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1990s  
Economic Crisis  
The Research Programme on the  
Economic Crisis of the 1990s in Finland:

**Down from the heavens,  
Up from the ashes**  
**The Finnish economic crisis of  
the 1990s in the light of  
economic and social research**

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## Preface

The Finnish economic crisis of the 1990's was much more severe than ever expected. The collapse of the GDP in 1991 - 1993 was about 12 percent. It was four times bigger than the collapse in Finland during the Great Depression of the 1930's. The unemployment rate rose from 3.5 percent in 1990 to 18.4 percent in 1994. The motivation to do economic and social science research on these phenomena is certainly very strong.

The Board of the Academy of Finland decided in 1997 to organise a research programme on the economic crisis of the 1990's in Finland. The Research Council for Culture and Society organised the planning of the programme and launched this multidisciplinary three-year programme in 1998. The idea was that the Academy of Finland being a central science policy actor must take the economic crisis into the focus of social science research. The main aim of the programme was to boost research on the economic crisis on a broad basis. The events, causes, and consequences of the crisis were to be taken into consideration. It was hoped that the research work could indicate if the crisis has left some permanent traces into the society or if the shadow of the recession has already disappeared. Especially valuable would be results showing us what the lessons to be learned from the crisis were. Through these the findings of the research programme could be used in the economic and social decision making of the society.

The programme was the largest social science research programme funded by the Academy of Finland up to the time the programme started. The number of research projects accepted to the programme was 25, and the budget allocated was FIM 25 million (4.2 million euros). The Government Institute for Economic Research was chosen to co-ordinate the programme. The institute appointed Dr. Jaakko Kiander to be the programme co-ordinator. The Research Council nominated the steering group of the programme. Members of the group from the year 1998 were professor Paavo Okko (chairman), professor Risto Alapuro, director general Martti Hetemäki, professor Marjatta Hietala, and professor Hannu Uusitalo. Dr. Kaija Heikkinen has been a member of the group during the current year.

The research work done under the programme has been extensive and successful. Research teams have published a large number of publications on different forums. Many scientific conferences have been arranged. We are convinced that this investment into the research work has been productive. The economic crisis of the 1990's is a special research object for the Finnish economic and social sciences. They must know the phenomenon very well. Otherwise they could not serve the society in a proper way. The Finnish crisis is interesting also from the international point of view. This publication is the final

report of the programme. It is not covering all the work done, but it contains central reports from different fields of the work. It gives an overview and a collection of results at the same time.

On behalf of the Research Council for Culture and Society I have a great pleasure to express our gratitude to project leaders, to researchers, and to the people otherwise promoting the programme. We are especially grateful to the editors of the final report, which shows unconditionally how successful the programme was.

Helsinki, October 8, 2001

Paavo Okko

Chairman of the steering group

# 1 Introduction

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## 1.1 An introduction to the economic crisis of the 1990s

Finland experienced an exceptionally deep and long economic crisis during the first half of the 1990s. Within four years, output was reduced by more than 10 percent and the unemployment rate quadrupled to almost 17 percent. The economic crisis lowered standard of living at household level for many years, led to bankruptcies in firms and to a large scale banking crisis and finally caused severe public finance problems which endangered the existence of the Nordic welfare state model in Finland. In a way, Finland fell down from the heavens – from the booming economy of the 1980s and the heyday of the Finnish version of the Nordic welfare state. This volume aims to tell why such a change took place and how the economic and social policies reacted to the crisis.

Since 1994 the Finnish economy started to recover from the recession. The Finland was raised up from the ashes. However, in spite of the recovery, the country was not the same than in 1990. Persistent unemployment and widening inequality were new problems. The articles of this volume address them, too.

In the 1980's Finland was known as one of the small and rich Nordic countries with advanced welfare systems and corporatist labour markets. Finland, Sweden and Norway along with Austria and Switzerland seemed to be immune to the rise of unemployment and related social problems experienced in the other Western European countries at the same time. In the 1970s and 1980s the unemployment rates rose almost continuously in the member countries of the EEC while unemployment in these EFTA countries fluctuated between 2 and 6 percent without any serious upward trend. However, starting from the end of the 1980s all the Nordic countries – not only Finland – faced an economic crisis. The Finnish crisis turned out be the worst. While all industrial countries suffered from severe recessions in the end of the 1980s and the beginning of

the 1990s, it was only in Finland and Sweden where the recession was severe enough to be called a crisis or even a depression. In Finland the recession of the early 1990s was clearly the worst peace time crisis experienced in the 20th century. Output fell by more than 10 percent and unemployment climbed up to almost 20 percent, far higher than in the depths of the great depression of the 1930s.

What were the crucial factors that caused the recessions? In Finland it has become common to say that the crisis was caused by “bad banking, bad luck and bad policy”. Issues of banking and policy will be dealt with in detail below. As for the luck, two important events are worth mentioning. First, the fall of the Soviet Union had important political and economic consequences, and caused also losses for Finnish exporters. Secondly, the Finnish EU membership since 1995, after a fairly even vote in a referendum, framed the economic and social policy in a new fashion. In fact, the economic policy choices of the early 1990s can be seen as a preparation to the membership.

There are factors which help to explain the severity of the Finnish (and also the Swedish) crisis, and which are common to many countries which have experienced similar crises. First, Finland, like many other countries, had a fixed exchange rate regime and an overvalued currency before the crisis resulting from inflation rate which was higher than in the core countries of the European currency system. Secondly, the inflation and currency overvaluation problems were originally caused by a credit expansion and capital market deregulation in the latter half of the 1980s.

The Finnish capital markets were deregulated at that time. Deregulation increased the supply of credit. As a result, private sector indebtedness, domestic demand and asset prices increased. These changes led to widening current account deficits. Similar things happened also in other Nordic countries and in the UK in the 1980s and in many Asian countries in the 1990s. The Nordic and the UK recessions were preceded by debt-financed investment and consumption boom in the late 1980s. The booms were caused by financial deregulation, which was part of an international wave of deregulation and economic integration. In the first phase there was an abundant supply of credit and lower interest rates. As a result, asset prices rose, output and employment increased and inflationary pressures were build up. In many cases such developments were followed by a recession.

Table 1.1. *The economic crises of the late 1980s and early 1990s*

	Years of recession	Relative employment change, percent	Largest output gap (OECD estimate), percent of GDP	Change of inflation, percentage points	Increase of unemployment, percentage points
Finland	1990-93	-18.8	-11.3	-6.0	14.9
Sweden	1991-93	-14.7	-5.3	-9.5	6.5
Norway	1988-90	-8.7	-4.3	-7.3	3.9
Denmark	1987-93	-6.5	-5.5	-3.5	4.5
EU	1992-93	-4.0	-2.9	-3.1	3.7
USA	1990-91	-1.0	-2.5	-2.8	2.2

Source: OECD Economic Outlook (2000).

### Financial crisis

The boom of the late 1980s turned into a bust – a three-year period of high interest rates, falling output and collapsing asset prices, debt-deflation, financial and banking crisis and currency crisis. In 1989 investors started to lose confidence in the Finnish economy as a result of worsening current account deficits and deteriorating profitability of firms. These were caused by increasing competitiveness problems, decreasing demand in the export markets due to international business cycle and by the decline of Soviet trade, and by rising European interest rates. All these factors together started to erode the credibility of the policy of fixed exchange rates which was pursued by the Finnish government and central bank. In years 1989 - 1992, there was an almost continuous market pressure against the fixed exchange rate parity, and the central bank tried to defend the exchange rate by raising interest rates, a policy which soon started to harm firms and households. The interest rates fluctuated between 12 and 18 percent while inflation rate decreased from 6 to 2 percent, thus rising the real interest rate enormously.

Households and firms responded to high and volatile interest rates by increasing savings and cutting investment, a change that quickly led to downward spiral of domestic demand and asset prices. High interest rates in a debt-ridden economy constrained private demand effectively. Overindebted firms and households were forced to sell their assets, and falling asset prices caused negative equity and balance-sheet problems. As a result output fell for three years and unemployment soared.

The stubborn continuation of tight monetary and exchange rate policy made the recessions deeper. Afterwards it seems obvious that the recessions of Finland and Sweden were connected with the failure of the European system of fixed exchange rates (especially with the European Monetary System, EMS) and high

interest rates imposed before that to all European countries through the EMS by the German central bank, the Bundesbank. The climax of the recession was the European currency crisis in the autumn of 1992. It is likely that both the boom and bust phases could have been stabilised by adopting a floating exchange rate. However, all European countries tried to maintain exchange rate fixed, which made the recessions of the early 1990s worse.

In a way it was unavoidable that highly leveraged economies like the Nordic ones in the 1980s were bound to suffer from an interest rate shock. In this respect the Nordic banking crises had much common with the crises of Asia and Latin America of the second half of the 1990s. In the 1990s it became almost a rule that countries with financial deregulation and subsequent build-up of foreign-currency debt were almost bound to face either a currency or a banking crisis or both, if they had a fixed exchange rate.

What was the role of exogenous factors? There is a widespread view of Finnish crisis as a result of the Soviet collapse but closer analysis shows that is an oversimplified and inaccurate explanation. It is true that Finnish exports to Soviet Union decreased suddenly in 1991. However, the exports recovered rather quickly. The recession of domestic demand was much more long-lasting and much deeper than the export problems caused by the collapse of the Soviet Union.

Another exogenous shock might have been the international recession. However, that began in other European countries later than the Finnish recession, and did not cause elsewhere as severe consequences as in Finland. It is hence difficult to argue convincingly that the Finnish crisis was mainly by outside factors. On the contrary, it seems likely domestic policy failures had an important role. The recession was clearly financial and monetary by nature. The recession started with high interest rates which eventually led to debt deflation and contraction of domestic demand. The deflationary process ended only when Finland with many other countries allowed their currencies to float and depreciate in the autumn of 1992. After that interest rates decreased and domestic demand and employment gradually revived.

### **Public finance problems and the welfare state**

The recession caused a lot of strain to public finances. Initially the public sector had a healthy surplus. The recession, rising unemployment and high interest rates changed this situation quickly and fiscal balances deteriorated significantly; the cumulative change was more than 14 percent of GDP in a period of three years, a figure matched only by Sweden (see Table 1.2). Although the change was big and sudden, it was proportional to the contemporary employment losses. Hence there is no reason to argue that the large deficits would have been caused by expansionary fiscal policy. The rising

deficits was of course what one would expect to happen in a deep recession: the automatic stabilisers increase expenditure and decrease tax revenue. In the Finnish case, the fiscal balance was further weakened by the need for public bank support in 1992 - 1994, when the banking crisis became evident.

The central government and the local government sector responded to the widening deficits - after a certain lag - by cutting expenditures and raising taxes. The cumulative discretionary savings made by the central government in 1991 - 1997 amount to almost 10 percent of GDP. The largest single item in the central government's budget savings was its transfers to the local government sector.

The large budget deficits caused much worrying about the sustainability of welfare state model. It was clear that the financing of public expenditure could not rest for long time on large fiscal deficits. In the mid-1990s there were voices suggesting that Finland and Sweden would not be able to finance their welfare model in a sustainable way. The crisis intensified the critique against the Nordic welfare state model. The recession and the subsequent output and employment losses helped to make the case that the crisis and slow growth were not results of mere macroeconomic co-ordination failures but instead indicators of a deeper systemic failure, the ultimately cause of which were the structures of welfare state. It was argued that the welfare state is generally bad for growth because it creates bad incentives. According to this view, overly generous social benefits, labour market rigidities and high taxes will finally discourage investment, job creation and labour supply. By many critics the dismal growth record of the 1990s was used as evidence supporting this critical view both in Sweden and Finland.

*Table 1.2. Fiscal balance in the crisis, percent of GDP*

	Surplus in boom 1987-90 (1)	Surplus in bust 1991-95 (2)	Surplus in year 2000 (3)	Change from boom to bust (2)-(1)	Change from bust to 2000 (3)-(2)
Finland	6.3	-7.9	4.0	-14.2	+11.9
Sweden	5.4	-12.3	3.4	-17.7	+15.7
EU	-2.5	-6.5	0.3	-4.0	+6.8
USA	-4.1	-4.7	1.7	-0.6	+6.4

Source: OECD Economic Outlook (2000).

## Recovery

After the deep recessions of the early 1990s, all Nordic countries have experienced a strong recovery. Within the Nordic group, the growth rates of output, productivity and employment have been fastest in Finland, and even

better than in the US. It is also clear (see Table 1.3) that the recovery has been export-led. What factors have made such a development possible?

The competitiveness problem which was in the root of the recession, was finally solved when the Finnish markka depreciated significantly after it was allowed to float with many other EMS-currencies in the autumn of 1992. The floating enabled also lower interest rates and helped to first stabilise and then reflate asset prices, thus ending the deflationary process and banking crisis. What is surprising is how durable this improvement of the economy was. The competitiveness was not eroded by wage inflation in the 1990s – contrary to what happened many times before, in the 1960s, 1970s and 1980s. It is usual to argue that exchange rate movements have only temporary effects and in longer run they are neutral. The Swedish and Finnish experiences of the 1990s contradict this conventional wisdom.

*Table 1.3. Characteristics of the recovery; annual average growth rates from the end of recession to 2000*

	GDP	Exports	Labour productivity	Employment
Finland	4.7	10.6	2.4	2.3
Sweden	3.1	10.6	2.2	0.9
EU	2.5	7.7	1.3	1.2
USA	3.8	7.9	2.3	1.5

Source: OECD Economic Outlook.

The Finnish economy experienced unforeseen changes during the 1990s. The exceptionally deep recession was not followed by a revival of domestic demand as in many other countries, but by a rapid structural change and export-led growth. The economy was opened to foreign ownership and new trading partners and new industries emerged. The structure of production shifted from traditional engineering and forest industries to growing share of high tech products and ICT, as exemplified by the rise of mobile phone industry. It is possible to view the Finnish adjustment process as a consequence of integration; as a change towards more openness, higher exports, more imports, mergers and international ownership, relocation, and finally job creation. Firm structure integrated rapidly according to logic of the single market, and new governance culture emerged through foreign ownership.

The good economic record of the latter half of the 1990s indicates, that the Finnish economy is still well-functioning and able to adjust, notwithstanding the earlier crises. With the help of tighter fiscal policy and strong economic recovery, the Nordic countries were soon able to return to fiscal surpluses after the recessions. The strength of recoveries and the rapid improvement of fiscal

balances were surprising, at least to the most critics of the Nordic model. The growth of public demand was restrained in Finland (and in Sweden, too) in the 1990s and the growth contribution of public demand was almost non-existent. This was a marked difference from the earlier recoveries of the 20th century. It is clear that in Finland the welfare state has gone through squeezing in the 1990s although there were not any outright reductions in social expenditures. However, even after these adjustments, the Nordic welfare state model still existed in Finland.

After several years of strong recovery it seems clear that the Nordic welfare state was not an obstacle to structural change and necessary adjustment. It could even be argued that the welfare state made the adjustment process easier by helping to maintain family income (through high female labour participation and public employment), preventing poverty and providing active labour market policy measures. However, in the case of Finland the welfare state did not succeed fully in avoiding the birth of relatively large scale long-term unemployment and social exclusion.

Finland has gained reputation as a country capable of doing long-range planning that enables both local-level decision-making and citizen participation although the final say remains with the national level and in the hands of political decision-makers and experts. The issues might be extremely complex and difficult, such as membership in the European Union, but they still remain under control, if managed with care, because they hardly touch the so-called ordinary people directly to a larger extent. This kind of social maneuvering skills, in their part, ensure that overt homogeneity is reached in society. All 'constructive forces' are collected under one umbrella heading toward a better future, and those presenting opposing views are often presented backward elements of society, unwilling to face realities.

In the case of the economic recession in the 1990s, this admirable formula was not fitting, predominantly due to the fact that those who would have most reasons to oppose were marginalised, most often through unemployment. A person had gained his/her value as a citizen and human being through work in the Finnish society for hundreds of years. What happened on the individual level and on the level of social ideology, when more than one-fifth of the population was driven outside the labour force, as it was when the economic recession in Finland was at its worst in the early 1990s? The ideology of rational planning did not operate properly, when one of its pillars, the right and responsibility to work, became a rarity. A quest to challenge existing value structures became more and more evident, but so did the obvious fact that not everything in society can be planned in advance. In a way, the early 1990s could be characterised in Finland as the era when the social practice and the social rhetoric departed. One could give very hard criticism of such a dishonest social behaviour, but it should perhaps be understood within its framework: the

idea of extending the welfare rhetoric even when its basis was shaken could be interpreted as being a measure to support social stability and individual security.

The Finnish economic crisis is a prime example of the larger shift in politics as it was one of some twenty financial crises, experienced around the world in the context of a similar shift from regulated markets to the free flow of capital. The crisis was enhanced by the collapse of the Soviet Union as the considerable trade between the two countries ceased abruptly. At the same time Finland turned politically to the West and the free market economies while applying for the membership in the EU. In this context the crisis was a part of a change of political regime from state controlled markets to market liberalisation, a shift of power from politics to markets.

On the whole, it seems like the crisis had also considerable political consequences. Since the crisis, the whole post-war regime based on welfare thinking was questioned in political discussions. In terms of everyday experiences of the citizens, the economic crisis affected almost every Finn: not only in reference to their economic realities, but also when they were influenced by the above described shifts in political and in related socio-cultural values. The most notable issue that structured citizens' experiences – as well as divided them – was the question of (un)employment. Work or lack of work and the appreciation of both of the two conditions in society are crucial factors in defining one's position, and it has been traditionally assumed that citizenship is constructed around the concept of work. From the people's point of view the whole crisis was about unemployment. Suddenly it was not 'them' that lived on welfare, it was 'us' - everybody knew someone who lost his/her job during the recession, and since the risk of losing one's job was not negligible, private consumption decreased, which only made the national situation worse. As the established concept of citizenship begun to disintegrate, so did the general understanding of politics.

This collection of articles discusses and analyses the causes and consequences of the Finnish economic crisis of the 1990s. The articles review the roles of economic and social policies, development of inequality and poverty, individual survival, the media coverage of the crisis as well as the historical backgrounds and comparisons. The articles are based on the results of a large multi-disciplinary research programme on the Finnish crisis initiated and sponsored by the Academy of Finland. The severity and the exceptional character of the depression makes it an interesting period for research. These sudden, unexpected and significant changes make the depression years an interesting social laboratory for economic and social research.

## 1.2 Economic and social policies and the crisis

The paper of Heikkinen and Kuusterä (*The economic crises in the 20<sup>th</sup> century in Finland*) examines the Finnish economic crisis of the 1990s from a historical perspective by comparing it to four other crises – or near crises – experienced earlier. In all of them, international cycles and shocks have played a major role, which is no wonder in the case of a small open economy such as Finland. However, world economy cycles alone do not explain the different courses of the crises; changes in the institutional setting of the economy also have to be taken into account. Their interpretation of the crises is the one with interaction of global market forces, socio-political changes, institutions, economic behaviour and crises. The focus of the article is on the tension between competition on the one hand and regulation or co-operation on the other, which in our opinion was one of the main plots of Finnish economic history in the 20<sup>th</sup> century. Finnish economic history from the 1910s to the 1980s is, to a great extent, a story of increasing economic regulation and co-operation – both public and private. New layers of regulation piled up. Then, in the 1980s this regime started to dissolve under global pressure. Economic behaviour changed more slowly, however, and therefore fell in contradiction to the emerging new institutional setting. Furthermore, institutional change was not inclusive or coherent, resulting in conflicting incentive structures. This “institutional friction” deepened the 1990s depression and retarded the recovery. In this sense, this depression represented also a “transition crisis” in the Finnish economy.

The paper by Koskela and Honkapohja (*The economic crisis of the 1990s in Finland*) analyses the reasons behind the Finnish depression of the 1990's. According to the authors, the reasons can be aptly described as “bad luck and bad policies”. The external shocks played a significant role in the Finnish boom-to-bust process - this is the “bad luck” part. However, they were far from being the whole story. If there had been no additional factors, Finland would have experienced a recession but not a depression. The authors argue that Finland (and to some extent Sweden) experienced a classical financial crisis, which was similar to crises in a number of countries so different from Finland and Sweden as Mexico, Chile, Korea, Malaysia and Thailand. They also emphasise the failure to reform regulatory schemes of the financial markets and the decision to leave tax system unchanged in the process of financial deregulation were clear policy mistakes in Finland. Evidently, one lesson is that financial market deregulation should not be carried out in isolation, but it must be tackled with the reform of the tax system and tightened bank supervision. The failures of exchange rate and monetary policy suggest another lesson. When the financial deregulation starts, there is a tendency for the external value of the home currency to appreciate due to the huge capital inflow. To mitigate overheating coming from financial deregulation and liberalisation of capital movements one should let the currency float. When the turnaround starts to happen the financial system would then be less fragile and thereby the authorities would have better

alternatives to deal with evolving problems. An early floating of the currency appears to be an appropriate complement to policies for financial deregulation. If the currency is not floated as part of the deregulation phase, then the exchange rate cum monetary policy alternatives seem all bad. Finally, the Finnish experience with rising unemployment posed a major challenge for policy during the recovery phase. The analysis of the authors suggests that a financial crisis and the depression can significantly increase the level of structural unemployment via tax increases, high indebtedness of firms and the exchange rate depreciation. If the view is at all correct, then measures to alleviate structural unemployment should be an important part of the economic policies during the recovery from a major financial crisis and macroeconomic depression. According to the article, structural unemployment increased and made it harder to return into 'normal' levels of unemployment after the recession.

Six of the studies in the research programme on the Finnish economic recession in the 1990s directly concerned the welfare state and its activities. Basic themes that were discussed were the survival and forced adaptation of the welfare state, and the underlying changes in political, financial and economic structures around the welfare state apparatus. But it was not only the technical apparatus and its survival that was in the focus. The whole political and cultural basis, even the mentalities that ruled in the decades of building the Finnish variant of the Nordic welfare state were challenged. And this was to happen quite soon after Finland had finally reached its Nordic neighbours in the construction of the welfare state in the 1980s (see e.g. Kautto et al. 2001).

The research programme on the Finnish economic recession met these changes from a number of various angles. The studies of the structural and ideological changes of the welfare state activities (*Did the crisis change the welfare state* by Lehtonen et al., in this volume), completed with the analysis of the financial background of health and social policies (*Bridging the gap: financing of social policy in Finland 1990 - 1998* by Saari, in this volume) and the survival of the health care and social service system (*The survival of the Finnish health and social service system during the economic depression of the 1990's* by Simpura et al., in this volume) all show how the recession was met by the system, and how the reactions were not only short-term adaptation but long-term processes before and after the recession.

Indeed, a multi-faceted picture emerges. On the system level, the story of the Finnish welfare state during the recession is one of survival and even success. The welfare policy apparatus worked effectively to help those in need, although with reduced resources. The financial arrangements were successful in avoiding a total financial crisis. This survival story only becomes more impressive when comparing Finland with Sweden. One interpretation of the

experience is that the Finnish welfare state passes the recession test and is ready to return to its earlier developmental path after a temporary fall.

But other results indicate the the return is slow to emerge, if it is even started yet during the economic boom after the recession. Several studies of the research programme show how the recession was effectively used as an excuse for turning the welfare state development to another direction. This direction was one on diminishing solidarity and generosity, even one of increasing inequality and universalism. It turned out in the analysis that these new directions were not always invented during the years of the recession, but some were brought to the agenda already in the 1980s, as an attempt to stop the heedless expansion of the welfare state. And similarly, such a political agenda did not die when the recession was withering away, but survived even after then. Besides the recession itself, the political changes in the 1990s such as the collapse of the Soviet Union in 1991, the EU membership of Finland in 1995 and the economic boom hastened by the rise of information technology business, contributed to the search for alternatives for the pre-recession welfare state development. In short, globalisation entered the scene of the debate around the welfare state.

In a critical account on welfare policies during and after the recession, Julkunen (2001) abandons the success story view of the fate of the Finnish welfare state and welfare policies during and after the recession. Instead, she arrives at the conclusion that a turn has taken place, away from the pre-recession line of extension of the welfare policies and increasing solidarity and equality. Using a wide variety of sources, among them several reports of the resarch programme on the Finnish economic recession, she shows how the survival of the welfare state may be a misleading interpretation, hiding behind it the significant turn towards a "Europeanization". In the case of Finland, this would mean a distancing from the Nordic model and its ideals, with the concomitant changes in mentalities concerning the welfare policies. Her interpretation is that behind the adaptation to depression and the slow recovery thereafter, a process of "creeping changes" is underway. Such processes will lead to radical changes, although the process consists of minimal adaptations that certainly would not appear as a turn to new directions.

The social policy articles of the present collection give some support to Julkunen's interpretations, but they also show how complicated multi-level and multi-dimensional operations are involved, operating over a time range that far exceeds the core years of the recession. Here, the lessons of older history will be of use, and new lessons will be learned (see Lehtonen et al., and Heikkinen and Kuusterä). Also, the complexity of the findings require a view that does not look at the welfare state development and apparatus during the recession as a reflection of economic development and policies only. The processes of showing, interpreting and experiencing the recession should also be accounted

for. Here, the studies on media publicity and the politics visible there (*Politics displaced, politics replaces, elites' and citizens' talk on the economic crisis* by Aslama et al.), or socio-ethical considerations (*Ethics and changing incentives, social-ethical model for examining changes in the Finnish incentive system during the economic crisis of the 1990s* by Mäkelä) enter the scene. According to Aslama et al., the decision-makers emphasise the importance of public discussion in the crisis: they see it as an important arena of political action and try to appear there. Generally it looks, however, like the political elites view media in a rather negative light. Media are seen as irrational and even dangerous in the crisis. The media tend to focus on 'wrong' issues and also tend to go along with "the people" creating emotional and even hysterical reactions to non-important issues. Thus, the elites do not seem to believe very strongly on the possibility of a rational public discussion in the media. Instead, the public is many times in the midst of the crisis perceived as a place of statements, which are aimed at disciplining the public and the people. Many times the public place is thus not a place for discussion and an arena for opinion building and democratic process but rather a threat to rational discussion and a façade for disciplined public appearances.

The study of the basic services in health and social work in a welfare state under stress (Simpura et al.) indicates how complex such issues might turn when economic scarcity becomes a reality but there is willingness to preserve the rhetoric of welfare state. According to the authors, the rhetoric lived longer than the mode of services. For the latter, the recession was definitely a turning point, but predominantly due to political and practice-level developments which in fact had started far earlier. In short, the recession offered an ideal, "natural" excuse to carry out changes which had been planned much earlier. This coincidence was publicly analysed first years later. During the recession, rather such an impression was supported that serious attempts were made to save the welfare state despite problems.

### **1.3 Labour market**

The rise of unemployment raised questions about the possibly changed relationship between economic growth and employment. This problem is addressed by Pehkonen and Kangasharju's contribution *Employment and output growth in the 1990s*, which is a study of the employment-output relation and its determinants. The authors examine this relation with two types of data. First, they use quarterly data on the aggregate economy from the period 1975 - 1995 to find out to what extent adjustment to shocks occurs via wages vs. employment in general, and especially in early 1990s. It turns out that when the collapse of the economy resulted in a 12 percent decline in GDP over the years 1991 - 1993, the demand for labour declined by almost 20 percent, the number of employed fell by 450,000 and unemployment rose from 3.5 to about

18 percent. The response of wages to the shock was considerably smoother. Although real wages also declined during the recession, relative change was much smaller than that in employment. During the recession years (1991 - 1994), nominal wages continued to rise by about two percent per annum. In short, the labour market reacted to the shock mainly via the adjustment of quantities (employment), not via the adjustment of prices (wages). The relationship between aggregate-level employment and output growth remained relatively stable throughout the investigation period. Second, the authors use regional panel data to investigate output-employment relations in 85 Finnish regions, and especially what happened to them during the depression. The results imply that there are differences in the employment-output relation between different regions and they can be partly explained by differences in industrial specialisation. Furthermore, the contemporaneous relation between changes in employment and output growth temporally disappeared in early 1990s.

Part of the structural changes which the Finnish economy went through in the 1990s was globalisation; a process where the openness of the economy was increased, and the corporate ownership and governance became more international. In practise globalisation meant that foreign owned companies and domestic-owned multinational companies account for a significant and growing share of total sales and employment in Finland. Tuomiari's article *The internationalisation of Finnish economy and labour market adjustment – An analysis using Finnish employer-employee data for the years 1988 - 1996* looks at labour market adjustment from a globalisation perspective. It examines how both the internationalisation of firms and foreign ownership have affected the structure of labour demand and labour market adjustment in Finland before, during, and after the recession. Tuomiari uses data over the period 1989 - 1996 in which company information and worker data are merged. The internationalisation of firms is measured by export intensity (the ratio of exports to sales). According to the results an increase in export intensity had a positive effect on employment among the workers over 29 years of age and in the lower level educational groups. Furthermore, fluctuations in real sales have a larger influence on employment in firms operating only in domestic markets compared with export-oriented firms within these age and educational groups. Changes in output also had a greater impact on labour demand in domestically owned companies than in foreign-owned companies. Thus a rise in internationalisation of Finnish firms had probably balanced the effects of economic fluctuations in the Finnish labour markets and dampened the effect of recent technological change which seems to favour skilled and young workers.

With an unprecedented growth of unemployment in early 1990s, it is an obvious challenge of research is the study of labour markets under these circumstances. In their article *Unemployment and early retirements of the Finnish aged workers in 1989 - 1996* Huovinen and Piekkola elaborate gross job and worker flows in

order to find out what happened to different types of jobs and workers during the 1990s. Especially, they study the destinies of unskilled and skilled, and aged employees. Approximately 50 percent of the jobs held by people aged 55-59 vanished in the first half of the 90s. The former employees who ended up being unemployment pensioners and disability pensioners had shorter educational histories and lower skills than the Finnish workers in general. The total withdrawal from employment did not depend on firm size. However, large firms channelled their older workers to unemployment or unemployment pensions and small firms to disability pensions, both of them using the method, which is least costly for them. The results imply that high social security payments at firm level contributed to job destruction and in this case there was particularly high negative effect emerging from the higher social security payments in the large firms. Finally, in addition to job flows from employment, flows back to working life were examined as well. The demand for older workers remained weak during the late 90s. This, together with the persistence of high job destruction for older workers, especially in manufacturing, may relate to skill-biased-technical change.

In the light of these studies one could conclude that the recession increased inequality in the labour market; the opportunities of young and well-educated workers remained good while the jobs available to older and less-educated workers disappeared to large extent. The rise of inequality is also shown in the article by Kyyrä, *Evolution of inequality in the Finnish labour market, 1988 - 1996*. He uses a large administrative panel data of Finnish males to estimate a model of lifetime welfare measures for different groups. Although the wage structure remained relatively stable in the 1990s, it was the incidence of unemployment which contributed to the rise of inequality.

#### **1.4 Income distribution and poverty**

All major crises faced by a nation have both case specific and common elements. In the article *On the social history of unemployment and poverty in Finland 1860 - 2000* by Häkkinen and Peltola, the authors take the challenge of comparing six periods of crises in Finland: the famine years of the 1860s, the period of transition at the turn of the 20<sup>th</sup> century, the 1930s depression, the period between the war and the 1970s, and the contemporary welfare state and the crisis of the 1990s. Combining structural, cultural, political and action perspectives, they study changes in the construction of poverty and unemployment giving special attention to the question of the so-called social underclass as an extreme manifestation of poverty in each historical case. Although the material standard of living has increased immensely since the famine years of the 1860s, and people no longer starve to death, poverty still remains. Their main point is that in the long run mass poverty has changed into mass unemployment and seems to have taken a special form in the last decade

of the 20<sup>th</sup> century. Furthermore, in addition to analysing economic-structural changes, they study the forms of adopted social policy and other safety nets, and factors of culture and social action in the formation of poverty, unemployment and the social underclass in each period. Although poverty has changed from an old agrarian type into a modern type, they find common elements across periods. Somewhat surprisingly, even poverty in the crisis of the 1990s had similarities to the Great Famine Years of 1860s in many respects.

The article by Kangasharju, Laakso, Loikkanen, Riihelä and Sullström *Economic Crisis of the 1990s: What happened to regional convergence and inequality, and housing market phenomena in boom and bust?* summarizes the results of three sub-projects in a research consortium called *Economic crisis of the 1990s, regional development and the welfare state*. Kangasharju's sub-project studies disparities of per capita GDP among the 85 Finnish sub-regions during 1988 - 1997. He also disaggregates the change in regional per capita GDP into the components of productivity, jobs and population and studies the effect of changing regional production structure on regional disparities. The results indicate that there has been convergence among Finnish regions over time, more of it earlier and less when we come closer to the end of 1980s. The economic crisis of early 1990s led to regional divergence when GDP per capita was considered. In the sub-project of Loikkanen, Riihelä and Sullström micro level data is used to study both regional convergence and inequality. Household Survey data gives a long run view over 1971 - 1990 and annual income distribution statistics data are used for 1990 - 1998. They divide Finland into four major regions and apply three income concepts: factor, gross and disposable income. Also micro data based (factor, gross and disposable) incomes at main region level have converged over time, more earlier and less closer to the end of 1980s. At main region level, however, regional disparities remained more or less the same in early 1990s, and increased slightly only thereafter. As for inequality, the greatest decline in (disposable) income differences at national level occurred before mid-1980s, thereafter they remained pretty much the same, including early 1990s when all market incomes decreased and public transfers played a major role in income formation. Only when the recovery began in mid-1990s inequality began to increase rapidly. Inequality developed surprisingly similarly both at national level and at the level of main regions, thinking of both time profiles and levels of most typical inequality indicators (Gini-coefficients etc.), until mid 1990s. Then inequality in the Helsinki Region began to increase earlier and to greater extent than elsewhere. In the third sub-project Laakso considers housing market developments both from national and regional perspective. The sky rocketing rise of housing prices in 1987 - 1989 and their dramatic collapse in 1989 - 1993 belong to the best-known events since mid-1980s. The housing sector was also an essential part of both the overheating and the depression. Laakso describes

what happened to housing consumption, construction, housing prices and rents, vacancy rates, and how liberalization of financial markets, tax reforms and what changes in international economy were involved in the dramatic changes shaking the Finnish economy. Furthermore, he summarises results of an econometric regional housing market model based on panel data of 85 sub-regions from 1981 - 1997. According to his results the tremendous housing price hike and construction boom following financial liberalisation, and the following bust were common throughout Finland, and greater than in other countries. Only in the recovery of late 1990s, he detects regional divergence in housing markets as, unlike in earlier booms, job growth and migration benefited only a half a dozen urban areas. As a result, housing prices and construction activity have increased more in growth centres and especially in the Helsinki metropolitan area.

