of the changes could have been avoided if the government had not been convinced that they were necessary or beneficial.

### **The birth of a structural unemployment paradigm**

As mentioned the idea of structural unemployment became the focal point of consensus formation among the Danish policy elite. It came to be taken for granted that the high levels of unemployment was not a matter of insufficient demand for labour power but primarily a matter of structural problems on the Danish labour market. Thus, the only efficient way to combat unemployment was to implement various supply-side policies that could reduce the structural level of unemployment. Without such policies traditional Keynesian demand side policies aimed at lowering unemployment would only generate inflation. And this holds even for the alternative export/competitiveness strategy which the Conservative/Liberal governments after 1982 adhered to. The unemployed would remain unemployed due to insufficient qualifications (relative to minimum wages), insufficient work incentives (relative to unemployment benefits), and other sorts of mismatch problems (wrong qualifications, low geographical mobility etc). The logic is that firms would simply compete by bidding up wages for those workers already employed and fit for available jobs. The result is (wage-driven) inflation. So the story goes.

The question is how this structural unemployment paradigm which both includes a diagnosis of the problem and cause-effect beliefs came into Danish politics. As in Hall's study, one can point to the younger generation of economic researchers where "supply side economics" rapidly

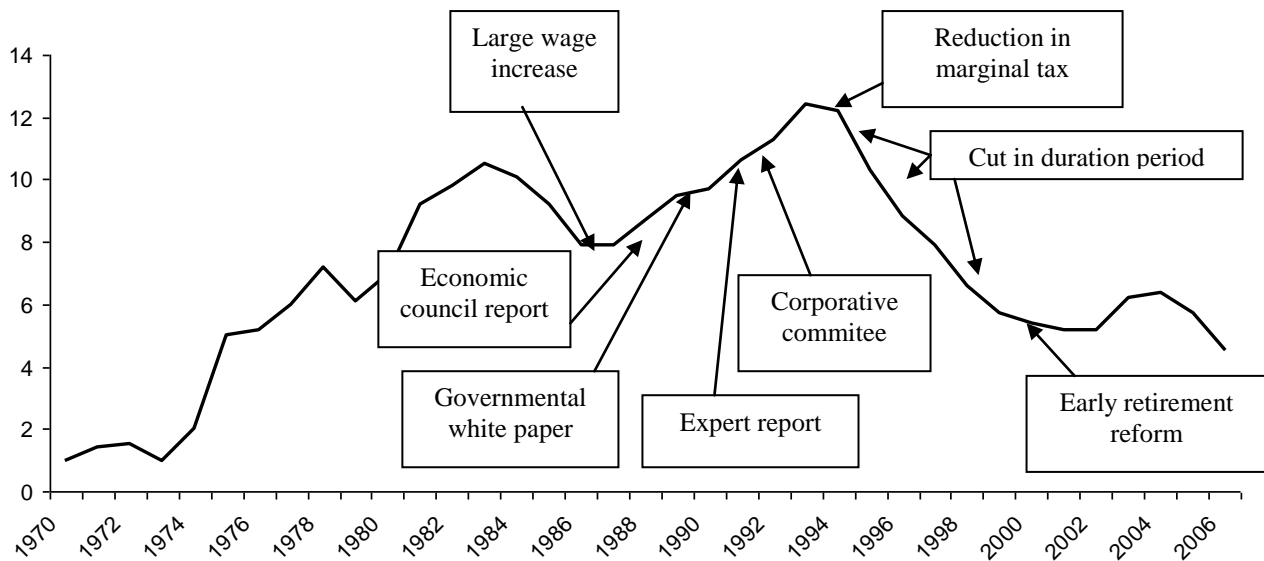
gained ground. In a Danish context the idea of structural unemployment was first brought into policy discussions by the 1988 June report by the chairmanship of the Economic Council, albeit in a preliminary and tentative version. Whereas the later 1994 OECD Jobs Study linked structural unemployment to rapid technological development and globalisation, the Danish economists were originally inspired by Lindbeck and Snower's (1988) theory of insider-outsider problems. However, the question is why a consensus about this idea of structural unemployment could be established among the leading economists, politicians and interest representatives in the 1990s.

