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Publication details:
Working Paper No. 70
SPRC Discussion Paper
0733414532 (ISBN)
1447-8978 (ISSN)

Publication Date:
1996

DOI:
https://doi.org/10.26190/unsworks/202

Social Policy Research Centre

ECONOMIC CRISIS AND SOCIAL POLICY IN FINLAND IN THE 1990s

by Hannu Uusitalo

SPRC Discussion Paper No. 70
October 1996

ISSN 1037 2741
ISBN 7334 1453 2

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The series is indebted to Diana Encel for her continuing editorial contribution.

Tony Eardley
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Abstract

This paper discusses the social policy consequences of the exceptional economic decline in Finland in the 1990s. It asks what happened to the Finnish welfare state in these exceptional economic conditions, and consequent political problems. It describes Finland's economic performance in a comparative perspective, studies how government(s) have defined the goals of economic and social policies, and examines how the opinions of the Finns concerning the welfare state have changed during the recession. It also looks at the welfare outcomes, focusing on income levels, income distribution, poverty and social and health services. The results suggest that Finnish households have suffered economic losses which are smaller than the decline in the GDP would predict. The findings show that equivalent income distribution and relative poverty levels have not changed during the recession. The income losses of the recession have been spread relatively evenly, and the redistribution of the welfare state has been an important tool. Finally, it is argued that the explanatory factors of the growth *vis-a-vis* the retrenchment of the welfare state (or the lack of it) are different. Once established, structures and institutions of the welfare state can work as powerful tools even when economic and political conditions are difficult.

1 Introduction

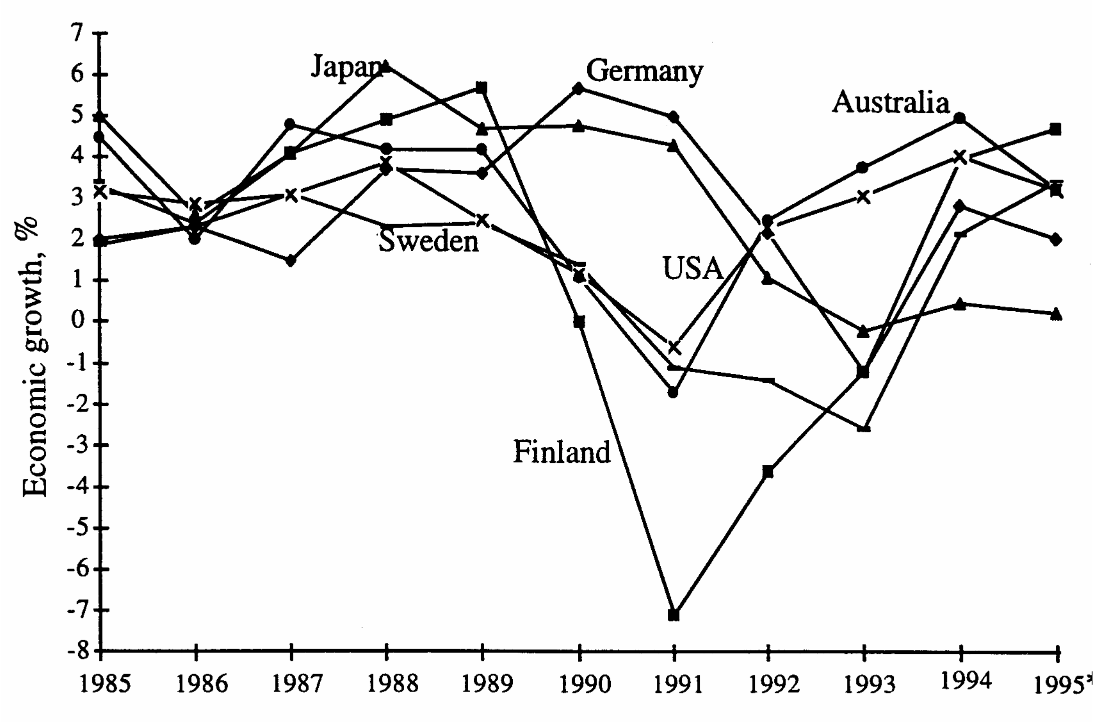
In most Western advanced industrial nations, the welfare state has faced economic and political problems during the 1980s and 1990s. The fiscal crisis of the state has been on the political agenda, although the severity and the timing of the problems has varied from one country to another. In many countries economic and political problems were visible in the 1980s. In Finland, the 1980s were economically very successful, and Finland was frequently referred to as Europe’s Japan. All that changed at the beginning of the 1990s, when Finland’s economy fell into an exceptionally deep decline which has no parallel in any of the OECD family, former Central and Eastern European socialist countries apart.

This paper discusses the social policy consequences of this economic decline. It asks what has happened to Finnish welfare in these exceptional economic conditions, and consequent political problems. The paper is organised as follows. First, Finland’s economic performance is put into a broader comparative perspective. Second, we study how the government(s) have defined the goals of economic and social policies. Third, we look at the outcomes of policies and other developments, focusing on income levels, income distribution, poverty and social and health services. Fourth, we claim that the case of Finland in the 1990s has particular relevance for some theories of the welfare state and draw some tentative theoretical conclusions concerning the irreversibility of the welfare state and the distinction between explanatory factors of the growth and retrenchment of the welfare state.

2 Economic Performance in the 1990s in Comparative Perspective

Let us start with two key economic indicators, GDP growth and unemployment. Figures 1 and 2 display the trends from 1985 to 1995 in some countries. After high growth rates in the latter part of 1980s, 1990 was a zero growth year in Finland, followed by three years of negative growth, during which the GDP declined about 13 per cent. In no other OECD country has the economic situation been so gloomy as in Finland during this decade. 1994 witnessed some relatively high growth, which is

