

The 1980s and 1990s saw employment “miracles” in Denmark, Australia, and the Netherlands. This article analyzes the dynamics and substance of Danish policy responses to poor export, employment, and fiscal performance to see whether remediation should be attributed to pluck (intentional, strategic remediation of dysfunctional institutions to make them conform with the external environment), luck (environmental change that makes formerly dysfunctional institutions suddenly functional), or just being stuck (endogenous, not entirely strategic change that leaves institutions in conformity with the environment). It addresses these issues to remedy biases in the literature toward Sweden-as-model, toward pessimism about the welfare state’s survivability, and toward privileging intentional action. The analysis finds that stuck (endogenous dynamics) probably explains as much as pluck (strategic choice), suggesting only limited transferability for policy lessons from the miracles.

## THE DANISH “MIRACLE” Luck, Pluck, or Stuck?

HERMAN M. SCHWARTZ  
University of Virginia

**T**he Dutch miracle is the best publicized of a number of employment “miracles” in the Organization for Economic Cooperation and Development (OECD). However, Australia in the 1980s and Denmark in the 1990s also experienced employment miracles. The contrast with rising unemployment in France, Germany, and Sweden created a small literature looking for transferable policy solutions. The first three were particularly attractive to analysts uneasy with the British or New Zealand neoliberal policy route to

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*AUTHOR’S NOTE: A longer version of this article delivered at the 1999 Society for the Advancement of Scandinavian Studies annual meeting contains text, tables, and figures not presented here because of space considerations and is available at <http://www.people.virginia.edu/~hms2f/Sass-99.html>. Thanks to Karen Anderson, Robert Cox, Leslie Eliason, Christoffer Green-Pedersen, Asbjørn Sonne Nørgaard, Jonas Pontusson, and David Waldner for comments. All errors remain mine. Unless noted, all data, including that for the figures, are from OECD (1999a), Economic Outlook, annex tables, various dates through #65, June 1999. The designation “12 small OECD economies” refers to an average of values for Australia, Austria, Belgium, Denmark, Finland, Ireland, Netherlands, New Zealand, Norway, Spain, Sweden, and Switzerland.*

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employment gains because they generated relatively good employment outcomes without sacrificing essential features of their welfare state.

Most of the literature on these economic miracles assumes that actors' intentional policy behavior changed dysfunctional local institutions in ways that created desirable economic outcomes. However, deliberate policy choices that bring local institutional structures into better conformity with the environment are not the only possible cause for desirable economic outcomes. Positive outcomes can also occur if the external environment changes in ways that make what were dysfunctional and unchanged institutional structures more functional in the context of the new environment. Similarly, dynamics that are endogenous to a given but dysfunctional institutional structure can create unintended changes that accidentally make institutional structures more functional in the context of a changed environment. This article analyzes the Danish case to see how much of the Danish miracle can be attributed to pluck (strategic, intentional change), luck (environmental change), or just being stuck (endogenous, not entirely strategic change).

This analysis thus addresses three biases in the literature. First, parochially, writing on welfare states, and social democratic welfare states in particular, has always viewed Sweden as the epitome of both. This literature saw Denmark as a weak version of this generic "Scandinavian" (i.e., Swedish) model, whose incomplete acquisition of Swedish institutions and policies left it burdened by higher unemployment and fiscal and current account deficits. The 1980s seemed to confirm this vision, for Denmark entered the 1980s on a fast train to macroeconomic hell, whereas Sweden seemingly pursued its successful third way. But in the 1990s, Denmark and Sweden traded places. Sweden endured rising unemployment and current account and fiscal deficits, whereas the Danish economy absorbed labor market entrants and generated current account and, for a while, fiscal surpluses. Analyzing Denmark on its own terms usefully corrects this Swedo-centrism.

Second, precisely because the generic "Scandinavian social democratic model" was so closely identified with Sweden, Sweden's recent difficulties called into question whether social democratic welfare states could survive in a globalizing economy. But to the degree that pluck underlay Danish prosperity in the 1990s (or Australian and Dutch prosperity because the policy choices were similar), this suggests transferable policy lessons for those wishing to avoid both neoliberal policy choices and the problems plaguing Sweden.

Finally, this analysis corrects for the implicit privileging of intentional action in causal explanations by explicitly considering the possibility that although actors may have considered their actions intentional, their policy choices might have been essentially endogenous outcomes of the interaction

of specific institutional structures and particular environmental conditions. If markets, like any environment, select for and reward specific institutional structures and behaviors, then some actors will always appear to have made the "correct" strategic response to their environment, even if they chose their strategy somewhat randomly. But this may not necessarily be the "optimal" response or strategy. Furthermore, because actors do respond to their environment, that environment is always changing, eroding the degree to which any prior "best" response to a given environment fits the current environment. At any given time, stochastic changes rather than intentional action may create what looks like an optimal or best response to a given environment. But in this situation, causality will be located in the system (in the environment created by other actors' behaviors), not in the choices of specific actors who are usually studied in isolation.

This article thus tests luck, pluck, and being stuck as competing explanations for Danish "success" to illuminate the narrow trading places question and also broader questions about whether any welfare state can survive or thrive in the current world economy. To foreshadow the findings, Danish capacity to preserve the welfare state in the face of severe macroeconomic constraints without generating popular dissatisfaction is only partly accidental. Intentional reform whose potential was created by Danish political and social institutions did ameliorate Danish macroeconomic problems. Although this makes it hard to adjudicate adequately between pluck and stuck arguments, the Danish case suggests that neither environmental change nor endogenous dynamics are sufficient or necessary conditions for a crisis of a welfare state composed of publicly funded services and transfers. Sufficient conditions for economic crisis and a crisis of the welfare state rest in domestic policy choices and institutions.