One classical answer is that new ideas enter politics when they can serve as a "weapon" (Blyth, 2002) for new actors that come into power. This is the story of Thatcher's use of ideas of monetarism in Great Britain. In the Danish context there was no change of leadership, but the idea of structural unemployment was welcomed by the bourgeois coalition government searching for ways to gain new momentum – or at least by influential ministers who also managed to convince the Prime Minister. In May 1989, the government presented a huge economic plan and concomitantly issued a white book about the structural problems of the labour market. As something completely unusual, a group of labour market economists were invited to participate in the writing of the report. The economic plan was the government's main strategic attempt to get back to a more liberal policy as it felt pressured from a mobilisation of the populist right (Larsen & Goul Andersen, 2004:87). Thus, as in the British case it becomes difficult to distinguish between interests and ideas. The crucial part of the story, however, is that the Social Democratic party and the unions also came to accept the ideas of structural problems on the labour market. This acceptance poses a major challenge to an alternative explanation in terms of interests.

From an ideational approach, there are different explanations of the formation of shared consensus among elites. One classical line of reasoning is that policy makers learn from previous policies. As in Kuhn's understanding of scientific revolutions, a main source of paradigm

shift is accumulation of anomalies within the old paradigm which end up questioning its very premises. Thus, one interpretation of the shift from a business cycle paradigm to a structural unemployment paradigm is that the former was not consistent with reality anymore. The stereotypic example is stagflation in the 1970s; according to mainstream Keynesian thinking there should be a trade-off between unemployment and inflation (the Philips curve) but suddenly both were present at the same time. In the 1970s Social Democratic governments experienced that expansive fiscal policies did not reduce the level of unemployment. On the contrary, unemployment continued to increase until the bourgeois government came into power in 1982 (see figure 1).

Figure 1: Average unemployment rate (national statistical definitions).



Source: Statistics Denmark, Statistisk Tiårsoversigt, 1980ff. Unemployment defined as those registered as unemployed and calculated as full-time unemployed.

However, it is well-known (e.g. Blyth, 1997) that the analogy to scientific paradigm builds on a too rationalistic understanding of learning (and of Kuhn's theory). Public policy is at best a case of social learning under conditions of very high uncertainty, far from the situation of research groups testing natural laws. Furthermore the oil crises and the economic policies during the 1970s were complex phenomena which could be given many different explanations. The experiences of the 1970s did influence the Social Democrats' understanding of the limits of Keynesian policies, but it certainly did not provide them with a clear alternative diagnosis of the causes of unemployment, let alone with a rational policy solution to the problem. With reference to Kingdon (1995) we will rather emphasize the importance of a focusing event. The argument is that before an idea is pushed to the decision agenda, it often needs to be attached to one single event which in a very simple manner highlights a certain problem (see also Beland, 2006).

In the Danish case the wage negotiations in 1987 became such a focusing event for building consensus about the idea of structural unemployment. This can be seen by the fact that all economic reports, policy documents and all the interviewed actors make a reference to the 1987 experience. The story goes as follows: After the bourgeois government came into power in 1982, they stabilised the Danish economy by dismantling the possibility of devaluation and removing the automatic indexation of wages. At the same time Denmark benefited from significantly improved competitiveness since 1979, from growth on export markets, and (unintentionally) from rapidly increased domestic consumption released by lower interest rates and sky-rocketing real estate prices (Goul Andersen, 1997). From 1983 to 1987 Denmark experienced the first significant decline in unemployment since the oil crises in the 1970s. The official unemployment rate declined from 10.5 percent to 7.9 percent (and employment improved even more). However, this economic boom ended with very high wage increases in 1987 which was followed by seven years of low growth and increasing unemployment; unemployment peaked at 12.4 percent in 1993 (see figure 1).

The wage explosion in 1987 was interpreted as evidence that unemployment had declined below the level of structural unemployment which by definition means accelerating wage increases and thereby lower competitiveness. Even though this interpretation was in fact wrong or problematical at best (see below) it became a common understanding among researchers and decision makers 1) that the level of structural unemployment was about eight per cent or more and 2) that only reforms which altered the structures of the labour market could bring unemployment below that level. The aftermath of the 1987 wage negotiations made it clear that if unemployment fell below the level of structural unemployment it would only generate wage inflation, reduced competitiveness and even more unemployment (see figure 1, the period from 1987 to 1993).