Figure 1: Economic Growth in Selected OECD Countries: 1985-1995



Estimates

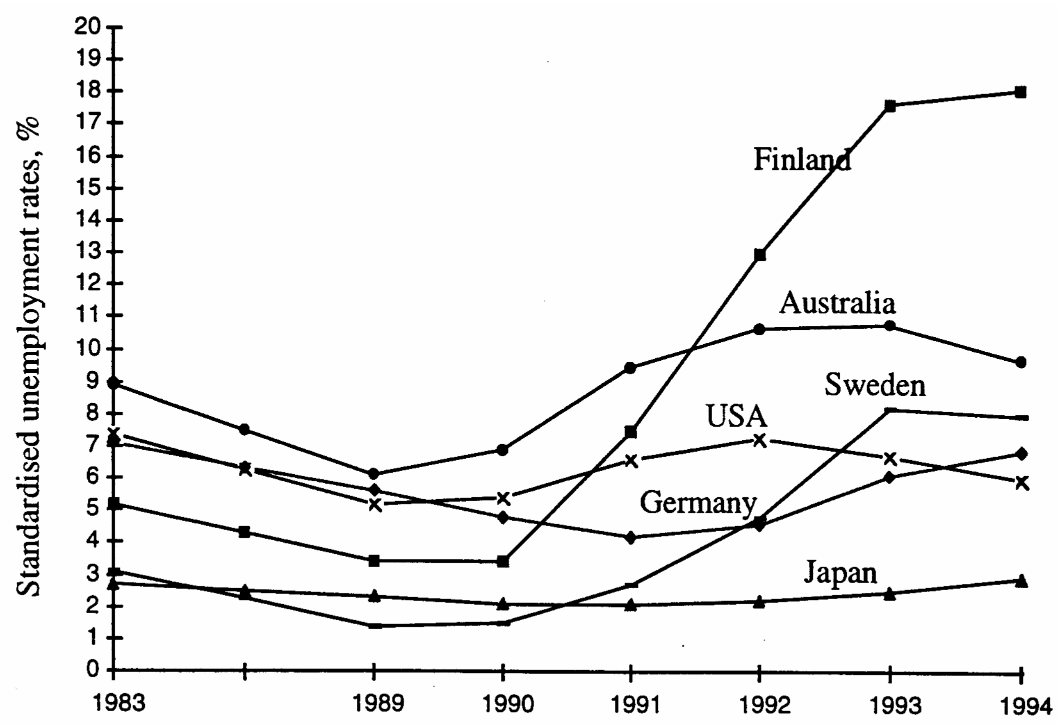
Source: OECD, 1995.

expected to continue, although not at the same speed. As shown in the figure, some other countries have had economic difficulties in the 1990s as well, but not at a parallel degree.

The growth of unemployment shows similar exceptional developments in Finland, as seen in Figure 2. In three years, the unemployment rate climbed from under four per cent to 17-18 per cent of the labour force. These figures are actually the second highest, after Spain, in the OECD area. Although the numbers have started to decrease, long-term unemployment, especially, continues at a very high level.

Of course, negative growth and unemployment were not the only economic problems. The public economy had considerable income losses, while expenditures tended to grow due to the increased needs of the population, but also due to a severe banking crisis, which during the recession caused expenditures of 45-50 billion Finnish marks to the state,

Figure 2: Unemployment in Selected OECD Countries: 1985-1994



Source: OECD, 1995.

which had to subsidise banks to keep them in business. Consequently, the state budget deficit grew dramatically from 10 per cent of the GDP in 1990 up to 50 per cent in 1993, and 70 per cent in 1995.

Finland is an exceptional case in its economic performance in the 1990s. The causes of this decline probably include unhappy economic policy decisions, such as the binding of the Finnish mark to the German mark at a level which undermined the competitiveness of export industries, and a very rapid deregulation of financial markets but also such external factors as the collapse of trade with Soviet Union. Because of this exceptionalism, it is particularly interesting to look at what has happened to the Finnish welfare state. This exploration requires a brief excursion through the economic and social policies of the governments which have ruled the country during these years.

3 Economic and Social Policies

3.1 The Centre-right Cabinet, 1991-1995

After the general election in March 1991, a centre-right cabinet assumed power. The core of this cabinet was formed by the Centre Party (formerly the Agrarian Party) and the National Coalition (conservatives), with the participation of some smaller parties. The cabinet had a firm majority in the parliament. Social Democrats experienced losses in the general election, and remained in the opposition.

Prime Minister Esko Aho's centre-right cabinet stayed in power through the whole time, until the next election in March 1995. In 1991 the cabinet could not have foreseen the depth of the economic crisis: no one could. Gradually, the consciousness of the crisis increased, and the key elements of the cabinet's economic policies in the crisis were formulated.

The cabinet began to see *public deficit* as the major problem and proposed and made considerable cuts in public expenditure, while the rate of taxation increased considerably. *Inflation* was seen to be an important issue as well, leading to *tight fiscal policies*. Traditionally, the Finnish governments have considered the *international competitiveness* of paper and metal industries as a key element in economic growth, and consistent with this presupposition, the centre-right cabinet introduced measures (deflation of the Finnish mark) to improve the conditions of these major export industries.

The growth of *unemployment* was also perceived as a major problem, but measures to fight it were mainly indirect: growth, control of inflation and stability of the currency were seen as keys to decrease unemployment rates.

Social expenditure continued to grow in the first years of recession, although the cabinet started to cut social benefits as early as 1991. The real growth of social expenditure decreased from the record high 9.3 per cent in 1991 to 1.6 per cent in 1993, despite the dramatic growth of unemployment and social assistance expenditure. Cuts to social benefits did not concentrate on any particular benefit types, but were spread to all schemes. The techniques varied: indexed increases to benefits were cancelled, compensation levels of earnings-related unemployment, sickness and maternity benefits were lowered and eligibility for some benefits were tightened.

3.2 The Rainbow Cabinet 1995-

The new parliament was elected in March 1995. The parties in the cabinet lost, especially the Prime Minister's Centre Party, while Social Democrats - the largest opposition party - made considerable progress. The new cabinet was formed in April by the chairman of the Social Democratic Party, Paavo Lipponen. It is a broad coalition cabinet formed by the Social Democratic Party, the National Coalition (conservatives), the Leftist League (a party to the left of the Social Democrats), the Swedish People's party, and the Green League. These parties have more than two-thirds of the seats in the Parliament. The Centre Party, which had the key role in the previous cabinet, became the largest opposition party.

The program of Paavo Lipponen's cabinet has emphasised two targets: the improvement of the employment situation and the decrease of the ratio of the public debt to the national product. It has claimed that unless these goals can be achieved, welfare society is endangered. In order to maintain the core of the welfare society (social welfare and health care services, income-related social security and minimum security for everybody), considerable restructuring and cuts in expenditure were seen to be necessary. The cabinet estimated that the cuts should be carried out in the first two years. It also set monetary targets for the cuts, and outlined a program which specified the expenditures from which savings are to be made. Details were left to be designed in future work.

In this restructuring, the cabinet program has emphasised the following principles. The *disincentives to work* existing in the subsidy system must be removed. The cabinet established a working party, the task of which is to present a total estimate of the coordination of social income transfers, charges and taxation and to suggest necessary measures without diminishing the security of those in the most vulnerable positions. The working party has finished its task before the budget for 1997 has been announced.

The social security contributions levied from the enterprises but not connected with work-related benefits will be abolished gradually. Also the national pension contribution levied from wage-earners and pension recipients will be abolished.

In order to balance employment pension contributions and pension benefits and to reduce the pressure to increase pension contributions, employment pension schemes were reformed in 1996. Before 1996, the Finnish national pension scheme consisted of two parts. The so-called basic amount was universal and payable to all above 65 years of age. The second, supplementary amount, was tested against legislated employment-related pensions so that other pensions gradually decreased the supplementary amount until it ceased at a certain employment pension level. In the 1996 reform, the two parts of the national pension were merged so that the previously universal basic amount became subject to income testing.

A similar step was taken in the sickness insurance system in which eligibility for the receipt of the minimum daily allowance was tightened. Earlier, even those who did not have any income (housewives, students) could qualify for the daily allowance of sickness insurance, but from 1996, only those who lose income because of sickness can receive the daily allowance.