For a long time in the post war period income differences declined in many industrialised countries until early 1980s when a reverse process started in several advanced countries. Nevertheless, income inequality did not increase in all countries in the 1980s, among others in Finland where it was lowest in OECD countries in the 1980s. With this background the article by Riihelä, Sullström, Suoniemi and Tuomala concentrates on *Income inequality in Finland during the 1990s*. They note that income inequality remained almost constant until the turning point in the beginning of the 1990s. During 1990 - 1994 income inequality rose only modestly, coinciding with a period of rapidly increasing unemployment. Thereafter, when the economy began to recover in 1994, average real income has grown significantly. However, at the bottom of the scale there has been little or no rise in real income, whereas top incomes have risen much faster than the average, resulting in a clear rise in inequality. Having described what happened, the authors use a decomposition analysis of income inequality by income groups and income sources to understand and explain the inequality increase in Finland during the 1990's. The results suggest that the rising share and distribution of capital income is the most significant contributor to the increase in overall inequality. The 1993 tax reform, introducing a so-called dual income tax system, is also undoubtedly one of key factors responsible for this trend. Rising unemployment in the early 1990's, perhaps surprisingly, did not just increase income inequality. More importantly, the number of unemployed below the poverty line (50 percent of national average income) has risen from 1994. One of the most striking findings of the study is that since 1991 there has been a declining trend in the average real disposable income of unemployed households. The paper also shows that the redistributive impact of taxes and transfers has declined during the 1990's.

The outcomes of the crisis were inequally distributed. This is shown also by the study of Ritakallio, *Multidimensional poverty in the aftermath of the recession: Finland in 1995 and 2000*, where the poverty is measured in different ways. The number of people under the official poverty line, 50 percent of median income,

remained very low throughout the 1990s. However, the use of broader measures of poverty and social exclusion reveals that the number of those who had experienced poverty was relatively high in the mid-1990s, more than quarter of the population. Since 1995 the inequality increased further in Finland and those with lower incomes lagged behind the well-to-do. This did not lead to increased poverty, however. In fact, from 1995 to 2000 poverty decreased. The main explanation for this change was the improved employment and reduced long-term unemployment. Although poverty decreased, Ritakallio argues that poverty has become a more severe problem. Before the recession poverty was usually temporary by nature, but after the recession it has become a more persistent problem, experienced mainly by long-term unemployed. In addition to this, those who were poor in the year 2000 tended to be poorer than those who were poor in 1995.

The media during the crisis years is studied in the article *Mediated economic reality or aching spots of civic society? Finnish mainstream media publicity of welfare disparities 1988 - 1997* by Aslama et al. The examinations of the crisis as well as other similarly oriented research elsewhere indicate that there exists a profound disjuncture between the popular (citizens') and the media framing of public issues, and that the public's limited interest in the official side of affairs resulted from a certain sense of powerlessness. The citizens do not consider the media as a forum for discussion; but rather, a suffocating overflow of information was experienced. In this regard, the elites and the citizens agree: they both regarded the media incapable of addressing the right issues. Furthermore, when the elites clearly connect democracy, public discussion, and politics, the citizens could not make such a link. Instead, their experiences of conventional politics are blurred, narrowed, and politics has become more distant. Quite frequently, the media allied with the organised society, giving an image of having things under control despite serious problems; these were discussed of course, but predominantly on the nation level, thus leaving fairly much outside the focus the fact that the recession did not treat all people in the same way.

## **1.5 Survival strategies of groups and individuals**

A group of studies of the programme focus more precisely on themes related to social policy and survival. Two features are found, in one form or the other, in all texts of this set of studies. First, they discuss value-thick issues and second, the individual has a greater role in them, although the elaborations might remain on the national level as such. What these studies tend to suggest is that the rhetoric of welfare state outlived the practices of the welfare state.

Social networks emerged essential during the recession years; they acted as buffers against problems. A group of researchers (*Individual survival* by

Lampela-Kivistö et al.) even consider that people that met a crisis survived through the recession predominantly due to these networks. However, members of the middle-class were able to utilise established safety-nets offered by the society and the church, to a markedly higher extent than people lacking education and wider social experience. Among those able for self-help, women were especially prominent. They went to Centers for Family Issues, they called the crisis hotlines, and if couples sought help together, the initiative came most often from the wife. Here, the authors point out, the Finnish ethos of survival through work became counter-productive for men, preventing development of individual survival strategies. In such strategies, some people adopted problem-orientation and rationality, some sufficed with passive reflection, while religion-oriented people sought personal cohesion from the religion and the community life it offered.

The article by Nätti et al., *Perceived job insecurity among Finnish employees in 1990 - 2000: prevalence and antecedents*, focuses on perceived job insecurity, which was the one of the most important mental shifts caused by the recession. The subject was studied by using questionnaires. Not surprisingly, the rise of unemployment was followed by increased job insecurity. However, that feeling did not disappear although employment began to improve in 1994. What was surprising, was that the feelings of job insecurity were twice as common in the public sector as compared to the private sector. Although the perceived insecurity appears to be linked with emotional elements, the authors argue that the continuation of long-term unemployment, poor organizational communication and increased use of temporary contract in the 1990s are the structural factors which contributed to increased job insecurity.

The Finnish society has hardly ever offered easy access for immigrants, but the treatment of the newcomers became even harder during the years of recession. The Vietnamese refugees who entered the country in the 1970s and 1980s found employment, while even highly educated refugees — generally assessed as being the easiest to be integrated among immigrants -- were left outside the labour market. According to Valtonen (*The labour market participation of immigrants in Finland during the 1990s recession*), the most common reason for refusal of work, expressed by employers, was lack of language skills even when the work itself did not require fluency in the Finnish language. The parameters of suitability were constructed in such a way that the immigrants jobseeker always found himself/herself falling outside the acceptable criteria. The researchers claims that mechanisms approaching a monopoly of exclusion were developed. In any case, the Finnish society showed its lack of interest to support the integration of the newcomers, and in order to still appear as politically correct, it developed criteria which the immigrants never could meet in a competition with Finnish citizens. Quite expectedly for the social science perhaps, the society experiencing crisis showed tendency to become markedly harder and less tolerant.

The society did make attempts to meet those in trouble, and tailored policies were developed to encourage social activity and various forms of self-help. One of these was the incentive mechanism, meant to encourage economic efficiency in a rational way. As indicated in a study focussing on the incentive system from the perspective of values, *Ethics and changing incentives* by Mäkelä, much remained implied, said between the lines only. She studies incentives and morals via three modes of argumentation, stressing social efficiency, rationalisation or welfare values. The researcher comes straightforward to the conclusion that economic gain in society must not outweigh incentives that respect human dignity, but she also points out the existence of "invisible hand" assumptions behind each of the explicit argumentation modes discussing the incentives. If these assumptions did not come true, the incentive system might turn counter-productive or at least morally suspicious.

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# **I Economic and Social Policies and the Crisis**

2. Finnish Economic Crises in the 20<sup>th</sup> Century
3. The Economic Crisis of the 1990s in Finland
4. Did the Crisis Change the Welfare State in Finland?
5. The Survival of the Finnish Health and Social Service System during the Economic Depression of the 1990's
6. Politics Displaced, Politics Replaced, Elites' and Citizens' Talk on the Economic Crisis
7. Bridging the Gap: Financing of Social Policy in Finland 1990 – 1998



## 2 Finnish Economic Crises in the 20<sup>th</sup> Century

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### Abstract

The aim of the article is to put the Finnish economic crises of the 1990s in a historical perspective by comparing it with the other economic crises in the 20<sup>th</sup> century. Five economic crises of varying gravity are examined: 1) 1914 – 1919, 2) 1929 – 1932, 3) 1953 – 1958, 4) 1975 – 1977 and 5) 1990 – 1993. The comparison emphasises the severity of the 1990s depression: the fall in GDP was more drastic and recovery more slow only during the First World War. The Great Depression of the 1930s was relatively modest and short in Finland. The coincidence of rampant inflation (triggered by oil crisis) and recession was the special characteristic of the 1970s crisis. Compared with other cases the third (1953 – 1958) was not a crisis at all (there were only two recession years) but rather a turbulent period reflecting the difficulties of post-war deregulation. In explaining the different courses of the crises the article emphasises the role of the institutional setting of the economy.

### 2.1 Introduction

The aim of our article is to put the Finnish economic crisis of the 1990s in a historical perspective by comparing it with the other economic crises in the 20<sup>th</sup> century. Our approach is institutional. Institutions, i.e. the “rules of the game” of the economy, are seen as a “filter”, which, by defining the incentive structure of an economy, determine how the “players” – different actors in the economy – behave. The differences in economic behaviour, in our opinion, result in different economic outcomes during the crises.<sup>1</sup>

The basic idea of institutional economics is that formal rules, such as tax systems and property rights, and informal rules, such as conventions and codes of conduct, form the “rules of the game” according to which economic actors must behave. These rules mould the incentive structure of the society and thus

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<sup>1</sup> See North 1990. The crisis analysis based on the ideas of the “French regulation school” has some resemblance to the institutional approach, see Mazier, Besle and Vidal 1999.

have an effect on economic behaviour, and furthermore on the allocation of resources for productive or unproductive – purposes. Economic development is a result of innumerable decisions made by individuals, firms and other economic organisations. Thus, macroeconomic outcomes are the sum of microbehaviour, which again – so institutional thinking goes – depend on the prevailing rules of the game.

We assume that economic behaviour is always rational, but also that rationality is always defined by the prevailing rules of the game, which may also encourage behaviour that leads to inefficient macroeconomic outcomes. The institutional deficiencies, which may go unnoticed in “good” times, surface during economic crises. Institutional environment determines how labour and capital markets function and how households and firms behave, for instance. Government has an important role in controlling the institutional setting, but other actors in the economy, such as different interest groups, are also significant. In this article we examine how institutional factors shaped the Finnish economic crises in the 20<sup>th</sup> century. Furthermore, we reverse the question and ask what kind of institutional changes these crises brought about.

Our article is organised as follows. In Section 2.2 we describe the growth phases of the Finnish economy in the 20<sup>th</sup> century and identify the five crises, which we then analyse case by case (Section 2.3). The crises are compared with each other in Section 2.4. The institutional changes are described in Section 2.5, and in conclusion we discuss the role of crisis and institutional change in the development of the Finnish economy in the 20<sup>th</sup> century.

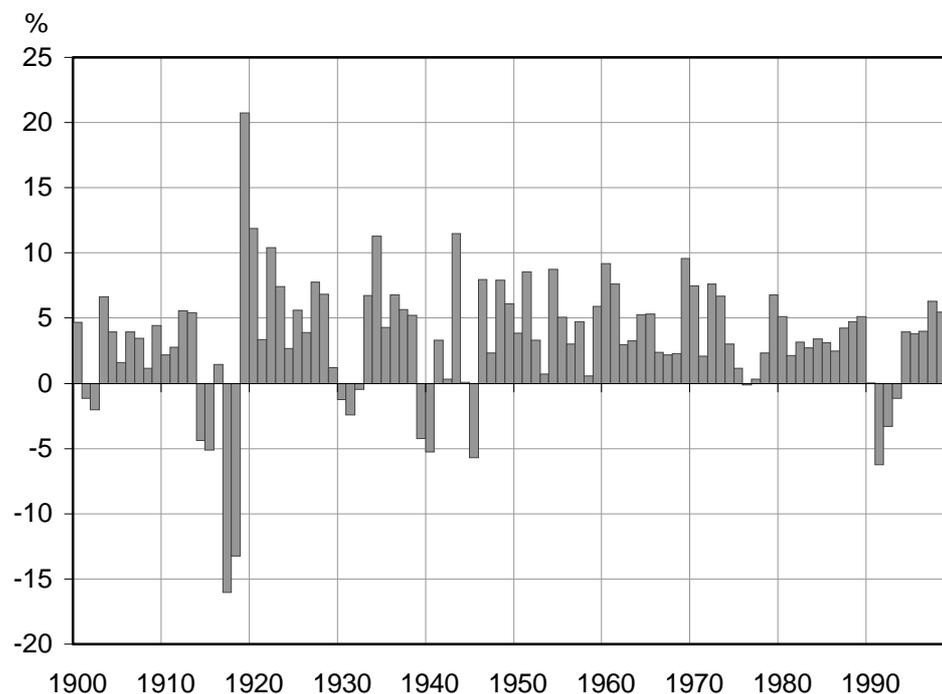
## **2.2 Phases of economic growth**

On the basis of the overall growth rate, the development of the Finnish economy in the 20<sup>th</sup> century can be divided into three main phases. The first phase is the period stretching from the middle of the 1890s up to the Second World War. The inclusion of exceptional times such as the First World War and the Great Depression of the 1930s in the same growth phase may raise objections, but in our opinion these severe interruptions did not fundamentally change the “growth regime” that started in the 1890s. Thus we interpret the 1920s and the post-depression 1930s as returns to the old, long-term growth path. The annual growth rate between 1895 and 1938 was 3.0 % for real GDP and 2.1 % for GDP per capita; the percentages were almost the same for the periods 1895 – 1913 and 1913 – 1938.<sup>2</sup>

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<sup>2</sup> The data presented here is derived from Hjerpe 1989, and the Historical Database of Statistics Finland.

Figure 2.1. GDP, annual changes 1900 - 1999



After the Second World War Finland, like other developed economies, entered a phase of fast and sustained economic growth – the “golden years”, as they are called.<sup>3</sup> The country was exceptional, however, in the sense that the golden years did not end with the oil crisis of the 1970s, but lasted up until the end of the 1980s. GDP grew by 4.2 % on average between 1945 and 1990, and GDP per capita increased 3.6 %.

The “long golden years” ended with a bang and a crash in 1991. The Finnish depression of the 1990s was very deep indeed: deeper than other depressions in the 20th century, and exceptional in comparison with other European countries in the 1990s. Economic growth was again very fast after the crisis, and therefore the 1990s has been characterised, using Joseph A. Schumpeter’s words, as a period of “creative destruction”.

The difference between the two growth regimes (1895 – 1938 and 1945 – 1990) comes out even more strikingly when investment rather than growth rates are compared. The overall investment ratio of the Finnish economy rose to a whole new level after the Second World War (see Figure 2.2). The pre-First-World-War investment ratio was exceeded in the late 1920s, but the rate dropped back during the Great Depression. It rose again rapidly in the late 1930s, but was

<sup>3</sup> Crafts and Toniolo 1996.

brought down by the Second World War. The 1920s and 1930s might, then, be characterised as a transition period towards a high-investment-ratio regime.

Figure 2.2. Investment ratio 1900 - 1999

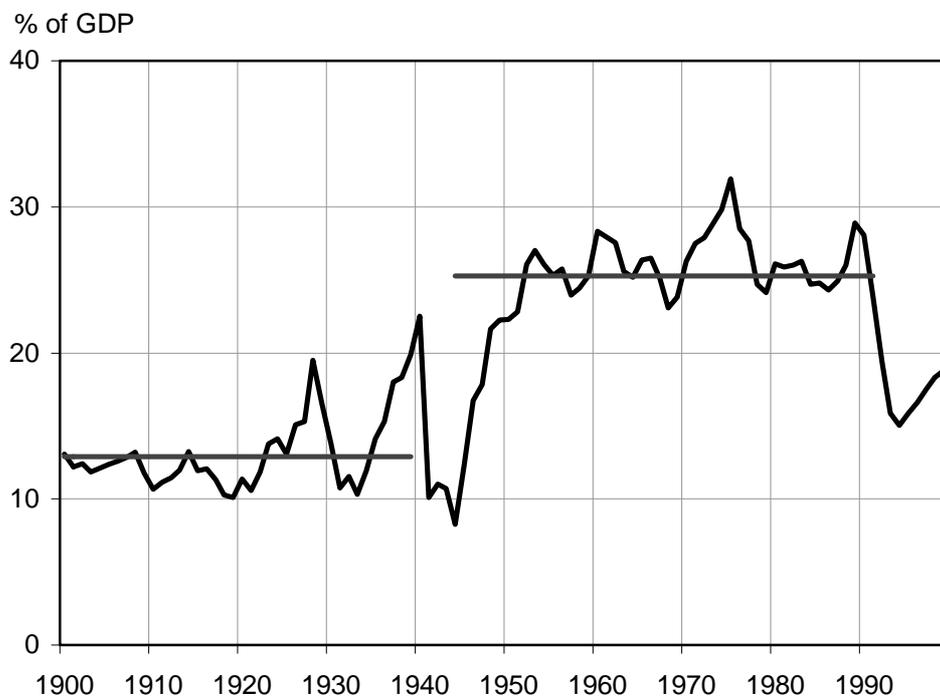
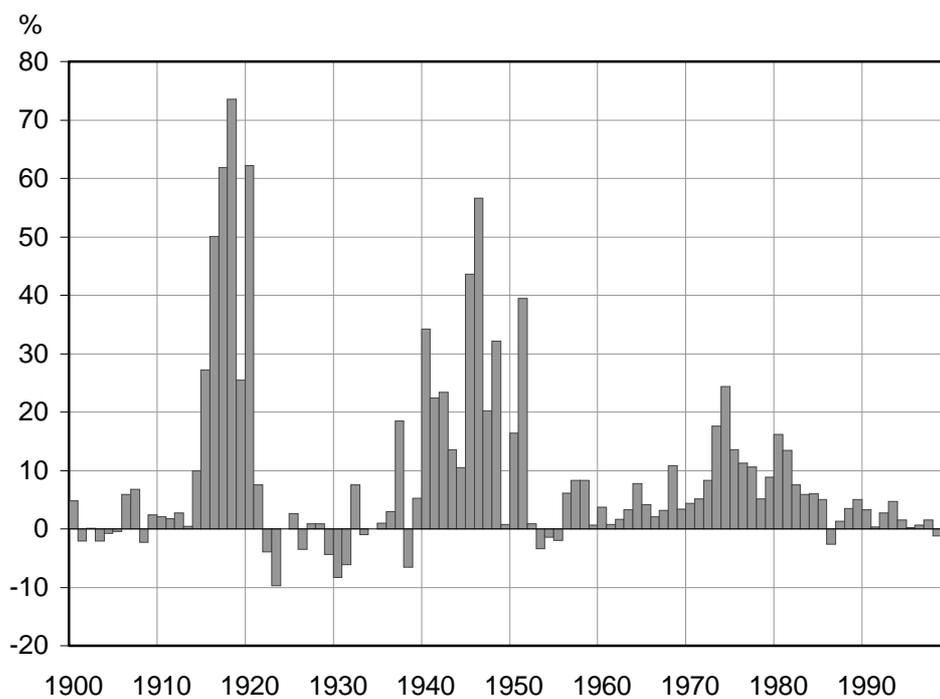


Figure 2.3. Wholesale prices, annual changes 1900 - 1999



There were, of course, several cyclical downturns in the Finnish economy during the 20<sup>th</sup> century. We do not deal with all of them in this article, but rather focus on five economic crises or transition periods. When choosing these crises we, firstly, kept an eye on the GDP: we chose years when it declined, or its growth slowed down to less than a fifth of its long-term rate (0.6 % for the pre-1938 and 0.8 % for the post-1945 period). Secondly, we paid attention to prices: deflation and inflation (see Figure 2.3), as well as changes in the terms of trade. We have focused on five crises: 1) 1914 – 1919, 2) 1929 – 1932 3) 1953 – 1958, 4) 1975 – 1977 and 5) 1990 – 1993.

## 2.3 Five crises

### **The First World War and its aftermath (1914–1919)**

The First World War changed the conditions of the Finnish economy in many respects, even though Finland played no part in it. The first significant effect of the war was the closing of Western markets. However, this was not fatal to the Finnish economy because rapidly increasing exports to Russia compensated for the loss.<sup>4</sup> GDP dropped in 1914 and 1915, but by 1916 the Finnish economy was operating at full speed again. Many sectors suffered from overheating, mostly because of flourishing exports to Russia, and this exceptional boom manifested as excessive liquidity in the banking sector. Money supply was abundant, but at the same time only a few investors were willing to make long-term commitments because of uncertainty about the future.

The speculative boom came to an end in 1917 when the old Russia collapsed and Finland lost its main export market. The situation was deteriorated further when the Civil War broke out at the beginning of the following year. Normal economic activities were disturbed for almost half a year.

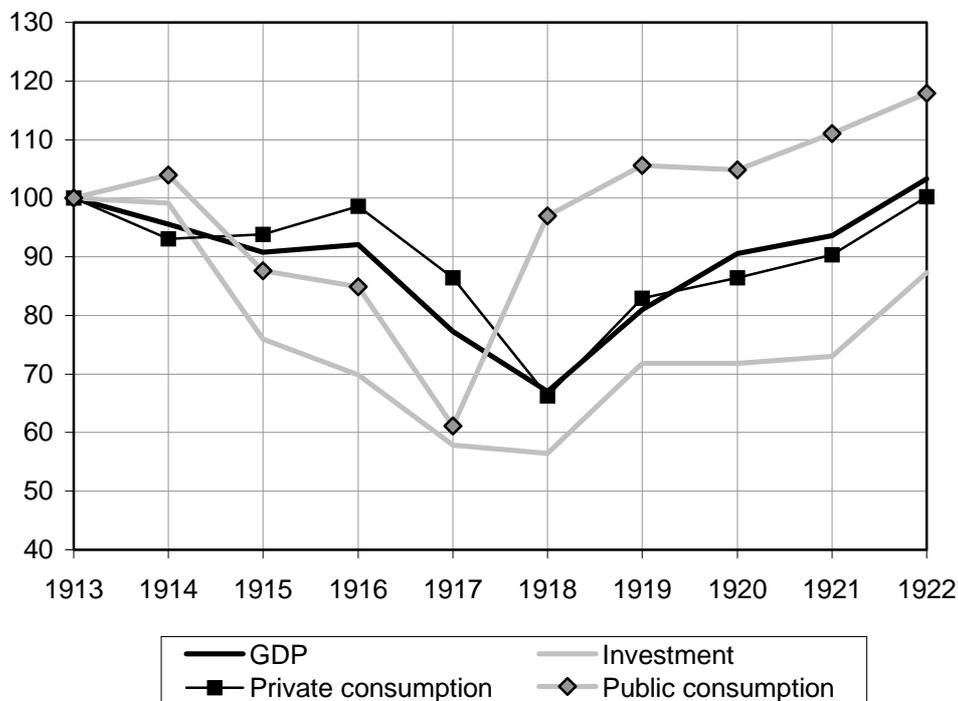
Finland, like other countries that were part of the Classic Gold Standard system, abandoned the Gold Standard and lost its monetary mainstay. Although the country was part of the Russian Empire, the Finnish economy was in many ways separate that of Russia. However, the Bank of Finland was compelled to accept Russian roubles at a fixed, overvalued rate, and roubles poured into the Bank of Finland. Russian war-induced inflation also encroached on Finland, and in 1917 the value of the markka diminished to less than a third of the 1913 level. This was followed by very severe over-demand because all importing had ceased. Finland suffered from demand inflation and the value of the markka

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<sup>4</sup> Finland was a Grand Duchy in the Russian Empire. Russian general tariffs were not applied to Finnish goods, which could be exported to Russia freely or for lower tariffs than goods from other countries.

declined still further. The final outcome was the almost total collapse of the Finnish monetary system.

Figure 2.4. 1913 - 1922



During these years the government had to replace the markets by regulation, through measures such as foodstuff rationing, foreign-trade regulation and price regulation. The government also persuaded the private sector to increase co-operation between firms and economic associations in order to help collaboration between the private and public sectors.

After independence, the first task for Finnish firms was to find new markets to replace Russian markets. At this time it was vital for the Finnish economy to gain a foothold in western Europe. Finnish firms in the export sector were mostly small, and even the international position of Finland was insecure. Thus, the problem with both the new independent state and its firms was a lack of confidence. In order to overcome this, the Finnish export sector chose co-operation as its strategy. By setting up extensive selling associations, i.e. cartels, Finnish paper firms succeeded in getting access to Western European and also overseas markets.

Finnish firms became divided into two groups during these years. The first comprised the open sector, which consisted of sawmill, pulp and paper-industry companies. These firms competed in global markets and their main weapon in the competition was co-operation and close connections to the government, or

rather to the Bank of Finland. Then there was the closed sector, which operated in the home market, its largest sectors being the metal, textile and food-processing industries. Co-operation was a typical mode of behaviour among these firms, too. Associations emphasised the importance of self-sufficiency and the need for a more protective customs policy.

Firms in both groups gained from the flexible monetary policy during the recovery years. The Finnish markka was stabilised at an undervalued level. Thanks to this, the competitive position of the export firms was increased, but the home-market firms also benefited because import prices increased.

The Bank of Finland approved the collapse of the *markka*, and after a short period of hesitation abandoned all hope of regaining its old parity. This meant that the nominal value of debts collapsed which was a very positive surprise to those involved. As firms regained their pre-war turnover levels, their financial structures automatically strengthened. Thus the post-crisis the situation of companies in Finland was easy, at least compared to the situation in other Scandinavian countries where firms suffered from deflation and rising real debts. On the other hand, the diminishing of the debts brought about negative incentives to improve production efficiency. These factors eased the recovery of the economy in the early 1920s, and partly because of this, structural changes among the firms were quite modest.

Firms were among the winners in these circumstances because they usually had liabilities, real wealth and only modest deposits or other monetary claims. The losers were ordinary middle-class people whose liabilities were small and whose wealth was in monetary claims. Their losses were so large that private consumption declined among these groups. A remarkable income transfer from depositors to debtors took place in Finnish society.

The dramatic incidents of 1918 were reflected in the labour market. The labour movement lost the civil war, and this undermined the power of the trade unions. It is hardly an exaggeration to say that labour had no bargaining power during these first years of independence. This made the labour market very flexible: wages went up and down with the cycles.

The structure of agriculture changed radically after the land reform in 1918, when crofters and cottage households gained the right to redeem their holdings on favourable terms. The number of independent peasants almost doubled, and the structure of the sector became biased to the smallest farms. The institutional setting for the agriculture sector also changed. During the Russian period, Finnish agriculture competed in global markets without any safety nets, and most of the cereal consumed was imported, for example.

New targets were set for agriculture in the first years of the 1920s. The starting point was the independent peasant farmer who operated mainly in the protected home market. Agriculture was seen not only as an occupation, but as a way of living and as a way of securing the political stability of the whole society. The land reform also increased the number of forest owners, and from then on, agriculture and forestry were closely linked together. A notable part of the revenue came from forests.

We have already pointed out the importance of the measures introduced by the Bank of Finland in securing the competitiveness of the Finnish export sector. Otherwise, the economic policy was liberal in essence, although the role of the state was stronger than in pre-war times.

### **The Great Depression (1929 – 1932)**

The Great Depression began in Finland in 1929, a year earlier than in many European countries. The consequences were familiar: a decline in GDP, a rise in unemployment, falling prices, and bankruptcies in both industrial and agricultural sectors. The boom of the 1920s ended – or started to end – in 1927, when the export of the country's main export article, sawn wood, reached record levels. The crop failure in 1928 increased imports and caused a deficit in the trade balance. This was the last time that agricultural cycles had a major effect on the business cycle. Activity in the overheated urban-building sector decreased drastically in 1929 and continued to fall due to strict monetary policy - a consequence of puritan commitment to the gold standard.

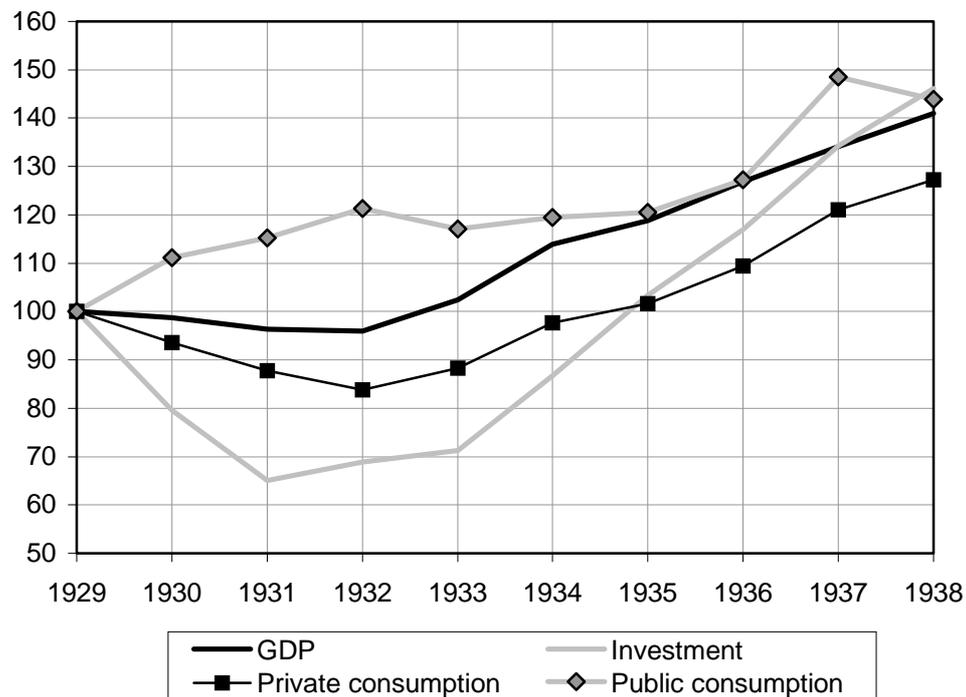
The decline in real GDP was very slight in Finland compared to most countries: it was only 4 percent lower in 1932 than in 1929. This figure does not tell the whole truth about the depression, however. The volume of private consumption fell at the same time by 17 percent. In other countries the proportions were usually the reverse: consumption fell less than GDP.<sup>5</sup>

The effects of the depression were notably greater in nominal than in real figures. Wholesale prices fell by 17 percent from 1928 to 1931. From the perspective of wage earners and salaried employees, the fall in prices was, of course, a positive phenomenon, but things looked different from the standpoint of the farmers. Global agricultural depression dragged prices down, and demand declined so that farmers' nominal income fell. Yet the interest rates stayed high causing, severe debt problems for many of them.

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<sup>5</sup> Pekkarinen and Vartiainen 1995, 428.

Figure 2.5. 1929 - 1938



An important feature of the Finnish economy in the inter-war years, and also later, was the connection between the main export industry, i.e. the forest industry, and the rural economy. Since the farmers owned most of the forest, the fluctuations in exports of forest products had direct backward linkages to the income of farmers. Furthermore, employment in logging and floating were very important in the countryside. As exports of forest products declined, so did the forest income of farmers and wages in the forestry sector. Stumpage prices almost halved and forestry wages fell by about a third during the depression of the 1930s, and because the volumes of sold wood and employment levels in logging and floating also fell, the fall in income was even greater. Nominal wages also fell substantially in the sawmill industry (c. 25 %), but in other industries the decline was slighter so that real wages stayed almost unchanged.

The basis of export recovery lay in the devaluation of the *markka* in 1931. It is quite clear that without this the depression in the sawmill, pulp and paper industries would have lasted longer. There were, nevertheless, some differences between the two main branches of the forest industry – the sawmill industry on the one hand and pulp and paper on the other. The number of sawmills was very large and there were a lot of firms of varying size. This made the adjustment to recovery competitive: there were bankruptcies and the fittest survived. Adjustment was regulated in the pulp and paper industry, and the co-operation of the producers made it smoother. Of course there was the crucial difference that the export of pulp and paper developed much more favourably in

the 1930s than the export of sawn goods. Some home-market producers reacted to the depression by extending co-operation: the cotton manufacturers founded a domestic cartel in 1932. The recovery of the manufacturing industries was also facilitated by their sound financial structure: small debts made it relatively easy for them to adjust to declining demand and prices

The flexibility of prices and wages is one factor explaining the rapid recovery after the depression. There were no sticky nominal wages, which would have prevented firms from transferring the effects of declining demand down the production chain – to wages and raw-material prices. The result of recovery was a notable decline in the labour share of manufacturing. This development is explained by the weak bargaining power of the trade unions and the lack of unemployment benefits or minimum wages, which would have kept wages from declining.

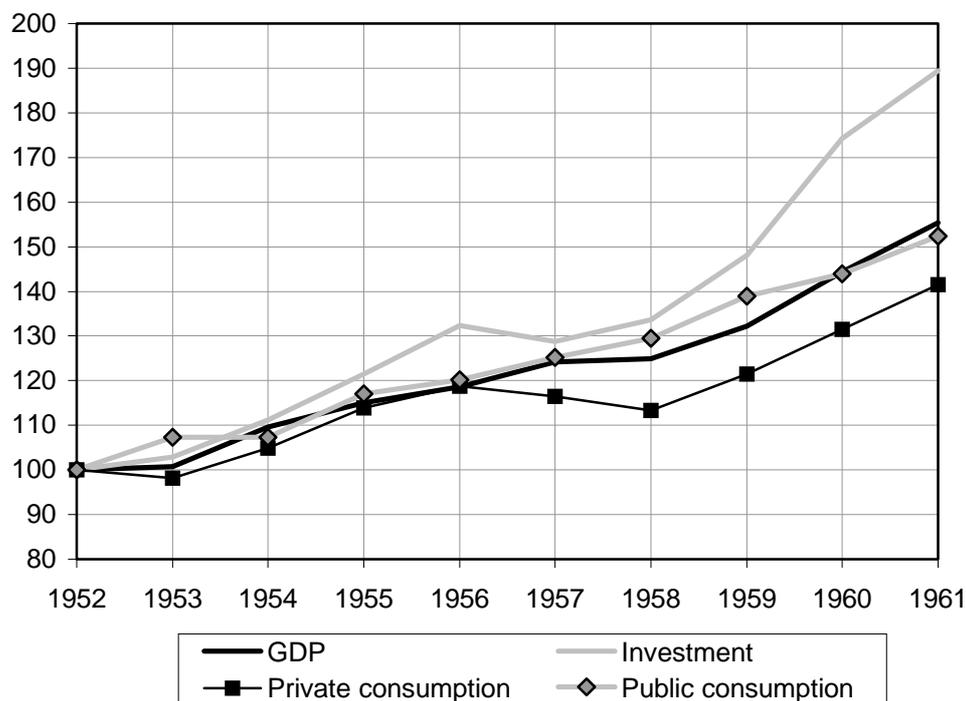
The inherent doctrine of Finnish economic policy during the depression of the 1930s was based on a belief in automatic stabilisation. According to this view, there was no need for large-scale government intervention, apart from arranging relief work for the unemployed. Instead of stimulating private consumption, the government concentrated on supporting export industries through devaluation. This, together with the price flexibility of the factors of production, improved the international competitiveness of Finnish producers. Home-market industries were supported by tariff protection, and in agriculture steps were taken towards protected and subsidised agriculture. Another important factor in the recovery was the interest-rate regulation. The banks, with the blessing of the Bank of Finland, agreed on a common level in 1931 causing a fall in real interest rates.

### **The latent crisis of the turbulent fifties (1953 – 1958)**

The third period we are examining in this paper comprises the “turbulent fifties”, 1953 – 1958, which could also be labelled the years of “latent crisis”. Real GDP grew by 8.5 percent in 1951, but growth fell to almost zero in 1953 and, after years of more rapid growth, it fell again in 1958. Prices fluctuated even more wildly: the high inflation of 1951 (wholesale prices rose by 39 %) turned into deflation in 1953 – 1955.

The boom was clearly export-led, fuelled by the Korean boom. The terms of trade rose by 37 percent in 1951 more than in any other year of the 20<sup>th</sup> century. The main export industries, i.e. paper, pulp and wood, benefited from this price jump, but it also gave a boost to the whole economy, which was just leaving behind a period of strict post-war regulation. The early 1950s was still a decade of reconstruction, visible in urban house construction, for example, where the 1928 peak was exceeded in 1952.