This story was told by the Economic Council in 1998 and by the bourgeois government in the white paper from 1989, but it was perhaps most clearly spelled out in the reports

from the so-called Social Commission (1991-1993). This expert committee did not have any immediate political impacts, nor was it meant to, but its reports became an important reference point in the policy debates of the 1990s. It concluded that without structural reforms, increasing demand for labour power (even if driven by exports) would not lead to lower unemployment. Moreover, due to loss of human capital more and more workers would become unemployable and therefore the level of structural unemployment would become higher and higher – a phenomenon known as “hysteresis” in the economic literature (Blanchard & Summers, 1986). Thus, the prediction for the future was even higher levels of structural unemployment, which gave the impression of a real crisis. Furthermore, policy makers were presented to a link between structural unemployment and social problems. The Social Commission described a “lost generation” of people who had never been included at the labour market and would become less and less employable. Thereby the Social Democratic policy makers were introduced to a structural unemployment paradigm that also included a social dimension.

### **The structural unemployment paradigm as a social construction**

The status of the structural unemployment paradigm can be discussed. If the new diagnosis was simply a matter of improved understanding or a “pure” reflection of reality, it could be argued that it was “reality” rather than “perceived reality” that influenced Social Democratic policy makers once they came into office. However, a number of circumstances seem to question this rational line of reasoning.

First of all, one can seriously question the interpretation of what happened in 1987. Wages did increase, but by and large they increased only in the collective negotiations, not due to wage drift as would be expected (Ibsen, 1987). A very important reason for these wage increases was purely political; 1987 was election year, and ever since its intervention in the collective wage

negotiations in 1985 which generated large protests, the government had been lagging behind in opinion polls (Goul Andersen, 1988). Partly in an attempt to gain popularity, the government had promised large wage increases to public employees, and the unions were keen to have a revenge for the 1985 intervention.<sup>3</sup> This is not to say that policy makers simply got it all wrong. Even though in retrospect, 1987 would seem to tell nothing about structural unemployment, it was not self-evident at the time of decision making, and only a few policy experts at that time publicly expressed an alternative view.

Secondly, it would look almost like a contradiction in terms that unemployment could decline so rapidly from 1994 onwards – by 1999 unemployment was halved - without accelerating wage increases (see figure 1). Policy makers and ministries naturally claimed that lower unemployment was an effect of “structural policies”, but in retrospect even the chairmanship of the Economic Council - formerly convinced about structural unemployment - recognised in 2002 that previous estimates had been ‘questionable’ (Economic Council, 2002:135, see also Larsen, 2003). It is also telling that Denmark was later heralded for its extremely flexible labour market – a type of “flexicurity” model that has been presented by the EU Commission as an example of “best practice”. There was nothing new about Danish “flexicurity”, however, except the new term. Apart from increased emphasis on active labour market policy, Danish “flexicurity” was basically unchanged since the 1970s.

In short, there are strong arguments that the diagnosis of structural unemployment was not simply a reflection of new objective problems. It was an outcome of a process of social learning which also entailed the risk of mis-learning. In other words, it was not simply reality by rather an elite consensus about perception of reality that subsequently influenced the policy process.

### **Labour market policy and adoption the idea of structural unemployment**



The diagnosis of structural unemployment naturally implied a critical focus on existing labour market policies and a search for possible new ‘treatments’. However, thereby the new ideas faced the unions - one of the strongest and most well-organized power resources in the Nordic countries. Together with the Social Democrats, the unions had fought to maintain relatively generous unemployment benefits, not least a very long duration period. Combined with a public opinion that did not blame the unemployed (e.g. Larsen, 2008a) the resistance to change had been so strong that the bourgeois governments from 1982 to 1993 had not dared to make fundamental changes in the unemployment insurance system.<sup>4</sup>

Therefore it was obvious that possible new ‘treatments’ aimed at combating structural unemployment could be the subject of a severe fight between strongly organised interests. However, even the unions came by and large to accept the idea of structural unemployment. This acceptance by the unions was formally obtained in the so-called Zeuthen-Commission (“Commission to elucidate the structural problems on the labour market”) that worked in 1992. It was a classic corporatist committee with representatives from the unions, the employers, the ministries, the municipalities, and labour market experts. In this forum the diagnosis of structural unemployment was by and large accepted, even though the concept remained slightly ambiguous and (at least to the unions) contained traces of earlier meanings of the concept. However, the consensus about unemployment being structural was the most important achievement of the committee, alongside the agreement to expand activation and have regional corporatist bodies to guide and adapt the efforts to regional variations in supply and demand for labour power.