A revision of unemployment benefits was carried out rapidly in consultation with the labour market parties. The reform includes a reconsideration of the period for which the benefit is paid and of the bases on which the benefit is granted. At the same time there is an increase in activating factors - rehabilitation, training - and in measures of labour policy to improve the employment situation.

In Finland, social and health (as well as educational) services are, to a very large extent, publicly provided. In practise the responsibility is in the hands of the municipalities, who tax their citizens to provide these and other services. They also get a block grant from the state to finance these services, the level and quality of which is monitored by the state. In its program, the cabinet emphasised the role of basic social and health services for the welfare society. Social and health services should be restructured by developing non-institutional care and various half-way services. The program also mentions preventive social welfare and health care policies, in particular activities keeping up the ability to work and early rehabilitation. These goals have not hindered the cabinet from cutting considerably the block grants to municipalities. It has justified these savings by arguing that the economies of the municipalities have been in a far better condition than those of the state.

Amongst all cuts and discussions about the curtailment of the welfare state one important improvement of social security has been carried out. This is the extension of the right to day-care for children under school age. Previously, only children under three years of age were eligible.

The goal of taxation policy of the rainbow cabinet is to make tax structures and ratios comparable with the OECD countries. This implies that the balancing of the state economy will be carried out without increasing the overall tax rate. The taxation structure will be changed to favour work and employment. The tax relief will benefit all income classes, with particular emphasis on low- and middle-income groups. The tax rate for capital income, income from interest and corporate income has been increased to 28 per cent. The lower taxation of labour will, to a considerable extent, be compensated by new environment taxes.

So far, the cabinet has, with minor exceptions, succeeded in getting its way in parliament. It has also been able to foster a large base incomes policy agreement together with trade unions and employers' organisations. Furthermore, it seems likely that the state budget deficit will be under control in a few years.

Having been in power one and a half years, the major new element in the economic policy of the cabinet is the emphasis on the fulfilment of EMU criteria which the European Union has set as a condition for entry into the forthcoming European Monetary Union[1]. The government has emphasised that this does not imply that a decision to join the EMU has been taken, but it means that Finland will be able to join if and when the

1 EMU criteria are: (1) inflation at most 1.5 per cent units above three low inflation countries; (2) public deficit at most three per cent of the GDP; (3) public debt at most 60 per cent of the GDP; (4) exchange rates within the limits of ERM; (5) interest rate at most two per cent units higher than in three lowest countries.

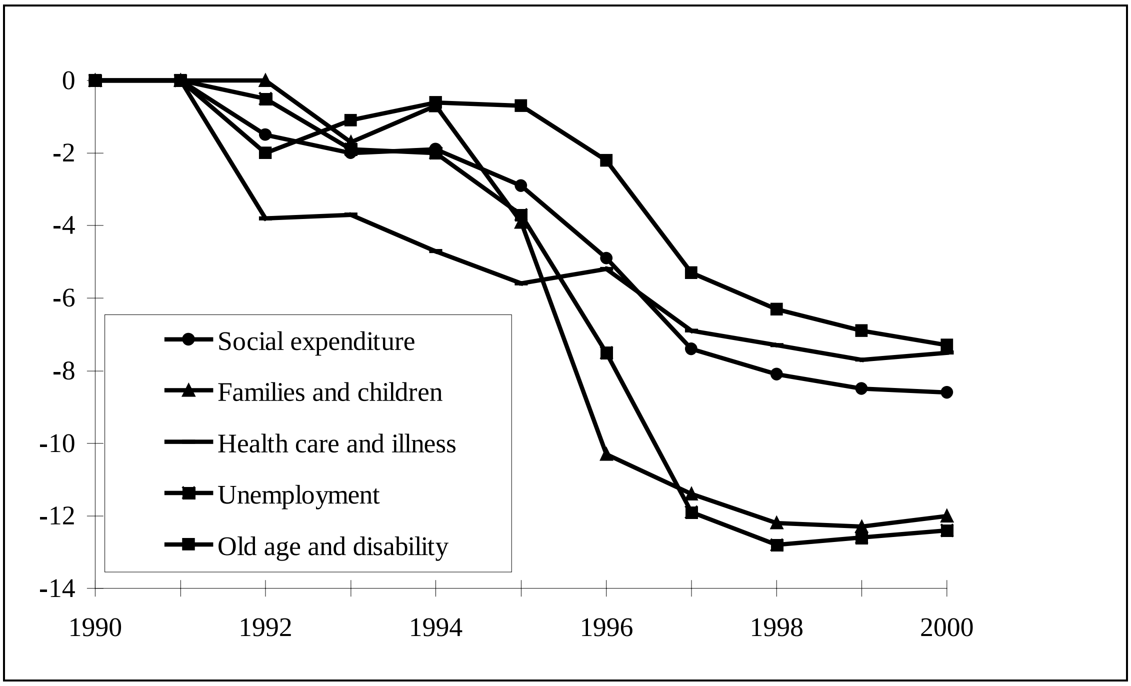
day comes that she so wishes. This emphasis has strengthened the priorities to control public expenditures and to keep fiscal policies tight, and has consequently weakened the employment target, which aimed to halve unemployment within the government’s four years in power. It seems fairly obvious that this target cannot be achieved, and unemployment will remain above ten per cent even at the end of this millennium.

One could ask what are the major differences between the former centre-right cabinet and the present one, led by social democrats and the conservatives. Broadly speaking they seem to be pretty similar. Budget deficit, control of public expenditure, international competitiveness are keywords in the agenda of both cabinets. However, there are two crucial differences. First, the present cabinet has tried and succeeded in maintaining negotiations with labour market organisations when making its cuts in pension and unemployment expenditures, whereas the former cabinet maintained a confrontational state with the trade unions. The centre-right cabinet, in turn, had far better relations with the federation of agricultural producers. Secondly, the social policy profiles of the cabinets are somewhat different, reflecting traditional differences between Social Democrats and the Agrarian Party (now the Centre Party) (see Alestalo, Flora and Uusitalo, 1985). The Finnish Agrarian Party has been an advocate of universalism and basic social security, and it has tried to avoid cuts in expenditures related to these goals. Social Democrats, have been the main advocates of work-related benefits. Although the cabinet has touched these benefits, it has also introduced some changes which involve reduction in the universalism of the Finnish welfare state - as exemplified by the reforms to the national pensions and daily sickness allowance.

3.3 Social Policy Cuts and the Development of Social Expenditure

The Ministry of Social Affairs and Health has assessed the economic impact of the changes in the social welfare system by estimating how much these changes decrease social expenditure in comparison with a counterfactual based on no changes having been made. Figure 3

Figure 3: The Impact of Savings on Social Expenditure in Finland: 1991-1996



describes the outcomes of this exercise. It shows that in the year 2000, social expenditure will be 8.6 per cent smaller than it would have been without savings. This figure can be put into perspective by noting that in the 1980s the average annual growth of social expenditure in real terms was somewhat less, about 8 per cent.[2] Furthermore, one can see that the cuts to unemployment and family benefits will have a higher than average impact, whereas old age and disability as well as health care and illness have managed with smaller losses.