Figure 2.6. 1952 - 1961



The vigorous but short Korean boom was not only beneficial, however. As it dried out and export prices dropped, domestic prices kept on rising. Although the export prices of pulp, paper and sawn goods had already fallen, wood prices were still rising. The result was a “costs crisis” in the export industry, as contemporaries labelled it. Prices and wages had been flexible downwards in the 1930s, but this was no longer the case in the 1950s because of considerable changes in the institutions of the Finnish economy. Collective bargaining was introduced, and pressure groups of agricultural producers - and forest owners - attained a powerful position

Economic recovery by means of automatic stabilisation was not possible in a world of sticky prices and nominal wages. Consequently, when the competitive solution could not be used, the other alternative - regulation - was adopted. In 1951, a stabilisation programme was created in a corporatist spirit, the central aim of which was to halt inflation, i.e. prevent prices and wages from rising and thus fight the “cost crisis” of the export industry. The index clauses on wages kept prices in check, since the government preferred to regulate the prices of strategic “index goods” than to let the price – wage spiral work its way out.

The freezing of nominal wages was quite successful for a while, but they started to rise after 1953. Labour-market regulation no longer worked, which was manifested in the general strike of 1956. Adjustment was finally made by using an old trick: the devaluation of the *markka* (1957), which gave impetus to inflation. At the same time the post-war regulations on foreign trade were lifted,

and the scope of price regulation limited. As a result, the labour share in manufacturing decreased from the high level of 1952.

A further factor preventing the latent crisis of the 1950s from turning into a open one was the high level of both public and private investments. The government invested in infrastructure and also in the manufacturing industries, even in the “open sector”, i.e. the export-oriented forest industry. Since private firms invested heavily, e.g. in the paper industry, after 1953, the result was a very high overall investment ratio (see Figure 2.2).

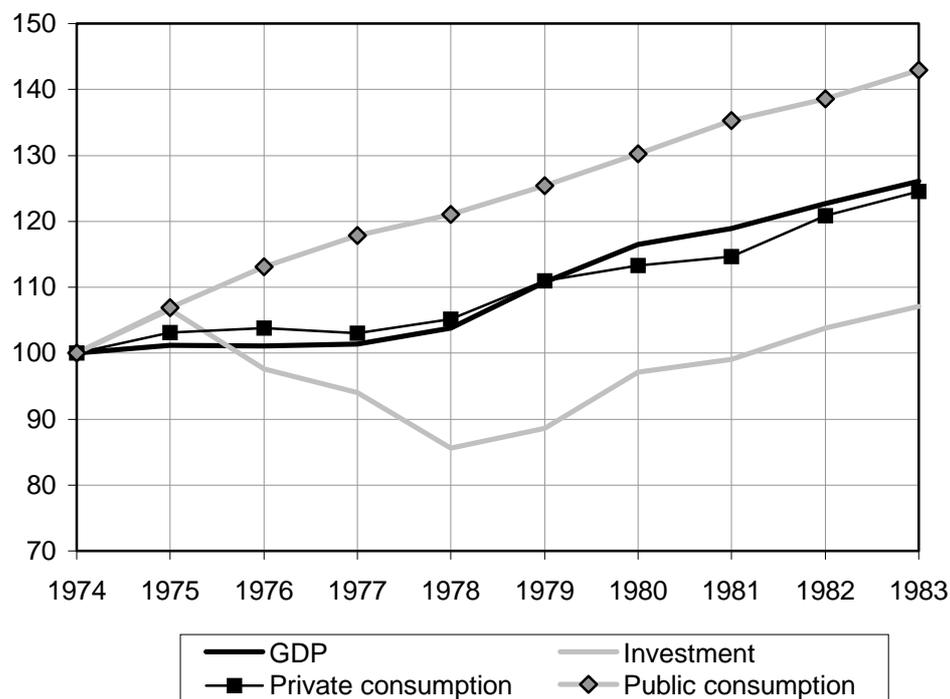
### **The stagflation years (1975 – 1977)**

The European Golden Years of economic growth ended with the oil crisis of the 1970s, which forms our fourth case (1975 – 1977). The Finnish devaluation-inflation cycle had taken another turn in 1967, when the *markka* was devalued by more than 30 percent. At that time, the government tried to dissolve the index clauses according to which wages, rents and prices were closely linked together. Indexation made inflation automatic, and attempts were made to stop this after devaluation. Efforts to restrain inflation were not without success, since the rate stayed at quite a modest level during the first post-devaluation years. However, pressures to increase wages were hard to resist as the export-led boom continued. The soft monetary policy accelerated the boom in the early 1970s. After the collapse of the Bretton Wood system, the markka was linked to the dollar, and as the dollar fell so the markka fell with it.

Finland, like the whole world economy, was hit by an exceptional price shock in 1974, when the Organisation of Petroleum Exporting Countries (OPEC) strengthened its cartel policy. The price of crude oil more than tripled in a few months and brought high inflation to all developed countries. This was the first oil crisis; the second one burst out in 1979 – 1980, when oil prices rose 150 %. Western economies experienced recession and inflation simultaneously, or in one word – stagflation. Inflation began to accelerate in 1972 in Finland, reaching its highest level in the middle of the decade. In 1975 alone, consumer prices went up by almost twenty percent.

The growth of the Finnish economy slowed down in 1975 and turned into depression in the following years. Exports to western markets declined significantly, and industrial production fell during 1975 – 1977. The bilateral trade with the Soviet Union rescued the Finnish economy from a deeper depression, since the more oil prices rose the more Finland could export industrial products to the Soviet Union – this was the logic of bilateral trade. Also halting the decline were public investments, which remained on quite a high level. Growth stopped, but GDP did not decline.

Figure 2.7. 1974 - 1983



The money market was still strictly regulated during the 1970s, and interest rates were kept artificially low. As a consequence, the real interest rates were negative. This resulted in low capital expenses, which again was favourable to Finnish firms. Requirements for the profitability of investments were modest. Matti Pohjola introduced the term “ineffective capital” to describe the capital-intensive development of the post-Second-World-War Finnish economy.<sup>6</sup> The negative real interest rates of the 1970s bolstered up this trend and gave the incentive to invest. No wonder that, in 1975, the all-time high investment ratio was reached (see Figure 2.2).

Inflation also enabled inefficient firms to survive. This diminished the pressure to make structural changes in Finnish industry. Although the EFTA agreement of 1961 gradually opened up the home market to international competition, only the wool industry lost out. The structure of the forest and metal industries, i.e. the main export industries, remained quite unchanged. The existence of strong cartels in paper and pulp industries was at least partly responsible for this.

Recovery from the crisis the the 1970s followed the Finnish tradition. In the years 1977 – 1978, the *markka* was devalued three times, following the examples of Sweden and Norway. Yet, unlike with earlier devaluations (1957 and 1967), the policy of the Bank of Finland was now notably less aggressive.

<sup>6</sup> Pohjola 1996.

The 1970s crisis also encouraged a regulative policy. The devaluation of 1967 was followed by an emphasis on low inflation, which was pursued by means of price regulation. This course continued in the 1970s: at the end of the decade, price regulation was applied to almost half of the commodities in the average consumption basket. An essential element in the regulation of the goods markets was the heavy protection of agriculture: EFTA and EEC agreements did not apply to agricultural products.

The Finnish corporatist model of incomes policy survived in the labour market. This corporatist consensus was put on trial during the boom of the early 1970s, and was somewhat fractured, but it regained its strength in the depression. The trade unions accepted quite modest nominal wage increases in order to speed up the economic recovery. The real wages of industrial workers declined in 1977 – 1978 and 1980 – 1981, which facilitated the recovery of manufacturing.

### **The deregulation crisis (1990 – 1993)**

Measured by production figures, the crisis of the early 1990s was deeper than any other peace-time crises in Finland (the decline in GDP was still bigger in 1918).<sup>7</sup> It was preceded by the deregulation of the financial markets in the 1980s, which led to the unexpected boom that was especially feverish in the closed sector of the economy. The most striking examples of overheating were the stock and real-estate markets. The deregulation of capital markets increased lending and widely led to great indebtedness in the economy. The Finnish export industry, used to repeated devaluations, had difficulties adjusting to the new regime of fixed exchange rates. The steadily growing overvaluation of the *markka* gnawed at the competitiveness of export industries.

When the vulnerable Finnish economy faced two external shocks – the simultaneous decline of both Western and Soviet markets – it headed towards crisis. Unemployment rose to record levels, and the banking system nearly collapsed. In the first phase of the crisis the Bank of Finland committed firmly to a new policy of fixed exchange rates, which further aggravated the situation of the export sector. The end of the inflation economy, which had lasted almost four decades, made it even more difficult to adjust to economic depression. The transition from negative real interest rates to high positive rates was a real cultural shock to all economic actors (see Figure 2.9). Wrong decisions were no longer pardoned by inflation.

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<sup>7</sup> On the 1990s crisis see Kiander and Vartia 1996; Honkapohja and Koskela 1999.

Figure 2.8. 1989 - 1998

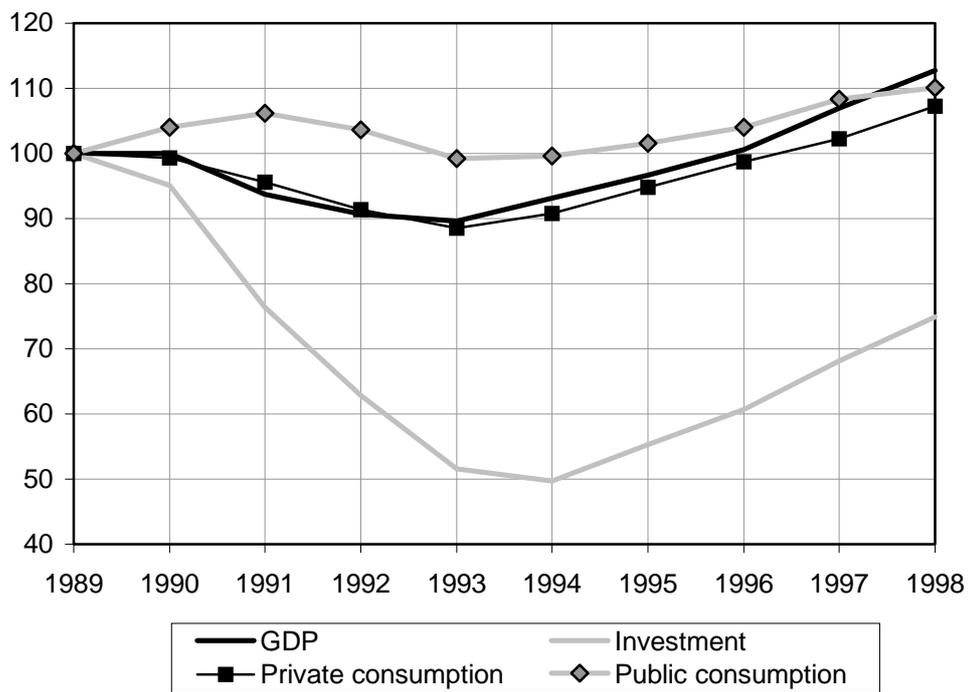
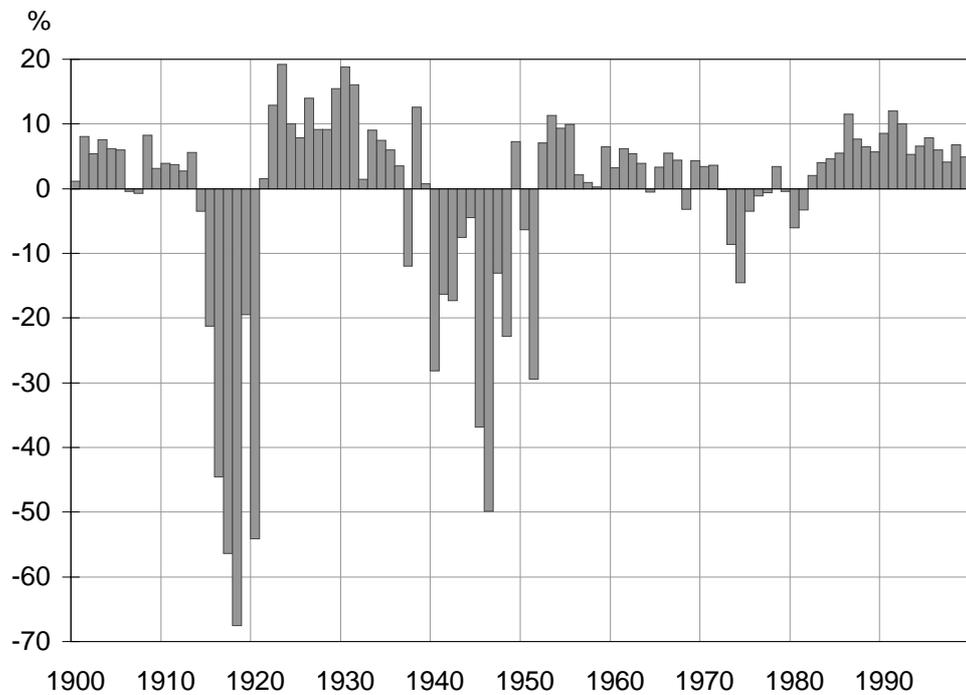


Figure 2.9. Real interest rate 1900 - 1999



In order to secure the competitive position of Finnish exports the Bank of Finland once more had to rely on the old “D-vitamin” – the devaluation of the markka in the autumn of 1991. However, this was not enough. The 1992 markka was allowed to float in autumn 1992, and its value sank still lower. The recovery of the economy was notably slower in the 1990s than in the 1930s, for example. Among the factors delaying the recovery were the exceptionally high real interest rates, the inferior financial structure of firms, and the corporatist rigidities in the economy. Recovery began after the fall of real interest rates and the amelioration of the competitive position of Finnish exporters. Once more the recovery was export-led. However, this time crisis promoted fundamental changes in the structures of the economy and in the behaviour of the economic agents. Old cartel-like sales associations in the forest industry were abolished, and a wave of mergers restructured the whole industry: first on the national level, then beyond the Finnish border. Furthermore, new export industries expanded vigorously. New IT firms, with Nokia in the lead, revolutionised the industrial structure of the country.

## 2.4 Crises in comparison

Comparison of the five crises analysed above show some similarities and some differences. A common feature in all of these cases was the decline of exports.<sup>8</sup> This was caused by the war in the first crises (1914 – 1919), and in other cases by global cyclical downturn. There were also other external shocks at play in the first (1914 – 1919), fourth (1975 – 1977) and fifth (1990 – 1993) crises: the Russian revolution, the oil crisis and the collapse of the Soviet Union. A special feature in the last crisis was the deregulation of the financial markets, which overheated the economy and thus made the inevitable downturn exceptionally sharp.<sup>9</sup>

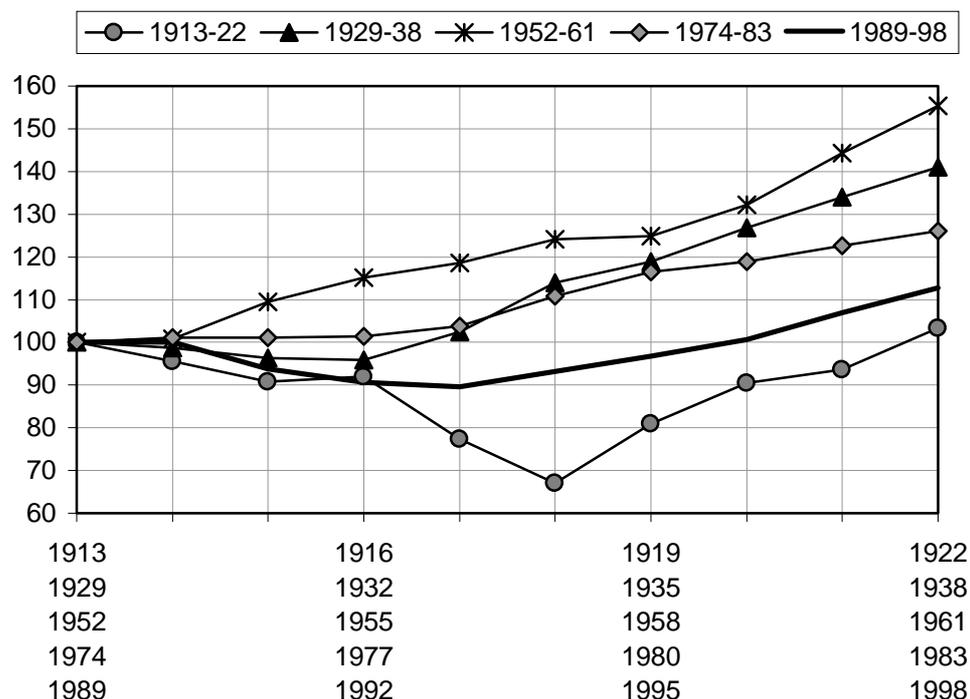
Since Finnish exports consisted mostly of manufacturing products, especially forest-industry products, the decline in exports led to recession or depression in the manufacturing sector in all of the crises. Their overall depth was dependent on to what degree the other sectors of the economy were hit by the downturn. The depression in the construction sector was very severe in three cases: during the First World War, in the Great Depression of the 1930s, and in the 1990s. The specific feature of the 1930s crisis was the agricultural depression, which was aggravated by declining forestry income – both to forest owners (mostly farmers) and to forest workers (smallholders among them).

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<sup>8</sup> In the 20th century the volume of exports declined in 1900, 1907–08, 1914–15, 1917–18, 1921, 1928, 1930–31, 1938–40, 1944–45, 1952, 1956, 1958, 1971, 1974–75, 1982, 1989 and 1991.

<sup>9</sup> See Honkapohja and Koskela 1999.

Figure 2.10. GDP, volume



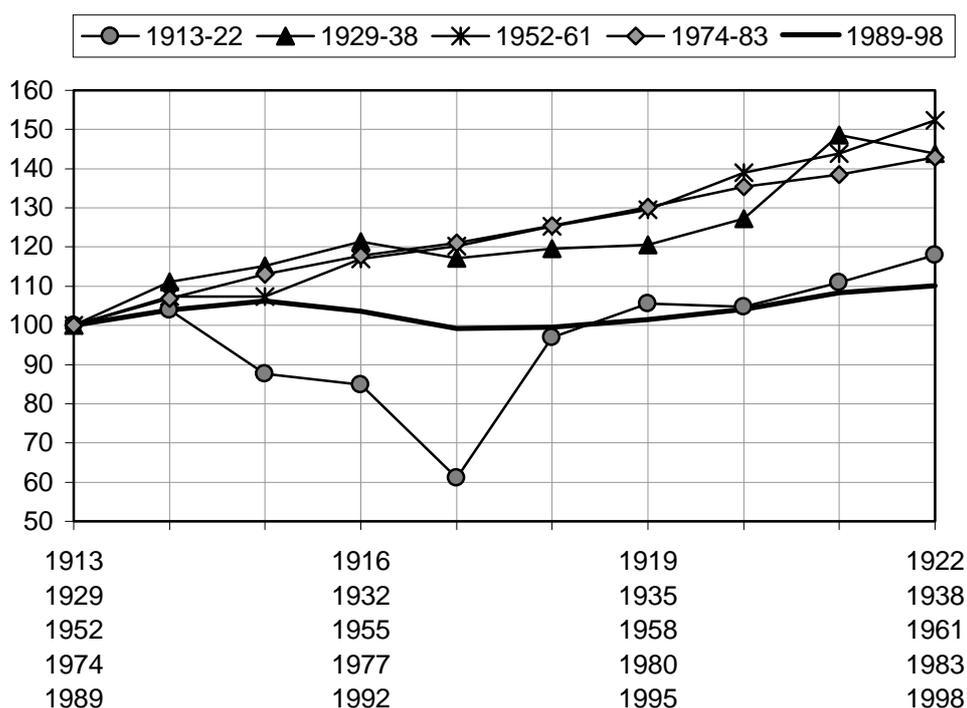
Measured by GDP figures, the crisis around the First World War was exceptional – both in depth and in length: GDP fell by 33 % and it took nine years to reach the pre-war peak level. The Great Depression was relatively modest and short in Finland: GDP declined by 4 % and remained below the 1929 level for only three years. One reason for this was that the peaks and troughs of the different sectors did not coincide, and if they had, the decline in GDP would have been triple the actual figure (12 %).<sup>10</sup> The words “crisis” or “depression” are too strong when speaking of the 1950s, since GDP did not decline. There were two recession years, 1953 and 1958, but growth was quite rapid in other years. Recession is also the right word to describe the 1970s, but here the stagnation was notably longer and more severe than in the 1950s. Economic growth was almost zero for four years. Comparison with other 20th-century crises emphasises the severity of the 1990s depression – the fall in GDP was more drastic, and recovery more slow, only during the First World War.

The length of the recovery, as shown above, represented an essential difference between the five crises analysed. We would argue that it stemmed from differences in economic behaviour, which again reflected the changes in the institutional setting of the economy. Since Finland has been an export-dependent economy, the common response of economic policy to cyclical

<sup>10</sup> See Hjerpe 2001.

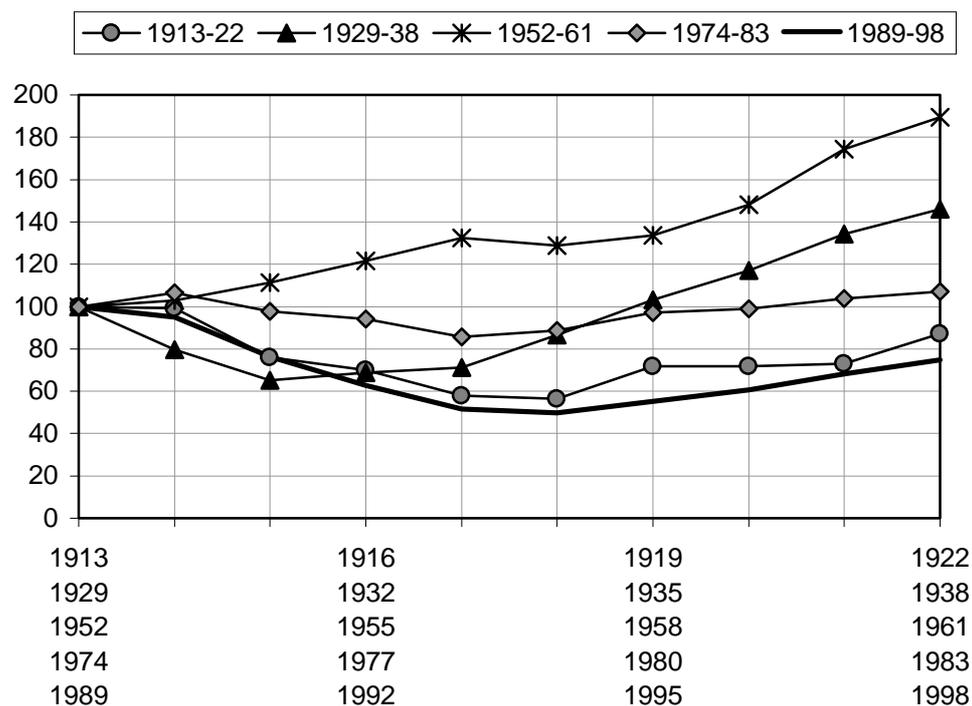
downturns has been an active exchange-rate policy. Recovery was accelerated in all five crises by depreciating the value of the markka. The aim of the devaluations was to secure or restore the competitive position of Finnish export industries, and thus to foster economic growth. In many cases, however, Finnish decisions were reactions to the exchange-rate policies of other countries. The devaluation of 1957 was exceptional, both because of its size (39 %) and because it was an independent Finnish policy choice.

Figure 2.11. Public consumption, volume



The reactions of fiscal policy can be crudely gauged by the volume of public consumption (see Figure 2.11). During and after the First World War, public consumption was procyclical: it declined more than GDP, but also rose faster after 1918. It was clearly contracyclical during the Great Depression, which is quite astonishing, since the Finnish economic policy of the 1930s is customarily considered very liberal, lacking the aspirations of an active fiscal policy. Fiscal policy was neutral in the 1950s: public consumption expanded at the same rate as GDP. The expansion of the public sector was an important factor in keeping up economic activity during the recession years of the 1970s, but this expansionary phase ended in the 1990s crisis. Public consumption declined during the deepest depression, making fiscal policy procyclical: the contrast with the countercyclical 1930s is quite clear.

Figure 2.12. Investment, volume

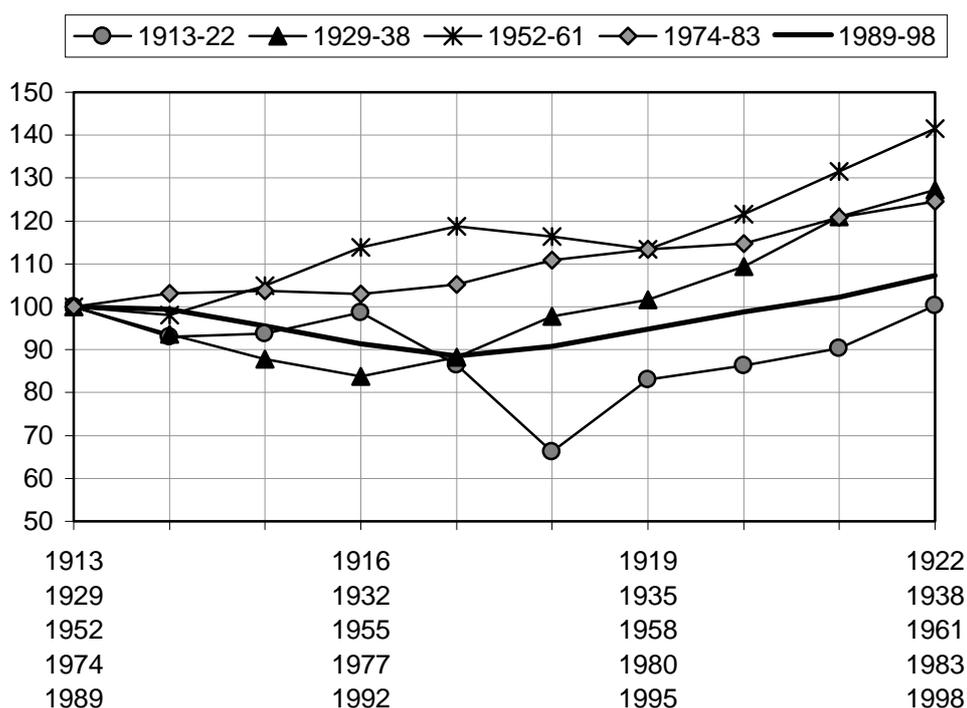


Investments have fluctuated more than GDP: in booms they have grown at a faster rate than the economy as a whole, and in depressions they have declined more rapidly. Investment curves (see Figure 2.12) largely tell the same tale as the GDP figures. There were, however, two exceptions: the 1950s and the 1990s. Investment volume kept on growing more rapidly than GDP in the 1950s (see also Figure 2.7) and in the 1990s, again, investments diminished more and recovered more sluggishly than in any other crisis studied.

The situation of the labour markets was different in each of the five cases, which is mostly explained by the changes in its institutional environment. Rampant inflation took care of the downward adjustment of real wages during the First World War years, while in the deflation years of the Great Depression, nominal wages fell more than consumer prices, causing a fall in real wages. Real wages were thus flexible in both crises, which could be explained by the minor negotiation power of the trade unions. In the 1950s, when labour had gained more power, nominal wages were sticky, and therefore real wage adjustment was carried out by means of price and wage control. This was the first attempt towards corporatist wage regulation, an “incomes policy”, which reached established forms in the late 1960s. The aim of this policy was to keep wages from rising faster than productivity. The unions gained more power in the 1970s, and the corporatist system of wage control began to crack. Inflation, which was already high in the early 1970s, became rampant during the oil crisis. A vicious circle of wage and prices rises set in. Despite high nominal wage

increases, real wages fell, but this was not enough to restore the equilibrium in the labour market, and therefore unemployment increased. This was the end of the long full-employment period, but the really dramatic rise in unemployment took place during the 1990s crisis. It was employment and not real wages that adapted during this period, since real wages remained quite stable in these low-inflation years. The recovery in employment was much slower in the 1990s than after the other crises discussed here.

Figure 2.13. *Private consumption, volume*



Private consumption directly reflected the changes in real incomes in the three first crises. It decreased more and recovered more slowly than production in the 1930s private, and also fell in the 1950s when there was only recession in GDP. Consumption figures showed no signs of depression in the 1970s. One could argue that the welfare system acted as a buffer, which made it possible to maintain pre-crisis consumption levels despite the rising unemployment. The same applies to the 1990s crisis, although now the decrease in the volume of consumption was deeper because of the severity of the depression.

## 2.5 Institutional change

The five crises studied above were of varying gravity. This variation was, to a great extent, caused by fluctuations in the world economy, but this is not the whole story. The institutional setting of the Finnish economy - the "rules of the game" - also had an impact on the course of the crises.

On the eve of the First World War, the Finnish economy functioned very much according to the rules that were basically established in the 1860s to the 1880s - during the formative decades of the market economy. The gold standard and fairly free foreign trade connected the Finnish economy closely to the global economy. On the national level, the basic economic framework was competitive: market freedom was not restricted by the kinds of regulation that were typical of the post-Second-World-War economy. In the labour market, the power of the trade unions was limited and local, making wage setting flexible – from the point of view of the employers, that is. There were tendencies towards co-operation between producers in the goods markets, since Finnish legislation did not prohibit cartel-type organisations. Yet, compared with the post-1918 situation, the role of cartels was still quite limited. An exception to market liberalism was the ancient law of a 6 % maximum interest rate, which was not abolished until 1920.

The institutional setting that the Finnish economy “inherited” from the nineteenth century underwent a lot of changes during the twentieth century. These changes were caused not only by changes in the economic environment, but also by socio-political transformations. Finland’s external and internal political situation both changed radically in 1917 – 1918: the country became a sovereign state and went through a civil war. Independence made the Finnish government – for the first time – sovereign in its economic policy, which was conducted in the spirit of economic nationalism. The new fiscal needs of the independent state made a reform of the old tax system necessary. The main aim of this tax reform was to increase the role of direct taxes, i.e. income and property taxes, and decrease the role of indirect taxes, especially customs duties. The new tax system was quite neutral towards different kinds of incomes, and the tax burden was quite evenly divided between private persons and corporations. The main consequences of the civil war, from the point of view of economic institutions, were seen in the labour market. The defeat of the “reds” weakened the position of the trade unions and thus gave Finnish employers more power in wage bargaining than their Nordic colleagues had, for instance.

The Second World War brought many changes in the institutional setting of the economy. There were, of course, exceptional war-time arrangements, but there were also changes that had long-lasting effects on the economic institutions. The size of the public sector was, of course, very high in the war years, but after the war it was “normalised” almost to the pre-war level. The economic role of the government was quite significant in the late 1940s and the 1950s – not so much because of the size of the public sector, but because of the regulative role of the government. The economy was almost totally regulated in the war years, and much of the regulation remained during the years of reconstruction and beyond. Foreign trade and financial markets were strictly regulated. The government also took an active role in directing investments, both by

establishing new state-owned companies and by influencing private investments. A government-guided industrialisation policy was one reason for the rise in the investment ratio in the 1950s. Bilateral trade with the Soviet Union added a further regulative element in the Finnish economy because of its centralised nature. War also brought a significant change to the labour market. Employers, in the name of national solidarity, recognised trade unions as negotiating partners, and this opened the road to collective bargaining. As the labour parties gained more power after the war, there was no return to the old “rules of the game” in the labour market.

The creation of the “welfare state” was a process common to most of the developed economies after the Second World War. This process started later in Finland – in fact in the late 1960s – and was more moderate than in other Nordic countries, for example.<sup>11</sup> Yet, the change from the 1950s to the 1970s was notable – whether measured by the size of the public sector or by the level and scope of social benefits. The welfare state was built in a corporatist spirit – by co-operation between government, employers, trade unions and farmers’ interest organisations. An essential element in this co-operation was the centralised incomes policy that started in the late 1960s. One central aim of this policy was to regulate wage setting and social benefits so that economic growth and the competitive position of Finnish industry were secured. Social benefits made private consumption less sensitive to changes in economic activity than had been the case in the 1930s. At the same time, the old economic policy favouring investments continued. A new system of corporate taxation introduced in 1968 lowered the tax burden of firms and gave new incentives for investment. Companies were comprehensively allowed to enter reserves, depreciation and appreciation in their balance sheets. As a result, the corporate-tax yield decreased drastically.

This development in the institutional setting of the Finnish economy following the Second World War was, to a great extent, a process of increasing regulation, but the tide turned in the 1980s. As a part of the integrating European economy (EFTA treaty in 1961, EEC treaty in 1974) and of the broader Western economy (OECD membership in 1969), Finland faced growing global pressure to deregulate. The financial markets were liberated and new European standards of competition were adopted, which meant an end to the extensive co-operation between Finnish firms, e.g. export cartels. Corporate taxation was also reformed. Simplicity and equality between firms of different size, and neutrality between different kinds of income, were the aims of the new tax system introduced in 1989. Now corporate taxation no longer gave incentives and opportunities to firms to minimise taxes by using complicated accounting tricks. The favourable position of the big firms over to small or

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<sup>11</sup> See Kautto et al. 2001.

medium-size firms was also abolished. Finland's membership of the European Union in the 1990s meant an end to nationally subsidised agriculture. Moreover, joining the European Monetary Union brought to an end the national exchange-rate policy: thus the often-used remedy of devaluation could no longer be brought out to better the competitive position of Finnish export industries.