Thereby the political conflict moved to a new level; namely what ‘treatment’ should be given and how it should be legitimised. In the end, active labour market policy (ALMP) (alongside some subsidization of services for private households) became the alternative to neo-liberal solutions. Later, this became a widely used alternative, but in the beginning of the 1990s,

ALMP was rarely promoted as a serious solution; for instance, even in the large OCED Job study from 1994 ALMP was only discussed in vague terms and referred to as a second-best solution. In Denmark, however, ALMP was perceived as a functional equivalent to neo-liberal solutions. Participation in activation programmes, e.g. job search courses, education and job training, was believed to work in two ways. In the mid-1990s, the qualification effect was prioritized, not least in political discourse. Instead of bridging the mismatch between minimum wages and qualifications by lowering wages and benefits, the idea was to enhance productivity – in particular to re-qualify those considered unemployable. However, as improved evaluation methods indicated that qualification efforts had very limited employment effects for the individual (Ministry of Labour, 2000), and as the employment situation improved, the ministries involved came increasingly to emphasize the “motivational” or deterrence effects of mandatory participation in activation. But this largely belongs to a later stage and was more fully developed in the following decade.

With the structural unemployment diagnosis being hegemonic among policy makers, the activation strategy – even with its tighter obligations – could be legitimized as the least of two evils. This was not directly an argument for reductions in the duration period of unemployment benefits but it delivered the background for a new line of reasoning; namely that the public effort to find jobs to those unemployed would be so intense that a long duration period would not be needed. The unions had their doubt about this latter part of the logic, and the Zeuthen Commission could not reach any consensus about changing the duration of benefits. The main confederation of unions (LO) also had its worries about mandatory participation in activation measures and attached sanction mechanisms, but it was calmed by the fact that the unions, jointly with the employers, were planned to supervise and influence the regional implementation of these policies.

In relation to Hall’s definition of a paradigm it is important to notice that the new diagnosis did not dictate one single instrument to be applied. Diagnosis, goals and instruments did

not come in one fixed package. On the contrary, the strength of the paradigm of structural unemployment in Denmark – understood as the new frame of reference and new beliefs about causes and effects – was exactly that it allowed a political fight about proper instruments. This also explains why the new paradigm was adopted in a silent revolution and not through dramatic conflicts (Torfing, 2004) – before the instruments were developed and long before the impacts began to materialize.

However, even the consensus about ‘soft’ instruments generated opposition among the left-wing parties, some of the more radical unions, and part of the electorate. Without a shared perception of the ‘rational link’ between the diagnosis of structural unemployment and the new ‘treatment’ the public would naturally come to discuss whether it was fair or unfair to treat the unemployment in a harsher way. The Social Democratic defence rhetoric or “communicative discourse” (Schmidt, 2002, 2003) followed two paths. First, the leaders had already launched a “rights and obligations” discourse. The argument was that entitlements to unemployment benefits had always been accompanied by the duty to search actively for job and to be mobile across branches. This “rights and obligations” discourse was a case of pure legitimization. The second rhetoric defence had more substance. Under the label of ‘passive versus active’ it was argued that more had to be done to help those unemployed than just providing economic security. This ‘doing more’ had an appeal to the critical left-wing segments, and it created the idea of a win-win situation; active labour market policy would both alleviate the problem of structural unemployment and the social and psychological problems connected to not being at the labour market. This was a convincing discourse even though survey-based studies actually questioned the strong causal link between unemployment and social and psychological problems (Goul Andersen, 1995b, Goul Andersen, Larsen & Jensen., 2003; Clement 2004). In accordance with previously conducted policies, these studies actually pointed out that economic insecurity was a more severe problem than

being without work *per se*. Nevertheless, the “lost generation” argument of the Social Commission gave the Social Democrats a way to legitimize a gradually more tough treatment of those unemployed.

### **The politics of the new labour market policy**

It still required some political manoeuvring to cut the duration period. The main political strategy to do so was to break with the tradition of corporative decision making within the field of labour market policy.<sup>5</sup> Thus, the 1993 labour market reform was not discussed with the unions or the employers. Even though this reform was “soft” and could be legitimized by the fact that it largely followed the recommendations of the Zeuthen Commission, the strategy of not hearing the social partners came to the latter as an unwanted surprise (Larsen & Goul Andersen, 2004: 221). The exclusion of social partners became even clearer in the second labour market reform (1995) – negotiated as part of a package agreement with the Conservatives over the 1996 state budget – where the duration period was reduced to five years. It seems that the interest organisations were not even invited to informal discussions prior to these reforms (Larsen & Goul Andersen, 2004:213; Winther, 2003: 298). The third labour market reform in 1998 which reduced the duration period to four years was also prepared by a group of civil servants. Prior to this reform, the social partners were invited to a number of seminars, but soon got the feeling that they were not really included in the decision making process. Out of frustration the unions negotiated an agreement with the employers where they accepted the third cut in the duration period in return for a right to comprehensive (and expensive) activation. The federation of unions was widely criticised for having accepted this cut but defended themselves by the argument that the reduction would have taken place in any case (Winther, 2003:299; Mailand & Due, 2003:213; Torfing, 2004: 264).