As seen in Figure 4, the share of GDP devoted to social expenditure grew rapidly in the first two years of the recession. This was, in the first place, due to the decline in the GDP denominator but, secondly to real growth in expenditure. In a couple of years, Finland jumped from the ranks of middle spenders to the top league, superseded only by Sweden, and possibly by the Netherlands.

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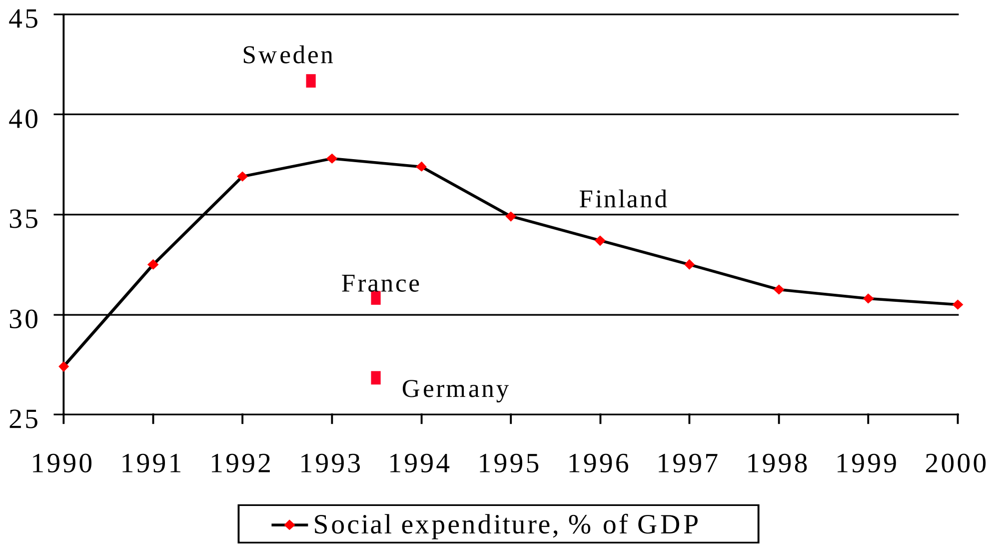
2 The comparison is not quite adequate, because the growth of social expenditure in the 1980s was due to changes in the provision and changes in the utilisation of benefits due to changing age structures and unemployment, whereas the impact of cuts include here only the former.

Figure 4: Social Expenditure as Percentage of GDP in Four Countries: 1990-2000



Source: Ministry of Social Affairs and Health, 1996.

Figure 4 also displays the projection of social expenditure made by the Ministry of Social Affairs and Health up to the year 2000. This particular projection is based on the assumption that economic growth will be 3.5 per cent per year, and that unemployment rates will decline. In 1995, the GDP share of social expenditures will decline, and the decline will continue so that in the year 2000, the level of 30 per cent is reached.

Such estimates are dependent on assumptions, but according to OECD estimates, the average growth rate of 3.5 per cent is not totally unreasonable. Even though the growth in 1995 was 4.2 per cent, the GDP share of social expenditure did not quite drop to the level of this projection, which casts some doubts as to whether the decline will be as large as assumed in the projection.

3.4 The Finns Understand the Need to Save Public Expenditures, but Give their Support to the Welfare State

The fiscal crisis of the state has provoked public discussion about the future of the welfare state in Finland. The frontlines of this debate are manifold and not easily summarised. As elsewhere, public discussion has some neoliberal tones. Issues of freedom, the excessive wardship of the state over the citizens, tax rates that are too high, and disincentives created by social benefits have been the core claims of the neoliberal critique. The opposite side also wants to maintain the Scandinavian type of welfare state in the future. It has dismissed the claims of neoliberals as empirically false. The third stream in the debate appreciates the virtues of the Scandinavian welfare state, but claims that it must not rest on the laurels of its past achievements, but must adjust to new conditions and challenges, both internal and external.

However, it is fair to say that the debate is not so much dominated by ideological disputes but rather by a more practical discourse, the core of which is the claim that public expenditures - and hence the welfare state - must be reduced in order to win back the balance of state incomes and expenditures and in order to clear space for private initiatives.

The National Research and Development Centre for Welfare and Health has, since 1991, conducted opinion surveys in order to find out what the Finns think about the welfare state (see Sihvo and Uusitalo, 1995a, 1995b). The study analysing these data shows that during Finland’s unforeseen economic recession in the 1990s the support for the welfare state decreased to a level lower than at any time since 1975, when the first systematic measurements were made. The newest data for 1994 and 1995 show that support has started to increase again. The studies also reveal that the welfare state occupies a special place in the hearts of the Finns. They understand the need to make savings, but they do not want to cut this expenditure and would like savings to be made in other state functions, such as defence, agricultural and industrial support, support for cultural activities and sports. The dilemma facing the decision makers is, of course, that the expenditures on social transfers and social, health and education services make up the lion’s share of public spending.

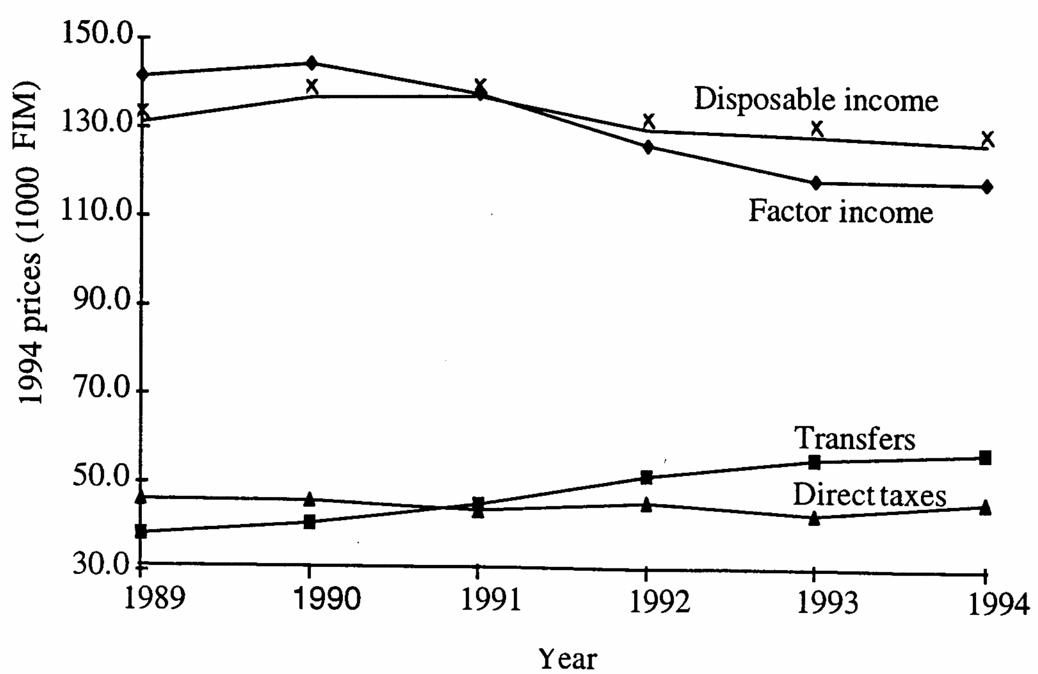
4 Outcomes

What then are the outcomes of these policies on the living standards of the Finns? These outcomes cannot be fully examined here, and we concentrate on four issues only. We look at the income levels of households, study the development of income inequality and poverty, and describe what has happened to social and health services.