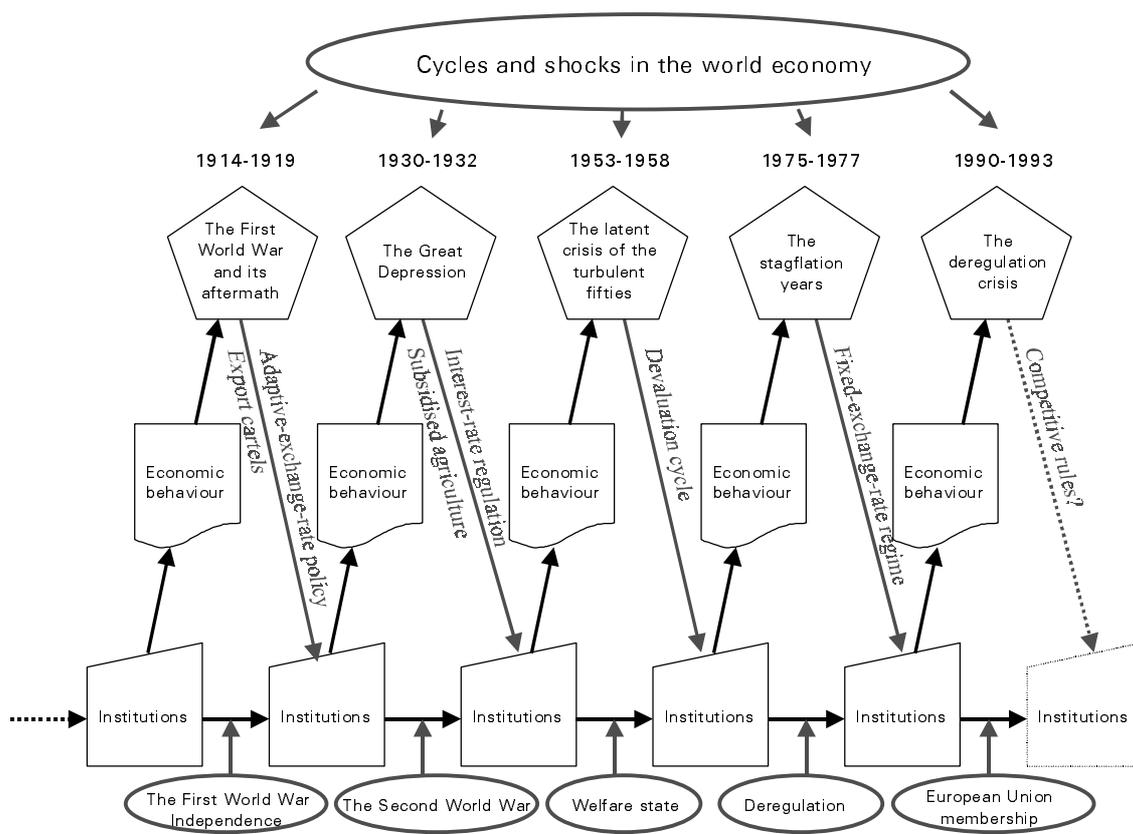
There were also changes in the institutional setting of the Finnish economy, which could be seen as a direct consequence of the crises analysed in this article. As a result of the first crisis (1914 - 1919), Finland adopted a flexible exchange-rate policy, the central aim of which was to guarantee the position of Finnish exports in the world market. The birth of comprehensive forest-industry export cartels in 1918 was also a direct result of the grave situation of the industry after the loss of the Russian market. The depression of the 1930s again gave birth to interest-rate regulation and to subsidisation of agriculture. The "latent crisis" of the 1950s started the "devaluation cycle", which was criticised more and more after the crisis of the 1970s: a fixed exchange rate now became the new aim. The 1990s crisis - along with the other changes in the economic environment - gave the impetus to "market fundamentalism", emphasising the role of market mechanisms in economic development. There has been a considerable amount of discussion, especially on the "structural rigidities" of the labour market, but for the time being there has been no radical change in the old rules of the game.

## 2.6 Conclusion

This article examined the Finnish economic crisis of the 1990s from a historical perspective by comparing it to four other crises – or near crises. In all of the five cases we have analysed, international cycles and shocks have played a major role, which is no wonder in the case of a small open economy such as Finland. However, world economy cycles alone do not explain the different courses of the crises; changes in the institutional setting of the economy also have to be taken into account. Our interpretation of the interaction of global market forces, socio-political changes, institutions, economic behaviour and crises is schematically outlined in Figure 2.14. The focus is on the tension between competition on the one hand and regulation or co-operation on the other, which in our opinion was one of the main plots of Finnish economic history in the 20<sup>th</sup> century.<sup>12</sup>

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<sup>12</sup> Competition refers to situations in which economic behaviour is determined by markets, and regulation or co-operation to situations in which government or private organisations, or both together, have managed the allocation of resources in non-market means.

Figure 2.14. *Institutions and economic crises*

There were relatively few regulatory elements in the Finnish economy before the First World War, so that economic behaviour was mostly market-determined. The situation was different after the War in that the export industry became organised in strong cartels in order to strengthen its position in the world market and to compensate for the small size of the firms. The government, in the spirit of economic nationalism, gave support to this kind of anti-competitive behaviour. Trade unions and farmers' organisations were relatively weak pressure groups compared with industrial organisations. The prices of labour and wood – the most important raw material in forest-industry-led Finland – were elastic. Under these conditions the adjustment to business cycles and recovery from crisis were mostly market-based. Since there were no significant social safety nets, consumption reacted immediately to the changes in economic activity. Competition in the banking sector led to high real interest rates in the 1920s, and since industry had a low debt-equity ratio, the main sufferer was agriculture.

Regulation preserved its central role in Finnish economic policy after the Second World War. Another feature of the post-war era was intensified co-operation between the government and the business sector. The government

had a guiding role in investment policy and in organising bilateral Soviet trade. Traditional cartel-type co-operation continued in the export industries. A new parity between employer associations and trade unions was achieved in the labour market and the government later took an active role in wage bargaining. This added a further regulatory element to the Finnish economy. The financial markets were strictly regulated, and therefore the interest rate did not act as an allocative mechanism. Low or even negative real interest rates (especially in the 1970s), together with the corporate tax system, led to inefficient investments and unsound financial structures in firms.

Finnish economic history from the 1910s to the 1980s is, to a great extent, a story of increasing economic regulation and co-operation – both public and private. New layers of regulation piled up. Then, in the 1980s this regime started to dissolve under global pressure. Economic behaviour changed more slowly, however, and therefore fell in contradiction to the emerging new institutional setting. Furthermore, institutional change was not inclusive or coherent, resulting in conflicting incentive structures. This “institutional friction” deepened the 1990s depression and retarded the recovery. In this sense, this depression represented also a “transition crisis” in the Finnish economy.

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### 3 The Economic Crisis of the 1990s in Finland<sup>13</sup>

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#### Abstract

We develop an interpretation of the severe economic crisis in Finland in the 1990s, when real GDP dropped about 14 percent from the peak in 1990 to the trough in 1993 and the unemployment rate rose from 3 percent in 1990 to almost 20 percent at the beginning of 1994. Finland's case is an example of the classical financial crisis, which have been experienced in countries so different from each other as Chile in the early 1980s, Mexico in mid 1990s and some of the Asian countries quite recently. The background for the Finnish crisis lies in poor design of financial deregulation and this appears to be a common feature in several countries. Our specific contribution is to provide econometric evidence, which has been seldom presented in the discussion of financial crises. We evaluate the role of financial factors in the real economy as factors explaining fluctuations in private investments and consumption behavior. The period of recovery in Finland has also been puzzling. Despite of high economic growth unemployment has fallen very slowly. We argue that indebtedness of the private sector has increased the structural unemployment, which provides an explanation of the puzzle.

JEL classification: E21,E22,E24,E44

#### 3.1 Introduction

The economic experiences of Finland in the second half of 1980's and through 1990's have been dramatic. In this period the Finnish economy first experienced a strong upswing and an overheating of the economy and then a major fall in

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<sup>13</sup> We thank Stefan Gerlach, Lucrezia Reichlin, Charles Wyplosz and other members of the Economic Policy panel, as well as Willem Buiter, Daniel Cohen, Jaakko Kiander, Robert Solow and Vesa Vihriälä for useful comments on an earlier draft. The usual disclaimer applies. We are grateful to Mr. Jyrki Ali-Yrkkö, Mr. Juhana Hukkinen, Mr. Kari Manninen and especially Dr. Markku Lanne for research assistance. Financial support from the Academy of Finland and the Yrjö Jahansson Foundation is gratefully acknowledged.

GDP and a rapid rise in unemployment. Real GDP dropped in real terms about 14 percent from the peak in 1990 to the trough in 1993 while the rate of unemployment rose from 3 percent in 1990 to almost 20 percent in the beginning of 1994. Since 1994 the economy has been recovering, but in spite of rapid GDP growth the decrease in unemployment has been slow and even at present (summer 2001) it remains at a high level around 8 percent.

These macroeconomic figures show just the tip of the iceberg. The Finnish depression of the 1990's has been the most serious economic crisis in its peacetime history. It is more severe than the depression of the 1930's in terms of many indicators, and in fact it is the perhaps most severe crisis of any OECD economies. The 1990s crisis has been characterized by many features which do not appear as part of a regular business cycle of a market economy. These are the huge expansion of bank lending as a consequence of financial market deregulation and major inflows of foreign capital during the boom, periods of speculative attacks on the currency, and the emergence of a major banking crisis as part of the depression, just to mention a few.

This paper develops an interpretation of the Finnish economic crisis of the 1990s. More specifically, we argue that the depression was no ordinary recession. Even though the Finnish economy experienced several exogenous shocks both during the boom and the bust periods that contributed to the business cycle up and down, shocks are only a part of the story. The case of Finland is a very good example of the classical financial crises, which have been experienced in countries so different from each other as Chile in the early 1980s, Mexico in mid 1990s, some of the Asian countries quite recently, and (we believe) Sweden in early 1990s.

While macroeconomic developments and institutions in these countries vary from country to country, these countries have several common features which seem to have dominated their economic developments.<sup>14</sup> The beginning of the story is a poorly designed deregulation of financial markets. Deregulation usually means two things. First, domestic interest rate regulation is lifted and, second, the private sector is allowed to borrow freely from abroad while authorities indicate their desire to stick to the fixed exchange rate. Since financial market deregulation is not usually connected with other measures like the reform in the tax system to tighten the deductibility of interest expenses and the more stringent bank supervision, and since investors perceive little likelihood of a loss from exchange rate movements under these circumstances, financial market deregulation leads to a lending boom both domestically and from abroad often in foreign currency terms. As a result the private sector becomes highly indebted both in domestic and foreign currency terms and is

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<sup>14</sup> See e.g. Edison et al (1998) and Corsetti et. al (1998) and Stiglitz (1998).

thereby very vulnerable to changes in the domestic interest rates and in the exchange rate.

When the economy has developed a huge lending boom often showing features of a bubble, sooner or later the turnaround starts to happen and this often shows up as a tendency for outflow of financial capital. This is the stage, where authorities have only bad alternatives available. If they want to defend the value of the currency, they have to tighten monetary policy. As a result domestic interest rates increase and this hurts the highly domestically indebted private sector. But if the authorities desire to improve the weakened competitiveness of the export sector, they should either devalue or let the currency float. These measures in turn hurt that part of the private sector which has borrowed from abroad. They become subject to a kind of capital levy.

The final stage of the crisis starts from deteriorating economic developments due either to tighter monetary policy and/or depreciation of the value of currency. As a consequence bankruptcies and thereby unemployment start to increase. Banks face difficulties, because their customers are in trouble. A banking crisis emerges and a rise in unemployment takes place. For both reasons public sector finances becomes worse-off. In fiscal policy there is a need to increase taxes and cut expenditures, i.e. to exercise procyclical fiscal policy. High real interest rates and indebtedness, as well as higher tax rates, increase structural unemployment. Hence, as the recovery ultimately starts to develop, it tends to alleviate unemployment very slowly if all for the reason that unemployment has turned structural to a significant extent during the depression. As a mirror image public sector budget deficit turns out to be hard to close despite the revival of economic growth.

This is in outline the story of a financial crisis we tell about Finland and compare the Finnish developments with those of the other countries. Our paper also contributes to this topic by providing econometric evidence from Finland.

We start the paper by telling in section 3.2 the story of both the events and a general view about the reasons behind these developments in Finland. After this descriptive part we provide a diagnosis of the Finnish economic depression as a classical financial crisis in section 3.3. We make some comparisons of the developments with other countries like in Chile, Mexico, some East Asian Countries and Sweden. We also carry out some econometric studies to evaluate the role of financial factors in the real economy as factors explaining fluctuations in private investment and consumption behaviour.

Section 3.4 evaluates the role of economic policies – monetary and exchange rate policy as well as fiscal policy – both before, during and after the crisis. Section 3.5 deals with the recovery period and a puzzling phenomenon associated with it in Finland. Even though economic growth has been relatively

high, unemployment rate has fallen very slowly and therefore public sector finances have been in relatively bad shape until last two years. This leads us to analyze what has happened to structural unemployment in Finland. We argue that, as a result of several features in depression, structural unemployment has increased and has made it harder to return into 'normal' levels of unemployment. In particular, we evaluate econometrically potential role of indebtedness in wage and price setting to check the view that financial factors matter not only for investment and consumption behaviour, but also price and wage setting and thereby for structural unemployment.

Finally, section 3.6 provides our views on what can be learned from the Finnish experience.

Before proceeding we want to stress that this paper is best seen as a 'country case study'. While we often discuss the Finnish experiences in relation to some other countries, the comparisons are not based on as detailed analyses as for the case of Finland. There are various reasons behind this. For the analysis of the influence of financial factors data limitations did not allow a detailed comparison, while for certain other aspects we can occasionally cite relevant country studies using closely related methodologies.

### **3.2 The Road from Boom to Bust<sup>15</sup>**

This section is designed to present an overview of the Finnish crisis in three stages: overheating, depression and a recovery. The experiences of the Swedish economy are in many respects similar, though there are some notable differences. We will make comparisons between these two countries in the course of our discussion. For convenience Box 3.1 provides the basic macroeconomic indicators for Finland and Sweden during the overheating (1985 - 1990), the depression (1991 - 1993) and the recovery (1994 - 1997).

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<sup>15</sup> See Honkapohja, Koskela and Paunio (1993) for a detailed description of the overheating and the onset of the crisis. There exist several other studies as well, see Honkapohja, Koskela and Paunio (1996) and Jonung, Söderström and Stymne (1996), and also the other papers in the Special Issue of Finnish Economic Papers (1996) for some English-language contributions.

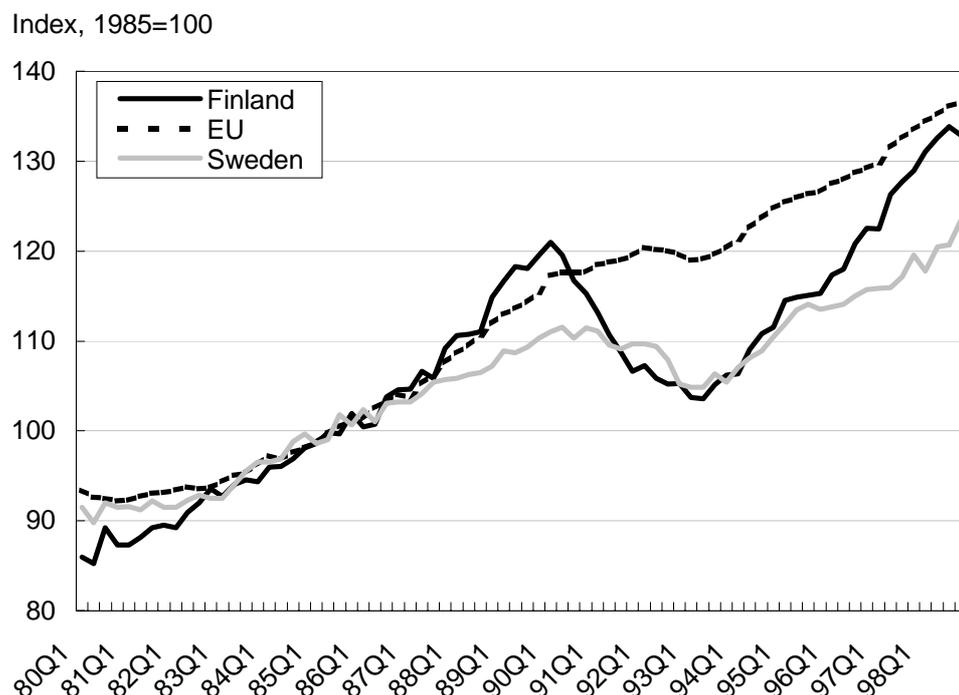
**Box 3.1. Macroeconomic indicators for Finland and Sweden, annual average growth unless indicated otherwise**

	Finland			Sweden		
	1985-90	1991-93	1994-97	1985-90	1991-93	1994-97
Real GDP	3.4	-3.8	4.8	2.2	-1.6	2.6
PCP (private consumption deflator)	4.7	4.7	1.2	6.8	6.1	2.3
Private consumption	3.6	-3.8	3.4	2.5	-1.2	1.5
Private Fixed Investment	5.0	-20.7	9.0	6.1	-14.7	4.6
Exports	1.9	6.7	9.6	2.8	2.6	11.4
Imports	6.3	-3.3	8.6	5.4	-2.1	9.7
Stock market	17.2	4.1	29.1	17.1	2.8	26.6
Total lending	17.7	-4.8	-0.5	20.5	0.0	1.5
Commercial property prices	11.9	-13.2	6.3	18.2	-26.5	
Fixed investment / GDP, %	25.9	19.8	17.0	19.3	17.2	15.5
Unemployment, %	4.4	11.1	14.8	2.1	5.5	7.9
Total employment	0.6	-6.1	1.2	0.9	-4.0	-0.3
Total employment / population (15-64 years),%	73.2	65.5	61.9	80.1	75.5	69.9
Current account / GDP, %	-2.9	-3.8	3.7	-0.9	-2.6	1.9
Household saving/disposable income, %	1.3	5.8	1.9	-1.6	6.4	4.9
Money Stock	12.4	1.8	2.4	6.8	3.7	4.0
Business bankruptcies, no	2709	6792	4527	6698	19109	
Credit losses, % of bank lending	0.3	4.1	2.5	0.4	4.3	
Public saving/ GDP, %	3.8	-5.0	-4.1	2.0	-7.1	-5.3
Unit Labour Cost	6.2	1.6	-0.3	7.8	2.3	1.5
Hourly Earnings in Manufacturing	8.0	3.3	4.4	8.1	4.4	5.1
Capital Income Share in the Business Sector	28.6	26.5	33.7	30.6	31.0	34.6

Starting with the period preceding the crisis, we note that in the first half of the 1980's the performance of the Finnish economy, measured in terms of economic growth, was relatively smooth, with an average growth rate slightly above the OECD-European rate. Looking at GDP growth, it can be seen that, relative to Sweden, the Finnish growth rate was higher as a result of catching-up features on the one hand and the relatively sluggish growth performance of the Swedish economy on the other.<sup>16</sup> Figure 3.1 shows GDP growth for Finland, Sweden and EU-countries since 1980.

<sup>16</sup> The slow growth in Sweden since mid 1970's has been subject to a lot of controversy. See e.g. Gylfason et al (1997) and Lindbeck (1997) and the references therein for detailed discussions of the fading Swedish miracle.

Figure 3.1. GDP in Finland, Sweden and EU-Countries



In contrast to most other European countries, Finland and Sweden did not experience any major rise in unemployment in the aftermath of the oil crises of the 1970's. The first half of 1980's can be characterized as a gradual disinflation process for Finland, there were no major indebtedness problems in the external dimension or in the public sector, and unemployment remained low, as it did in Sweden. Overall, the macroeconomic performance in this period can generally be viewed as favorable.

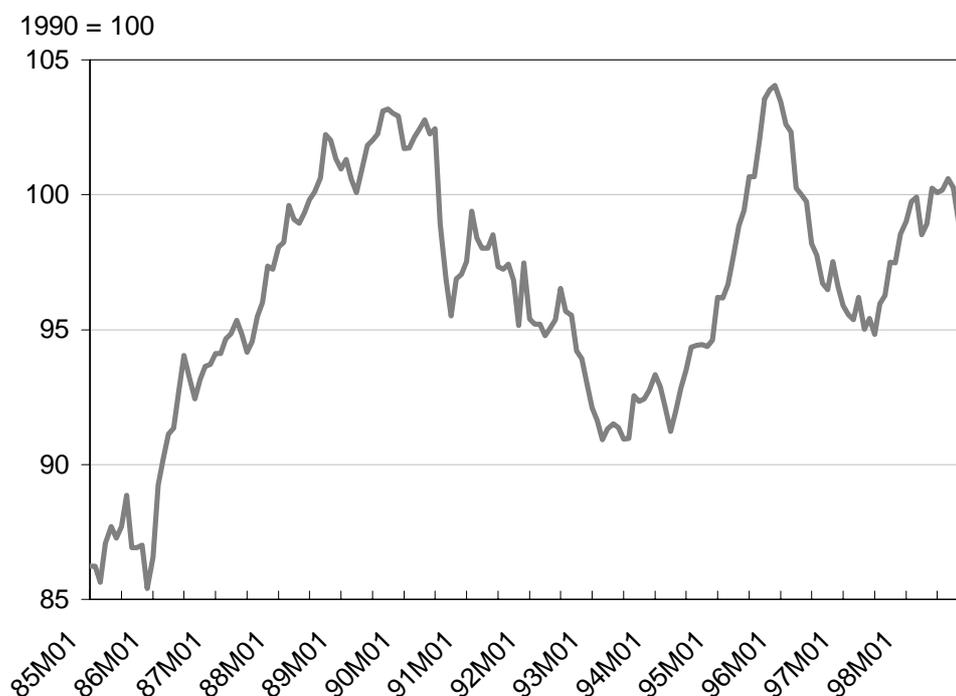
### 3.2.1 The Overheating

The smooth developments changed around 1986 - 1987. As shown in Figure 3.1, growth accelerated significantly and the economy entered a period of overheating. Several factors were behind this change. Without trying to quantify their relative significance these can be classified into the following categories:

(i) Financial market deregulation, which included both the abolition of regulation of domestic bank lending rates and the lifting of restrictions on private borrowing from abroad, led to an explosion of bank credit and large capital inflows. We discuss these developments in the next section.

(ii) A sharp increase in the terms of trade as a result of the fall in energy prices and the rise in world market prices of forest products. The data on terms of trade is shown in Figure 3.2.

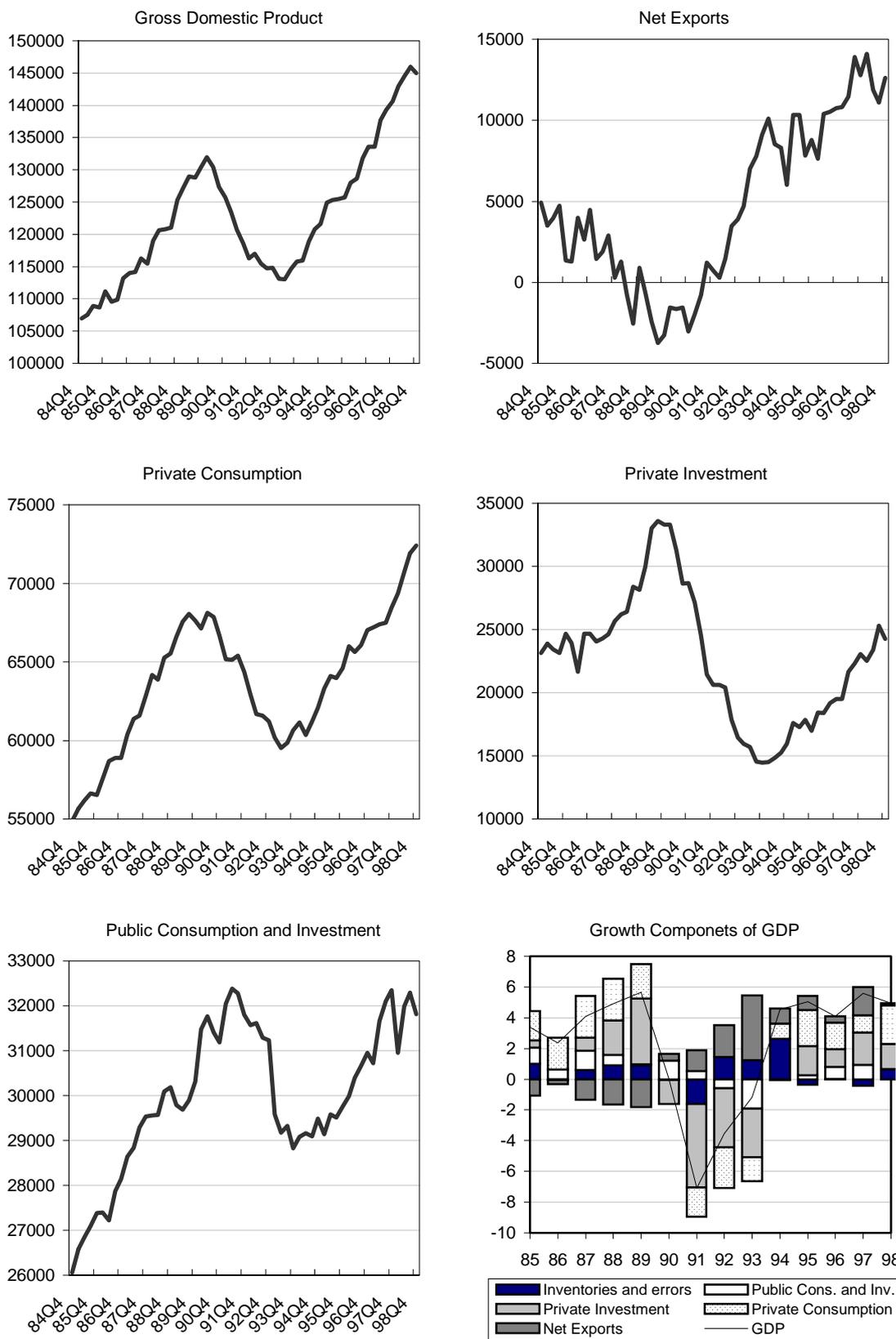
Figure 3.2. Terms of trade



(iii) Economic policies which were not sufficiently restrictive.

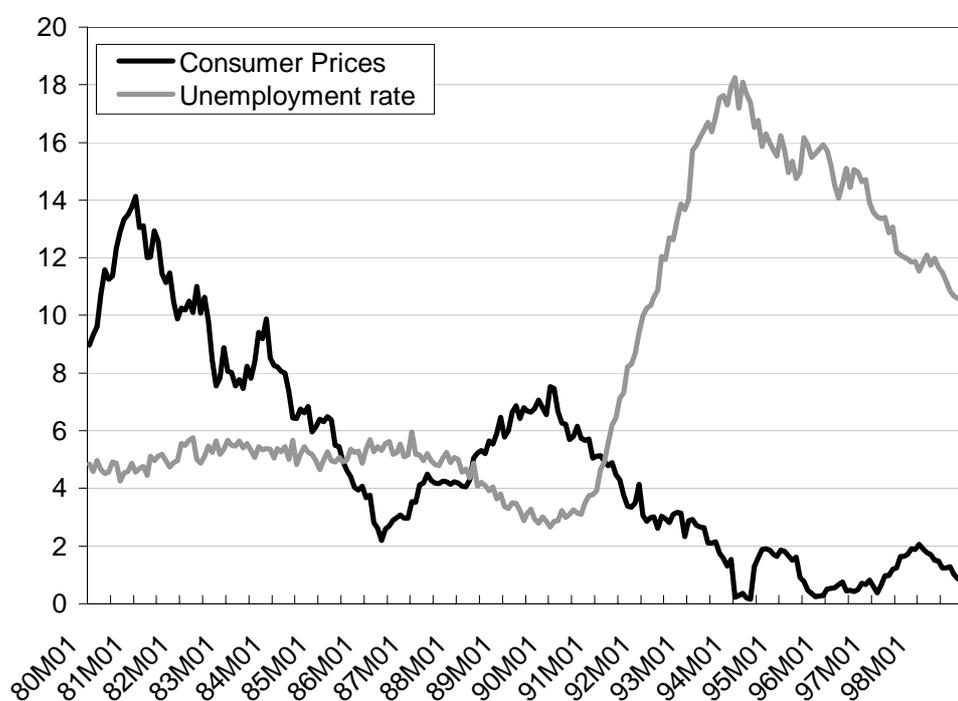
Figure 3.3 shows the development of the components of GDP, together with their contribution to GDP growth. The panel showing the contributions illustrates that private consumption and investments had the biggest positive impacts. Fiscal policy did not appear to counteract the fast growth. On the contrary, public consumption and investment contributed positively to it. We consider economic policies further in Section 3.4.

Figure 3.3. Components of aggregate demand and their contribution to growth



In the process of overheating the rate of inflation rose from about 2-3 percent in 1986 to about 7 percent in 1989 - 1990, see Figure 3.4. From the same figure it is seen that the rate of unemployment declined from the approx. 4 percent level of the first half of the decade to about 2.5-3 percent at the end of 1989. In comparison to Sweden it may be noted that Swedish unemployment showed a very gradual decline for most of 1980's, which suggests that Sweden experienced less pronounced overheating in the second half of the decade. The GDP growth performance of Sweden supports this view, compare Figure 3.1 and Box 3.1.

Figure 3.4. *Inflation and unemployment*



The Finnish boom led to weakened price competitiveness and serious current account problems. These are shown in Figures 3.5 and 3.6, respectively. For 1985 - 1990 the average current account deficit to GDP ratio was 2.9 percent for Finland, while the same figure for Sweden was only 1.1 percent, again suggesting that in Sweden the overheating was less pronounced (compare Box 3.1).

Figure 3.5. Relative unit labor costs in manufacturing

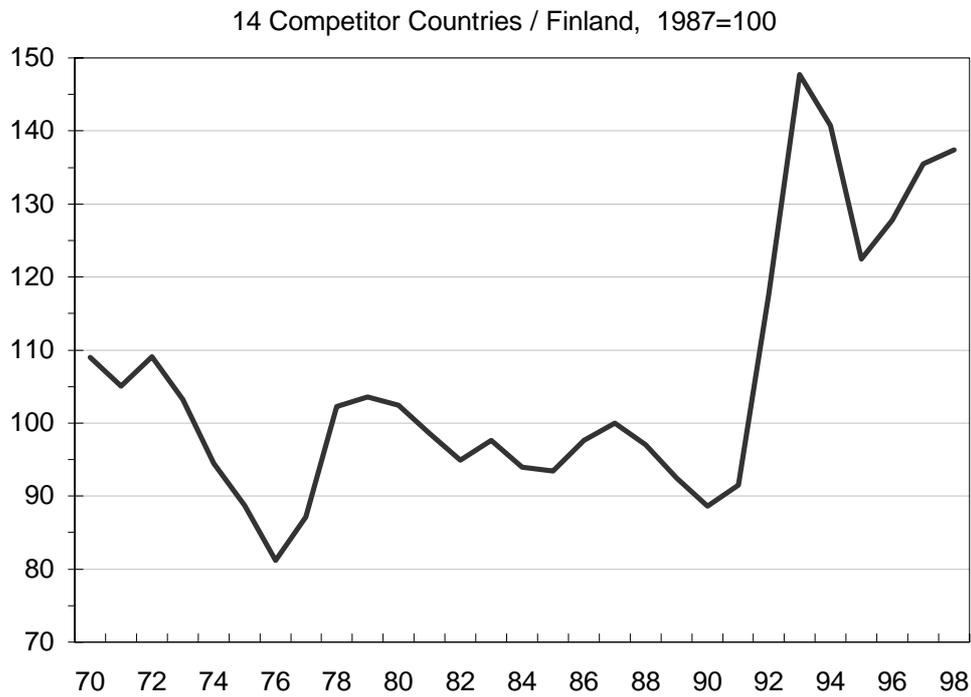
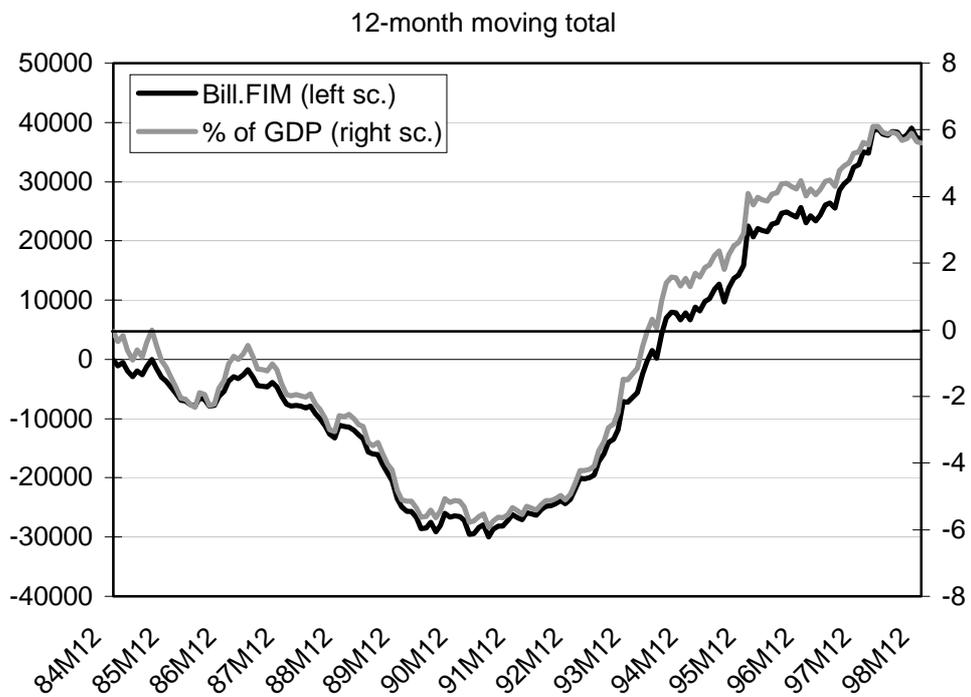


Figure 3.6. Current account



In the boom years competition among banks intensified in line with the financial deregulation. The new possibilities for competition between banks led to increased risk-taking, probably as a result of moral hazard and myopic behavior.<sup>17</sup> As a result indebtedness of the private sector went up. Moreover, capital inflows increased hugely, partly as a result of the interest rate difference between the domestic and foreign interest rates and partly because investors perceived little likelihood of a loss from exchange rate movements. All this led to the soaring of the real estate and other asset prices. (The data on asset price developments will be discussed in Section 3.3.)

### 3.2.2 The Onset of Depression

The end of the boom came in 1990, when a rapid process towards bust started. Economic activity as measured by the growth rate of real GDP declined extremely rapidly from +5.4 % in 1989 to -6.5 % in 1991. As shown in Figure 3.3, domestic private investment, private consumption and net exports of goods and services all fell sharply. Thereafter, the decline continued, though at a slower pace through 1992 and most of 1993. The decline in GDP stopped and a turnaround took place in the Fall of 1993.

As Figure 3.3 shows, while all domestic components of aggregate demand contributed to the decline in economic activity, a particularly important feature was the major decline in investment activity. Quite expectedly, price inflation slowed down significantly and came close to a standstill (cf. Figure 3.3). This and the depreciation of the Markka since November 1991 led to a major improvement in the price competitiveness of the Finnish economy (cf. Figure 3.5). Moreover, the current account deficit gradually disappeared and turned into a surplus (cf. Figure 3.6).

The emergence of a major banking crisis was a notable feature of the bust process. The rapidly falling asset prices and bankruptcies of firms led to credit losses and the government had to provide public support for banks. (Section 3.3 discusses the details). The banking crisis was an episode of major financial restraint and it, as well as the overheating, allow us to consider empirically the view that the financial factors accentuated both the rise and the fall in the different components of aggregate demand. We test for the effects of interest rates and other financial factors on investment and consumption in section 3.3.

Both international and domestic factors contributed to the onset of the crisis. These factors can be classified into shocks and economic policy effects as follows:

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<sup>17</sup> Savings Banks were the most aggressive competitors in the banking sector. Vihriälä (1997) has found evidence that moral hazard contributed to the expansive lending behavior of Savings Banks.

(i) The Finnish exports to the market economies declined as a result of slow international growth, loss in the price competitiveness of the Finnish industry and the fall in the terms of trade. With the collapse of the Soviet Union, the Finnish exports and imports to Russia dropped in 1991 by 70 percent almost overnight. This fall contributed to the decline in Finnish GDP in the crisis years, but - as we will argue - it was not the main factor in the onset of the depression.