In addition to excluding the social partners, the government also improved its room of manoeuvre by excluding the Parliament. The first Social Democratic led government 1993-94 was a majority government, and the first reform package was negotiated between the key ministers and presented to parliament more or less as a *fait accompli*. Subsequent reforms were included in the annual budget negotiations which takes place between a few party leaders. This means that the Parliament was de facto excluded from open discussions, and perhaps even more significantly, this also by and large holds for the press (Larsen & Goul Andersen, 2004). In the case of the 1998 reform the press remained uninformed that the early retirement allowance was included in the negotiations until the very last minutes before the agreement was reached. In short, the somewhat less pleasant ‘treatments’ derived from the new paradigm were carried through – deliberately or unintentionally – by excluding any interests that could possibly oppose them.

The other political strategy was the classical retrenchment strategy (Pierson, 1994) of making large policy packages that were difficult to disentangle and where the ‘bitter’ came with the ‘sweet’. The mix of the ‘bitter’ and ‘sweet’ was clear in the first labour market reform in 1993. The (small) reduction in the duration period came together with a new system of implementation (where the social partners were granted substantial influence), a wide range of activation possibilities, a pre-early retirement programme for long-term unemployed between 50 and 59, and a number of new leave arrangements (strongly improved maternity leave and educational leave, and even sabbatical leave). The latter arrangements were intended as means to break the unemployment curve instantly (and preferably before the 1994 election). At the time of the first labour market reform, however, it was difficult to see whether the reform as a whole represented a softer or a harsher policy towards those unemployed. It was a two-track strategy, so to speak. The 1995 and 1998 agreements were also part of larger packages, but here the move towards tighter conditionality, to use Clasen & Clegg’s (2007) term, was unambiguous. In the 1995 agreement, the pre-early

retirement scheme was abolished, and sabbatical leave was almost dismantled (finally abandoned in 1999); from 1999 followed the educational leave for those unemployed and finally the entire educational leave scheme from 2001. Eligibility was restricted, requirements to mobility and active job-seeking were tightened substantially, state control with the implementation was increased, and duration period was reduced.

One can actually argue that the new paradigm generated a “lock in” effect comparable to institutional path dependency (Blyth, 2001; 2002). Given the diagnosis that unemployment was structural, policy makers became more and more worried about inflation pressure as unemployment began to decline (see figure 1). Therefore harsher and harsher policies seemed to be needed, and they were also less difficult to legitimize. The reduction of the duration period from eight and a half years to four years was probably not a master plan from the outset, but as unemployment declined it was felt more and more necessary, or at least, as a “natural” adaptation.

The structural paradigm also had a great impact on how evaluation results were interpreted. The numerous evaluation reports of the 1990s found it difficult to prove any positive employment effects of activation; sometimes qualification efforts were even pointed out to have a small negative effect on finding a job (e.g. Langager 1997). However, this never led to a questioning of the underlying diagnosis which assumed that qualifications and motivation was a problem. Rather, the dominant logic was that if the ‘medicine’ did not work, then a larger ‘dose’ was needed (Larsen, 2002). This is in perfect accordance with Hall’s (and Kuhn’s) theory of how paradigms work.

It is also obvious that paradigms can function as ‘institutions’ that limit the political opportunity structure; any policy proposal that could possibly be depicted as ‘passive’ labour market policy was effectively ruled out. However, there is one important exception to Hall’s description: The structural unemployment paradigm did not completely rule out all Keynesian

measures. As mentioned, the introduction of the new measures in 1993 was in fact accompanied by an attempt to “kick-start” the economy by stimulating effective demand through lower taxes. Besides, leave arrangements and pre-early retirement were introduced to limit labour supply. It illustrates that Keynesianism was not entirely abandoned by the Social Democrats (nor by subsequent governments) but survived in a “light” version with stronger focus on the supply side at the labour market (Goul Andersen, 2002; Asmussen, 2007).