4.1 Household Incomes During the Recession

Bearing in mind that during three years the GDP declined by 13 per cent, it is interesting to look at the development of household incomes, and ask how much they have declined. This question can be examined with the help of Figure 5, which displays the development of household incomes from pre-recession years up to 1994, which is the latest year for which we now have statistics of household incomes and their distribution. The figure describes the incomes of households, and makes no adjustments for household size or structure. It should be observed, then, that we can only describe reliably the developments which took place during the first cabinet of the recession period.

Figure 5: Household Incomes in Finland: 1989-1994



Sources: Uusitalo, 1989; *Income Distribution Statistics 1994*, 1996.

The average disposable income of households was at its highest in 1991. In succeeding years it dropped significantly, and the drop has continued to 1994. Estimates for 1995 indicate that a return to growth took place in that year. From the top year (1991) to the bottom year (1994), the average decline of household disposable incomes has been 7.6 per cent, which is much less than the decline on the GDP.

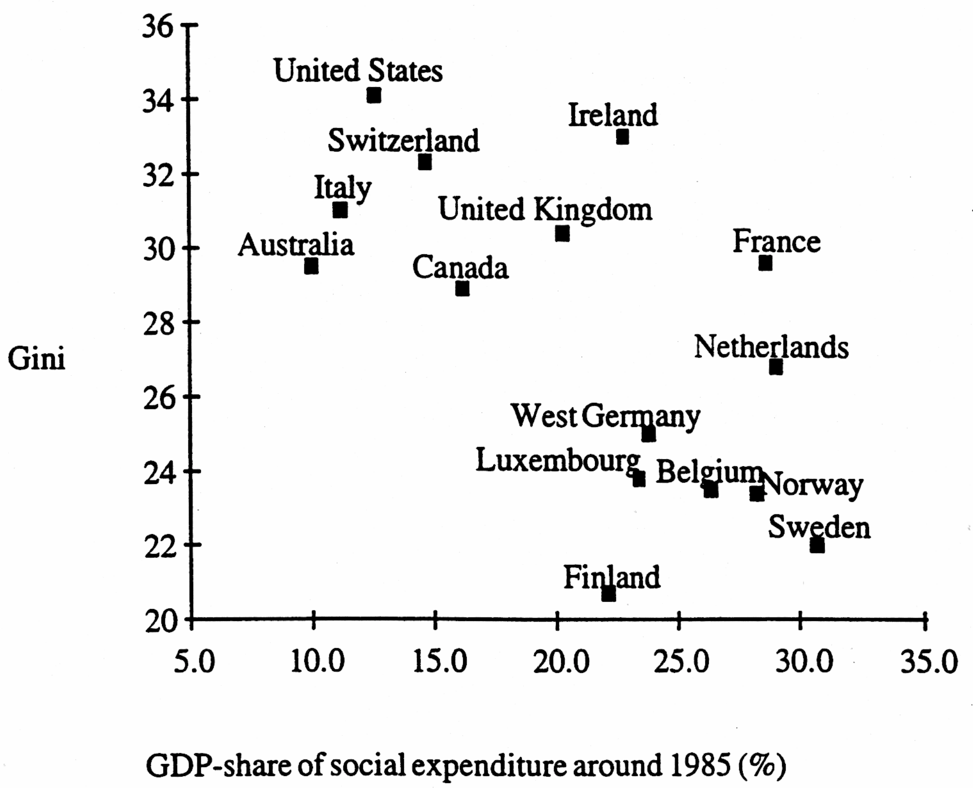
The most interesting feature of Figure 5 is the comparison of the development of factor and disposable incomes. The factor incomes of households were at their highest in 1990, and the decline to 1994 has been as high as 18 per cent, compared to 7.6 per cent in the drop in disposable incomes. This decline is for the most part due to increased unemployment levels. However, the welfare state has, through its cash transfers, compensated for a large part of this decline: income transfers have in real terms increased by almost 40 per cent. The growth is caused by expenditure on unemployment payments, but pension expenditure and social assistance expenditure have also grown remarkably. Earlier, Figure 4 showed how social expenditures had grown at the level of national economy, and this figure shows the same at the level of the average household. This is, of course, what the welfare state is about: to help individuals and households when they meet difficulties. Judged from this frame of reference, the welfare state has shown its ability to soften the harshness of dramatic economic changes, which at another level, that of the national economy, have contributed to the problems of public finances.

4.2 Income Distribution

International Perspective

The recent OECD study by Atkinson, Rainwater and Smeeding (1995), based on the data sets of the Luxembourg Income Study (LIS) shows that Finland had, in the late 1980s, the most equal income distribution in the OECD area, irrespective of the measure used. This is shown in Figure 6, which also sheds light on the relationship between the size of social expenditure and income distribution. The relationship is obvious: the more a nation uses for social protection, the more equal is its income

Figure 6: The Distribution of Equivalent Disposable Income and the Size of the Welfare State in 15 Countries: 1985



Sources: Atkinson, Rainwater and Smeeding, 1995; ILO, 1992.

distribution. This is not a coincidence, but a causal relationship: the redistributive impact of social transfers and (direct) taxes work for the equalisation of income distribution (see, e.g. Mitchell, 1991; Korpi and Palme, 1996).

However, the correlation is not a perfect one, other factors influence income distribution in addition to the mere size of social expenditure. It could be noted that Australia and Finland deviate from the pattern: both countries have more equal income distributions than their social expenditure levels would predict. One reason for Australia's exceptionalism is probably the compressed wage distribution: it is almost as equal as in Sweden (Fritzell and Saunders, 1994). As regards Finland, one cause of her deviation from the general pattern is found in the relatively even distribution of factor equivalent income. It is, for example, less unequal than in Sweden (Gustafsson and Uusitalo, 1990).

The other outliers are Ireland and France, which have relatively high inequality compared to their social expenditure levels.

These results refer to the latter part of the 1980s, that is, the pre-recession period in Finland. How has income distribution changed in Finland since then?

Income Distribution in Finland

Finland has comparable income distribution data from 1966 up to 1994. The data for the years 1966 to 1985 are based on household budget surveys, carried out at five-year intervals, while data for 1986 to 1994 are based on income distribution statistics, both collected by Central Statistical Office of Finland. *Income Distribution Statistics* is an annual collection, based on a larger sample than household budget surveys[3]. Both operate with very similar income concepts. Comparisons of the two sources indicate that *Income Distribution Statistics* displays a slightly higher inequality than the household budget surveys (see Uusitalo 1989: 28-29). The data sets are not exactly comparable, but their differences are likely to be within the limits of sampling variation.