(ii) The German unification raised the interest rates in Europe as a result of loose fiscal and tight monetary policies in Germany.

(iii) Monetary policy turned very restrictive in early 1989 after the revaluation of the Finnish Markka. The defence of the Markka against speculative attacks kept nominal and real interest rates high and made the short rates volatile (see Figure 3.8). Real interest rates rose from the beginning of 1990 to the end of 1992. This fixed exchange rate/hard-currency policy ran into problems of credibility, and it was eventually abandoned with the depreciation of the Markka in November 1991 and September 1992. (Figure 3.7 shows the behavior of the exchange rate, together with its bands up to 1992 and the ECU central rate since 1996.) Moreover, public consumption and investment declined in 1991 and 1992 as part of the depression and government policy. We discuss economic policies further in section 3.4.

Figure 3.7. *The exchange rate*

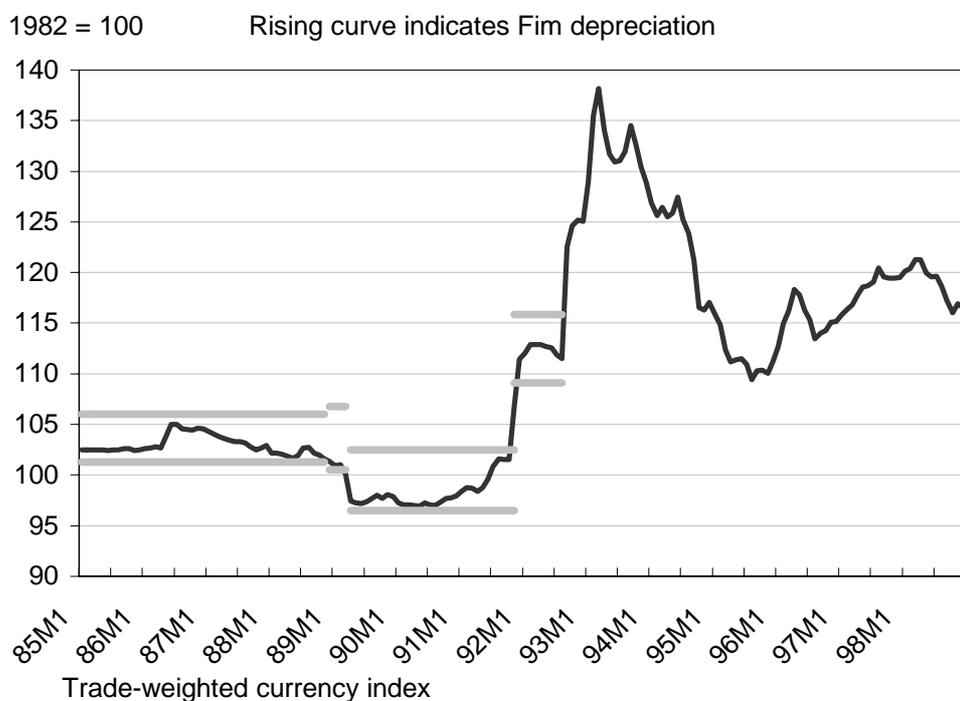
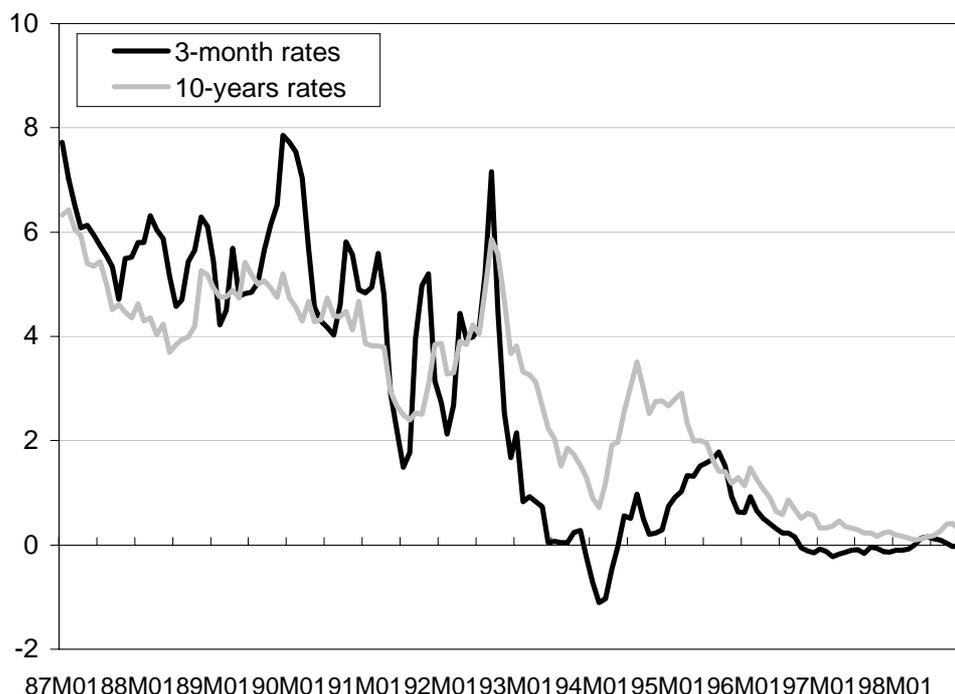


Figure 3.8. Interest rate differential between Finland and Germany



While it is evident that these three elements contributed to the onset of the Finnish depression as external or domestic impulses with consequent propagation mechanisms, it is not straightforward to assess their relative significance. In our opinion the external shocks are not the whole story. For example, consider the collapse of Soviet trade. In 1991 it was around 15 percent of total exports, and the export share in GDP was then 23 percent. After allowing for a fairly large multiplier it is evident that a 70 percent decline in this trade can account for roughly three percentage points of the total nearly seven percent decline in DGP in 1991. Similarly, the Western recession and the rise in German interest rates contributed to the depression, but were not the main story.

The influence of financial factors as a further propagation mechanism in the depression process has been suggested as a key element of the crisis. In our view the financial factors have played a central role amplifying the effects of some shocks, especially those coming from the exchange and interest rates. Several financial market considerations can be identified.

First, the exchange and interest rate shocks from first the defence of the hard-currency and then from the major depreciation of the currency must have influenced both consumption and investment behavior, given the high levels of indebtedness of both firms and households and the fact that significant part of their borrowing was from abroad. Second, the collapse of asset prices led to difficulties in the banking system and the emergence of a banking crisis. This

crisis may have in turn led to financial constraints in the financing of firms and households. We examine these issues in a more systematic way in Section 3.3.

### **3.2.3 Recovery**

The economy turned around in late 1993, but this recovery was mostly concentrated in the capital-intensive export industries and domestic sector remained relatively depressed until 1995 - 1996.

These features are reflected in unemployment which continued to rise well into 1994 reaching the level close to one fifth of the labor force. After that it started to decrease very slowly and it is still at a high level (11 percent in 1999 and around 8 percent in 2001) despite the revival of economic growth. The fall in open unemployment became more rapid only in 1997, as part of the fast and general recovery of the economy.

Thus in the most recent years the Finnish economy has been experiencing a strong and general recovery, where also domestic sectors of the economy and not only export-related activities are growing (see Figure 3.3). These last developments are beginning to bring open unemployment down somewhat more rapidly. Inflation has remained low and external competitiveness strong (cf. Figures 3.4 and 3.5), so that the current account has continued to be in surplus. The recovery period may be characterized as a policy of 'getting the fundamentals right'. We also remark that Finland joined the EU in the beginning of 1995 and is one of the eleven countries that joined the European Monetary Union at its inception in 1999.

Concluding the overview it may be said that in the beginning of 2001 the general picture about the economy was rather favorable. The remaining major macroeconomic problem at present is high unemployment. While one might think that fast growth will, at least partly, take care of this problem, this view may well be too optimistic. We will argue in Section 3.5 that a significant part of the unemployment appears to be structural, and growth by itself cannot cure structural unemployment. Moreover, the emerging rapid slowdown in the Western economies will make the problem harder to solve. We do not discuss the most recent experiences in any detail, as our focus is on the depression years.

## **3.3 The Main Diagnosis: A Financial Crisis**

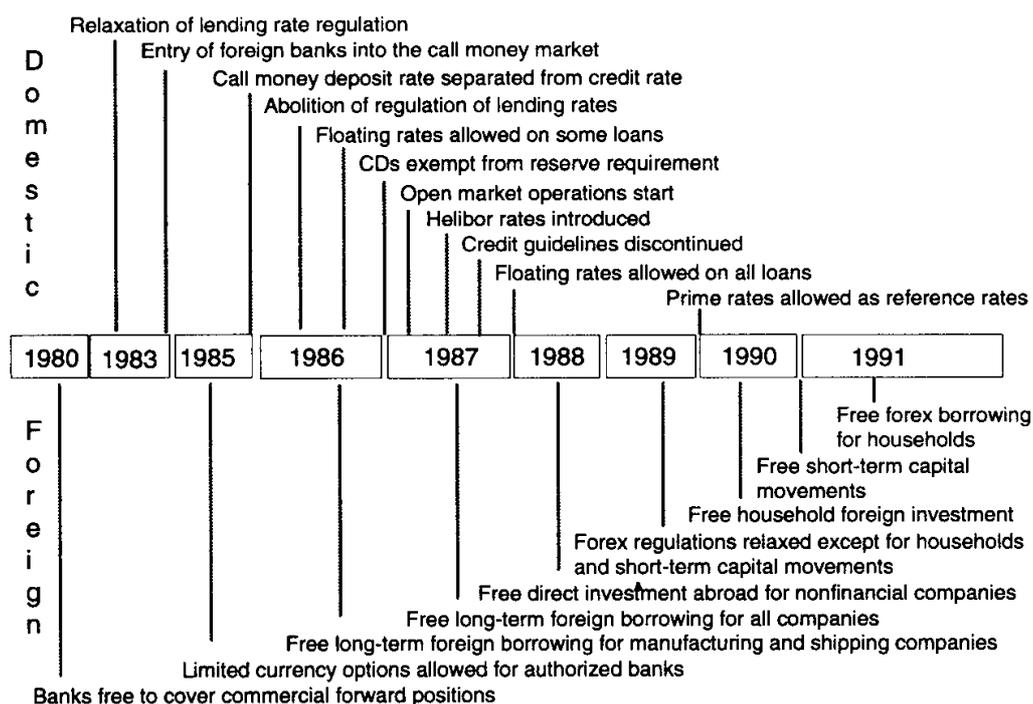
We have already stated our view that the role of financial factors was the key element in the Finnish crisis. The roots of the crisis can be traced back to the deregulation period of the financial system in the 1980's. The fact that financial deregulation precedes a crisis has now been documented for many countries,

including Chile in early 1980's, Mexico in mid-1990's and, most recently, several Asian countries in the second half of 1990's.<sup>18</sup> In this section we first take a detailed look at the financial developments. After that we argue that Finland, like the countries mentioned above, faced problems in international indebtedness and liquidity. Finally, we analyze the role of financial factors further and provide some econometric evidence of their importance for consumption and investment behavior.

### 3.3.1 The Financial Developments

The process of financial deregulation was started in the early 1980's, but the greater part of the deregulation was carried out in the second half of the decade. Figure 3.9, adapted from Vihriälä (1997), shows the timing of the deregulation steps during 1980 - 1991 in both domestic and international dimensions.<sup>19</sup>

Figure 3.9. *Deregulation of financial markets in Finland*



<sup>18</sup> See e.g. Sachs, Tornell and Velasco (1995), Corsetti, Pesenti and Roubini (1998), and Radelet and Sachs (1998).

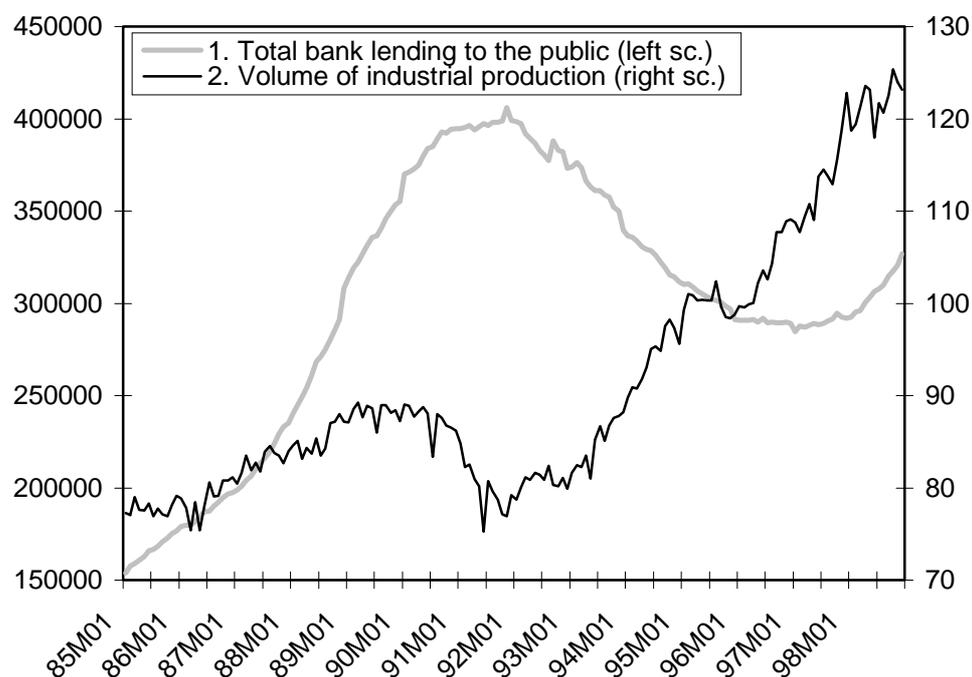
<sup>19</sup> The last step was the liberalization of foreign ownership of Finnish shares in 1993, which is not in the figure.

The deregulation process was problematic in several respects. First, its timing in the 2nd half of the 80's unfortunately coincided with the upswing of the business cycles in the Western market economies. Second, rules and practices in prudential regulation and bank supervision were left unchanged. They were tightened later on in 1991, when the depression had already started. Third, the tax system, which had favored debt financing of investments, was not reformed. Fourth, in the deregulation lending rates were liberated earlier than deposit rates, which also helped to make banks' position relatively loose. Finally, when monetary policy under the fixed exchange rate with a narrow band tried to maintain some tightness in the wake of the boom, it in fact increased the interest rate differential between Finland and Germany and thereby gave further impetus to the foreign capital inflow, which was growing in any case as a result of freeing of the capital movements.

The inflow of foreign capital was mediated to large extent by Finnish banks and led to foreign-currency denominated borrowing by firms in the non-traded sector. The Central Bank held the exchange rate in a narrow band, but there was pressure for Markka to strengthen. This was resisted at first, but in 1988 the band was first widened from  $\pm 2,25$  to  $\pm 3$  percent and then Markka was revalued by 4 percent in early 1989 (see Figure 3.7).

These factors contributed to an exceptionally rapid growth in bank lending (see Figure 3.10). Much of the borrowing was directed at investments in real estate and other assets. For example, the share of deposit banks' credit to business and financial services out of total corporate lending rose from 9.3 percent in 1985 to 22 percent in 1991.

Figure 3.10. *Bank lending and industrial production*



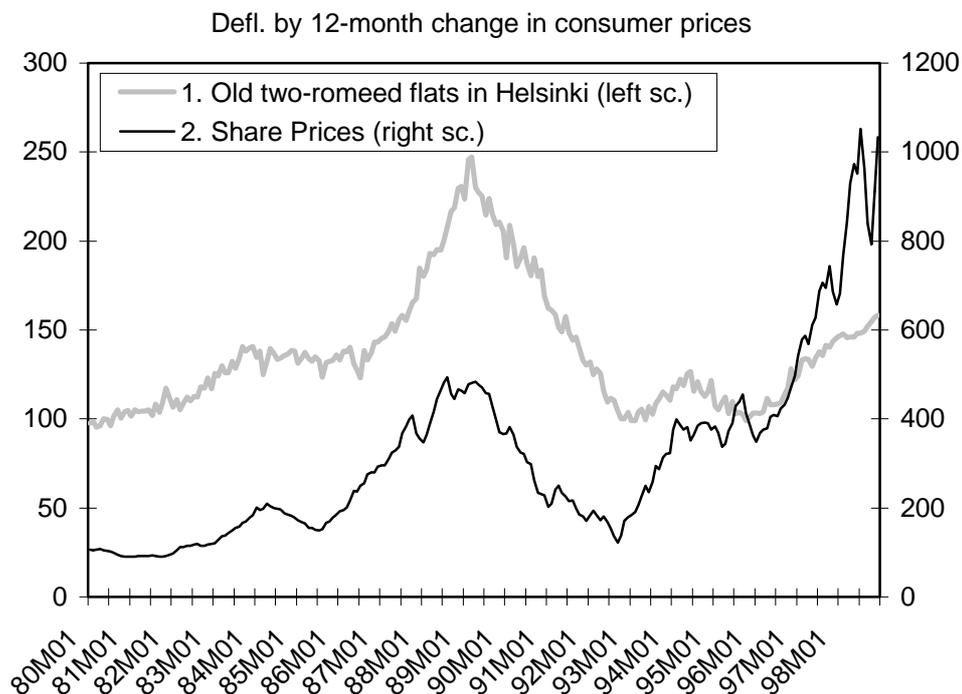
The rapid growth in lending in turn led to a doubling of real asset prices in the boom. Subsequently, the asset prices halved during the depression (see Figure 3.11). Bank lending decreased from 400 to less than 300 Billion FIM in 1992 - 1995. It is remarkable that, despite the strong upturn in the economy, it barely increased for the two years 1996 - 1997 after the low point reached in 1995 (cf. Figure 3.10). Only since 1998 there has been a significant increase in bank lending.

Comparing these developments to Sweden, we see that the two countries behaved similarly in many respects. Both the rapid growth in bank lending and the huge rise in asset prices also took place in Sweden after the deregulation. There is, however, one notable difference: as documented in Box 3.1, the current account deficits were much smaller in Sweden than in Finland.

A banking crisis emerged as part of the depression. It became visible in 1991 and it deepened in 1992.<sup>20</sup> The banking crisis required major policy interventions by the government and the Parliament. It also led to major restructuring in the Finnish banking system. Box 3.2 describes the main policy actions and the restructurings that took place.

<sup>20</sup> See Honkapohja, Koskela and Paunio (1993, section 4) or Nyberg and Vihriälä (1994) for a more precise description.

Figure 3.11. Real Asset Prices



A modest improvement in the banking sector took place in 1993, and this tendency continued in 1994 and 1995. The loss making by banks more or less stopped during 1996, and since 1997 the banks have showed significant positive profits (see Figure 3.12). The crisis is most clearly shown by the negative net (accounting) profits and the relatively higher credit and guarantee losses during 1991 - 1995. They are particularly high during the same period. (This can be contrasted with the income side, where there are fluctuations but they are not visibly abnormal.)

*Box 3.2. Policy Measures in the Banking Crisis and Restructuring of the Banking Sector in Finland*

Policy actions in the banking crisis began in September 1991 when the Bank of Finland took control of Skopbank, the "central bank" of the Savings bank system. In early 1992 the government injected public funds in the form of preferred capital certificates to the banking system and set up a Government Guarantee Fund (GGF). GGF could use various instruments to support the banking system. With the continuation of the crisis first the government and then the Parliament made public declarations that the stability of the Finnish banking system will be guaranteed under all circumstances. In early 1993 the GGF was strengthened and it was given additional capital. Public support to the banking industry continued through 1994. Total fiscal cost of bank support is estimated to be around 7.5 percent of the 1992 GDP.<sup>21</sup> (see Nyberg and Vihriälä (1994) for more details).

Major restructurings of the banking sector occurred during the crisis. First, most of the 250 Savings Banks were grouped into a Savings Bank of Finland,<sup>22</sup> but subsequently this bank was splitted and the pieces were merged to Commercial, Cooperative and the Post-Office Banks. A small commercial bank STS-Bank was also merged into KOP. Then the two big commercial banks (KOP and SYP) also merged, and the structural changes continued with the recent merger of the remaining Finnish commercial bank (Merita Bank) with Nordbanken of Sweden. Another restructuring occurred in 1998 between the government-owned Post-Office Bank and Vientiluotto (Export Credit Institution).

The banking crisis was the result of several factors: The boom of the real economy, the speculative rise in asset prices and the rapid expansion of credit led to problems in the banking sector when the economy entered a downswing and asset prices started to fall. Very high real interest rates and the dramatic decline in asset prices contributed to liquidity and collateral problems and increased bankruptcies of businesses which in turn led to credit losses of the banks as shown in Figure 3.12. The indebtedness problems of the sheltered sector were aggravated by the depreciation of the Markka, since during the

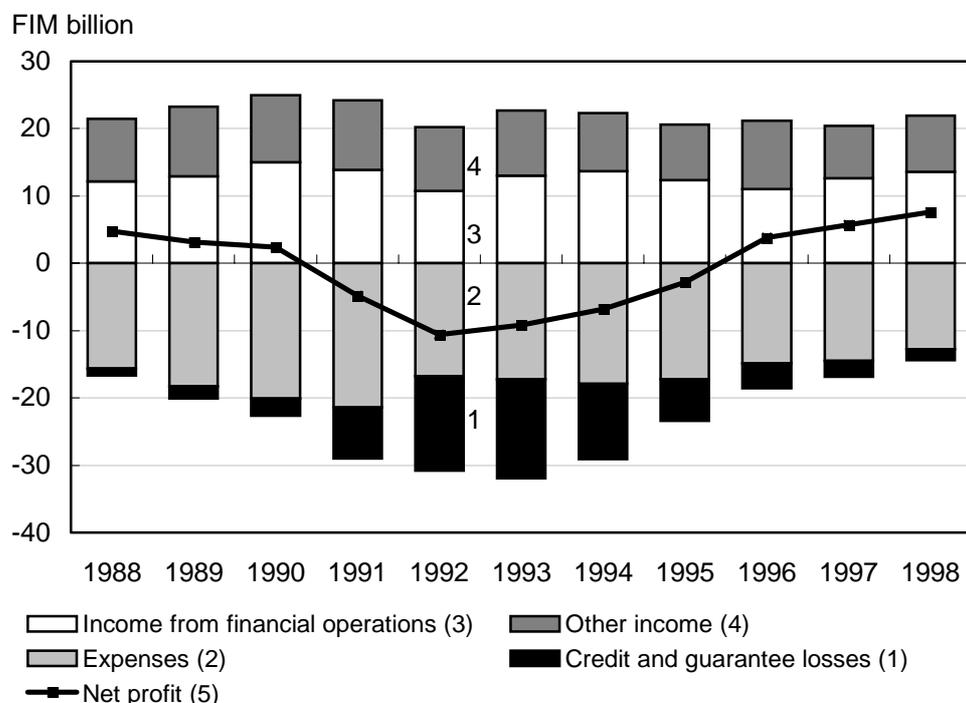
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<sup>21</sup> For comparison we note that the corresponding figures for Sweden and Norway are 5.2 and 3 percent, respectively, see Edey and Hviding (1995). The figures for total fiscal support continue to be adjusted as the assets acquired by the state are being resold. The relative ranking by these costs illustrating the severity of the crisis in these countries is not likely to change though.

<sup>22</sup> Only a handful of small Saving Banks retained their independence.

boom this sector had accumulated large amounts of foreign currency loans following the deregulation process.<sup>23</sup>

Figure 3.12. Profitability of Finnish deposit banks



We do not make a detailed comparison of the banking crisis in different countries, but it may be remarked that in Nordic countries, with the exception of Denmark, the banking industries have all experienced similar crises.<sup>24</sup> This is remarkable, since in many respects Denmark experienced similar macroeconomic developments. Edey and Hviding (1995) provide a review of the financial reform processes in OECD countries. They argue that the important difference between Denmark and the other Nordic countries lies in the prudential supervision and disclosure rules and in the stricter capital adequacy standards in Denmark, where these were tightened concurrently with the reform.<sup>25</sup>

<sup>23</sup> The share of foreign-currency loans in total lending was 13-15 percent in mid 1980's and it rose to over 27 percent by 1991. The share is currently about 6 percent.

<sup>24</sup> The table in Box 3.1 shows that the ratios of credit losses to bank lending were of similar magnitudes in Finland and Sweden.

<sup>25</sup> Drees and Pazarba•io•lu (1998) provide a detailed comparative discussion of the Nordic banking crises. A recent empirical study of 53 countries during 1980-95 finds that (a poorly

### 3.3.2 Problems in International Indebtedness and Illiquidity

Recent analyses of financial crises in different countries have stressed that problems of international illiquidity, real exchange rate appreciation and lending boom are central characteristics of such crises largely resulting from a preceding process of financial deregulation, see e.g. Sachs, Tornell and Velasco (1995) and Velasco and Chang (1998). We demonstrated in Section 3.2 that Finland was facing real exchange appreciation (measured as relative unit labor costs in Figure 3.5) and a lending boom both at home and from abroad with a consequent worsening of international indebtedness.

Table 3.1. *International Indebtedness, net foreign debt, % of GDP*

	Finland	Sweden	Mexico	Chile	Korea	Malaysia	Thailand
1982	17	19	30	21			
1983	20	22	45	33			
1984	19	20	48	73			
1985	19	21	46	88			
1986	17	19	58	85			
1987	20	17	53	74			
1988	19	19	41	50			
1989	23	21	31	33			
1990	29	27	30	17	14	36	33
1991	35	28	26	17	14	36	38
1992	41	24	22	14	14	35	38
1993	53	43	20	16	14	41	34
1994	57	48	19	18	14	40	33
1995	42	42	33	11	24	39	34
1996	42	41	28	7	28	40	50

A country may put up with a relatively high level of international indebtedness, provided its economic growth is relatively fast and the economy is internally relatively well in balance. Nevertheless, a high debt position means increasing risks, should a country run into other economic difficulties. For Finland these risks were realized with the slowdown of the economy at the start of the 1990's. Table 3.1. shows the external debt to GDP ratio for Finland and Sweden for the period 1982 - 1996. For comparison, the table also shows the figures for Chile, for Mexico for period 1984 - 1995 and for Korea, Malaysia and Thailand for the period 1990 - 1996.

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designed) financial liberalization increases the probability of a banking crisis, see Demirgüç-Kunt and Detragiache (1998).

The build-up of debt for Finland is much more pronounced in 1988 - 1991 than for Sweden.<sup>26</sup> This suggests that the external situation for Finland was relatively risky, so that the pressures mounted rapidly once the general outlook became gloomy in 1990 - 1991. International indebtedness for Mexico has been very high in the 1980s and for Chile even higher in mid 1980s. Also Korea, Malaysia and Thailand increased their foreign indebtedness quite rapidly in 1995 - 1996.

*Table 3.2. Indicator of International Illiquidity, money to foreign reserves ratio*

	Finland	Sweden	Mexico	Chile	Korea	Malaysia	Thailand
1980	11	21	19	2			
1981	14	19	19	3			
1982	14	17	65	5			
1983	16	13	11	4			
1984	8	14	7	3			
1985	7	9	9	3			
1986	18	10	6	3			
1987	7	10	3	4			
1988	9	10	3	4			
1989	11	9	6	4			
1990	7	6	6	3	6	3	4
1991	9	6	4	3	8	3	4
1992	12	5	5	3	7	3	4
1993	9	5	4	3	7	2	4
1994	5	4	19	3	6	2	4
1995	7	4	5	3	6	3	4
1996	9	6	5	4	7	4	4
1997	7	10	4	4	11	5	5

International indebtedness of a country includes both long- and short-run external liabilities. In contrast to debt, liquidity is exclusively a short-term issue, and problems of international illiquidity provide indications of a financial crisis. The financial system of a country is internationally illiquid if its potential short-run obligations exceed the amount of foreign currency it can have access to on short notice. When governments are committed to act as lenders of last resort for the banking sector, deposits can be regarded as liabilities (see Velasco and Chang 1998 for more details). For this reason the ratio of M2 money to foreign exchange reserves is a commonly used indicator for international illiquidity. We now look at this indicator for Finland and compare it to other countries that have experienced financial crises.

<sup>26</sup> The numbers for the post-depreciation years are naturally even higher since debt is measured in terms of the domestic currency.

Table 3.2 shows that this indicator of international illiquidity for Finland not only exceeded one but fluctuated in the second half of 1980's with some build-up of illiquidity at the onset of the crisis in 1990-92. The behavior of the same indicator for Sweden is a bit different, but its behaviour in the second half of 1980's points to potential international illiquidity problems as well. Table 3.2 also provides values of this indicator for some other countries. It is seen that the M2-foreign reserves ratio exceeded one for all countries in the Table 3.2 and increased in the buildup of the crisis.

The conclusion we draw is that Finland appears to have experienced problems of international indebtedness and illiquidity. These contributed to the pressures on the Finnish Markka and led to subsequent depreciations and banking sector problems. The same argument appears to apply not only to Sweden, but also to Chile, Mexico, Korea, Malaysia and Thailand, though to slightly varying extent.

### 3.3.3 Financial Factors, Investment and Consumption

In the light of the dramatic developments in the financial system it is natural to consider whether the banking crisis may have led to a credit crunch which, in addition to the effects of high interest rates, may have directly affected investment and consumption in the aggregate economy in 1990 - 1992. The view that financial factors have a direct influence on business fluctuations in the real economy is usually based on capital market imperfections and agency costs in financial intermediation, especially in debt and bank lending. This "credit-channel view" has been subject to extensive research in recent years.<sup>27</sup>

Empirical evidence and tests of the credit channel of monetary policy have been sought recently. Some studies of the Finnish bank loan markets have also been done with the 1990's data. The evidence about the credit crunch provided by Vihriälä (1997) and Pazarba•io•lu (1997) is mixed. They see the decline of bank lending to be, at least to an extent, a result of weakness in loan demand. However, the results of Pazarba•io•lu (1997) suggest that banks' willingness to supply credit deteriorated during the banking crisis as a result of reduction in asset quality, low profitability and tightened capital requirements. Saarenheimo (1995) has provided evidence of the importance of credit crunch for investment in a VAR framework.

Focusing attention exclusively on bank credit may be too narrow a viewpoint. It has been suggested as an alternative that there is in fact a broad credit channel, so that attention should be directed at the supply of funds in general.<sup>28</sup>

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<sup>27</sup> Recent overviews are given in Cecchetti (1995), Hubbard (1995), and Bernanke, Gertler and Gilchrist (1998).

<sup>28</sup> The empirical evidence of financial factors has been developed on microeconomic data from the US, see e.g. Bernanke, Gertler and Gilchrist (1996) and Oliner and Rudebusch (1996).

This channel should manifest itself in the differential responses of external and internal finance as well as of small and large firms. The impact of financial factors on investment has been studied with microeconomic data in a number of countries, and Hubbard (1998) provides a review of the methodology and evidence. For studies focusing on consumption and financial factors, see e.g. Bacchetta and Gerlach (1997), Bayomi (1993), Wilcox (1989), and Zeldes (1989). In this subsection we look at Finnish evidence about the influence of financial variables on firms and investment as well as on consumption-savings behavior.

### **Cash Flow, User Cost and Investment Responses of Firms<sup>29</sup>**

To analyze the investment behavior of firms we utilize a panel data set on 500 largest Finnish firms to see whether evidence of the direct effects of financial factors on investment can be found in Finland for the period of 1986 - 1996.<sup>30</sup> The fact that the data consists of 500 largest firms prevented us from considering the importance of size differences which have been one way of testing the agency cost theory.<sup>31</sup> Nevertheless, it is possible to examine econometrically whether cash flow and other financial factors had an effect on investment by Finnish firms during the depression.

#### **Box 3.3. *Financial Factors and Investment***

The basis for research on financial factors and investment is in models of asymmetric information and incentive problems which imply that information costs and internal funds of firms affect the (shadow) price of external finance for investment. A standard

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These papers look at several different types of evidence about the broad credit channel of financial factors and monetary policy.

<sup>29</sup> The extensive empirical work in this section has been done by Mr. Jyrki Ali-Yrkkö. For further results see his Licentiate thesis, Ali-Yrkkö (1998).

<sup>30</sup> For a description of the data set, see Appendix in Honkapohja & Koskela (1999).

<sup>31</sup> Bernanke, Gertler and Gilchrist (1996, section 4) examine the differential response of small and large firms in sales, inventories and short-term debt using financial reporting data from the US.

empirical framework was used to consider econometric evidence on the role of cash flow and other financial factors for investment behavior of Finnish firms. It is based on an Euler equation for financially constrained firms, see e.g. Bond and Meghir (1994) or the review discussion by Hubbard (1998). The econometric model is postulated as

$$\left(\frac{I}{K}\right)_{i,t} = \beta_1 \left(\frac{I}{K}\right)_{i,t-1} + \beta_2 \left(\frac{I}{K}\right)_{i,t-1}^2 + \beta_3 \left(\frac{\pi}{K}\right)_{i,t-1} + \beta_4 \left(\frac{Y}{K}\right)_{i,t-1} + \beta_5 \left(\frac{B}{K}\right)_{i,t-1} + \beta_6 uc_{i,t-1} + d_i + \alpha_t + v_{it}$$

Here the investment (I) of each firm i in each year t depends on its lag and lag squared, its profits ( $\pi$ ), sales/turnover (Y) and total debt (B). All these variables have been scaled by value of total capital, and the other variables  $uc_{i,t-1}$ ,  $d_i$  and  $\alpha_t$  consist of the firm-specific user cost of capital, firm specific factors and time-specific factors. In the equation the term  $(\pi / K)$  controls for the role of cash flow, the output term (Y/K) for imperfect competition and the debt term (B/K) for non-separability between investment and borrowing decisions. A priori one would guess  $\beta_3$  and  $\beta_4$  to turn out positive and that  $\beta_5$  and  $\beta_6$  negative.

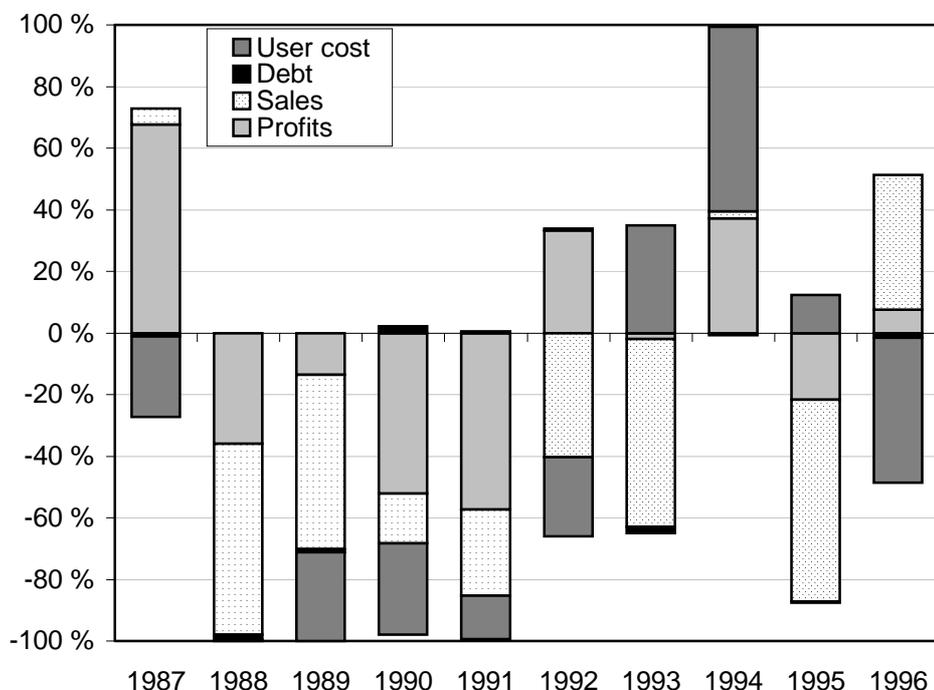
Box 3.3 describes the main features of the setup. We estimated<sup>32</sup> this standard model of investment and finance constraints from a panel constructed from the previously mentioned financial-reporting data set on Finnish firms. A GMM estimation method was used. The results accord rather well with the theoretical model. While these results were suggestive about the influence of financial factors, a proper analysis requires the estimation of different decision rules for financially unconstrained and constrained firms. This was also done by using some alternative criteria to define financial unconstrainedness.