### **THE STRUCTURE OF THE ANALYSIS**

What roles did luck, pluck, and being stuck play in resolving Danish problems with current account deficits, unemployment, and fiscal deficits? These three problems threatened to erode the economic sustainability of a welfare state based on tax-funded services and transfers. Unemployment raises expenditures, decreases revenues, and erodes social solidarity (Martin, 1996). The cumulation of fiscal deficits into rising public debt and interest payments can crowd out services and transfers. Current account deficits and public foreign debt are simply an external and more pernicious version of fiscal deficits because foreign debt cannot be monetized away. Current account deficits are also a proxy for competitiveness and often are associated with

higher unemployment as imports crowd out local production or as competitors displace exports from third-party markets. In short, these three issue areas represent core economic preconditions for a tax, service, and transfer welfare state. However, I will also touch on narrowly *political* issues of sustainability while discussing fiscal balance.

The structure of the luck arguments is transparent: Dysfunctional institutions promoting excessive wage gains, a weak export capacity, and high (imported) consumption in the 1960s and 1970s came into their own in the 1980s and 1990s when world markets shifted in favor of differentiated quality production and when declining global interest rates made past deficits less burdensome. Danish small- and medium-sized enterprises (SMEs) were well suited to fragmented markets that put premia on good design. Danish public sector institutions did not need to be fixed once their interest cost decreased.

The pluck arguments are more complex. Briefly, with regard to the private sector, central and corporatist actors used an innovative industrial policy to resolve problems plaguing the provision of collective goods for an economy characterized by SMEs and high levels of long-term unemployment. On the labor market side, a fortuitous shift to an active labor market policy first eased tight and potentially inflationary labor markets in the early 1990s and then firmed up softening demand for labor in the mid- to late 1990s. Meanwhile, collective-bargaining patterns shifted power downward from national organizations and upward from shop stewards toward sectoral associations (so-called cartels). This kept wage increases below productivity increases. On the public sector side, central actors with a reform and reorganization agenda used two interlocking attributes of the public sector's institutional terrain—intergovernmental corporatism and administrative corporatism—to moderate the growth of public consumption, thus allowing a return to fiscal stability.

Stuck arguments would suggest that Danish institutions evolved incrementally according to logics of appropriateness held by actors in those institutions and that the institutional outcomes were either better than prior configurations or at least less dysfunctional than those into which the competition stumbled (March & Olsen, 1989). Actors' conscious policy choices were conditioned by embedded notions about the social purpose of their activity and what could be attained given the institutional landscape in Denmark. In that sense, they were not perfectly free choices but rather conditioned by accidental or incidental qualities of those organizations. Because the external environment surrounding Danish production and public sector institutions was also not characterized by optimal organizations, Danish organizations merely had to be less dysfunctional than their global competitors to look "good." Note that stuck arguments are thus not arguments for convergence toward any optimal organizational form, nor do they offer much

guidance about policy transferability. As Alchian (1950) and others have argued, markets are like ecologies. Firms display a multitude of strategies—expressed as organizational structures—that can be well or ill suited to their environments. Competitive pressures force firms to adapt their strategies (organizational structures), but they do not enforce conformity. Ecologies with multiple niches permit multiple successful strategies, and both successful and unsuccessful strategies change the environment. Moreover, competitive pressure on any given organization can be diffused if it is in an ecological niche (market) with few competitors. Pressures on public sector organizations are even more diffuse because they have quasi-parasitic sources of revenue (or put differently, something approximating a monopoly in the provision of regulated and common pool services).

### **LUCK, PLUCK, OR STUCK: PRIVATE SECTOR EXPORTS AND THE TRADE BALANCE**

#### **LUCK**

A luck perspective would argue that Danish failure to avoid current account deficits in the 1960s through 1980s derives from a mismatch between an industrial sector dominated by SMEs and an environment favoring long production runs of standardized goods; Denmark's recent trade success, then, is nothing more than a fortuitous change in world markets favoring the differentiated goods at which SMEs excel. This offset Denmark's bad luck in sending two thirds of its exports to the slow-growing European Union.

The arguments about postwar fordism are reasonably well known. Postwar regulation of the economy created an environment favoring production of standardized goods, with minimal design changes, using technologies mixing assembly lines and dedicated capital goods with unionized semi-skilled labor. Thus, the breakup of fordist mass markets in the 1980s and 1990s should favor smaller, more agile firms producing design-intensive goods with skilled labor and general-purpose machinery.

Denmark's industrial sector is both small in relation to the economy and in terms of structure (OECD, 1994, pp. 62-64). Only 20% of private employment is in firms with more than 500 workers, below the OECD average, whereas the share of employment in enterprises with fewer than 20 employees is the second highest in the OECD. This industrial structure arguably creates some problems for the Danish economy. Despite the predominance of SMEs, a substantial share of Danish exports is scale-intensive goods. Manufacturing specializes in consumer nondurables (about 5% of exports),

design-intensive goods, intermediate metal inputs for other firms, specialized machinery, chemicals (10%) and food production (20%). Most of the first four products are characterized by short production runs, high levels of differentiation, and low levels of research and development (R&D), whereas the last two are typically fordist. Danish service exports (about 25% of exports) are also produced by large firms with scale advantages.

Denmark's firms are also heavily concentrated in low-technology, low-growth sectors. Small firms typically lack the funds to enter new markets and to generate significant amounts of R&D. Although Danish firms employing more than 500 workers represented only 20% of employment, they generated 60% of R&D spending in 1995 (OECD, 1999b). Finally, the absence of a well-developed shares market in Denmark might make it hard for firms to attract new capital. The Danish share market amounted to only 8% of gross domestic product (GDP) in 1980 in contrast to an average of 25% in Australia, Sweden, and New Zealand.

These problems should make it difficult for Danish firms to export or substitute local production for imports. And, indeed, Danish exports by and large did not grow as fast as export markets in the 1970s when the fordist model (while in crisis) created conditions conducive for scale-intensive production. Danish export performance in the 1970s was below what a constant market shares analysis would have predicted, partly because Denmark exported goods with below-average growth rates and partly because it exported those goods to countries with below-average growth rates (Horwitz, 1984). Over the 1980s, manufacturing exports underperformed export market growth by about 11% (OECD, 1994). Figures 1 and 2 display export performance and the trade balance.