From the viewpoint of economic welfare or standard of living, the most crucial income concept is *disposable income*. Wages, salaries, income from self-employment and property income add up to *factor income*. When income transfers such as pensions, sickness insurance benefits, unemployment insurance benefits and others are added, we get *gross income*. Gross income minus direct taxes (including other tax-like payments) is disposable income.

In order to compare the income levels of households having varying numbers of members and varying structures, an adjustment must be made. This is done by equivalence scales. There is no one scale which can be regarded as the right one, but there are many alternatives. The equivalence scale used by the OECD is applied here[4]. The first adult gets

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3 For a description of household budget surveys, see Uusitalo, 1989: 28-31. *Income Distribution Statistics 1994* describes this data source (only in Finnish).

4 Uusitalo (1989) includes sensitivity analyses for the years 1966 to 1985. For later years such analyses have not been performed.

the weight of 1.0, the second 0.7 and children 0.5. This means that a two-parent family with two children needs 2.7 times the income of a single adult in order to have the same standard of living.

Finally, we do not compare the distribution of income between households, but the distribution of household equivalent income between persons. For further information on methods and specifications see Uusitalo (1989: 20-31). The OECD study referred to above used similar methods, and examined the robustness of the results by experimenting with different equivalence scales and inequality measures.

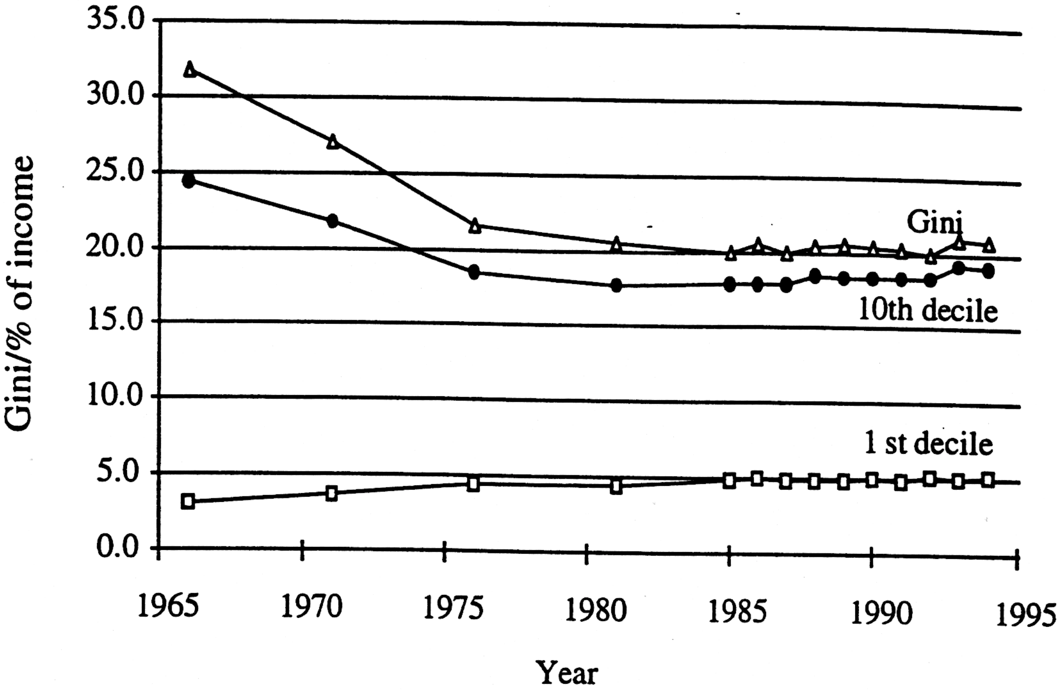
By comparing the distributions of factor and gross income we can find the redistributive effect of social transfers. The comparison of gross and disposable income shows the impact of direct taxes. Finally the comparison of factor and disposable income gives the combined effect of transfers and taxes.

As a measure of income inequality we use Gini coefficients and the respective income shares of deciles of persons. The higher the Gini, the greater the inequality. Redistribution due to transfers and taxes are estimated by the changes in Gini coefficients.

Figure 7 shows the development of equivalent income inequality in Finland 1966-1994. Inequality declined dramatically between 1966 and 1976. The main causes of this decline are to be found in the growth of social transfers and direct taxes, but also in income policy introduced in Finland in the late 1960s, which considerably compressed the distribution of earnings (see Uusitalo, 1989, for a detailed analysis). During the next ten years one can also observe a decline, but a much weaker one. From 1985 to 1994, inequality remained at roughly at the same level. It is of particular interest to note that the recession years have not witnessed any growth of income inequality. For instance, the income share of the lowest decile has remained astonishingly stable during the recession.

As seen in Figure 8, the distribution of *factor income* became more equal between 1966 and 1976, but in contrast with the distribution of disposable income it has become more unequal since 1981. The main

Figure 7: The Distribution of Disposable Equivalent Income in Finland: 1966-1994



Sources: Uusitalo, 1989; *Income Distribution Statistics 1994*, 1996.

reason for this is likely to be the increased proportion of the elderly and non-working population. During the recession, the unequalising tendency has accelerated. Increased unemployment has worked for the widening of factor income parities. The development of *gross income* distribution is broadly similar to that of disposable income, indicating that the impact of direct taxes has not changed dramatically.

The redistributive impacts of social transfers and direct taxes are more explicitly displayed in Figure 9. They are measured as percentage change of the Gini coefficients[5]. As a long-term trend, the redistributive effect of *income transfers* has been increasing since 1966. In the late 1980s, the

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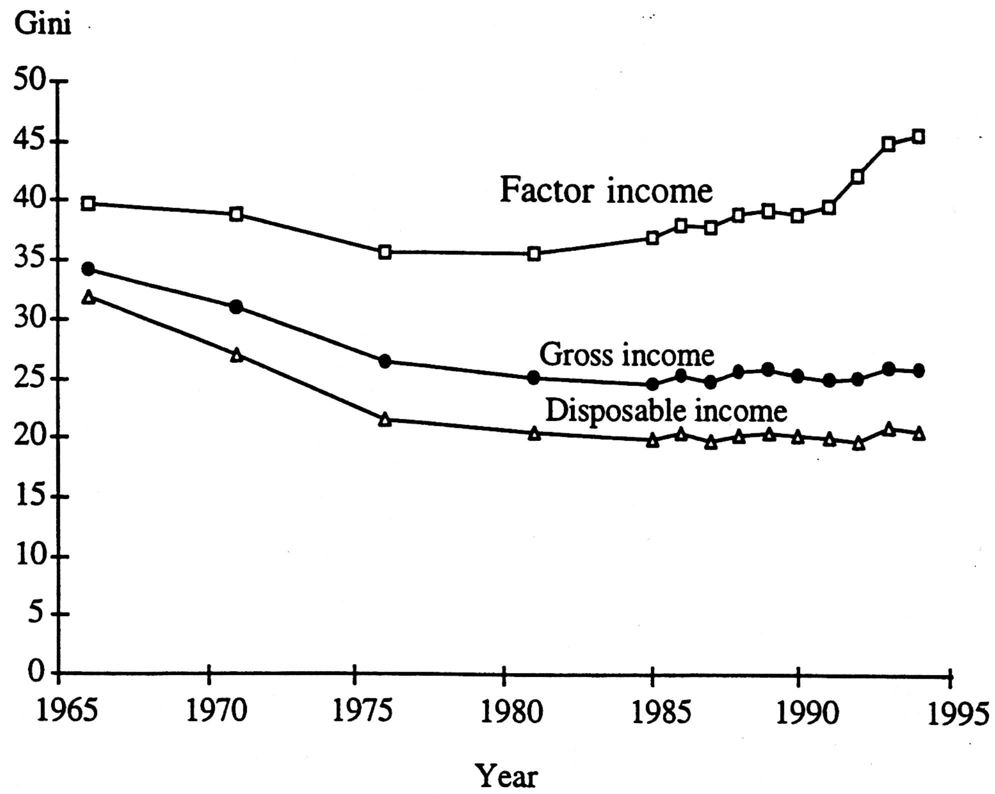
5 The redistributive impact of social transfers = 100 * (factor income gini - gross income gini) / factor income gini; the redistributive impact of direct taxes = 100 * (gross income gini - disposable income gini) / gross income gini; the redistributive impact of both = 100 * (factor income gini - disposable income gini) / factor income gini.