In the estimations the coefficient on the user cost of capital was found to be negative. The positive coefficient on debt suggests that investments are partly financed by debt. The coefficients on explanatory variables were usually statistically significantly different between unconstrained and constrained firms. The coefficient on profits is much larger for constrained firms in comparison to the estimate for unconstrained firms. This accords with the notion that profits are more important as a source of finance for firms which are financially constrained. The economic significance of this difference is illustrated by computing the long-run elasticities of the investment-capital ratio with respect to the profits variable for unconstrained and constrained firms. They are 0.0648 and 0.2690, respectively, using the classification whereby a firm was defined to be financially unconstrained in year t if it managed to cover interest in debt from

<sup>32</sup> For estimation results, see Appendix in Honkapohja & Koskela (1999).

its profit during period  $t$  or  $t-1$ , and the respectively average values over the whole period.

Figure 3.13. Contributions of financial factors on investment fluctuations



In order to see the relative importance of various financial factors contributing to fluctuations in private investments we calculated the relative contributions of user cost, debt, sales and profit variables. This calculation is presented in Figure 3.13 for all firms in the sample (using annual averages of the data). It suggests that a decline in the sales has contributed to the decline in investments for most of the period. Moreover, a rise in the user cost of capital caused the fall in investments over the period 1988 - 1992 and the other way round in 1993 - 1996 after Markka had started to float and the interest rates went down. The cash flow variable was relatively the most important in 1990 - 1991.<sup>33</sup>

All in all these results accord in general quite well with the view that financial factors matter. The profit (cash flow) and sales variables have a positive significant effect on investment, and the profit variable is larger for financially constrained firms than unconstrained ones. Simple cross-section estimates

<sup>33</sup> One should notice that figure 3.13 describes the relative contributions of user cost, debt, sales and profits. This calculation accounts neither for firm dummies, time dummies, nor lagged values.

(details not reported here) showed also that the significance of cash flow appears to have strengthened during the depression years, so that the role of internal finance for investment took on added significance.<sup>34</sup>

### Consumption, Net Wealth and Financial Factors

In section 3.2 we argued that besides private investment also private consumption contributed both to the boom of the late 1980s and to the decline of economic activity in the early 1990s. In what follows we look empirically at the determinants of the fluctuations in private consumption. In particular, we are interested in evaluating the effects of changes in net wealth and financial factors like interest rates and credit constraints have had on consumption behaviour. Box 3.4 summarizes the setup.

#### Box 3.4. Net Wealth, Financial Factors and Consumption

The starting point is the following consumption function which can be regarded as an approximation to a much richer theoretical structure<sup>35</sup>

$$\Delta \ln C = \alpha_0 + \underset{(+)}{\beta} (\ln Y - \ln C_{-1}) + (1 - \beta) \underset{(+)}{\lambda} \Delta \ln Y + (1 - \lambda) \underset{(+)}{\beta} \gamma W_{-1} / Y + (1 - \lambda) \underset{(?)}{\beta} \eta r + other$$

Here C denotes private consumption, Y disposable income, W net wealth, r the real interest rate. The equation has an error correction term, and  $\beta$  reflects the adjustment

<sup>34</sup> The interpretation of the cash flow variable as reflecting finance constraint is not, however, uncontroversial. One can argue that if cash flow is correlated with future profitability, a link between cash flow and investment could reflect the link between expected profitability and investments according to the usual neoclassical investment theory with perfect capital markets. Also a cross-sectional link between cash flow and investment could be similarly suspect: firms with high cash flow have had successful investment and face incentives to expand production. While this question cannot be fixed here, we would like to point out that in our specification current investments are strongly related to cash flow even after controlling to output fluctuations, leverage and year dummies. Moreover, the significance of cash flow increases with our definition of financial constrainedness.

<sup>35</sup> See e.g. Muellbauer and Murphy (1993) for further details, and Agell and Berg and Edin (1995) for an application to Swedish data.

due either to habit formation or adjustment costs in consumption. A fraction of  $\lambda$  of aggregate disposable income accrues to households that are subject to binding liquidity constraints, while a fraction  $(1-\lambda)$  accrues to households that obey the permanent income hypothesis.<sup>36</sup> In the basic version for the first group of households the rate of growth of consumption depends solely on the rate of growth in disposable income, while for the second group the real interest rate and the net wealth/income ratio play a role. As for the first group, private consumption may be affected by credit constraints via other channels as well. To the extent that lenders follow a practice of restricting borrowing so as to keep current payment-to-current income ratios below some ceiling level, nominal interest rate  $i$  affects the growth rate of aggregate consumption, see e.g. Wilcox (1989). Moreover, other credit market variables like credit growth and/or the wedge between borrowing and lending rate - which has been used in the literature as a measure of the tightness of credit conditions - may affect consumption growth.<sup>37</sup>

As for the "other variables" category one could argue that for Ricardian-type reasons increasing government deficit tends to increase private saving and thus decrease consumption. Similarly, the rapid rise in unemployment might have a negative effect on consumption to the extent that households perceive an increasing income risk as unemployment increases. Permanent income might increase if a fall in deficits signals a future decrease in tax burden, which would increase consumption. These non-Keynesian effects of fiscal policy have been analyzed in the context of consumption behaviour by Giavazzi and Pagano (1996) who have emphasized that sharp and persistent fiscal actions might have non-standard effects on private consumption. In estimations unemployment and government deficits turned out to be insignificant.<sup>38</sup>

Several relatively robust observations can be drawn from a set of instrumental variable estimation results using Finnish annual data over the period 1970 – 1996.<sup>39</sup>

First, the net wealth income ratio as well as the change in disposable income have a positive effect on consumption, while the real rate of interest variables

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<sup>36</sup> See e.g. Campbell and Mankiw (1991).

<sup>37</sup> For international empirical evidence that aggregate consumption may be 'excessively sensitive' to credit conditions as well as to income, see Bacchetta and Gerlach (1997).

<sup>38</sup> We also included a variable intended to capture the effects of transitory changes in net wealth on consumption. Private consumption in Finland has been rather highly correlated with changes in real housing prices and one could conjecture that windfall gains in the housing market stimulate consumption and depress saving. A house price innovation measure was computed as the forecasting error from an AR(2)-model for real housing prices. This temporary windfall gains variable had a positive, but not very significant effect on private consumption.

<sup>39</sup> We have used annual data here and later on in section 3.5 in the evaluation of structural unemployment. This is mainly because the seasonally unadjusted quarterly aggregate time series data covers relatively short time span.

were consistently insignificant. This lies in conformity with the view that real interest rate has effects on consumption via changes in asset values by stimulating it in the boom and depressing it in the recession. The short run net wealth elasticity of the consumption change is about 0.03-0.05.

Second, the nominal interest rates affects consumption significantly negatively.<sup>40</sup> A natural way to interpret this is to say that it reflects liquidity constraints. Also the change in credit growth has a significantly positive effect on consumption. In fact, credit growth appears to be roughly as important a determinant of consumption as disposable income growth. The short-run elasticities with respect to disposable income and credit growth changes are in the neighborhood of 0.30.<sup>41</sup>

Our estimates of private consumption in Finland support the view that both the changes in net wealth and the changes in financial variables like the nominal interest rate and credit growth as well as changes in disposable income can explain variations in private consumption behaviour. During the boom asset values, liquidity variables and credit expansion went up and boosted private consumption, while the reverse happened when the recession came in.<sup>42</sup>

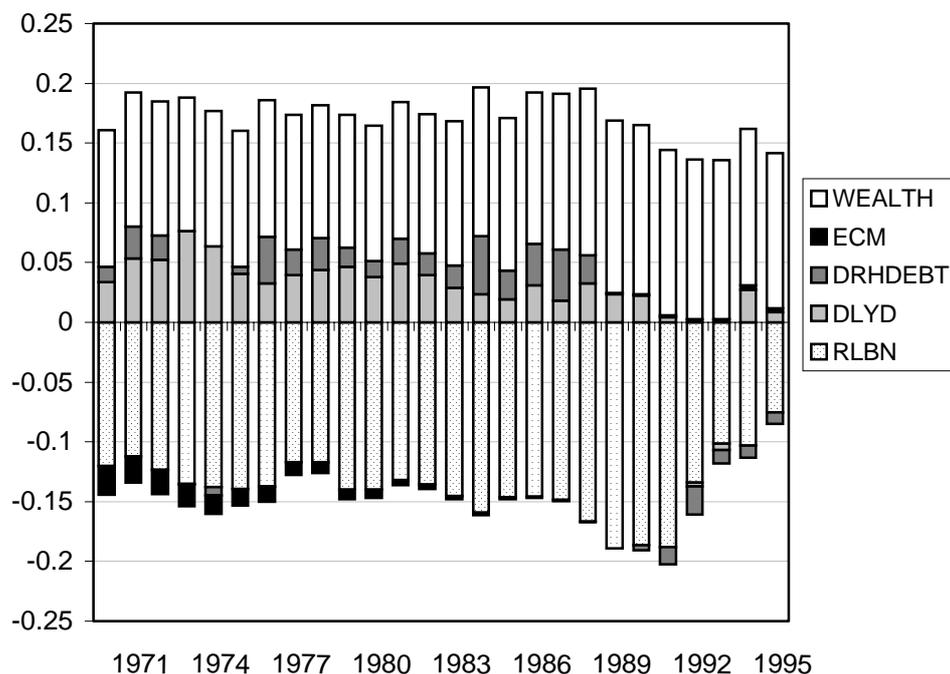
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<sup>40</sup> In estimations the borrowing-lending rate wedge turned out to be positive and sometimes statistically significant depending on the precise specification, but the overall performance of the equations was slightly worse than those with the nominal interest rate. In general the results were qualitatively quite similar.

<sup>41</sup> We also used government deficits and unemployment as alternative explanatory variables. While both affected consumption negatively the coefficient estimates were not statistically very significant. Finally, we tried to evaluate the role of non-Keynesian behaviour. This was done by first constructing the indicator for the fiscal stance (we used the Blanchard fiscal impulse indicator) and then using the idea that if the discretionary fiscal deficit is high and persistent, it may have a smaller effect on consumption. This hypothesis did not get support from the estimations, however.

<sup>42</sup> Agell and Berg (1996) have argued that Swedish boom of the late 1980s can be explained along other lines than financial deregulation. The idea here has, however, been that liberalization of the financial system comes through the associated changes in availability and cost of debt, revised expectations of income growth and increases in net wealth. All this leads to a consumption boom and to a fall in the savings rate.

Figure 3.14. Contributions of explanatory variables for consumption



In order to see the relative importance of various factors contributing to fluctuations in private consumption we calculated the contributions of the explanatory variables. This calculation is presented in Figure 3.14. It suggests that changes in net wealth and in nominal interest rates have been the most important factors in the fluctuations of consumption. The change in disposable income was important during the boom years and not surprisingly, nominal interest rates took added significance during the depression years.

### 3.4 Policies Before, During and After the Crisis

#### 3.4.1 Monetary and Exchange Rate Policy

Maintenance of a regime of fixed exchange rates has been the long-term basis for monetary and exchange rate policy in Finland in the post-war period. However, through much of this period the Finnish economy was prone to periodic inflationary pressures which in turn led to corresponding deteriorations of price competitiveness and balance of payments problems. The latter were corrected by major devaluations of the Markka from time to time, for example in 1957, 1967, and 1977. Thus this earlier policy can be characterized as fixed but adjustable exchange rate. The devaluations, which were in the 30 percent range, often contained the seeds of a further inflationary process and led to pressure for another devaluation in the future. However, due to the financial regulations - including Central Bank control of interest rates in bank lending and

control of international capital movements – expectations of future devaluations did not affect domestic interest rates.

In the aftermath of the oil crises a new regime for monetary and exchange rate policy, starting in early 1980's, was established in an attempt to eliminate the inflation-devaluation cycle. This was executed by means of a fixed exchange rate policy, where the exchange rate was used as an anchor that would keep inflation under control. This policy was relatively successful for some years, though in the Summer of 1986 there was significant speculation against the Markka. This pressure was successfully resisted and the exchange rate remained fixed six and half years within a band of 4.5 percent from October 1982 to November 1988 and within a band of 6 percent from November 1988 to March 1989. See Figure 3.7 for the nominal exchange rate and its bands (as well as the ECU central rate since 1996).

The strong Markka regime came under gradually increasing pressure during the financial deregulation in the second half of 1980's. With the liberalization of international capital flows a major inflow of capital to Finland occurred and created pressures for the Markka to appreciate. It is notable that this appreciation pressure existed though since 1987 the current account had already been in deficit and price competitiveness had been deteriorating. This was due to the huge capital inflow which exceeded the current account deficit. In addition, exports to Soviet Union were gradually falling which added to the overvaluation of the Markka. In March 1989 the Markka was revalued as response to appreciation pressures thereby weakening the competitiveness problem further.

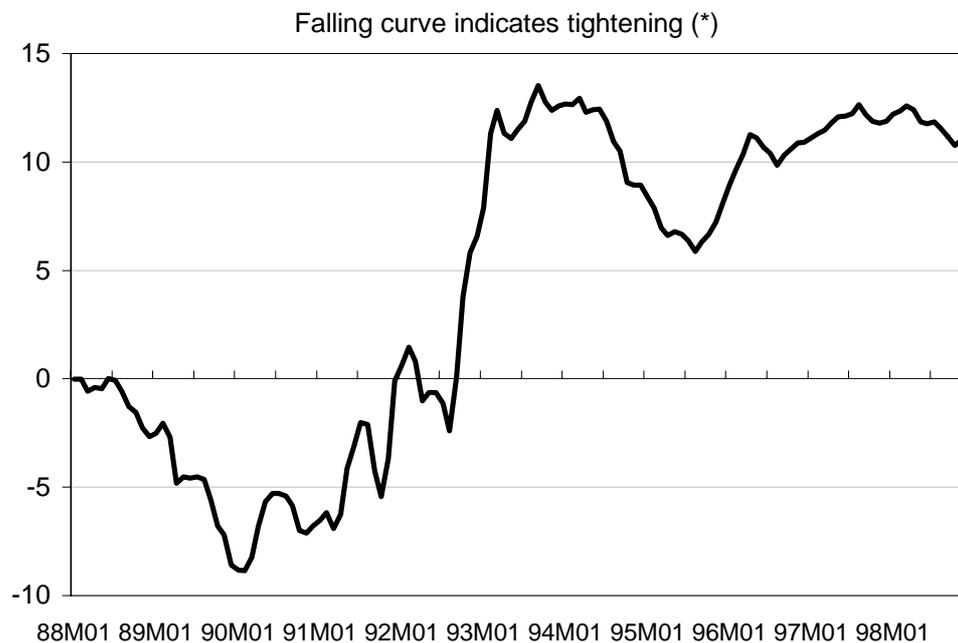
When the domestic boom ended, the Markka started to become subject to speculative attacks from 1990 onwards. The policy response was to remain in the strong Markka regime. Defence of the fixed exchange rate led to high domestic real interest rates. The fixed exchange rate/hard currency policy was eventually abandoned; first a forced devaluation of approximately 12 percent took place in November 1991 and in September 1992 the Markka was floated.<sup>43</sup>

In the floating regime the Bank of Finland introduced a domestic inflation target. This rule gradually gained credibility. As an indication of increased credibility the interest rate differential between Finland and Germany narrowed significantly (see Figure 3.8). Some of the differential for long rates remained, and actually widened temporarily in 1994 but was brought under control by the fiscal policy package of the new government which had taken office in Spring 1995. The period of floating ended in October 1996, when Finland joined the ERM (with wide bands), and now Finland is a member of the European Monetary Union.

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<sup>43</sup> See Dornbush et al (1995) for a critical discussion of this episode.

Figure 3.15. Monetary conditions index 1998m1=100



(\*) One %-point rise in interest rate corresp. to 2.5 % markka appreciation

Figure 3.15 provides an index for monetary policy stance. Looking at monetary and exchange rate policy, it is evident that the strong Markka policy was clearly misguided on two occasions. First, during the financial deregulation period domestic monetary policy could not counteract the boom. Since the exchange rate was fixed, the attempt to tighten monetary policy in 1988 led to a higher interest rate differential between domestic and foreign rates and this further increased the inflow of foreign capital. Moreover, at the end of the boom this policy showed a direct failure in credibility with the revaluation of the Markka in 1989. This revaluation was forced by the strong capital inflows and it came far too late. An early revaluation of the currency in the boom and/or a move to floating (or active exchange rate management) would have limited the capital inflows. However, while we see capital inflows as contributing to the boom-bust process, there is a caveat. Causality tests (available upon request) show that in Finnish data there is a causality from inflows of foreign capital into the appreciation of the Markka, but it is not statistically significant.<sup>44</sup> We think that

<sup>44</sup> In the literature it is suggested that liberalization of capital movements and the resulting inflows of capital have been a primary source of overheating and slump. See e.g. Edwards (1998) and Bacchetta and van Wincoop (1998) for this argument and evidence in the context of Latin America and emerging market economies. Estimation of equilibrium real exchange rates for Finland lends support to the view that the Finnish real exchange rate was overvalued in late 1980's and became undervalued during the crisis, see Feyzioğlu (1997).

this is partly due to the target zone system, which prevented free movement of the nominal exchange rate, though Markka had a tendency to appreciate. However, as discussed in Section 3.3, there is some evidence that Finland was running into a position of international illiquidity (see Table 3.2.).

The second failure of monetary and exchange rate policy occurred in the wake of the depression. The fixed exchange rate was maintained in spite of all indicators pointing towards a serious downturn. The very high interest rates from the defence of the currency contributed to the collapse of aggregate demand, which started in early 1990. The late move to floating exchange rates initially worsened the situation, given the high largely unhedged foreign debts that had been accumulated during the boom. However, it subsequently permitted the easing of monetary policy and contributed to the turnaround of the economy.

The short-term nominal interest rate differential between Finland and Germany fell from seven percentage point in late 1992 to close to zero in mid 1993. This contributed to a fall in the long-term nominal interest rate differential as well (see Figure 3.6).<sup>45</sup>

These two failures of exchange rate and monetary policy provide a clear lesson. When the financial deregulation starts, there is a tendency for the external value of the home currency to appreciate due to the huge capital inflow and fiscal policy which does not offset the demand –augmenting effect of the capital inflow. One should float the currency to mitigate overheating coming from financial deregulation and liberalization of capital movements. Exchange rate flexibility can provide some help in curbing the capital inflows. In our view the Finnish boom-bust cycle would have been less extreme with a floating exchange rate regime, though the extent of mitigation can be debated. But we want to emphasize that financial deregulation, jointly with the incomplete policy package, led to the lending boom both in domestic and foreign currency terms. As a result of these developments only bad alternatives remained in the exchange rate policy.

### **3.4.2 Fiscal Policy**

In discussing fiscal policy during the period 1985-98 it should be recalled as a background that the size of the public sector in Finland, as measured by total

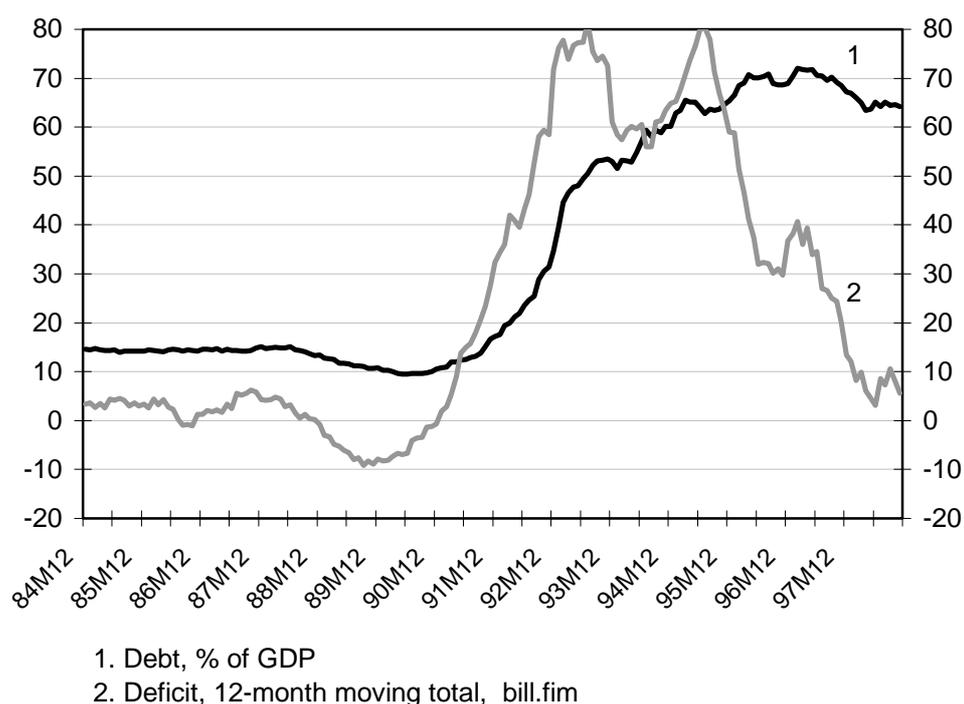
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<sup>45</sup> Since the Finnish markka started to float in September 1992, the long-term nominal interest rate differential between Finland and Germany has decreased with the exception in the spring of 1995, when the Bank of Finland temporarily tightened monetary policy. According to our estimates this can be explained by the lower Finnish inflation, the smaller short-term interest rate differential, and the decreased volatility of the Finnish financial markets. These factors were counteracted by the higher Finnish government budget deficits (results available upon request).

public expenditure relative to GDP, has traditionally been below the OECD average. Since 1990 the GDP share of the public sector has increased dramatically. From Figure 3.3 it is seen that public consumption and investment have declined in real terms in 1991 - 1993. However, total expenditure has (even without banking support) increased mainly as a result of increased transfers, especially on unemployment compensations.

These developments, together with a fall in tax revenues, have resulted in serious indebtedness problems, see Figures 3.16 for the development of the central government debt. The deficits responsible for the buildup of the debt were large relative to GDP, reaching the 10-15 percent range in 1992 - 1993. With falling GDP, the debt-GDP ratio shot up very rapidly, so that Finland shifted from the group of low public-debt countries to the group of medium debt countries in just a few years. These developments also meant that throughout the crisis the rise in central government debt became a major concern in fiscal policies carried out.

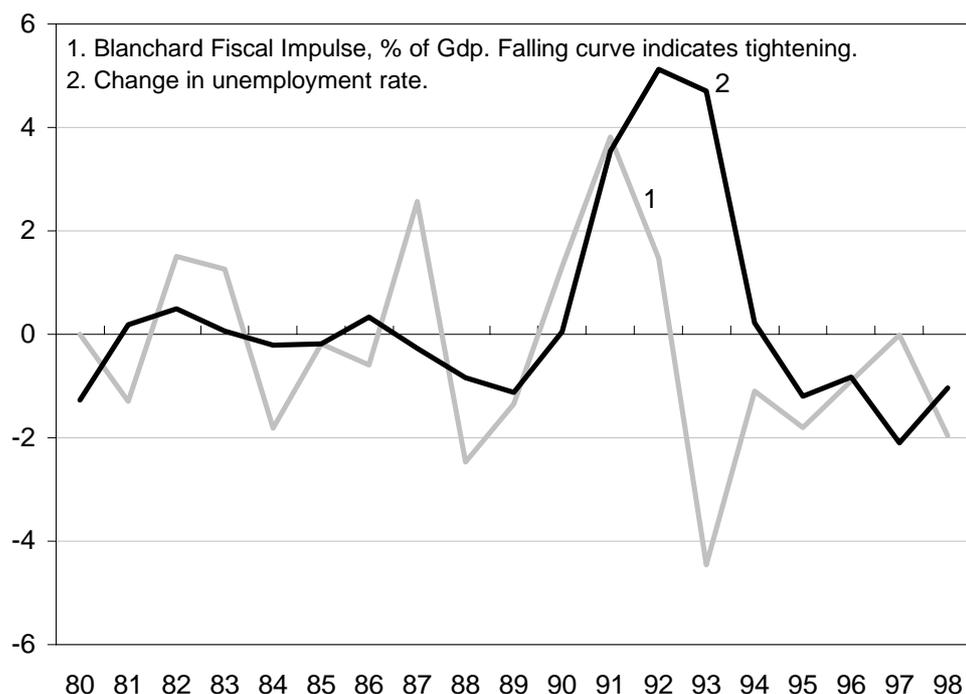
Figure 3.16. Central government debt /GDP ratio and deficit



For the purpose of measuring the stance of fiscal policy we define the fiscal impulse as the discretionary change in the budgetary position of the government excluding financial transactions. If the focus is on the discretionary changes in fiscal policy, the benchmark for any year can be assumed to be the

previous year. Blanchard has suggested an attractive way of measuring discretionary fiscal policy.<sup>46</sup> The interpretation of the change in fiscal stance is then the following: fiscal policy is 'loose' ('tight') if the difference is positive (negative). Figure 3.17 describes the Blanchard fiscal impulse measures as a share of GDP together with a change in unemployment rate.

Figure 3.17. *Indicator of fiscal policy and change in unemployment*



Looking first at the period of overheating it is seen that by the Blanchard measure fiscal policy was expansionary in 1987 but slightly restrictive for two years 1988 - 1989. Qualitatively, the growth contribution of public consumption and investment tells a similar story with some fiscal tightening in these two years. In the 1991 discretionary fiscal policy was countercyclical, while in 1992 it tightened a bit despite the increase in unemployment. Unemployment continued to increase in 1993 - 1994 but discretionary fiscal policy remained tight particularly in 1993. While bank support and automatic stabilizers have acted as expansionary fiscal components, cuts in government expenditures and increases in tax rates particularly during 1993 have had a contractionary effect

<sup>46</sup> The idea is to estimate what government outlays and revenues would be in a given year if the unemployment rate had remained the same as in the previous year. The Blanchard fiscal impulse measure is then constructed as the difference between the unemployment-adjusted measure of the primary deficit and the previous year's primary deficit. For a general discussion of measures of fiscal stance see Alesina and Perotti (1995).

on the economy. This interpretation is reinforced by the strongly negative growth contribution of public consumption and investment in 1993, as shown in Figure 3.3. This leads to our conclusion that fiscal policy decision making during the depression was not consistently designed as counter-cyclical smoothing policy.

In Spring 1995 a new government was formed and from the start it formulated a programme of fiscal consolidation. This has gradually led to smaller deficits, so that with the current GDP growth the central government indebtedness has started to decline. Over the period 1995-98 the discretionary fiscal policy has sometimes been procyclical, sometimes countercyclical with no consistent pattern. The impulses have been small which is natural since fiscal consolidation, and not active stabilization policy, was the primary objective of the government. This programme has been successful (see Figure 3.16).

As a general conclusion for fiscal policy it is evident that the Finnish picture is not very clear-cut (see Figure 3.17). In the boom it was only weakly counter-cyclical, and in the depression its directions seem to have been fluctuating in a somewhat inconsistent manner. The big deficits and the shoot-up of the public sector indebtedness during the crisis were quite remarkable as a result of the huge rise in unemployment and bank support. In such a crisis the policy-makers face the difficult problem of identifying the permanence of the shocks to the economy. In the case of Finland the shock coming from the collapse of trade with former Soviet Union seemed at least semi-permanent, but the other shocks appeared as basically cyclical.

Another lesson for fiscal policy emerges from the most recent times, namely the difficulties in restoring budgetary balances after the crisis. Despite the strong growth since 1994 the central government has run sizeable deficits.<sup>47</sup> This is partly due to the fact that that - as we argue later on in section 3.5 - structural unemployment increased during the crisis years, and this apparently made economic growth less effective in alleviating budget deficits.

### **3.4.3 A Brief Comparison to Swedish Policies**

It is of interest to briefly compare macroeconomic policies in Finland and Sweden. The policy approaches showed some interesting differences even though the two countries experienced similar crises.

Starting with monetary and exchange rate policy, it is evident that its general features in Sweden have been similar to the Finnish ones in the post-war period. Sweden also experienced periodic inflationary pressures and

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<sup>47</sup> The seriousness of the issue is better seen after noting that the EMU-defined deficit of 2-3 percent of GDP includes a surplus of the pension system which is around 4 percent.

devaluations in 1950's –70's, and in the 1980's it attempted to resolve this "devaluation cycle". Though the financial deregulation led to somewhat less pronounced overheating and did not create as big external imbalances as in Finland (cf. Section 3.2), the Swedish krona also had to be floated in 1992 after which it depreciated significantly. A floating regime for Sweden has continued to the present, as Sweden decided to stay out of the EMU and also the ERM-2.

As for fiscal policy may be noted that, as shown in Box 3.1, public deficits as percentage to GDP were bigger in Sweden during the acute crisis in 1991-93. Also during the recovery the Swedish deficits have been somewhat higher than the Finnish ones. Thus, while we have not calculated measures of the stance of discretionary fiscal policy for Sweden, looking at the deficits in the 1990's crisis Swedish fiscal policy would seem to have been more consistently countercyclical than the Finnish one.

### 3.5 Unemployment: the Remaining Challenge

Eventhough since the beginning of 1994 economic growth in Finland revived, this led to only a relatively small decrease in unemployment rate (see Figures 3.1 and 3.3). This development is puzzling, and it is important to understand the nature of unemployment in order to develop appropriate remedial policies. Understandably, part of the increase in unemployment during the depression has been cyclical i.e. it will be cured by the resumption of economic growth. However, to the extent that unemployment results from some structural malfunctions, attempts to reduce unemployment by growth-enhancing fiscal and monetary policies are bound to fail, possibly resulting only in higher inflation and/or increased foreign indebtedness.<sup>48</sup> In this section we study the nature of unemployment in Finland and argue that its structural component increased significantly during the crisis.

To this end we adopt a standard open economy model of the labor market and the current account to evaluate how the equilibrium unemployment has developed in the 1990s. The 'benchmark model' is extended to allow for financial considerations and thereby a bridge is built between the analysis of structural unemployment and the financial crisis.

Our approach to the estimation of equilibrium unemployment is more 'structural' than the most commonly used single-equation Phillips-curve type models.<sup>49</sup> The view that higher unemployment in Finland in the 1990s reflects a rise in

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<sup>48</sup> See e.g. Wyplosz (1994) for a good discussion about the nature of unemployment.

<sup>49</sup> Elmeskov (1994) gives a detailed account of how the Phillips curve approach works and present estimates of the equilibrium unemployment for OECD countries. His data does not, however, cover the 1990s.

equilibrium unemployment does not lie in contradiction with these simple Phillips curves. However, the single-equation Philips curve estimates can be criticized for a number of reasons: They do not account for open economy aspects, they completely abstract from financial considerations which might be important when evaluating the nature of unemployment, and they are 'black-box' in nature. In particular, with simple Phillips curve models it is not possible to trace the changes in equilibrium unemployment to underlying factors. These limitations led us to attempt a structural approach.

### 3.5.1 Structural Unemployment and Financial Factors

Our framework utilizes the ideas presented in e.g. Layard, Nickell and Jackman (1991), where both labour and product markets are assumed to be characterized by imperfect competition. If the real wage desired by wage-setters is the same as that desired by price-setters, then inflation will be stable at the intersection of wage- and price-setting schedules. The variable bringing about this consistency is the level of unemployment, which affects the wage mark-up and (indirectly) the price mark-up. In a closed-economy framework inflation will be stable when unemployment is at the equilibrium level.

Earlier we emphasized the role of financial factors both in the boom and bust of the Finnish business cycle. To evaluate their role in the development of structural unemployment we incorporate them as potential factors affecting wage and price setting.

To deal with equilibrium unemployment in open economies one has to introduce the current account equation, see e.g. Layard, Nickell and Jackman (1991). The latter is particularly important since it gives a second condition for the equilibrium unemployment, in addition to the non-changing inflation (or wage inflation) rate. Next we give a more detailed description of the equations of the adopted framework.<sup>50</sup> Box 3.5 describes some formal details.

#### Box 3.5. *Elements of equilibrium unemployment*

For the wage-setting schedule we adopted the following equation for the (log) of the real wage rate.

$$w - q = \alpha_0 + \underset{(+)}{\alpha_1} lp + \underset{(+)}{\alpha_2} t + \underset{(-)}{\alpha_3} u + \underset{(-)}{\alpha_4} \Delta^2 q + \underset{(+)}{\alpha_5} b + \underset{(-)}{\alpha_6} tp + \underset{(-)}{\alpha_7} indebt \quad (1)$$

<sup>50</sup> The price and wage setting equations presented below do not allow for possible hysteresis in unemployment. Econometric experiments (not reported but available on request) did not support this notion for Finland.

where  $w$  = the nominal wage,  $q$  = the price of industrial production,  $lp$  = labour productivity,  $t$  = the total tax wedge,  $u$  = unemployment rate and  $\Delta^2 q$  is the change in the inflation rate (the inflation 'surprise')<sup>51</sup>,  $b$  = benefit-replacement ratio,  $tp$  = progression of income taxation and  $debt$  = household indebtedness. The signs below the equation indicate the priori anticipations about the directions of the effects. It is to be expected that an increase in the the labour productivity, the tax wedge and the benefit-replacement ratio lead to higher real product wages, while unemployment and inflation surprises have a dampening effect on them. A rise in tax progression is expected to work like a higher tax on wage increases (see e.g. Lockwood and Manning (1993) and Koskela and Vilmunen (1996)). Finally and importantly, we have introduced a potential financial factor. The higher is the indebtedness of the households (members of the trade unions) the higher is the utility loss associated with becoming unemployed. It can be shown that this leads to wage moderation and tends to decrease structural unemployment.<sup>52</sup>

As for the price-setting schedule the following specification was adopted

$$q - w = \beta_0 + \beta_1 (q - w)_{-1} + \beta_2 (y - y_0) + \beta_3 s + \beta_4 \Delta^2 q + \beta_5 lp + \beta_6 c + \beta_7 r + \beta_8 debt \quad (2)$$

$\begin{matrix} & (+) & (?) & (+) & (+) & (-) & (?) & (+) \\ & & & & & & & \end{matrix}$

where  $y - y_0$  = deviation of domestic demand (and output) from a "normal" level,  $s$  = the sales tax rate,  $c$  = the real exchange rate (competitiveness using consumer prices),  $r$  = the real interest rate and  $debt$  = the indebtedness ratio of the firms. The signs below the price equation indicate hypotheses that, together with the sluggish price adjustment, sales tax and inflation surprises have a positive effect. The effects of domestic demand and the real exchange rate on the price-wage mark-up are a priori ambiguous, while quite likely positive. Labour productivity tends to dampen the price-wage mark-up. Following Phelps (1994) the price-wage mark-up is assumed to increase with the real rate of interest since higher real interest rates leads to higher emphasis on short-run considerations in pricing.<sup>53</sup> Finally, it can be argued that when firms become more financially constrained, they care less about future and cut their

<sup>51</sup> We could not reject the hypothesis that the  $\Delta q$  variable is  $I(1)$ , which justifies the use of  $\Delta^2 q$  as a surprise variable under rational expectations.