Nonetheless, Danish export performance surged from 1986 through 1992, a period characterized by stagnant domestic demand and then rising demand in Eastern Europe. But logically, if there had been an environmental shift to postfordist demand structures in the 1980s, Danish export performance would have been consistently high from the mid-1980s on rather than plummeting precipitously after 1992 and then recovering slightly in 1997. Despite this relative decline, Denmark turned its pre-1986 trade deficits into surpluses through 1999.

## PLUCK

Does pluck explain this shift? The Danish government and private sector actors generated a series of industrial policies addressing the underprovision of collective goods for SMEs in the 1980s and 1990s. In 1983, the existing Technology Board (Teknologistyrelsen) put forward three new programs for

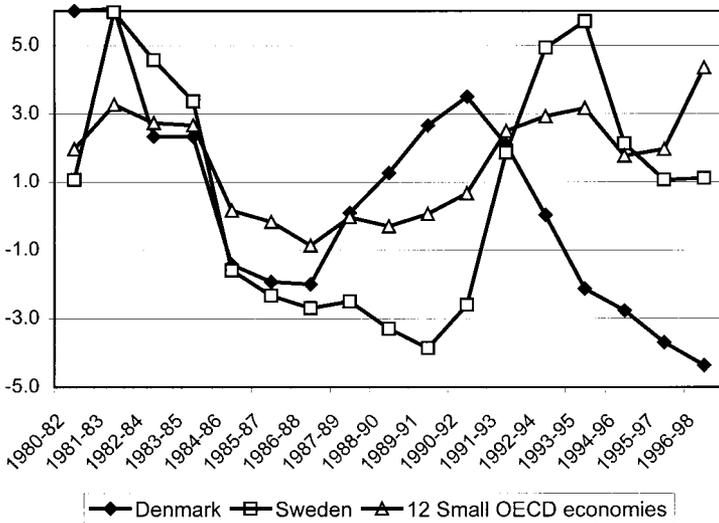


Figure 1. Export performance, 3-year rolling average.

technological development after the OECD pointed out the typical weaknesses of Danish SMEs (Annerstedt, 1989). The board helped create networks to rapidly diffuse knowledge about new technologies, new managerial strategies, quality control, and new financing arrangements. The Academy for Technical Sciences and two other national technical institutes helped develop dispersed, locally integrated engineering and consultancy services through the Danish Technological Services Network. R&D expenditures by Danish firms rose steadily from 1.13% of GDP in 1986 to 2.02% by 1995 (OECD, 1996, 1999b). Despite the initial lack of a comprehensive program, by the late 1980s public spending on a variety of efforts amounted to Danish Kroner (DKK) 1.3 billion (Christiansen & Sidenius, 1988).

On the financing side, the Teknologistyrelsen allocated about DKK 2 billion for the acquisition and dispersal of foreign source technologies. The Danish National Bank and private actors used DKK 0.5 billion to capitalize Dansk Udviklingsfinansiering A/s to provide venture capital in the absence of a deep shares market and directed public funds into public-private cooperative R&D (Christiansen, 1989). The government absorbed some of the exchange rate risk of overseas borrowing and now guarantees up to 50% of venture-type loans from banks (OECD, 1994). The shares market itself was deregulated in the late 1980s, and by 1996 total capitalization of shares han-

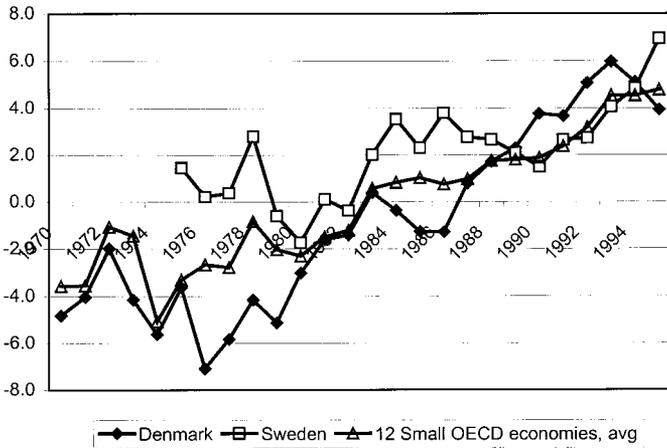


Figure 2. Trade balance, percentage of GDP.

dled on the exchange equaled 41% of GDP. Budget balancing after 1989 eliminated some programs, but the self-financing public-private networks lived on. Finally, as in many other small countries, the government elaborated a strategy based on seven local clusters of firms, including traded services.

Private sector individual and collective actors also responded to SME problems. Danish firms seem to have compensated for some of their weaknesses by aggressively substituting capital for expensive Danish labor at all levels of technology (OECD, 1994, p. 66). This probably allowed them to increase their share of low-technology markets. During the early 1990s, the union-controlled *Lønmodtagernes Dyrtidsfond* cooperated with Denmark's largest food processor, *Mejeri Danmark*, to consolidate the food-processing industry by buying up smaller competitors and launching common brands in major European markets (Nielsen, 1991).

## STUCK

Disproving a "stuck" argument is easier than proving one. A stuck argument ultimately rests on the degree to which actors' behavior flowed from a given logic of appropriateness rather than a strategic appreciation of and response to their environment. Most private sector actors certainly could be accused of simply acting out of a preexisting logic of appropriateness, especially

Mejeri Danmark's drive to consolidate food processing. Food-processing firms everywhere consolidated in the 1980s. Similarly, the preference for cooperative efforts and the diffusion of knowledge through extension systems was characteristic of Danish agricultural policy in the 19th century and carries over into all industrial policy today. Amin and Thomas (1996) show this clearly while making what they think is a pluck argument.

Some government efforts, however, suggest a true strategic vision that was ideologically and normatively at odds with traditional Danish practices. Annerstedt (1989) argues strongly that "industrial modernists" pushed for truly new remedies for SMEs' technological deficiencies. These modernists worked outside the usual policy networks and arenas, exploiting the vacuum created by dissensus between government and business organizations. Their program also diverged somewhat from the usual "help to self help" orientation of Danish government policy in its commitment to making firms change and strongly in the intensity of government involvement and directiveness. Precisely these programs were cut from post-1989 budgets after the social liberal party Venstre defended small industry's right to be left alone (Nielsen, 1991).