Figure 8: The Distribution of Factor, Gross and Disposable Equivalent Income in Finland: 1966-1994



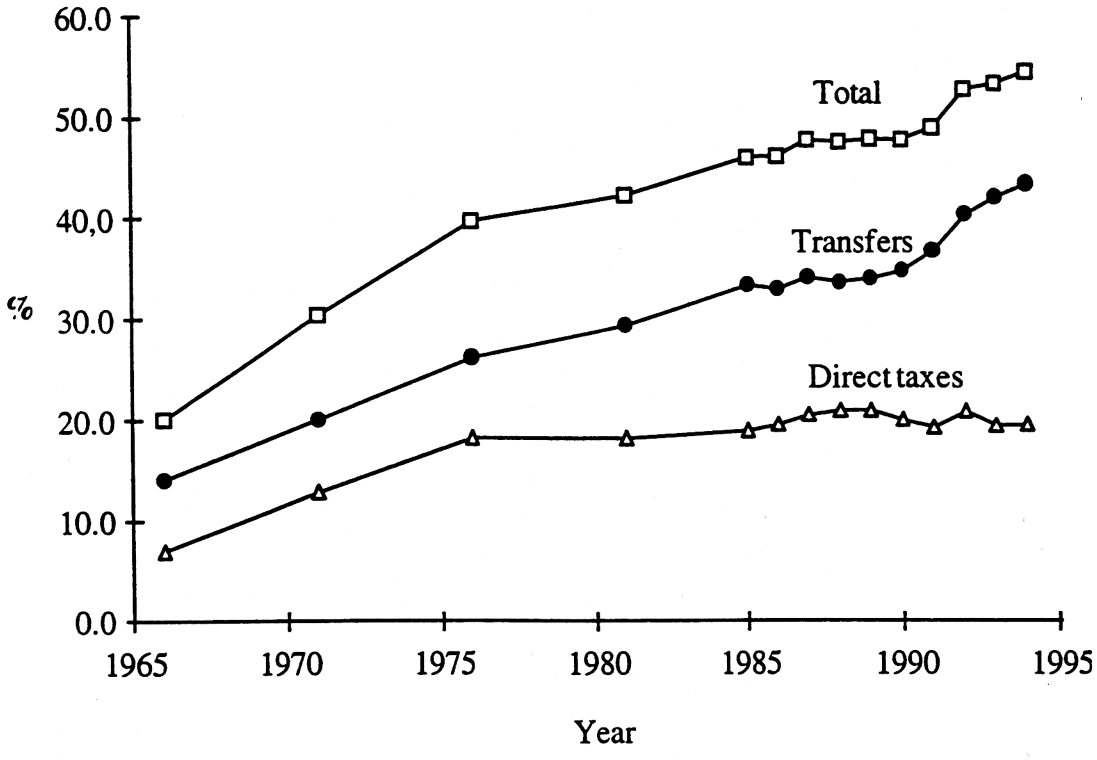
Sources: Uusitalo, 1989; *Income Distribution Statistics 1994*, 1996.

effect seemed to be stabilising, but during the recession it has grown again. The increase of social expenditure both in real terms and in relation to the GDP is the key explanation for this development.

The redistributive effect of *direct taxes* increased at the same pace as the effect of social transfers between 1966 and 1976, after which the increase up to 1989 has been much more modest. Since 1989 the trend has been towards a decreasing redistributive effect. This can be attributed to tax reform which started in 1989, the aim of which was to broaden the tax base and to decrease the marginal tax rates. Although the total tax rate has increased during these years, the share of direct taxes has been declining.

The total redistributive impact of transfers and direct taxes increased considerably between 1966 and 1975. After that it has increased a slower

Figure 9: Redistributive Effects of Cash Transfers and Direct Taxes in Finland: 1966-1994



Sources: Uusitalo, 1989; *Income Distribution Statistics 1994*, 1996.

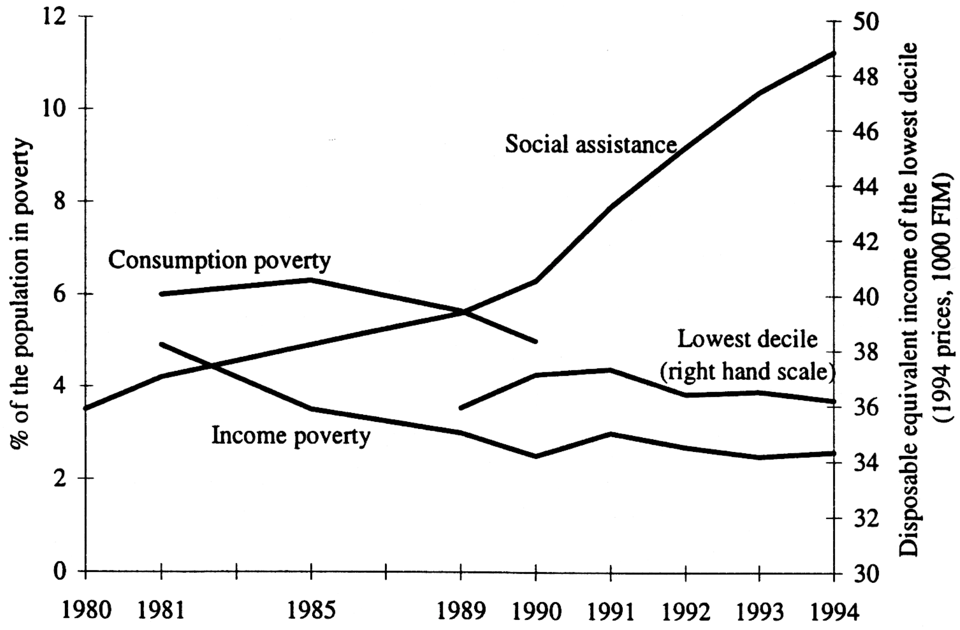
pace. The trends in the redistributive effects of transfers and direct taxes have worked in opposite directions in the 1990s, the impact of the increased redistribution of transfers being larger.