### **The structural unemployment paradigm and the early retirement reform**

The early retirement reform in 1998 was another major reform where the Social Democrats had to compromise with historical preferences and the interests of their electorate. The early retirement reform was not quite as intimately linked with the structural unemployment paradigm as the changes in the unemployment insurance system. At the time when the reform was originally introduced from 1979 it was expected to redistribute unemployment, in particular to reduce youth unemployment. But from a supply-side perspective one would rather expect a decline in the labour force. The latter prediction fitted reasonably well with data, but from a traditional perspective, one would still expect take up of early retirement allowance to decline with lower unemployment. Asked directly, former Minister of Finance Mogens Lykketoft who was the major architect behind the 1998 reform has confirmed that it was unexpected increases in expenditures that brought the reform proposal on the decision agenda, in particular the ever more worrying forecasts about expected expenditures for 1999. This statement and the fact that many other European countries have reversed the growth of early retirement schemes support the “exogenous pressure” argument about fiscal necessity. Still, as already argued, the fiscal pressure was modest in the Danish context. The bourgeois governments from 1982 to 1993 did not dare to change the scheme, and from 1993 to 1998 the Social Democratic government also tolerated the fiscal burden. As the level of

unemployment had nearly halved by the end of 1998, fiscal pressures on the Danish welfare state were much less severe (well on the way towards a stable budget surplus after 2000) than in 1993. Thus, a simple ‘austerity argument’ is not sufficient. And on the other hand, it was still too early for “exogenous pressure” arguments about shortage of labour power that were to appear later on.

Further, one can demonstrate that the new understanding of the functioning of the labour market actually influenced the way policy makers judged the impact of early retirement schemes. In the interview the minister acknowledged that “*there have been some moves in the perception of reality...* ”, which have influenced the policy process.<sup>6</sup> One of the central civil servants in the Ministry of Finance also states that “*the early retirement reform was one out of more elements that aimed at stimulation of labour supply ... part of a larger jigsaw*”.<sup>7</sup>

Equipped with the new cause-effect beliefs the bourgeois parties pinpointed that early retirement did not reduce unemployment. The missing link between early retirement and new employment was already documented by the Social Commission, and the economists involved in the commission eagerly maintained this position during the 1990s. It almost follows logically from the diagnosis of structural unemployment that early retirement cannot lower unemployment. If the problem is lack of qualification and motivation and not lack of general demand for labour then the unemployed will naturally not be able to fill the vacancies left open by early retired. The Social Democrats, themselves discussing their new labour market policy within a structural unemployment paradigm, could not completely dismiss this line of reasoning. The first confession by the Social Democrats was to accept that early retirement probably did not contribute to lower unemployment (Larsen & Goul Andersen, 2004:249)

However, being aware of the popularity of the scheme, the Social Democrats were reluctant to take any serious measures against it. They tried to argue that the increased use of early retirement was caused by exclusion from the labour market. Therefore they launched a number of



‘soft’ policies, e.g. campaigns to inform employers about the worth of elderly unemployed. The government also argued that the inflow into early retirement would decline or at least stabilize when unemployment declined even further. The Ministry of Finance defended this position in 1997, and in the last part of the election campaign in 1998, Prime Minister Poul Nyrup Rasmussen issued, as already mentioned, an early retirement guarantee. This probably contributed to the unexpected victory in the 1998 election when the government won by a margin of about one hundred votes from the Faroe Islands, securing the last mandate for a majority.

However, after the election it became increasingly clear that the inflow into early retirement allowance did not stop even though unemployment, also among the elderly, continued to decline. This made the scheme more and more expensive, but most importantly, top Social Democrats came to the conclusion that early retirement actually generated labour market problems instead of solving them. By 1998, one can speak of an elite consensus that the early retirement scheme was too expensive and problematic for labour supply. But this consensus was not easy to transform into public policy. The key problem came from within the main governing party’s own ranks. Most of the Social Democratic members of the parliament were not in favour of cutbacks on the early retirement allowance, and neither were the unions. Supported by the guarantee given by the Prime Minister they could make a forceful opposition. What helped the chances of retrenchment was the fact that there was more than three years to the next election – and the willingness of bourgeois parties to support it. Thereby the leading Social Democrats saw a chance to legitimize the reform as a long-term guarantee for the early retirement scheme because the largest bourgeois party now accepted the existence of the scheme, and at the same time, the largest bourgeois party had a chance to get rid of an unpopular policy position, i.e. the idea of completely dismantling the scheme, which could be an obstacle for voters to support a change of government.