## EVALUATION

The weight of evidence here mostly favors a stuck argument. Luck should have produced a secular rather than cyclical or erratic pattern to Danish export success. The industrial policy of the 1980s clearly helped boost Danish export performance for a while, suggesting that pluck matters. But if pluck explained everything, then Danish export shares would have expanded gradually after the initiation of the aggressive industrial policy of the 1980s. However, the termination of much financial support for industrial policy in 1990 correlates well with declining export performance, and this termination also corresponds to political changes that restored policy making to patterns "appropriate" with normal Danish policy making. Finally, Danish export growth also seems sensitive to absolute and relative labor costs and not just to problems with firms' size. The abrupt slide in Danish export growth from 1992, and the corresponding decline in the trade surplus from 6.0% in 1992 to 3% in 1997, indicates that the elimination of the trade deficit in the later 1980s and early 1990s has more to do with the unusually high level of demand created by German reunification, and perhaps by falling relative unit labor costs (RULCs) from 1986 to 1988 (about which more later), than with a favorable structural change in Danish industry or a determined effort to change structures. Score this 60% stuck, 30% pluck, and 10% luck.

## **LUCK, PLUCK, OR STUCK: PRIVATE SECTOR COLLECTIVE BARGAINING AND EMPLOYMENT**

### **LUCK**

The luck argument in labor markets is very short: Markets worked in the normal fashion. Rising unemployment from 1987 on led quite normally to wage moderation and a rising share of income going to capital just as the international economy began to pick up. The wage share of business sector value added fell from about 75% in 1980 to 66% in 1985, recovered to 70% in 1987, and then fell again to 61% in 1994 (OECD, 1996). This in turn permitted the modest export expansion noted above and a downturn in unemployment despite a stable employment-to-population ratio in the mid- to late 1990s (Figures 3 and 4). There is a .41 correlation between unemployment rates and capital income in the business sector from 1988 to 1997; the correlation between RULCs and capital income is similar.

The luck argument has two problems. The first concerns timing. Luck cannot explain how from 1983 to 1987, just as unemployment fell from 10.5% to 7.7% (local definitions), RULCs were rising from 81.3 to 103.4 (1990 = 100) and labor recovered 4 percentage points of value added. Similarly, just as Danish RULCs began to edge upward in the late 1990s, unemployment actually declined rapidly from 10.1% in 1995 to an estimated 6.4% in 1999 (Figure 5). Second, Danish collective-bargaining practices changed considerably in the late 1980s, away from a centralized system, but it is precisely at this point that RULCs stabilized and labor gave up 9 percentage points of value added to business.

### **PLUCK**

Perhaps pluck allowed Danish labor market actors to get RULCs under control and boost employment. Due, Madsen, Jensen, and Petersen (1994) argue that Danish collective-bargaining arrangements experienced simultaneous decentralization and centralization after 1989. Centralized negotiations among a small number of new "cartels" set broad frameworks in which specific local negotiations over wages and conditions could then occur. The new cartels simultaneously moved power in wage negotiations downward from union and employer confederations and upward from stewards and firms.

Prior to these changes, Danish collective bargaining generated two different kinds of contracts. (Table 1 shows relative coverage.) Centrally bargained standard wage contracts set industry-wide, essentially nonnegotiable wage

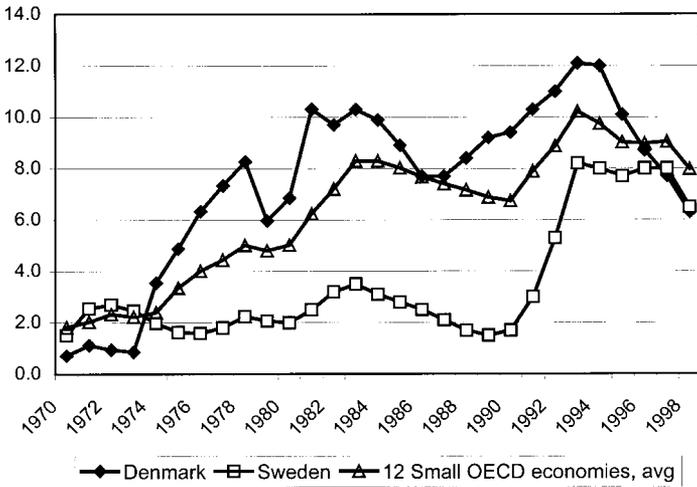


Figure 3. Unemployment rates, local definitions.

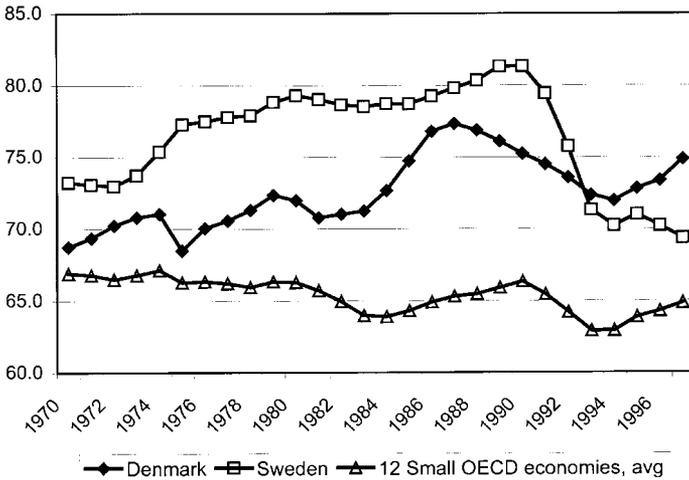


Figure 4. Employment-to-population ratio, 1970-1996.