<sup>52</sup> In the presence of transactions costs the utility loss associated with becoming unemployed is positively related to the budget share of durables. This higher cost of losing the job induces wage moderation. We use household indebtedness, measured as household debt divided by disposable income, as a measure of budget share of illiquid durables. For a more detailed argument and some cross-country empirical evidence, see Ellingsen and Holden (1997).

<sup>53</sup> This reflects the view that an increase in the real rate of interest decreases the planning horizon of firms and makes them more aggressive in pricing.

investment in market share so that mark-ups and structural unemployment increase. We use indebtedness as a proxy to financial constraints.<sup>54</sup>

To build up a connection between the deviation of output from a "normal" level and the unemployment rate we also estimated the usual Okun type equation, in which  $y - y_0$  was regressed against unemployment and its lagged value:

$$y - y_0 = \gamma_0 + \gamma_1 u + \gamma_2 u_{-1} \text{ where } \sum \gamma_i < 0. \quad (3)$$

Finally, we developed an equation for the trade account surplus (relative to nominal GDP) as a second condition for the equilibrium unemployment rate. We adopted the following specification:

$$tb = \delta_0 + \underset{(+)}{\delta_1} c_{-1} + \underset{(-)}{\delta_2} (y - y_0) + \underset{(+)}{\delta_3} (y^* - y_0^*) + \underset{(+)}{\delta_4} (x - x_0), \quad (4)$$

where  $tb$  = the trade account surplus (relative to nominal GDP),  $c$  = the real exchange rate,  $y - y_0$  = deviation of domestic demand (and output) from a "normal" level,  $y^* - y_0^*$  = deviation of foreign demand (and output) from a "normal" level,  $x - x_0$  = deviation of Finnish exports for former Soviet Union from a "normal" level.

According to (4) the trade account surplus/GDP ratio depends positively on competitiveness and foreign and former Soviet Union demand deviations from "normal" levels, negatively on domestic demand deviations from "normal" level. The foreign demand deviation variable turned out to be insignificant perhaps because of the lack of the appropriate proxy, so it was left out from the reported specification.

The system of equations in Box 3.5 was estimated by using the annual data from Finland over the period 1970 - 1994. The general performance of the equations is good, as are generally specification tests and diagnostics<sup>55</sup>. Coefficient estimates are usually significant, and in line with a priori conjectures. *The wage mark-up* depends negatively on unemployment, inflation surprise and the change in household indebtedness. The last finding is in line with the hypothesis that a rise in indebtedness increases the relative cost of becoming unemployed and thus moderates wages and tends to decrease structural

<sup>54</sup> For a detailed argument and some empirical evidence see e.g. Chevalier and Scharfstein (1997).

<sup>55</sup> We studied the stability of the estimating equations in several ways. First, we looked at the recursive time paths of the coefficient and +/-2 standard errors, the time paths of the standard errors of the equations and well as several recursive Chow tests. Not surprisingly, there were some, though not very dramatic, signs of instability. A full set of results is available upon request. See also the appendix in Honkapohja & Koskela (1999).

unemployment. Labour productivity, tax wedge, the benefit-replacement ratio and the tax progression variable increase the wage-price mark-up and thereby structural unemployment.<sup>56</sup>

As for the price mark-up labour productivity dampens the price mark-up. On the other hand, inflation surprise, sales tax, domestic demand deviation from its "normal" level, competitiveness, the real rate of interest and the corporate indebtedness have a positive effect on price-wage mark-up. The positive real interest rate effect on the price-wage mark-up lies in conformity with the hypothesis by Phelps (1994) according to which higher real interest rates make short-run considerations more prevailing in pricing behaviour. Finally and importantly, the statistically significant positive coefficient estimate for the corporate indebtedness variable supports the notion that indebtedness of firms increases structural unemployment by raising the price-wage mark-up.

According to the so-called Okun relation there is a negative relationship between the domestic demand deviation from its "normal" level and unemployment rate. In terms of trade account surplus the potential explanatory variables with the exception of the foreign demand variable were of expected sign and highly significant. Not surprisingly, the competitiveness as well as the variable describing export to the former Soviet Union and current Russia has a positive and the domestic demand variable a negative effect on the trade account surplus.

The equilibrium unemployment rate (NU) was derived from this structural model via the following procedure.<sup>57</sup> First, following usual practice we equated the real product wage from the wage and price equations. The Okun relation was then substituted into this relation and a constant rate of inflation was imposed.<sup>58</sup> Second, the definition of external balance must be formulated. Since the foreign indebtedness of the Finnish economy during the period of interest was quite high we introduced the notion of constant foreign debt to GDP ratio in place of the usual requirement of balance of trade. (In principle one could even contemplate allowance for some GDP smoothing which would result in a time-varying external debt ratio, but such refined notions are difficult to

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<sup>56</sup> We have used the so-called Musgrave-Thin residual progression  $tp = (1 - m(y))/(1 - a(y))$  as the measure of progression, where  $m(y)$  and  $a(y)$  are the marginal and average tax rates from the tax base  $y$ , respectively. This is the elasticity of post-tax income to pre-tax income, and it is less than one under a progressive system. A reduction in  $tp$  must thus be interpreted as an increase in progressivity.

<sup>57</sup> We use the term equilibrium unemployment and the short-hand NU rather than NAIRU in view of the open-economy complications. Also the terms equilibrium unemployment and structural unemployment are used interchangeably.

<sup>58</sup> See e.g. the Symposium in the Journal of Economic Perspectives (1997) for discussions of the difficulties in estimating NU.

operationalize.) This system can be then be used to compute NU as a function of exogenous variables and their lagged values. Since the lags were not eliminated, the concept of NU refers to short-run equilibrium unemployment.

On the basis of estimated equations we computed the equilibrium unemployment rate at (exogenously) specified time intervals. In the computation the exogenous variables were set at the average value for each interval. In Table 3.3. the first column describes the actual (open) unemployment rate and the second column our estimates of NU.

*Table 3.3. Estimates of NU (%)*

	Actual U	NU
1975-79	5.0	4.6
1980-85	5.1	5.3
1986-89	4.6	6.8
1990-93	10.5	6.1
1994-96	17.3	11.9

An interesting picture emerges from Table 3.3. It suggests that in the 1980s the labor force in Finland was "over-employed" in the sense that actual unemployment rate was clearly below the equilibrium unemployment rate. The reason for over-employment relative to equilibrium was in part due to current account deficit in that period which made it possible to keep unemployment temporarily below the equilibrium level. In the early 1990s the gap was reversed and actual unemployment has since exceeded its equilibrium rate by a clear margin.

Of much interest is the evolution of the equilibrium rate of unemployment. We experimented with various slightly different empirical specifications, and the estimated contributions of changes in the exogenous variables for a reported specification. The actual figures and the estimated level of equilibrium unemployment are somewhat sensitive to the specification, in particular to the treatment of dummies in the equations. Specifically, the relative estimated magnitudes of NU in the 1990's were sensitive to details of the econometric specification. However, alternative specifications suggest robustly that taxes and financial factors have raised the equilibrium unemployment during the depression years. The exchange rate also acts in the same direction. This effect stems from the influence of the depreciation on the price mark-up, which is not fully offset by its effect on the trade balance.

### 3.6 What Can Be Learned from the Finnish Experience?

It has often been argued that a financial crisis, as experienced by Finland and several other countries, leads to significant financial restraint in which both bank lending and other sources of finance are curtailed and this feeds into the real economy by weakening aggregate demand. Our econometric work with Finnish data supports this notion. Our microeconomic study on investment behavior with panel data suggests that financial factors like the profit (cash flow) are significant in firms' investment behavior and their significance tends to have strengthened with the depression years, so that the role of internal finance took added significance. In addition, the high interest rates in Finland from 1989 to the Spring of 1993 also had a clear impact on investment demand through the conventional cost-of-capital channel.

The household consumption-saving behavior was also affected by the deregulation process. In the boom the saving rate went down to almost zero, and in the depression it reached very high levels by conventional standards in Finland. The huge variations in asset prices due to changes in real interest rates in the boom-to-bust cycle were reflected in the net wealth of households, which has a strong influence on consumption according to our estimations with Finnish annual time series data. In addition to wealth effects, our study points to the influence of liquidity variables in consumption behavior, so that direct financial restraints have had a role in the fall of aggregate consumption.

Financial factors are not only important on the demand side as has been commonly argued. It has also been pointed out that the real interest rate might matter on the supply side by affecting the demand for labour, wage formation and/or the pricing behaviour by firms. Our analysis provides some, though not very strong, support for this view. But more importantly, we have identified a new channel for financial factors on the supply side, namely the effects of indebtedness on wage and price setting. Higher indebtedness leads to wage moderation since the loss of becoming unemployed increases, while firms tend to increase their mark-ups. The former effect tends to lessen, while the latter effect tends to raise structural unemployment. We argued in Section 3.5 that this channel has been important in Finland in raising the level of 'structural unemployment' in the 1990's. As a result of the rise in structural unemployment the recovery of the Finnish economy has alleviated unemployment surprisingly slowly and thereby government budget has been in deficit all the time until now.

Our analysis and interpretation of the reasons behind the Finnish depression of the 1990's can be aptly described by the summary "bad luck and bad policies".

We begin with the external shocks, exogenous to the economy and in this sense unavoidable. The collapse of trade with former Soviet Union in March-April 1991 is the most obvious shock, but two other important international

developments can also be identified. First, in the second half of 1980's the Western economies experienced a strong business-cycle upswing, which showed up as a considerable increase in the terms of trade. Second, the recession in the Western market economies in the beginning of 1990's and the high interest rates due to the policy mix between monetary and fiscal policy associated with German unification were additional negative external shocks.

Clearly, the external shocks played a significant role in the Finnish boom-to-bust process - this is the "bad luck" part of the short summary. However, in our view they are far from being the whole story, though our analysis has not systematically attempted to quantify the relative significance of the shocks. If there had been no additional factors, Finland would have experienced a recession but not a depression.

We have argued that Finland (and to some extent Sweden) experienced a classical financial crisis, which was similar to crises in a number of countries so different from Finland and Sweden as Mexico, Chile, Korea, Malaysia and Thailand. Problems originated from a badly designed deregulation of the financial system. Lifting domestic interest rate controls, allowing the private sector to borrow freely from abroad and sticking to the fixed exchange rate lead to a lending boom at home and from abroad in foreign currency terms.<sup>59</sup> In the case of Finland this lending boom was made worse by an unreformed tax system favouring debt finance and unchanged bank regulation. For all these reasons the private sector became financially very vulnerable to changes in interest rates as well as in the exchange rate.

A situation of financial vulnerability has the implication that when the turnaround happens and/or currency starts to become subject to speculative attacks, only bad alternatives are available to policy-makers. Defence of the value of the currency leads to tightening of monetary policy which, via increases in domestic interest rates, hurts the domestically highly indebted private sector. In contrast, devaluation of the currency as an instrument to alleviate weakened competitiveness of the export sector, is effectively a capital levy to that part of the private sector which had borrowed in foreign currency terms. Both of these policy choices at the downturn are grim for a country entering the crisis, and Finland was no exception to this in the beginning of 1990's.

Failure to reform regulatory schemes of the financial markets and the decision to leave tax system unchanged in the process of financial deregulation were clear policy mistakes in Finland. Evidently, one lesson is that financial market deregulation should not be carried out in isolation, but it must be tackled with

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<sup>59</sup> The reports by the three foreign experts of the Bank of Finland also emphasize this a great deal and point out that there was no clear overall strategy for financial deregulation, see Bordes et al (1993).

the reform of the tax system and tightened bank supervision. These measures would mitigate the domestic and foreign lending boom which stem from deregulation.

Next we discuss macroeconomic policies, which in Finland contributed to fluctuations in the financial system and thereby affected both cyclical and structural unemployment, i.e. consumption, investment, and wage and price setting.

Looking first at monetary and exchange rate policy, we argued in Section 3.4.1 that the strong Markka policy was misguided at least twice. The failures of exchange rate and monetary policy suggest another lesson. When the financial deregulation starts, there is a tendency for the external value of the home currency to appreciate due to the huge capital inflow and to the fact that usually – as e.g. in Finland - fiscal policy does not offset the demand-augmenting effect of the capital inflow. To mitigate overheating coming from financial deregulation and liberalization of capital movements one should let the currency float (and most likely appreciate at least initially). When the turnaround starts to happen the financial system would then be less fragile and thereby the authorities would have better alternatives to deal with evolving problems.

An early floating of the currency appears to be an appropriate complement to policies for financial deregulation. If the currency is not floated as part of the deregulation phase, then the exchange rate cum monetary policy alternatives seem all bad. The monetary policy becomes ineffective; in fact an attempt to fight boom leads to higher capital inflow thus making the financial system even more fragile if and when investors think wishfully that the likelihood of exchange rate movements is very small. Moreover, currency depreciation via floating seems necessary after the boom is over and the competitiveness has deteriorated. After the floating credibility of monetary policy can be improved by setting a clear domestic target, such as an inflation target. If it is not set very tightly, monetary policy should contribute to the recovery as inflation will normally not be a problem in depression.

As for fiscal policy we argued in section 3.4.2. that the Finnish picture is not clear-cut. While the discretionary part of fiscal policy was weakly countercyclical during the boom it become very tight in 1993. More generally, it is difficult to find a clear pattern in its discretionary component. As was pointed out, Sweden appears to have been more systematic in this respect.

For fiscal policy the general lessons from the Finnish experience are in principle straightforward. First, restrictiveness should complement any financial liberalization phase to mitigate the boom. Second, if a crisis and depression nevertheless emerges, big deficits and a rapid shoot-up of the public sector indebtedness are to some extent inevitable. This development makes it

imperative to pursue a program of fiscal consolidation at some stage of a major crisis. This increases credibility and thereby lowers domestic interest rates and paves the way for recovery. Its timing is the major difficulty. The timing of policies hinges on the nature of the impulse shocks. If they are basically cyclical in nature, a policy of fiscal smoothing appears natural. Then the economy must live with fairly sizeable public deficits and some build/up of public debt. However, if shocks are deemed permanent or semi-permanent, the fiscal adjustment should not be delayed too long.

Finally, the Finnish experience with rising unemployment poses a major challenge for policy during the recovery phase. Our analysis suggests that a financial crisis and the depression can significantly increase the level of structural unemployment via tax increases, high indebtedness of firms and the exchange rate depreciation. If our view is at all correct, then measures to alleviate structural unemployment are an important part of the economic policies during the recovery from a major financial crisis and macroeconomic depression.

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## 4 Did the Crisis Change the Welfare State in Finland?

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### Abstract

Finnish researchers have had varying interpretations on how the recession of the 1990s affected the welfare state. When the recession was at its deepest, these views were downright apprehensive. After the economic recession, these interpretations changed and became relieved or even triumphant: the Finnish welfare state coped well with the recession and endured without any major changes. At the turn of the millennium, the triumph seems to be changing into doubt again: unemployment persists, income differences grow, cuts in social security have come to stay, and underprivilegedness accumulates. In this article, we concentrate on the long-term consequences of the recession. From that point of view recessions are larger and farther-reaching phenomena than economic upturns and downturns. They were in the 1990s followed by long-standing recessions in employment and social policy, which still shadow the horizons of the Finnish welfare state.

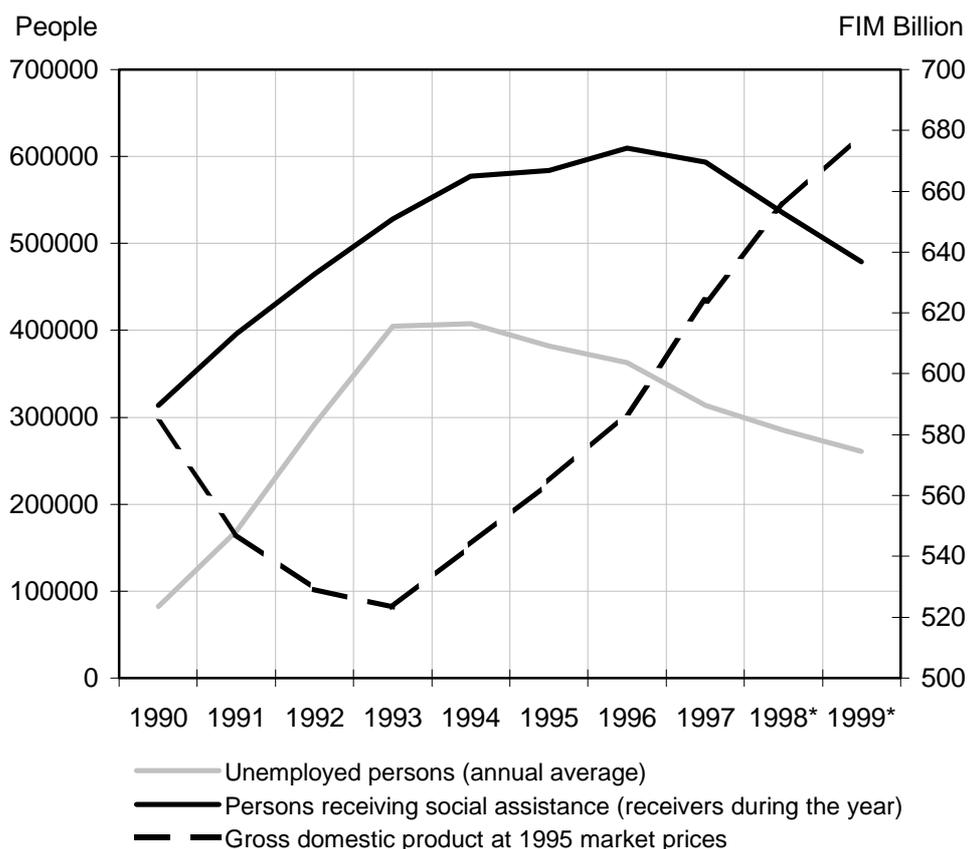
### 4.1 The Three Phases of Recession

In Finland, the welfare policy aimed at narrowing down income differences and expanding social services and welfare until the 1990s, when this development was stopped by the recession. Among the central factors that led to the recession and its deepening in Finland were the liberating of financial policy without sufficient economic and political control, the supporting of banks in difficulties without political control, stable-mark policy which delayed the implementation of devaluation, and heavy cuts in social policy. (see e.g. Honkapohja & Koskela, in this volume).

Finnish researchers have had varying interpretations on how the recession of the 1990s affected the welfare state. When the recession was at its deepest, these views were downright apprehensive. It was doubted if "anyone at all has the courage to foresee the culmination point of this development"; suspected that "the pot to be split seemed to slip through the fingers"; and that there would

be "a change of an era in the Finnish welfare state model" (Heikkilä 1993; see also Heikkilä et al. 1993; Soininvaara 1994, 290). After the economic recession, these interpretations changed and became relieved or even triumphant: the Finnish welfare state coped well with the recession and endured without any major changes (Heikkilä & Uusitalo 1997; Hjerpe et. al. 1999); it was said to be a Nordic survival story (Kautto & Heikkilä 1998). At the turn of the millennium, the triumph seems to be changing into doubt again: unemployment persists, income differences grow, cuts in social security have come to stay, and underprivilegedness accumulates (Heikkilä & Karjalainen 2000, 7-16; Lehtonen & Aho 2000). Some authors see it worthwhile to call the present phase in welfare state development "a change of course" in a pessimistic, critical tone. (Julkunen 2001). Evaluation still seems topical, even though we are living in the eighth post-recession year of fast economic growth.

Figure 4.1. *The Three Phases of Recession: GDP, the Unemployed and the Social Assistance Receivers 1990 - 1999*



Sources: Statistics Finland (GDP and the unemployed) and the Ministry of Social Affairs and Health (social assistance receivers).

In the following, our starting point is that recessions are larger and farther-reaching phenomena than economic upturns and downturns (Peltola & Parikka 1998; Lehtonen et al. 1999, 31). In Finland, the economic downturn in the 1990s was followed by recessions in employment and social policy (Figure 4.1).

The recession started as an economic slump which caused persistent unemployment that was to last considerably longer than the economic recession, and resulted in social security expenditure remaining at a high level after the economic recovery. The economy, especially the private sector, recovered quickly from the recession. The economy started to grow as early as 1994, and the pre-recession level was reached in 1996. Unemployment started to increase along with the economic recession, but despite starting to decrease steadily from 1994, it remained high, and the unemployment rate had not come even close to the pre-recession situation at the end of the decade. The number of social assistance receivers increased until 1996; and the development was essentially affected by tightened conditions of access. (Lehtonen 2000, 15-27).

Due to the long shadow cast by the recession, the question of its consequences becomes topical only after there is economic leeway for restoring social security at the pre-recession level. This is revealed in the recent political debates about income differences, poverty, and services for elderly people, for example. In this article, our purpose is to examine if the Finnish welfare state and the welfare state model changed in the 1990s. We look at the issue from the point of view of changes in the economic foundation of the welfare state, in employment, and in social policy.

## **4.2 The Economic Foundations of the Welfare State**

Mass unemployment caused by the recession drove the welfare state into financial difficulties. The Government reacted by increasing borrowing, by adjusting taxes, and by cutting public expenditure.

The Keynesian solution would have been to emphasise borrowing and thereby to increase total demand. In Finland, general government debt increased, but remained considerably lower than in Sweden, for example (Eurostat 2000, 48)<sup>60</sup>. As a result of the recession, general government debt, in other words the so-called EMU debt, increased from over 10 percent in 1990 to 58 percent of GDP by 1994, but decreased by the year 2000 to 44 percent.

The socially justified solution would have been to raise taxes; in that case, those who were able to keep their jobs as well as companies would have been the ones to carry the burden. The gross taxation rate went up in the recession years

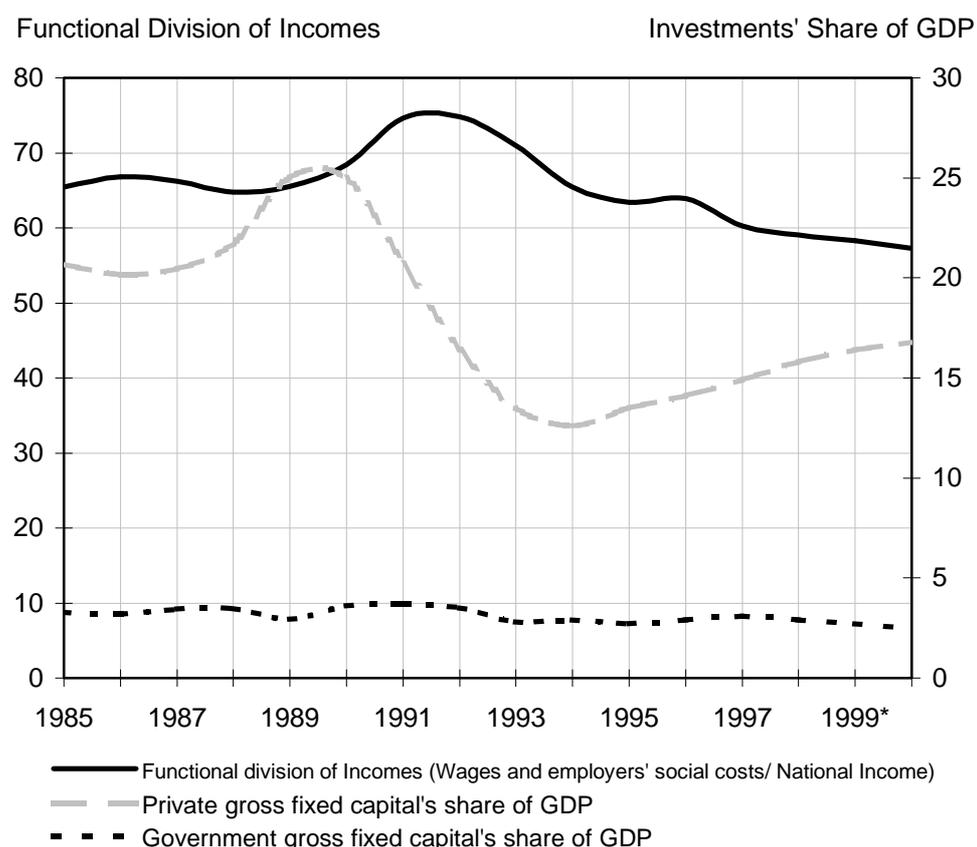
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<sup>60</sup> The figures deviate slightly from those calculated by using current methods of assessment.

only by a little more than one percentage point. The clearest rise took place in social security contributions all the way until 1994, after which their share of GDP has returned to the pre-recession level (Statistics Finland). In these contributions, wage and salary earners' proportion was increased and employers' proportion was decreased. (Lehtonen & Aho 2000, 107, 108). On the other hand, the wage development in the 1990s was moderate, which reflected an attempt to secure the competitiveness of industry and jobs. In the Finnish labour market model, taxation and income policies are indeed closely interlinked with each other.

In Finland, serious cost cuts in education, health care and social security were made, which was damaging especially for the underprivileged (Lehtonen & Aho 2000). The cuts were extensive and were not yet been taken back by 2001.

Figure 4.2. *Functional Division of Incomes Against Investments' Share of GDP in Finland in 1985 – 2000, %*



Source: Statistical Yearbook of Finland 1988-2000.

The general economic effects can be assessed, for example, by looking at the so-called functional division of incomes, which describes how large a proportion

of national income ends up in the pockets of wage and salary earners and income transfer receivers, and how large a proportion in the pockets of capital. The proportion of capital increasing, the financing of the welfare state becomes difficult, because the proportion of capital generates less tax revenue than the proportion of work. On the other hand, along with increasing profits, it could be assumed that willingness to invest would grow. In general, the greater the willingness to invest, the more new jobs are created. Improved employment would then facilitate the financial situation of the welfare state (Figure 4.2).

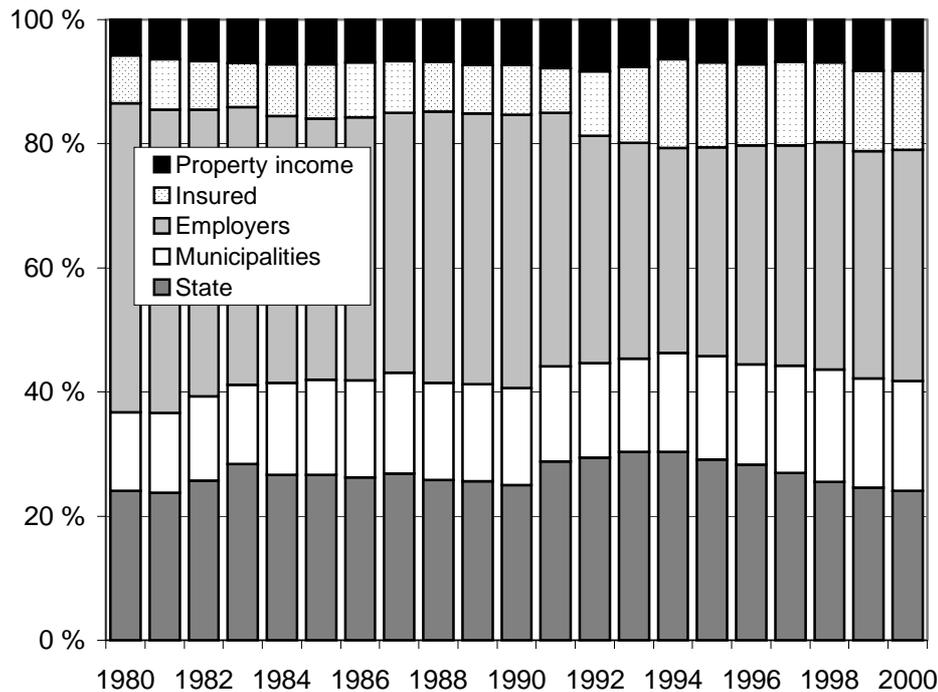
The figure shows, however, that the investment rate has remained low at the same time as the division of income has taken an exceptionally favourable turn from the capital point of view. Part of the explanation for the low investment pace can probably be found in the internationalised economy. The investment rate in Finland has been exceptionally high, and has only after the economic recession come down to the European level (Pohjola 1998, 298). The development of investments is no more as dependent on the increase in capital gains as before (*ibid.* 302). Profits gained in Finland have in the 1990s been invested abroad more than before (*ibid.* 307). Companies systematically reduced their dependency on the faltering bank sector by paying off the debts taken in the 1980s. In this regard, the public sector has followed a very similar policy as households and the entire national economy.

Behind the change in the functional division of income lie the recession, devaluation, the moderate wage development and the exceptionally fast-growing productivity of work. Sauramo (2000, 31 - 32) points out, however, that the change seems to have remained more long-term than could be expected on the basis of these factors (on the interpretation of the functional division of income, see also Pohjola 1998, Sauramo 1999). According to Sauramo, the permanence of change in the division of income is explained by low pay raises. Also internationally assessed, the proportion of wages and salaries of GDP has been decreasing. The global wage competition partly underlies the phenomenon; in Sauramo's opinion, however, the reasons behind the development in Finland are domestic. (Sauramo 2000, 26). He says that it has been typical of Finland for long to aim for investment-driven growth by reducing wage and salary earners' purchasing power. (Sauramo 1999). He also argues that wages should rather be increased to correspond to intensifying production. Investment-driven policy led to inefficient production in terms of return for investment, the discarding of which during the recession explains the enormous growth pace of productivity.

The recession and weakening positions of wage and salary earners indicated by the change in the functional division of income were visible in people's everyday life. At the household level, difficulties in earning one's living became more common during the recession. In many families, too extensive borrowing was linked with the weak labour market situation. Also, the pockets of the

employed were hit as well. The social security contributions were increasingly transferred from employers to employees, which meant a structural change in the division of financial responsibility in the welfare state: greater financial responsibility was accorded to clients, individuals and families (Figure 4.3.).

Figure 4.3. *Social Expenditure by Source of Finance in Finland, 1980 – 2000, %*

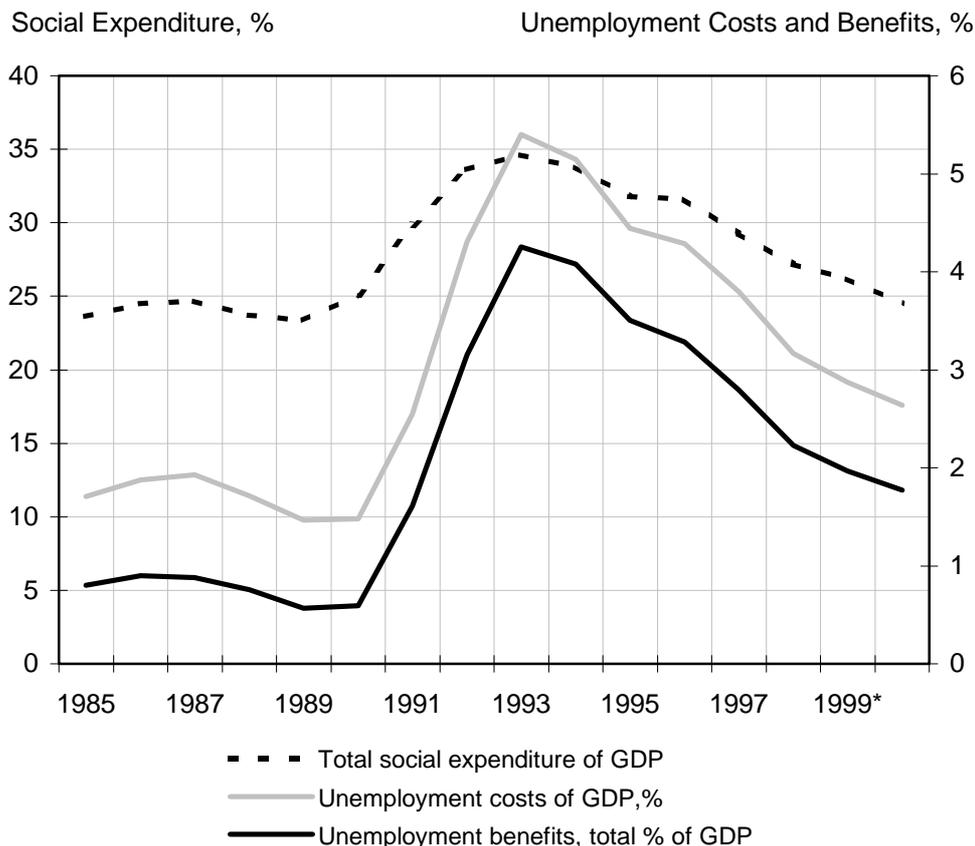


Sources: Statistical Yearbook of Finland 2000; Sosiaaliturvan suunta 2000-2001, Ministry of Social Affairs and Health, Publications 22/2000, Appendix 1.

By the turn of the millennium, the national economy had gained balance and debt had begun to decrease. This has not, however, led to the restoration of the welfare state's resources at the pre-recession level. The competitiveness of industry is secured by moderate pay raises. Wage and salary earners' purchasing power is being increased by lowering taxes, which in a way continues the cutting policy of the 1990s. This time, the increased incomes of the state are cut, not the increased expenses as earlier: the tax collector has been made to pay a part of the wages. By increasing capital income and knocking the bottom out of income transfers this policy supports the growth of income differences. In addition to aiming for investment-driven growth, this taxation policy is perhaps explained by tax competition with other EU countries (e.g. Uusitalo 1999b).

The recession raised unemployment and social security costs at a fast pace, which meant an increase in total social security expenditure from 25 percent to 35 percent of (decreased) GDP. The GDP proportions of social and unemployment costs took a decreasing turn as early as 1994. At the end of the 1990s, the proportion of social costs got closer to the pre-recession level. Unemployment costs also followed reversely general economic development, although in 1998, the proportion was still double compared with the year 1990 (Figure 4.4). The relative decrease of social and unemployment costs did not take place because of the corresponding decrease in the number of benefit receivers but mainly because of the cuts in benefits and of the growth in the relative proportion of minimum benefit receivers; and correspondingly, because of the decrease in the proportion of higher earnings-related benefit receivers. We will take a closer look at this later.