The further policy process very much resembles that of the cuts in duration of unemployment benefits. The leaders, primarily the Social Democratic Minister of Finance, created a 'room for manoeuvring' by running the negotiations in an extremely small forum. The talks within the government were not in any detail presented for the ordinary members of the party groups in Parliament – not even to all the ministers - and the Minister of Finance had secret negotiations with only one party leader from the opposition: Anders Fogh Rasmussen from the largest party, the Liberals. Ordinary members of the Social Democratic party group in Parliament were not informed at all, nor were the unions. Finally, the reform was presented in the budget negotiations for 1999 which already included a big policy package, in particular what was later referred to as the third labour market reform. Thus, one could see this as a master piece of making policy against historically rooted preferences. However, the after match was not successful for the Social Democrats. Party members were furious and so were the unions who fiercely criticized the government in public. The media focused on the broken promise, and the Social Democrats never succeeded in 'selling' the reform as a long term guarantee for the very existence of the scheme. According to opinion polls (Goul Andersen, 1999), the Social Democrats lost almost one-half of their voters from the March election to December 1998, and even though many voters defected to the left wing parties who supported the government anyway, it generated a demobilization that contributed to the Social Democratic defeat at the 2001 election (Nielsen & Thomsen, 2003).

### **Supply side economics and lower marginal tax rates**

Like in the area of unemployment and early retirement policy, the Social Democrats also acted against short-term electoral interests in the field of taxation. Core voters were not satisfied, and swing voters were not attracted. The 1993 tax reform was intended to be neutral in relation to the existing income distribution, and to a large extent, it probably was. The government's own

calculations showed that everybody would gain, and that variations were small. But they after all revealed that the poorest pensioners had the smallest gains whereas the main winners were pensioners with high incomes. Altogether, the redistributive effects remain unclear, but as judged from data on economic inequality in the 1990s (Goul Andersen, 2003), the effects were small.

However, it is interesting to compare with the Social Democrats' latest tax reform proposal from 1999 when the party was in opposition (Larsen & Goul Andersen, 2004: 144-148, 150, 155). There were many similarities, but two elements were entirely new: lower marginal tax rates and the "green taxes". As marginal income taxes are the most progressive and "green taxes" are the most regressive of all taxes in Denmark (Ministry of Finance, 2000: 79; 2002: 107; Economic Council, 2001: 127; Goul Andersen, 2003: 43), it seems safe to conclude that the Social Democrats had compromised with the party's own previous positions as regards progressive taxation. It might be argued that the party had to give in on distributional interests in order to pursue environmental concerns. However, if environmental concerns were the main motive, distributional impact could have been neutralised e.g. via adjustments of the Danish value added tax (VAT) which was unusually high and furthermore did not include any differentiation as regards food or other necessities.

It seems obvious that lower marginal taxes had become a pertinent concern which represented a shift in the party's preferences. Therefore it is difficult to find any other motives than a significantly increasing influence of the idea that taxes are detrimental to competitiveness and that the labour market is troubled by supply-side problems. The latter argument was exactly the main point in the report from the 1992 "Commission on Personal Taxes" (appointed by the previous government) which served as the explicit intellectual foundation of the 1993 tax reform. Not surprisingly, the argument was that lower marginal taxes would motivate those already employed to work more (as the substitution effect was implicitly supposed to exceed the income effect) and at

the same time motivate unemployed people to join the labour market. This logic is clearly anchored in new economic ideas about “structural problems” in the economy that disturbs the functioning of the market. Even though it is a well-known trick to include over-optimistic estimates of financing (there were a few, see Larsen & Goul Andersen, 2004), it is also telling that 16 percent of the reduction in marginal income taxes was to be financed by ‘dynamic effects’ caused by better structures.

In addition, considerations about competitiveness (listed under the label “Europeanization”) were also visible in the government report. But it is remarkable that both the structural argument and the competitiveness argument were very poorly spelled out in the report. As to competitiveness, there was little but a headline and some detailed comparisons of marginal tax rates in Denmark and various other European countries. Actually, this was the last year for the Europeanization argument to appear in Danish government reports over taxes. But it seems difficult to deny that the tax reform was strongly influenced by new economic ideas and perceptions of structural problems at the labour market and elsewhere in the economy, and it is even difficult to find any other motives.