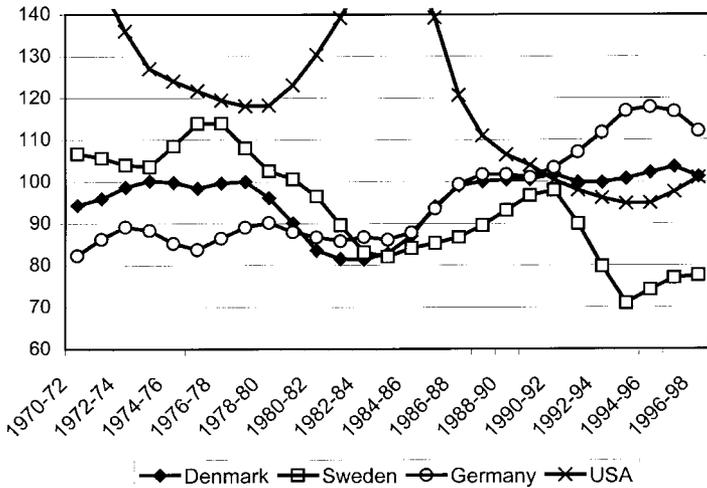


Figure 5. Relative unit labor costs, common currency, 3-year rolling average.

increases and conditions. Minimum wage contracts set a floor beneath second tier, locally controlled, plant-level bargaining. From 1983 on, employer associations and some unions introduced a third variation into this system by creating minimum-pay contracts in which central negotiations simply set a floor beneath wages and conditions within five large sectoral groupings, but then all increases were bargained locally at the plant level. Organizationally distinct, sector-specific bargaining cartels emerged on each side around these minimum pay contracts.

Minimum-pay contracts remedied the tendency for centrally set wages to generate across-the-board increases in pay for sectors that were unable to generate commensurate productivity increases, as well as the difficulties centrally set wages and conditions created for employers seeking to induce skills formation and introduce multitask work practices (Pontusson & Swenson, 1996). Arguably, this big change in the structure of private sector collective bargaining created significant stability in RULCs (which measure wage growth in relation to productivity) from 1986 on, as Figure 5 shows. Productivity grew faster than compensation in Denmark from 1986 to roughly 1998 (OECD, 1996). Wage restraint then generated rising employment and large trade surpluses (Figure 2) but not better export performance for Denmark. (However, it might also have averted even worse deterioration in export growth.)

Table 1

*Wage Bargaining Structures in the DA/LO Area (percentage of employees covered)*

	1989	1993	1995	1997
Normal (i.e., centrally set) wage increase	34	16	16	16
Minimum wage (local bargaining up to central maximum)	32	13	12	17
Minimum pay (central minimum, local top-up)	30	67	61	46
Fully local bargaining	4	4	12	21

*Source:* Organization for Economic Cooperation and Development (1999b, p. 66).

Finally, just as export performance deteriorated, expanded early retirement and paid leave schemes after 1994 helped activate workers who otherwise would have slid into long-term unemployment, reversing a secular decline in the employment-to-population ratio in the mid 1990s (Figure 4).

## STUCK

As with industrial policy and exports, evidence that actors consciously chose to change collective-bargaining structures in the direction described above provides enticing evidence for a pluck argument. The outcomes described by Due et al. (1994) did not emerge spontaneously but rather as the outcome of political struggles within employer organizations and unions as well as between them. But a comparison with other countries that started out with similar collective-bargaining structures and similar problems shows quite similar responses to those problems in pursuit of successful wage restraint and employment growth. Danish collective bargaining changed in the same ways that bargaining did in the Netherlands and Australia (Schwartz, 2000; Visser & Hemerijck, 1997). Those countries had relatively centralized collective-bargaining systems in which the state generalized wage gains and cost-of-living increases across sectors through processes similar to the "concatenation" found in Denmark. Dutch state mediators or Australian arbitration courts intervened recurrently in bargaining, and this frequent resort to legislated or juridically imposed settlements meant that labor market actors conducted their conflicts under the shadow of hierarchy (Scharpf, 1997). Consequently, organized but market-vulnerable actors sought to reestablish their autonomy in the 1980s by behaving responsibly and using state institutions to punish or discipline potential defectors rather than suffering indiscriminate state sanctions.

Employers in all three countries sought one-firm, one-contract-type bargains from one-industry, one-organization-type actors, and all three bargaining systems saw rising proportions of purely locally negotiated labor con-

tracts. Moreover, in all three countries, actors located in the metals industry drove decentralization following a long-established logic of appropriateness present in that industry, which exchanged wage gains for productivity gains and which then let employers and workers adjust local wages to local conditions (Due et al., 1994; Thornthwaite & Sheldon, 1996).

## EVALUATION

A luck argument is completely unpersuasive in light of intentional action, the evidence on the timing of changes, and the similarity of change across several countries. Given that actors deliberately changed their behavior, can a stuck argument be persuasive? The congruence between Danish changes and equally successful change elsewhere, and the similar origin of these changes in established bargaining patterns in the metals industries, suggest that a stuck argument cannot be completely dismissed. Although Australia, the Netherlands, and Denmark all had centralized bargaining systems, they also all had incomplete centralization of both business and labor organizations. Perhaps in this kind of structure, endogenous change allows politically dominant firms to impose their own, established preferences on the others. Score this two thirds pluck, one third stuck.

## **LUCK, PLUCK, OR STUCK: THE PUBLIC SECTOR AND FISCAL BALANCE**

### LUCK

The public sector luck argument is fairly simple. The single fastest growing source of public sector deficits was rising interest expenditures on debt accrued in the 1970s and 1980s (see Table 2, line 4, and Figure 6). As real interest rates rose through the early 1980s, the cost of running deficits climbed rapidly. In the mid-1980s, despite a narrowing of the interest rate differential between Denmark and Germany due to Danish entry into the Exchange Rate Mechanism (ERM) of the European Monetary System (EMS), real interest rates hovered over 7%; debt service on gross public debt amounting to 72% of GDP absorbed 8.8% of GDP. But as interest rates declined to less than 5% by 1997, the cost of servicing old debt declined to 6.7% by the late 1990s, permitting a falling total fiscal deficit (Table 2, line 5). The timing of shifts in the total deficit comports somewhat with a luck argument. Slightly rising real interest rates in the mid-1990s created renewed deficits after a period of falling interest rates and surpluses in the late 1980s; fall-