To summarise the developments during the recession in the 1990s: income distribution has remained remarkably stable. Increased factor income inequality, which probably can be attributed to extremely high levels of unemployment, has been compensated by the increased impact of social transfers, so that equivalent disposable income distribution has not changed.

4.3 Poverty

Finally, Figure 10 describes the development of some poverty indicators over time in Finland. 'Income poverty' is a measure usually applied in

Figure 10: Poverty Indicators in Finland: 1980-1994



Source: *Toimeentuloturvakatsaus,* 1996: 3 *Income Distribution Statistics 1994,* 1996.

international comparisons. It describes the proportion of individuals who live in households whose equivalent disposable income is less than the population median. 'Consumption poverty' is the same measure, but counted not on the basis of disposable income but on the basis of consumption expenditures. These two measures focus on relative poverty, and they both show the same pattern: poverty declined considerably in the 1980s. The measure of income poverty shows that relative poverty levels have not changed during the recession years, a finding which is fully consistent with the development of income inequality.

'Social assistance' measures the percentage of individuals who have, during a year, received the 'last resort' needs-tested social benefit. These numbers had grown already in the 1980s, which was at least partly due to broadened eligibility and improved benefits. However, no such changes in the supply of this benefit took place in the 1990s, when the proportion of the population relying on social assistance has doubled. The major causes of this growth are increased unemployment, decreased real income levels, and difficulties in paying back debts incurred in the golden years of the 1980s.

This poverty measure thus conflicts with relative measures like income poverty, in a way, however, which is not difficult to explain. As also shown in Figure 10, the real income level of the lowest income decile (10 per cent of people having the lowest equivalent disposable income) decreased during the recession - as has the income of all other deciles. So they, like people in other deciles as well, have faced economic difficulties in managing their households. These difficulties have lead more and more people to social assistance, and absolute poverty has increased. The conclusion is then, that economic recession with decreased income levels and increased unemployment has caused economic problems for Finnish households, but because of the welfare state, these problems have not fallen more on low income people than on others; hence, the stability of relative income shares and relative poverty.

4.4 Local Welfare Policies

We have now examined how some aspects of economic welfare, measurable in terms of income and money, have developed during the recession. This approach neglects one particular aspect of the ‘Scandinavian welfare state’, namely the role of social, health and other services, such as education, which in Scandinavia are overwhelmingly provided by the public sector.

In Finland, as in the other Scandinavian countries, the municipalities are largely responsible for the provision of social and health services. Their budgets have also been under stress during the recession, because their (tax) incomes have declined and because the state has lowered its block grants to them. In the late 1980s, the costs of the provision of social and health services increased yearly by about 10 per cent. This increase was transformed into a decrease in 1993. In the first phase, the municipalities cut services and costs rather evenly, but gradually started to clarify their priorities and make reductions in a more selective way. It is obvious that the quantity and quality of social and health services have decreased and the fees the clients have to pay have increased, creating additional problems for the population, whose needs during the recession are increasing[6]. Statistics compiled by the National Research and Development Centre for Welfare and Health show, however, that up to 1993 the performance of social and health services had in general been satisfactory. The main exceptions are in the services for alcohol abusers, mentally retarded persons and people suffering from mental problems. In these cases, the supply of services has clearly deteriorated (Uusitalo, Konttinen and Staff, 1995).

5 Too Early to Draw Firm Conclusions, But ...

We believe that a fair summary of the findings reported above could be as follows. It is obvious that the Scandinavian welfare state has been maintained in Finland during the recession, and moreover, it has worked surprisingly well in alleviating the harmful consequences of the recession to the well-being of the citizens. Income distribution has not changed and the relative poverty levels are as low as they were before the recession However, it is equally true that the Finnish welfare state is not as generous, not as universal and more reliant on means-tested benefits than just before recession.

These findings are interesting when related to theories of the welfare state. Typically, these theories have been developed and tested in conditions where the welfare state has grown. It is not self-evident that the retrenchments or reorganisations of the welfare state follow the same logic (see Pierson, 1994), and Finland is the country where the welfare state has experienced harder economic times than elsewhere, while the main political problems have been experienced in the United States and the United Kingdom.

One could argue that the case of Finland lends support to the thesis according to which the welfare state is irreversible, that is, once established, it cannot be turned off. Economic growth is regarded as a prerequisite for the growth of the welfare state, even though the relationship is not a linear one and even though the impact of increased prosperity on the welfare state is mediated by other factors. In our case,

6 This is not true for all services. For example, the demand of children’s day-care services has declined during the recession, because of increased unemployment.

the dramatic economic decline has not caused the dismantlement of the welfare state. This is even more peculiar when political theories of the welfare state are taken into account. These theories have emphasised the role of social democracy in facilitating the growth of the welfare state, and, on the other hand, the role of the cooperation of the bourgeois parties in hindering the growth. Neither of these conditions prevailed in Finland at the beginning of the recession: Social Democrats were in opposition and the centre and the right were together in the cabinet, which had an unquestionable majority in the parliament. Given the framework of both political and economic theories of the growth of the welfare state, the case of Finland in the 1990s seems peculiar indeed.

However, it may not be so peculiar. It could be argued that the case of Finland supports Pierson's (1994) view according to which the process of retrenchment differs from the process of growth. In the former, existing structures and institutions created by the welfare state play a significant role. They have created their own constituencies and interests, which, during such exceptional conditions as those in Finland in 1990s, work for stability and against dramatic retrenchments. Not that these structures and institutions stubbornly keep up with the old; on the contrary, they often adapt flexible strategies in order to survive in changing conditions and show considerable capabilities of political learning. In the case of Finland, these structures and institutions have been strong enough to survive in hostile economic and difficult political conditions, and are likely to do so in the future.

A strong case can be made that this analysis and these theoretical interpretations are too hasty. It should be observed that our statistical indicators have reached the year 1994, which was the fourth recession year and the first one showing some signs of recovery. However, it was almost two years until the first political reactions to the recession took place in terms of cuts and savings of public expenditure. Moreover, we have been able to describe the possible outcomes of the politics of the centre-right cabinet only. The outcomes of the politics of its successor, the rainbow cabinet, have not yet left their fingerprints on relevant statistics. As shown in Figure 3, the impact of savings first become significant in 1996. Cuts in family policy services and income transfers and in unemployment benefits will have large impacts on households who are dependent on these benefits, but cuts in other benefits (old age and health) will also be significant.

Therefore, it is conceivable that in the coming years the poverty alleviating impact of social transfers and their redistributive impact will decrease from their current levels. This could cause an increase in inequality and poverty, but only to a limited extent. It seems likely that even after these data become available, the conclusions made above will still be accurate.

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