## **Conclusion and perspectives**

This article has described three important instances where ideas have had an independent causal effect on policy change. The article has basically resembled Peter Hall’s seminal work on the importance of new economic ideas in UK during the Thatcher era. However, it is argued that the Danish case from 1993 to 2001 actually provides a more clear-cut example of new economic ideas having an independent effect on policy change. It is a critical case as new ideas made the Social Democratic party adopt reforms that compromised with previous long-term preferences of the party as well as with economic interests and political preferences of actual and potential voters. The

article has also argued that the new ideas were not a simple functional or “necessary” response to new objective problems. A number of findings substantiate the argument that the perceived level of structural unemployment was indeed a questionable interpretation of reality; since that time, the flexibility of the Danish labour market has in fact been rediscovered and heralded as an example of a “best practice” of “flexicurity” even at a European level. It all adds up to the argument that in the case of Social Democratic reform policy during the 1990s a new perception of the nature of the problems and new cause-effect beliefs clearly had a significant and independent impact. It is shown that ideas – understood as specific diagnoses and cause-effect beliefs produced primarily within economic science - can ‘matter’; even in a case where they are up against strong organised interests. This, in our opinion, provides one of the clearest pieces of evidence for the importance of ideas.

Needless to say, the emphasis on the strong influence of ideas by no means makes the study of interests irrelevant. In all the three policy areas analysed above it has been demonstrated how the Social Democrats actively tried to eliminate or alleviate the distributional consequences of a set of ideas that could most obviously serve as a ‘weapon’ for the right-wing parties, as they did in the British and American context during the 1980s. Even though the Social Democrats to a quite large extent came to acknowledge the diagnoses of structural unemployment, and more generally of “structural problems” pointed out by supply-side economics, they did not passively accept the neo-liberal ‘medicine’ that was typically suggested as a ‘cure’. Instead they worked hard to develop functional equivalents, or alternative treatments that were consistent with the diagnoses. In the field of labour market policy, activation served as a functional equivalent; duration remained comparatively long, reduction of unemployment benefits was avoided and high social minima were maintained. In the case of early retirement the Social Democrats also found a relatively “soft” solution rather than simply dismantling the scheme. And in the field of the tax policy the Social Democrats tried to finance the “necessary” lowering of marginal taxes with an expansion of the tax

base that could to a large extent neutralize the redistributive effects. Thus, one could not predict the Danish welfare reforms without taking interests into account. But without recognizing the independent effect of ideas, one cannot understand the very decision to initiate a reform process, the direction of such reforms, and the willingness to compromise with sacred policy interests and even short-term electoral interests.

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## Notes

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<sup>1</sup> For a more detailed documentation, see Larsen & Goul Andersen 2004.

<sup>2</sup> Actually, the small coalition partner's adoption of the new economic ideas is even more remarkable. Since the mid 1970's the party had been influenced by ideas of a citizenship wage, which run against all ideas about reducing unemployment by means of supply-side measures. At the yearly summit, just after entering the government, the party members - against the will of the party leaders – actually voted for a declaration that favoured a citizenship wage. The party leader, a former school teacher and newly appointed ministry of economy, had to calm the press, assign an internal commission, and finally to shelve the idea (Christensen, 2000:322). However, the point is that in the mid 1990s the leading figures in the coalition party also operated against the preferences of a significantly part of their electorate. See also Green-Pedersen (2003) who based on party competition theory provides an argument for the limited political influence of the small coalition partner.

<sup>3</sup> To complete the picture, it could be added that the domestic market was already on its way towards recession due to heavy credit restrictions imposed in the autumn of 1986 whereas exports after 1987 actually fared quite well, partly because the government relieved firms of taxation (replaced by a new VAT-like taxation that was later substituted by an ordinary VAT increase), partly because firms had to look beyond domestic markets to find growth opportunities.

<sup>4</sup> As part of a general cost containment policy indexation of maximum benefits was suspended from 1982 until early 1986, but this was partly compensated by a 10 per cent increase in 1988, and from 1992, benefits were in principle indexed according to wage increases. Member contributions were slightly increased, but otherwise unemployment insurance remained largely unchanged, except for somewhat harsher measures for young unemployed which could more easily be legitimized (Larsen, 2008b).

<sup>5</sup> There has been a general de-corporatization in Denmark, and excluding the social partners from negotiations of vital issues had been done also under the bourgeois governments, especially from 1982 to 1985. But these governments later came to recognize their interest in a cooperation with the unions, and for a Social Democratic government it was a significant innovation to carry through such big changes in labour market policies without negotiation with the social partners.

<sup>6</sup> Interviewed by author 12th of May 1999.

<sup>7</sup> Interviewed by author 12th of May, 1999. Birgitte Hansen.