Table 2  
*Fiscal Indicators (percentage of GDP)*

General Government Account	1980	1986	1988	1990	1992	1993	1994	1995
1. Current receipts	52.9	59.1	59.5	56.9	58.2	59.9	60.3	59.5
2. Noninterest expenditure	52.3	46.9	51.1	51.1	54.2	56.0	56.6	54.4
3. Primary budget balance	0.7	12.2	8.4	5.8	4.0	3.9	3.7	5.1
4. Net interest expenditure	3.9	8.8	7.9	7.3	6.8	7.8	7.1	6.7
5. Budget balance	-3.3	3.4	0.4	-1.5	-2.9	-3.9	-3.5	-1.6
6. Transfers (excluding interest)	18.4	17.7	19.6	20.5	22.0	23.0	24.7	24.1
7. Consumption	26.7	23.9	25.6	25.2	25.6	26.3	25.6	25.2

*Source:* Organization for Economic Cooperation and Development (1984, 1994, 1997).

ing interest rates after 1995 are associated with renewed surpluses. The problem with the luck argument is that it fails to explain the origins of public sector deficits in the first place, how and why surpluses replaced deficits during the high interest rate environment of the early to mid-1980s, and why deficits reemerged when real interest rates were actually somewhat lower than in the 1980s. Part of the answer surely is rising taxes in the 1980s, which helped make rising interest rates affordable. In addition, the expansion of transfers to persons (Table 2, line 6) nicely mirrors the changing interest rate environment. Once interest rates fell, transfers expanded from 19.6% in 1989 to 24.1% in 1995, more than absorbing the slack created by falling interest rates.

## PLUCK

Public sector pluck arguments rest at the intersection of public choice theories and organizational behavior under the shadow of hierarchy (Scharpf, 1997). These provide a more robust explanation for the emergence of public sector deficits and the expansion of transfers than the bad luck of rising interest rates. Danish public sector organizations restrained their spending when central governments seeking fiscal balance threatened local governments' and unions' institutional power.<sup>1</sup>

Public choice theory argues that producers seeking budget growth and client groups seeking increased services and transfers should cause welfare spending to rise inexorably and make budgets "sticky downwards." Moreover, Denmark's high degree of decentralization in service delivery should

1. European integration also put pressure on Danish fiscal policy. But most fiscal consolidation occurred pre-Maastricht, and Denmark was never in danger of violating Maastricht deficit targets. Moreover, the Danish "No" of June 1992 and its monetary unification opt-out suggest clear limits to these external pressures. So the question remains, Who created surpluses?

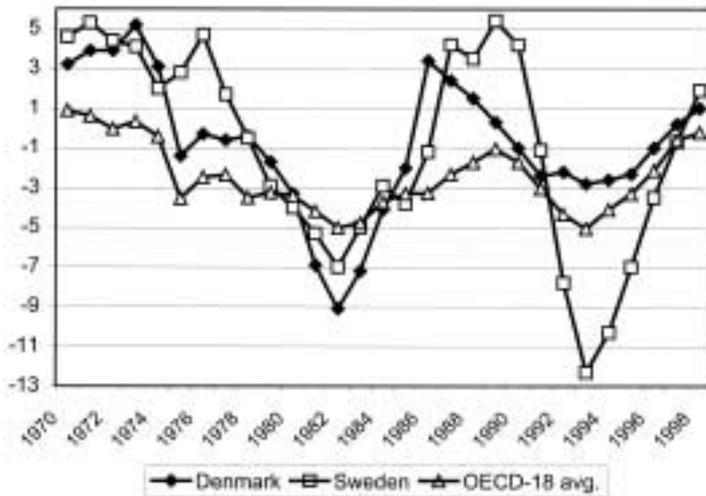


Figure 6. Fiscal deficit, percentage of GDP.

aggravate this (Hansen & Pallesen, 1998). Indeed, both Danish public spending and employment grew more than 50% in the 1970s, and as taxes did not grow, the fiscal deficit widened.

But the 1980s present a puzzle for public choice theoretic predictions about pervasive state incapacity to control entrenched public sector producers. Danish fiscal restraint in the 1980s did not upset delicate institutional balances among welfare service producers, but those producers restrained their budget growth. As a share of GDP, consumption spending actually fell from 1980 through 1986 and only recovered to 1980 levels in 1996 (Table 2, line 7). In Thatcherite Britain, by contrast, public consumption has grown more or less continuously since 1985 (OECD, 1999b).

How did this happen? Put simply, institutional actors cannot maximize all their desires at once. Critically, public sector producers can only (ab)use their position if the asymmetries that give them their privileged position stay intact. When producer organizations' ability to legitimately control an activity is threatened, these institutional actors will defend long-term interests and sacrifice short-term budget maximization. Established rights, powers, and procedures are more important than short-run monetary gains because institutionalized power involves high sunk costs and eliminates uncertainty about the future.

A pluck argument has to assert that central politicians in Denmark used fiscal crisis to politicize the asymmetries privileging producer groups and thus restrain those actors. This parallels labor market events both in the Netherlands after Wassenaar and in Australia under the Accord. In both cases, the central state used its ability to deny the extension of collectively bargained contracts to unorganized sectors to extract wage restraint from collective actors. What is unusual in Denmark is the extension of this pattern to a public sector in which producer groups exercise managerial control. Danish central politicians used two institutional features to constrain consumption spending. The first is the localization of public consumption, production, and financing, which creates regularized intergovernmental negotiations over budgets and which I will call *governmental corporatism*. The second is the domination of public service sector administration by professional producer groups rather than professional managers, which I will call *administrative corporatism*.

*Governmental corporatism: Localization's consequences.* Public consumption, the largest part of Denmark's welfare state, is extremely localized in terms of provision and financing. Considerable *local* flexibility in welfare provision increases all local politicians' responsiveness to citizen and producer group demands. On the funding side, Denmark has one of the highest ratios of local to central employees in the OECD, and local income taxes cover a substantial share of local expenditures (Christiansen, 2000). Sweden aside, Danish localities raise a greater proportion of total revenue than in any other unitary OECD state, roughly 31% as compared to an unweighted average of 6% (OECD, 1992).

In Denmark, local decisions over spending immediately affect the center's capacity to maintain fiscal balance.<sup>2</sup> However, the center can constrain local autonomy in three ways. Central transfers to localities account for a third of total local outlays. Second, the center mandates and regulates most local responsibilities, as well as intermunicipal redistribution of revenues. Finally, nationwide collective agreements constrain the organization of welfare services. Even if local unions and professional organizations develop localized demands, they closely coordinate these activities with their national organizations.

This standoff has put the central and local governments into yearly budget negotiations since 1970. Negotiations between the Finance Ministry and the

2. The analysis of decentralization parallels that in Hansen and Pallesen (1998), which came to my attention during the final revision of this article.

associations representing counties and municipalities determine the level and content of central transfers to localities. During the 1970s, the central government used public sector growth to temper unemployment, so there was little conflict (Nannestad, 1991). But fiscal stress in the 1980s motivated the Danish central government to try to control local spending. The center then waged a long and quite successful budget battle with localities, using changes in the structure of central funding and regulation, as well as financial penalties, to change local politicians' spending behavior.

The Finance Ministry changed central funding from a system of straight reimbursement for local service expenditures (e.g., health) to a system of shrinking block grants (Schou, 1988). Central government grants fell from 35.6% of local government funding in 1982 to only 28% in 1985 (Eliason, 1992, p. 596). The center also punished overspenders by sequestering funds. Meanwhile, the center progressively loosened control over how local governments spent.

The institutionalization of center-local budget negotiations formalized a peculiar public sector corporatism in which governments, not labor market actors, received representation and a say in national policy making. Normatively, this increased the center's capacity to translate its tight fiscal policy into local budgetary restraint because it recast Denmark's widely cherished local autonomy as *operational* rather than *fiscal* autonomy. But norms aside, why did local politicians refrain from spending more?

Governmental corporatism motivated local politicians to control producer demands and thus do the center's dirty work in restraining consumption spending. Local politicians naturally like to buy votes through expanded services, but they risk losing votes by raising very visible local taxes. The center's policies increased the share of local funding for local services, heightening local politicians' sensitivity about tax increases. Simultaneously, however, block grants allowed local politicians more freedom to shift money to the most pressing—that is, vote-generating—local problems. Local politicians used block grants to bridge the gap between service demands and tax resistance.

Like Ulysses, local politicians used negotiations with the center to tie themselves to the mast when facing local Sirens: they could hear professional groups' and citizens' demands yet effectively claim that they have an inability to meet all demands. The annual budget deal with the central government precluded a general free-for-all at the public trough, whereas the concentration of central transfers into block grants gave them some flexibility to help different groups at the margin. Conversely, once budget surpluses reemerged, central politicians could not resist the temptation to buy votes by expanding

transfer payments; central politicians could not reap political benefits from improvements in locally managed welfare services.

The somewhat unusual public sector governmental corporatism and public sector structures described above are not unique to Denmark because all Scandinavian localities levy taxes and provide the bulk of welfare services. But although all the Scandinavian countries have developed variations on governmental corporatism as a crucial instrument for public budget control, it has developed most fully in Denmark.

*Administrative corporatism.* Central politicians consciously used a second institutional feature of the Danish welfare state to produce fiscal restraint: administrative corporatism. Corporatism clearly is a system for sustaining and stabilizing collective action that can help subordinate narrow interests to broad social goals; it also can entrench the interests of specific organized groups. Why did Denmark's strongly organized and professionalized service producers go along with restraint?

Here, the second peculiarity of Danish corporatism emerges. In all welfare states, professional "street-level" bureaucrats exercise considerable influence on policy implementation (Lipsky, 1980; Wilson, 1989, pp.148-158, 168-171). However, Danish professionals control welfare state management and governance structures to a much greater degree than elsewhere. Their unions naturally negotiate pay and work conditions, but they also usually have a privileged position in welfare service management.

Thus, day care teachers themselves manage day care centers, and teachers have traditionally held a strong position on the boards of primary and secondary schools (Christensen, 2000). And Denmark is perhaps the only country in the Western world in which nurses (and doctors) take part in all levels of hospital management. Due to the lack of powerful centralized labor organizations, doctors negotiate as doctors, nurses as nurses, and so forth on a number of issues broadly affecting member interests. All are conscious not only of working conditions and pay but also of institutional privileges and professional turf.

Aside from professional norms, what has constrained Denmark's professional groups from budget maximization and other forms of opportunism with guile? One answer might be that nothing has. Certainly in the health and education sectors, professional organizations defended work norms and institutional prerogatives in the 1980s. Moreover, as Christiansen (2000) shows, cutting budgets and shifting resources was virtually impossible to do short of freezing budgets and letting inflation take its toll. This lack of control over spending was only partly real. Because these organizations pursue mul-

tiple and potentially conflicting goals, the center could induce self-restraint from professionals just as it did from local governments, and local governments could put professional organizations into the same position localities faced vis-à-vis the center.

The dual functions of professional producer organizations mean that they necessarily pursue more than one goal at the same time. One goal is short-term budget gains—usually better wages and working conditions. However, these short-term gains flow from professionals' long-term control over the institutional privileges and management prerogatives. Administrative corporatism, like all corporatism, institutionalizes "iterated games." This extends the time horizon of those enjoying a privileged position within these administrative networks. Actors will accept immediate economic losses from these iterated games either if participation maximizes long-term net gains or if participation prevents even worse outcomes. This is particularly apparent in negotiations over pay and conditions because Danish administrative corporatism is not organized around central labor market organizations worried about macroeconomic outcomes. Instead, it is organized around professional organizations whose colonization of the para-public committees that actually control policy implementation gives them an active hand in the *management* of welfare services. Control over management permits these organizations to defend professional prerogatives.

Because professional organizations controlled policy execution, it focused the local and central states' attention on gross budgets and general policy mandates rather than on detailed budgetary control and regulation of service delivery. In effect, local government's two associations bargained with unions as a representative of "shareholders" (i.e., taxpayers and voters) rather than management because management per se had been colonized by the professional organizations. This allowed local government to threaten to displace professional organizations from their management role if producers did not contain spending and improve "customer" (i.e., voter) satisfaction. Professional organizations then acceded to stagnant budgets to preserve their workplace autonomy, much as local politicians acceded to stagnant block budgets so long as they had discretion to use those blocks in vote-maximizing ways. In the 1980s, for example, nurses traded away budget and pay increases for more control over hospital administration and over the allocation of work inside hospitals, effectively expanding trained nurses' professional turf.

## STUCK

A stuck argument starts from the same observations as a pluck argument but adds the following spin. Unlike industrial policy, no one's behavior devi-

ated from long-established practices except for the shift from reimbursement to block budgeting. Could actors have behaved any differently than they did?

The Danish combination of professional group corporatism and a highly fragmented parliament made changing welfare institutions or the entire welfare system quite difficult. In general, any central government run by minority coalitions would find it hard to articulate a coherent vision for change, despite the adverse fiscal consequences of producer control. Furthermore, the center found it even harder to control itself when budget constraints eased in the mid-1980s. Although the corporatist institutions discussed above allowed the center to restrain the localities and welfare service producers, nothing prevented the center from improving highly popular social transfer schemes. If the central government also controlled welfare services, the costs of running these programs might have increased too.

Without any central vision for change, the well-entrenched Danish moral consensus favoring the welfare state strongly conditioned efforts at change (Anderson, 1997). Change to the welfare state had to be sold as welfare preserving cost containment understood in terms of traditional norms, not as a gutting and rebuilding (Cox, 1999). Meanwhile, welfare service producers stood ready to invoke similar norms by arguing that reforms attacked not their privileges but the quality and scope of the welfare state. This reveals limits to change in social democratic welfare states. It is hard to generate or maintain popular dissatisfaction with a welfare state only by raising *efficiency* issues. But attacking policy *effectiveness* risks undermining the legitimacy of the welfare state as well and thus causes supporters of the welfare state to rally in its defense. In Denmark at least, entrenched producer interests could probably rally large segments of the population in their defense and inflict electoral losses on politicians. But on the other hand, the center could use identification of producer privileges running counter to the moral base of the welfare state to threaten producer privileges. In this dynamic, producers could justify their continued control only if they delivered reasonable quality services at a reasonable tax price. Despite stagnant budgets, they could not allow service quality to deteriorate because this would make attacks on their professional privileges even more tempting.

So whether from calculation or belief, few Danish political actors could risk neoliberal-style assaults on welfare. Such tactics would neither gain immediate votes nor free up enough resources to buy votes later. Budget restraint and some efficiency gains could be implemented only by working within the various logics of appropriateness that already existed in Denmark. These logics dictated that local and central government challenge professionals' institutional privileges to get cost containment. Denmark's entrenched producer groups were well positioned to resist assaults on professional pre-

rogatives, particularly from minority governments, but it was less risky for them to accommodate budget restraint than to put their privileged position at stake. Thus, while on their own terms the threatened reforms had negligible impact, the politicization of management structures increased policy makers' capacity to curb budget increases. As detailed budget control probably impedes efficiency anyway, this structure probably is superior in terms of producing acceptable outputs and cost containment from public sector organizations (Saltman & von Otter, 1992). The logic of appropriateness in government-professional group relations let the governments set the budget and producer groups spend it, subject of course to their own internal norms about service delivery.

### EVALUATION

Although luck—falling interest rates—eased fiscal problems in Denmark, it can be ruled out as the determining influence on fiscal balance. Instead, deliberate restraint of some kinds of spending secured fiscal stability by the 1990s. The question is, how deliberate were these efforts? Because the strategies and outcomes all followed routine Danish logics of appropriateness about the provision of welfare services quite closely, and because the critical actors pursuing fiscal balance—central politicians—themselves contributed to fiscal imbalance by expanding transfer payments, it seems reasonable that pluck was not the overwhelming cause for success here. Let us score this 20% luck, 30% pluck, and 50% stuck.

### LUCK, PLUCK, OR STUCK?

We have (admittedly arbitrarily) scored the three issue areas we have examined in Table 3. On balance, this suggests that although deliberate policy rather than circumstance helped ameliorate the problems undermining the Danish welfare state in the early 1980s, actors operated within a very small margin of freedom in choosing their actions. This is somewhat comforting because it suggests that at the margin, correct (!) policies can make a difference, assuming of course that a correct policy can be found and implemented. But as policy emerges out of existing institutions that are already maladapted to the external environment, the probability that actors will generate "correct" policy is bound to be low, despite the faith some authors (e.g., Genschel, 1997) put in muddling and incremental adaptation as solutions.

Narrowly, the economic crisis in the 1980s in Denmark was not a sufficient cause of crisis for the welfare state, and it is likely that the same will be

Table 3  
*Luck, Pluck, or Stuck: Shares of Outcomes (in percentages)*

	Exports	Employment	Fiscal Balance
Luck	20	0	20
Pluck	30	66	30
Stuck	50	33	50

true of the Swedish state as it confronts a period of economic hardship and management problems similar to those Denmark faced in the 1980s. The Danish case suggests not only that welfare state preserving responses exist but that precisely the kinds of things Lindbeck, Sandmo, and Petersson (1994) see as pathologies are also sources for political responses that can remedy basic economic problems with the welfare state.

More broadly, this analysis of the Danish miracle suggests that it, like those in Australia and the Netherlands, does not present fully transferable policy lessons. In all three countries, policy responses to the kinds of problems analyzed here could only partially be characterized as fully strategic responses to each country's maladaptation to the international economic environment. Even without invoking the language of path dependence, it is clear that the inability of actors to generate fully strategic responses to institutional maladaptation to their environment makes these miracles in at least one sense: Human agency probably did not have much to do with them.

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*Herman M. Schwartz is an associate professor of government and foreign affairs at the University of Virginia. He is the author of In the Dominions of Debt and States Versus Markets (1st and 2nd editions). He is working on public sector reorganization in Australia, Denmark, Canada, New Zealand, and Sweden; see <http://www.people.virginia.edu/~hms2f>.*