Figure 4.4. Social Costs per GDP 1985 – 2000, %

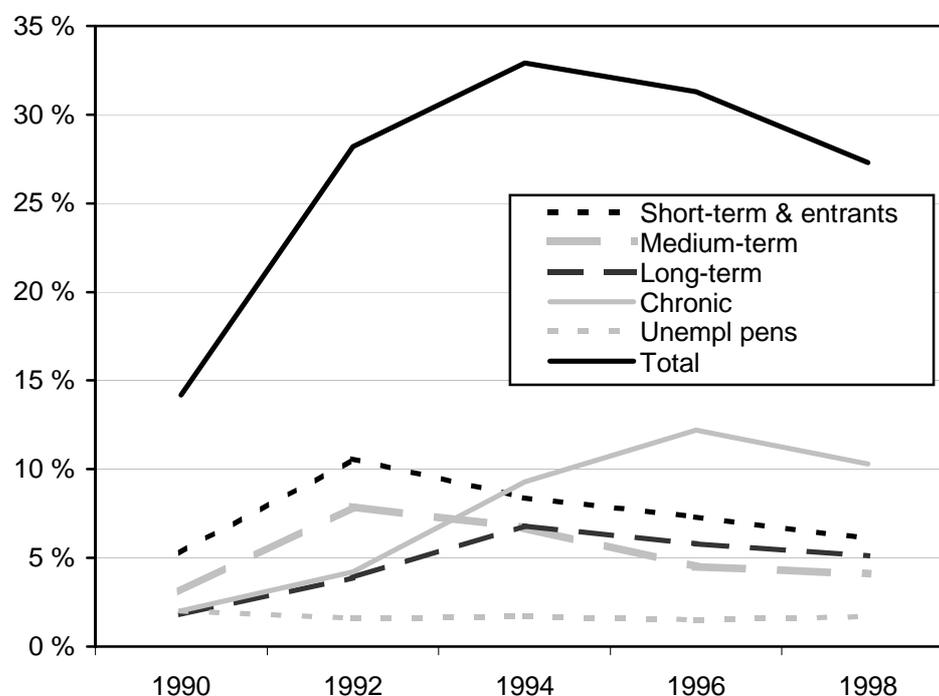


Source: Statistical Yearbook of Finland 2000; Sosiaaliturvan suunta 2000-2001, Ministry of Social Affairs and Health, Publications 22/2000, Appendix 1.

### 4.3 Unemployment and Labour Market Policy

In addition to a dramatic increase in unemployment, the recession was followed by a change in the unemployment structure, when long-term and repeated unemployment became essentially more common. Conventional unemployment statistics do not provide any clear information on the extent of the problem. The following Figures 4.5 and 4.6 are based on Aho's calculations, in which the annual flow of the unemployed (those having at least some unemployment experience during the current year) has been categorised on the basis of four previous years' work and unemployment history (on the data and classification criteria, see Appendix).

Figure 4.5. *Unemployment Types of Labour Force (Annual Flow) 1990 – 1998, %*

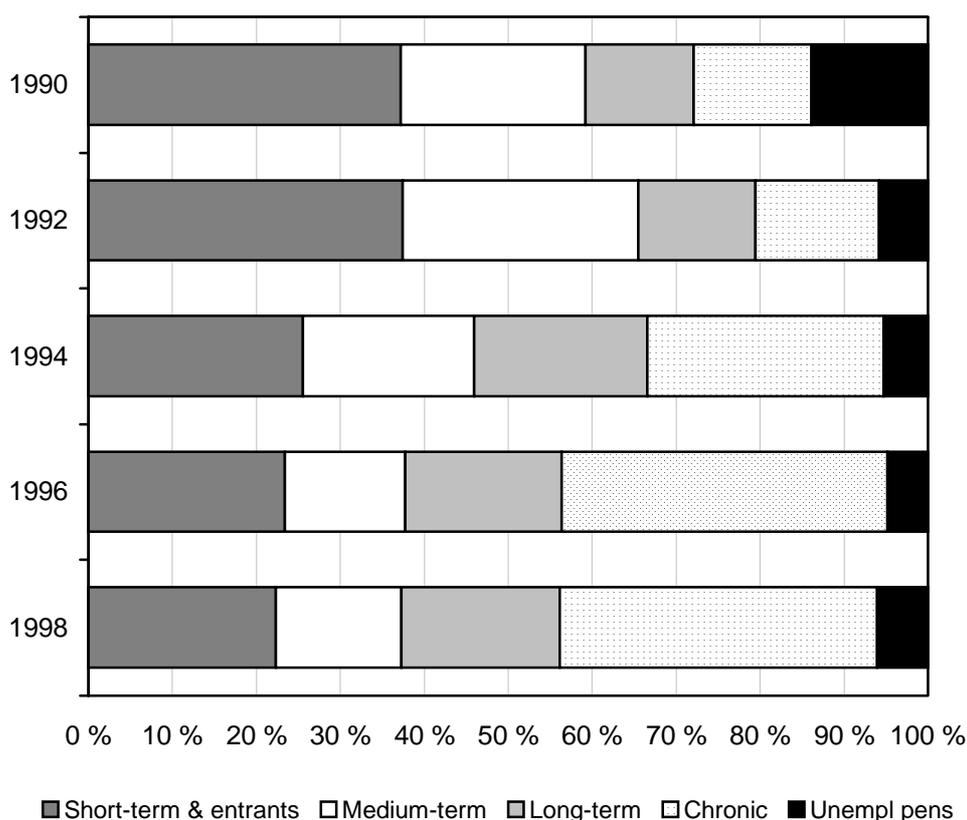


Source: Aho's calculations. Typology is based on employment histories during previous four years. (See Appendix).

In 1990, unemployment concerned directly 14 percent of the labour force (the combined proportion of the unemployed during the year and those on unemployment pension). In the worst year of unemployment in 1994, the corresponding proportion was as high as 33 percent. In 1998, the proportion had decreased to 27 percent, approximately to the level of the year 1992. Short- and medium-term unemployment increased naturally fast during the recession years, but had by 1998 gradually decreased back to the level only a little higher than in 1990. However, some victims of the recession were not able to

reestablish their position on the labour market and became persistently unemployed. The added proportion of the long-term and chronically unemployed reached its peak – 18 percent of the labour force - in 1996, and has decreased slowly since; in 1998 it was 15 percent of the labour force, which was four times higher than in 1990. When the proportion of unemployment pensioners (about 2% through the period) is added to these figures, we get an estimate of structural unemployment in Finland. (Figure 4.6.)

Figure 4.6. Structure of Unemployment (Annual Flow) in 1990 – 1998, %



Source: Aho's calculations. Typology is based on employment histories during previous four years. (See Appendix).

The structure of the unemployment issue has changed essentially along with the recession in Finland. Of the annual flow of the unemployed, a total of 41 percent were among the long-term and chronically unemployed and among those on unemployment pension in 1990. The proportion first decreased during the recession years, as a great number of those who earlier had a stable job became redundant; then, the proportion grew fast and continued growing until 1996, when it was as large as 62 percent. In 1998, the proportion still remained the same. The proportion of the chronically unemployed in particular (none or

very little open-market employment during the last four years) has grown (Figure 4.6.). While there are not only more unemployed in Finland now than before the recession, but also the majority of them seem to be more or less permanently excluded from the open labour market; the problem does not seem to be disappearing despite the improving employment situation.

In dealing with the unemployment problem, the role of active labour market policy has expanded since the 1970s. The measures include labour market training and subsidised jobs in the public and private sectors, and start-up grants for the unemployed starting their own business, for example. During the 1990s, their annual volume was doubled. Table 4.1 shows how significant the role of these measures was.

*Table 4.1. Participation in Active Labour Market Policy Measures  
1990 – 1998, %*

	1990	1992	1994	1996	1998
Participants of the labour force					
- at the end of the year	2	3	3	4	3
- during the same year	5	8	9	10	10
- during the past four years	9	12	17	20	20
Participants of the unemployed					
- during the same year	32	27	29	32	33
- during the past four years	44	38	46	52	56

Source: Aho's calculations, see Appendix.

In the ideology of the Finnish welfare state, the pursuit towards full employment has always been ranked high. The employment law of 1971 obliged the state to promote the demand for labour and implement labour market policy measures that help the demand and supply of labour to balance. In 1972, the Finnish Constitution was amended as follows: "if needed, it is the task of the state authorities to arrange for the citizens of Finland an opportunity to work". In spite of this, the Finnish state, in practice, was not as committed to achieving full employment as were the other Nordic countries. In the 1980s, however, this commitment became clearly stronger, which can be seen both in the legislation and in practice.

The employment law of 1987 defined full employment as the goal of the state, and made public authorities responsible for arranging training or subsidised employment (typically for six months) for the young unemployed and the long-term unemployed. Thus, a kind of universal social right to (temporary) employment was created. Quite soon, however, a considerable revision of the principles of the Finnish labour market policies was started.

First, with the fast-increasing long-term unemployment, it became impossible to fulfil the job guarantee, and it was abolished in 1993. While high unemployment turned out to remain persistent despite the start of a considerable economic growth after 1993, “benefit dependency” and “incentive traps” became big issues.

In 1994, the unemployment compensation system was reformed by introducing a new form of benefit, called a “labour market support”, for those not fulfilling the employment condition for unemployment insurance or having received the maximum period of unemployment benefit.<sup>61</sup> This benefit is means-tested and flat-rate. The level of the benefit is so low that its receivers must often also apply for social assistance.

In 1996, the Government implemented a programme of small reforms in various social security systems, social assistance norms, income taxation, and children’s public day-care-fee policy in order to make employment – even temporary or low-income – always profitable in comparison with living on social security. The conditions of unemployment insurance were also tightened. This was motivated by the fact that especially subsidised employment in the public sector was not effective in facilitating later employment on the open labour market, but seemed rather often to be used as a means to gain or renew the right to the earnings-related unemployment insurance benefit. After the reform, a period of subsidised employment has alone not been sufficient in fulfilling the employment condition any longer. Already from 1994 on, offering subsidised jobs for the young has increasingly been replaced by “apprenticeship with labour market support” (i.e. without wages and formal employment relationship). In addition, after the reforms of 1996-97, the right to the labour market support for under 25-year-olds is gained only by applying for and starting, or completing, vocational education (Aho & Vehviläinen 1997).

The reform of public employment services in 1998 further increased the activation emphasis in the Finnish labour market policy (Räisänen & Skog 1998). The major elements of the reform were fixed-term interviews with job seekers, drawing up a job-search plan with the employment office, and supplying of short training courses in the art of searching for a job extensively. After partly critical evaluations (Aho et al. 2000; Arnkil et al. 2000; Malmberg-Heinonen & Vuori 2000; Tuomala 2000), a plan to continue and develop the reform has recently been published under the title “The Second Wave” by the Ministry of Labour (Työministeriö 2001a).

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<sup>61</sup> A universal flat-rate unemployment compensation system for the non-insured existed before the reform and still exists for those that fill the employment condition. However, it has been mainly replaced with the new benefit.

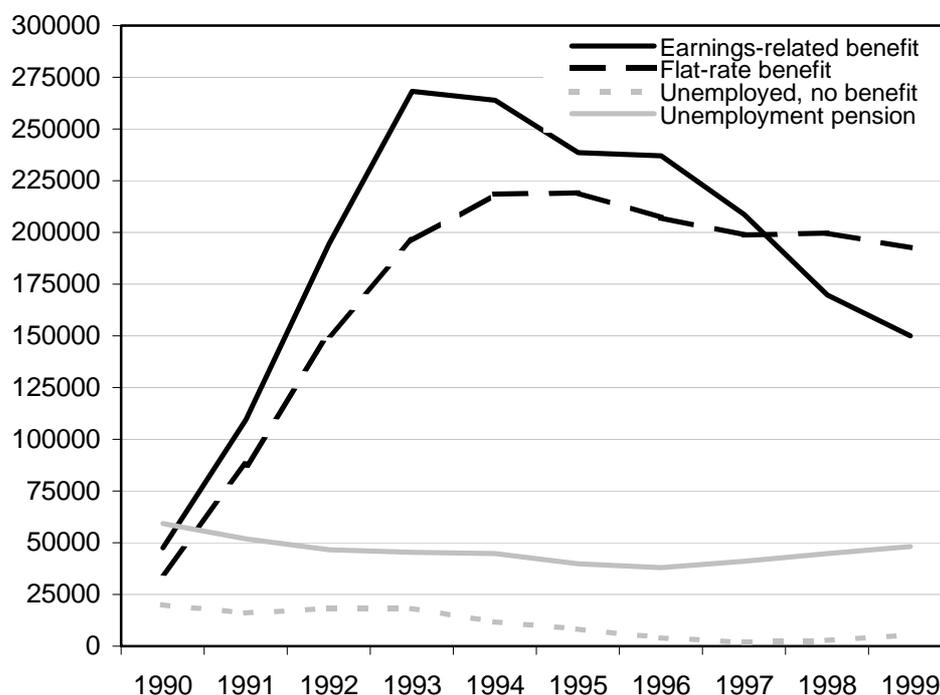
There has been an exception in the activation emphasis of the Finnish labour market policy: for the ageing unemployed, instead of active measures, an opportunity to early retirement has been provided through a rather generous unemployment pension system (Hytti 1998, Aho & Österman 1999). Since 1990, unemployment (with some other conditions) at the age of 60 has given the right to retirement with unemployment pension (earlier the age limit was even lower). However, the conditions of this opportunity were also tightened after the recession. In 1994, those not qualified to unemployment insurance benefit (who did not fill the employment condition or who had received the maximum length of benefit) at the age of 55 lost their right to the unemployment pension; in 1997, the age limit was raised to 57. Recently, in order to decrease the attractiveness of the unemployment pension, the contributions of employers were increased when employees retired on the unemployment pension, and the unemployment pension was slightly cut. Also, activating measures should be retargeted to the ageing, who earlier were largely left “inactivated”.

Finally, what effects have the labour market policies and their changes had during the 1990s? Extensive subsidised employment and labour market training have no doubt decreased open unemployment; in the 1990s, the unemployment rate was 3 to 4 percentage points lower than it otherwise would have been (see Table 4.1, above). Evaluation studies have shown, however, that participation in the measures has not notably promoted later employment on the labour market, compared with the non-participated (Aho et al. 1999; Aho et al. 2001). According to evaluations, the service reform of the year 1998 did not have any significant impacts on employment either. (Aho et al. 2000; Malmberg-Heinonen & Vuori 2000; Tuomala 2000).

Evaluation reports on the reforms of 1996 conclude that they actually were quite successful in removing “incentive traps”. The employment impacts of these reforms were small but clearly positive, however. (Niinivaara 1999; Laine & Uusitalo 2001).

Particularly subsidised employment and labour market training as well have apparently also fought off poverty and had positive social and welfare impacts (Työministeriö 2001b, 104-107). Abolishing the employment obligation in 1993 and tightening the employment condition in 1996 have no doubt weakened these impacts. These changes and the increasing of long-term unemployment caused by the recession as such have affected the fact that, after 1997, the majority of the unemployed have been among those receiving means-tested minimum unemployment security benefits (Figure 4.7).

Figure 4.7. Recipients of Different Unemployment Compensation Forms 1990 – 1999



Source: Finnish Labour Review 4/2000, Table 23.

The commitment to provide an opportunity for employment to all citizens (in the form of a subsidised job period after a certain length of unemployment) of the 1980s was replaced during the recession with a pursuit to improve “the functioning of the labour market” (Räisänen & Skog 1998; Työministeriö 2001a) and to activate the unemployed. In this respect, the Finnish welfare state has changed qualitatively. “Benefit dependence” has been repelled through tightened entitlement conditions and sanctions, and by removing “incentive traps” in a way that should promote casual employment as well. In 1995, the paragraph in the Constitution obliging the state to arrange an opportunity to work for the citizens was somewhat mitigated; it is no more “the task” but “a pursuit” of the public authorities “to secure everyone the right to work”.

Nevertheless, extensive investment in activation has not significantly reduced the persistent structural long-term unemployment originated along with the recession. There is no reason to expect that the impact of this policy would improve later either. If the demand for low-skilled labour is structurally low, as is the case in Finland, any temporary subsidised employment and conventional vocational courses seem unable to provide the crucial remedy to the problem of persistent unemployment. Apparently the attempt to solve the structural unemployment problem caused by the recession has been abandoned. An

indication of this is the most recent strategy definition of the Ministry of Labour, which gives priority to fulfilling the demand for labour. About unemployment it states that attempts will be made to shorten the average duration of unemployment and to reduce the flow to long-term unemployment. A certain concern about the least employable persons is shown in that the subsidised employment targeted to them (the so-called combined subsidy) will be increased and its maximum duration extended. Subsidised employment, however, is not enough to provide a right to receive earnings-related unemployment security. (Työministeriö 2001a.) There is cause to fear that the long-term unemployment of the 1990s will gradually be changing into the problem of the poor retired of the 2010s.

#### **4.4 Changes in Social Security**

The welfare state developed later in Finland than in other Nordic countries, and therefore, continued growing in the course of the entire 1980s, when it was said to have achieved the Nordic level. The 1990s signified a slowdown for this development, when about a hundred important cuts in social policy and social benefits were made. They concerned taxation, unemployment security, sickness insurance, medical care insurance, pension security, financial aid to students, child allowances, child home care allowance, housing allowance and social assistance (Kosunen 1997b; Huuhtanen 1998, Heikkilä & Uusitalo 1997a, 213; Lehtonen & Aho 2000, 102-107). The recession meant that the welfare state's growth period ended, or at least stopped (Alestalo 1994, 82; Heikkilä et al. 1993) and that the security provided by the welfare state weakened.

It is difficult to find any principles or logic behind the cuts (Lehtonen & Aho 2000, 101-102). The diversity of cutting methods refers to independent operations implemented without a general plan. Because of its incoherence, the process seems uncontrolled (Kosunen 1997a, 93-95). Attempts were made to cut costs in all expenses. The procedure was the least dangerous politically, since the impression it gave was that everybody lost. It was chosen, although with more systematically planned, structural changes, economically better results would have possibly been achieved with smaller sacrifices (Hjerppe et al. 1999, 79). Cutting methods became tougher during the recession (Kosunen 1997a, 94). At the beginning, the benefit levels were lowered. After that, the conditions for access to benefits were tightened. The cuts have thus turned in a more structural direction, and wage work has become an increasingly important condition for access to benefit systems (Kosunen 1998a, 350). The benefits of politically powerful groups have been better secured than those of the politically more scattered and insignificant groups (Kosunen 1997a, 95).

Finnish social security seems to be stabilising at the weakened level that was reached after cuts. Social costs have dropped below the European average in

Finland, which from the national economy's point of view can be a positive thing. It does, however, pose a question of whether Finland still is a "Nordic" welfare state or something else.

Finnish social security seems to have "europeanised" along with the cuts. The same central cutting methods have been employed in Finland as elsewhere in Europe: access to benefits has been made more difficult by attaching additional conditions and tightening regulations; income transfers have been targeted more carefully by increasing the use of means-testing, earnings-relatedness and by making benefits taxable; privatisation as well as the financial responsibilities of individuals and family members have been increased; and people's participation in the labour market has been encouraged (European Commission 1995, 14; Daly 1997, 133).

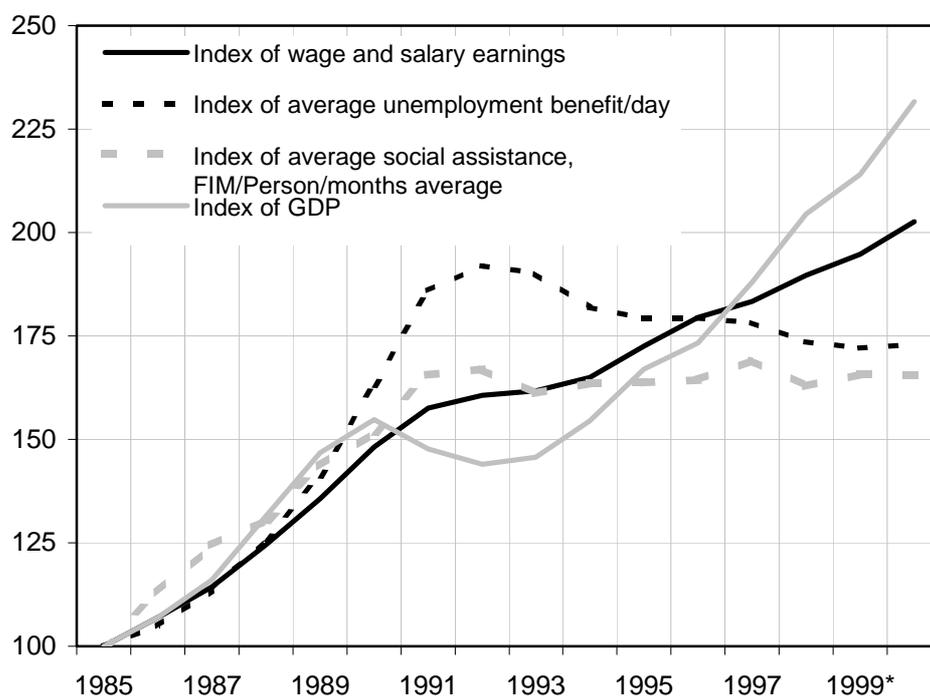
Earlier research has concluded that the structures of the Finnish welfare state were preserved (see e.g. Heikkilä & Uusitalo 1997, Hjerpe et. al. 1999, Kautto & Heikkilä 1998). This stand is justified in that increased social costs were paid and no central parts of the system were abolished despite the cuts – or due to them. The quantitative changes of cuts have been documented deservingly, but they have not led to qualitative re-evaluations. In our opinion, a number of important qualitative changes have then remained hidden. One of these is the change in the division of financial responsibility, which was already earlier discussed.

It is essential that the relationships between insurance-based, means-tested and inofficial social security changed dramatically. Insurance-based and other primary security have more and more often called for social assistance to complement them, and the proportion of the means-tested benefit receivers has grown substantially. In addition, it has been suggested that the relationships between official social security and inofficial food aid have been institutionalised in a way that has not been typical of a Nordic welfare state (Iivari and Karjalainen 1999; Karjalainen 1998, 445). The increasing number of social assistance receivers reveals a structural change (Pierson 1995, 48; cf. Kautto and Heikkilä 1998, 307 and 311). Iivari and Karjalainen (1999, 51) therefore state that primary unemployment security benefits and insurance-based social security do not guarantee a sufficient basic security anymore (see also Kosonen 1998b, 27). At the same time, a number of universal benefits and rights were abolished, or the rights to them were limited (minimum daily allowance of sickness insurance, universal part of national old age pension, public obligation to provide employment, labour market support of the young without vocational education, right to unemployment pension of the ageing left without a right to earnings-adjusted unemployment benefit).

The levels of unemployment security and income security per receiver are lagging behind both the GDP and wage and salary earners' wage development.

Until the recession, these indicators followed the same trend. At the beginning of the recession, the growth of the wage index slowed down. The average value of unemployment benefits first continued to grow because the proportion of earnings-adjusted benefit receivers first grew and decreased later, and the development of social assistance stopped. Although the indicators still met in 1996, the model change had started as early as 1993, and after the year 1996, the change was more drastic than before (Figure 4.8).

*Figure 4.8. Indexes of Wages, Unemployment Benefit/day, Social Assistance and GDP 1985 – 2000, 1985=100*



Sources: Statistical Yearbook of Finland 1988-2000; Sosiaaliturvan suunta 2000-2001, Ministry of Social Affairs and Health, Publications 22/2000, Appendix 1; STAKES.

Thus GDP is growing fast, wages less fast, and the relative level of unemployment and income security is going down. Cuts in social security have brought about a clear change in the welfare state model, but the change came up in political debate only quite recently.

The lowering of the average level of unemployment security is to a great extent due to the fact that the proportion of earnings-related security recipients has decreased and that of minimum security receivers has grown (Figure 4.8). The relative decrease in the level of average social assistance can at least partly be explained by the fact that social assistance has more and more often become a support form that complements other – insufficient – social security benefits.

Both of the mentioned facts reveal that insurance-based social security is becoming less important.

After various cuts, restrictions of the entitlement conditions, and considering the rise (although moderate) in consumer prizes, the real purchasing power of minimum social benefits has factually decreased. Thus, those whose livelihood is entirely based on these benefits, must be poorer in absolute terms than before the recession, although the relative poverty rate has remained low in Finland during the recession. Income differences have, deviating from the long-term contrary trend, started to grow after the recession (Uusitalo 1998, 1999), which can be seen as an indication of the welfare state's declining redistribution capacity.

The income development of the low-income population in the 1990s is alarming. The total incomes of the lowest quintile continued to drop slowly even after the deepest recession year (1993) at least until the year 1998. Disposable incomes did not reach the 1993 level in 1998 either. The proportion of earnings-related benefits in this quintile decreased after the recession despite the fact that the proportion of the unemployed in the lowest quintile grew from the year 1997 to the year 1998. The proportion of means-tested benefits was growing until the year 1997 and seems now to be steadying. The proportion of other (mainly universal) social benefits has in this group been increasing continually after the entire post-recession period (Lehtonen 2000c). According to earlier studies, in 1995-96 the disposable incomes of those 40 percent with the lowest income per consumption unit has not risen but rather fallen. The main reason for this is the decrease in the redistributing impact of social security (Uusitalo 1998, 430; Uusitalo 1999, 471).

The low-income population group thus still lives at the income level of the recession, and means-testedness plays a bigger role than before in their lives. The equally spread impoverishment occurred during the recession does not hold true anymore in the post-recession period. After the recession, the poor are poorer than before, and according to the available information, will also stay poor.

## **4.5 The Change of the Finnish Welfare State**

### **The Extensive Horizon of Change**

The 1990s have no doubt been times of quantitative changes in the welfare state. It is more difficult to take a stand on the question of whether these quantitative changes have also led to a qualitative change in the Finnish welfare state, to a change of the welfare state model. The recession and cuts in social security are not the only ones having affected the qualitative change of the

welfare state. In addition to them, this change has also been affected by changes in the operation environment of the welfare state. These are the incapability of the labour markets to achieve full employment, the increase in the instability of families that weakens the operating capability of the welfare state, (Daly 1997, 130; Esping-Andersen 1999), ageing that burdens the dependency ratio between the so-called active and passive populations (ibid. 148), the globalising of the economy that weakens nation-states' capability to steer social policy (ibid. 3), and related European economic policy that narrows the leeway of national economic policy, for example (Leander & Guzzini 1997; Minkkinen & Patomäki 1997, 71 – 76).

In analysing the Finnish welfare state, the above-mentioned issues seem essential. Instead of reaching full employment, Finland today has to reflect on the problems of prolonged unemployment. The change in family structures and family dynamics puts a strain on social security. The problem of the dependency ratio is becoming exceptionally serious in Finland (Ilmarinen 1999). The globalisation of the economy is a *fait accompli*, which is something that the instances steering the Finnish welfare state have only been able to state as having taken place. In addition to the change occurred in the operation environment, other changes occur in the ideas regarding the welfare state. These will be addressed at the end of this section.

### **A Change of the Welfare Model?**

What have the quantitative changes of the welfare state meant for the Finnish welfare state model? It has proved to be difficult to answer to this question that is essential from the viewpoint of the qualitative change of the welfare state. This is partly due to the weak differentiating capability of the welfare state model classifications, partly due to the fact that the existing welfare states as such are constructs consisting of multiple and mixed elements. The result of the evaluation is largely dependent on what are selected to be the model criteria (Haataja 1998, 42-45).

Classic model classifications (Wilensky & Lebeaux 1958; Titmuss 1968 and 1974) differentiated between institutional, earnings-related, and residual social policy. Korpi and Palme (1996) divide the welfare states into those following comprehensive, corporative and targeting social security. In his much-discussed typology, Esping-Andersen differentiates (1990, 1999) the social democratic, conservative, and liberal welfare regimes. Basically, the classifications of all these models are largely overlapping. In general, the Finnish (Nordic) welfare state has been considered to belong to the first of the above model classifications. Lehtonen (2000b) has looked more closely at the change of the Finnish welfare state in the context of these model concepts. As a conclusion, we state here only that the changes of the Finnish welfare state do not seem to signify a logical transition towards another welfare state model. The impacts of

the cuts go in different directions and are contradictory. (see also Kautto & al. 2001).

Tightening the conditions of access to the earnings-related system, the growth of the relative proportion of means-tested benefits, increase in control elements, the entrenchment of food banks and diminishing of universal benefits can be interpreted as transferring towards a liberal (targeting, residual) model (Kosunen 1997a, 95; Lehtonen 2000; cf. Cox 1998,1; Lehtonen 2000b, 134). There are also signs of a transition toward the conservative welfare state regime. Kangas (1992, 89) has concluded that increases in unemployment and pension contributions of the insured are a shift in the financial system of Finnish social security towards the conservative welfare state model (cf. Kautto and Heikkilä 1998, 305). The principle of universality has also become weak (also Esping-Andersen 1999, 80) and earnings-relatedness strong. There is one reform that points to the consolidation of the Nordic model, that is the defining of children's day care as a universal right (Kosonen 1998a, 350). Here the Finnish model differs increasingly from the conservative model (Lehtonen 2000, 138).

It has become evident that the changes seem to be persistent. The minimum security benefits of the low-income population are still low (cf. Figure 4.8) even at the beginning of the new century. Although regarded as annoying, food banks and bread queues are reality in the 21st century as well. Among other things, the trade unions consider improving the benefits of the underprivileged without improving the earnings-related benefits as an action against collective agreements.

It does not seem to be a question of consciously attempting to change the Finnish welfare state into another. Before the recession, the Finnish welfare model was a mixed model, and a mixed model it will also be after the recession. But it does not fulfil the ideals of the Nordic welfare state now as well as it did before the recession. If the ideals of the Nordic welfare state are described in Kosonen's way, from the perspective of the normative heritage of the Nordic countries, it is clear that the universal social rights are fulfilled considerably less than before the recession, although their popular support has remained high (Kosonen 1998a, 388). For over 100,000 Finns, social rights have remained rights to complement their inadequate minimum security in the queues of food banks (Iivari & Karjalainen 1999). In the way we understand social citizenship, citizens' social obligations have been stressed at the expense of social rights. For example, the rights and obligations of the unemployed have for the first time been defined (Räsänen & Skog 1997; Mäki-Kulmala 2000). The responsibility of public authority to secure welfare has become weaker, regarding both income transfers and social services. The equality of income distribution has been eroded by rapid increase in income differences since the year 1995. The goal of achieving full employment has weakened essentially (Kosonen 1998a, 387; Lehtonen 2000a).

## **De-structuring of the Welfare Ideology**

In evaluating ideological changes it has to be noted that criticism or pessimism over the welfare state is not a new phenomenon. Before the economic recession of the 1990s, the crisis of the welfare state had been predicted for over 30 years. It was typical of the 1990s to accelerate this criticism and to accept its arguments as self-evident. An extensive ideological change is taking place in which “new” ideas, such as communitarianism and neoliberalism, erode the idea of the welfare state. In new modes of speech, the state as the core actor of welfare is starting to give way to some other actors, which is referred to by concepts of the civic society or the welfare society. As Raija Julkunen (2000, 4; 2001) has stated, although the institutions of the welfare state are kept, the idea, goal, expectation horizons, modes of speech and language of the welfare state change.

Of the great changes in the 1990s, the most visible is that the circles of the political elite almost took for granted that the welfare state cannot grow anymore since there are no economic conditions for growth (Kangas 1992, 80 & 92; Hellsten 1996, 120-122; Uusitalo 1998, 425). A great conceptual change is also that the idea of developing the welfare state has been replaced with the idea of reducing the welfare state. As a direction of change it can be interpreted as the direction of dissolving the welfare state. On the other hand, citizens still strongly support the welfare state. This has led to the fact that various governments have had to follow through with cutting policy against the wishes of the citizens and have provided an opportunity for the opposition to present socially profiled criticism. In order to gain the acceptance of the citizens, governments have leaned on the “rhetoric of necessity”. The prevailing discourse has therefore produced a series of “necessities”, like committing to the strong currency, rejecting stimulatory borrowing, making cuts, paying back the national debt at the European record speed, accepting the growth of income differences, accepting lower pay raises than the growth of productivity would allow, prioritising and rationalising of services, and lowering the taxation rate, for example. As Simpura (2000, 37; see also Simpura et. al., in this volume) states, the recession has proved an “extraordinarily good” political justification for made cuts, which were in no way always necessary.

The change of thinking is also manifested in transferring financial responsibility from general government and employers to families and individuals: employers’ social security contributions were partly transferred to be paid by employees, the proportion of work and capital of income turned to favour capital, and the value of social benefits was lagging behind wages and GDP. Before the 1990s, this kind of change would have been interpreted as an indication of the eroding solidarity and joint responsibility of the welfare state, as an income transfer from work to capital, and not only as a technical support of the companies’ international competitiveness.

Among the goals of the welfare state, to repel unemployment is still ranked high. However, it seems that it is no more "the task of the state authorities to arrange for the citizens of Finland an opportunity to work" (as was written in the constitution between 1972 – 1995). Instead, the state must, with activation measures, make sure that "unemployment, as a relation between the state and the individual, is a full-time search for a job" (Työministeriö 2001a). Social security should never offer a disincentive to employment, however casual.

The growth of income differences and related debate manifest the change in the basic principles of the welfare state. In the Nordic countries, income differences were considered as very serious and harmful until the 1990s. Today income differences are allowed to grow and the advantage of growth is actively discussed. For example, a large daily newspaper saw in its editorial under the heading "Help – income differences are growing!" (Aamulehti 2 October 2000) that "increasing wealth is a sign of a functioning market economy. Through taxation, part of increasing wealth accumulates to benefit us all – also the ones whose living is the most dependent on the support provided by society. We still need to learn to absorb this way of thinking". This kind of talk was hardly heard in Finland before the 1990s. In 1998, the lowest income quintile was living at the level of the worst recession year. It is as if the low-income population had been consciously left without having a chance to reap the fruit of economic growth.

After the recession, it is difficult to justify the growth of income differences, the permanence of poverty and the deterioration of services by their being "necessary" anymore. The flaw in the lively discussion among citizens has been the fact that it has not led to any concrete policy changes. While the incentive trap discussion, in accordance with the prevailing ideology, led to quick changes in the income transfer system, the discussion about corporate managements' large option benefits, bread queues, income difference growth, or the state of the care of the elderly has not produced corresponding consequences.

The moral marching order of social policy has been the following. First, the banks were rescued, and after that, by means of devaluation, the export industry. Transferring the employer's social security contributions partly over to wage and salary earners was a relief to many employers. Wage and salary earners' incomes started to increase as the economy improved, but in order to secure their purchasing power, the taxation rate was also lowered. In this way, it is not only the employers that pay for the improved position of wage and salary earners but also the poor. The organisations of wage and salary earners have seen to their members' benefits in particular and prevented their unemployment and social security from being cut. In this marching order, the ones having had to live on means-tested benefits are in the worst position. The recession has hurt especially the long-term employed, whose disposable incomes (benefits) have been decreased because of the cuts in the benefit system as well as

because of the changes taken place in the structure and conditions of the system.

When combining all above-mentioned attitude changes, it begins to seem that the change in the way of thinking is vast and internally logical. Reducing the welfare state, weakening public and employers' responsibility, weakening social security, increasing individual responsibility and setting work- and study-related obligations as a condition for access to social security are changing the landscape of the Finnish welfare state towards a liberalistic welfare state.

Solutions like the ones made during the recession of the 1990s were not made for the first time. The same kind of solutions were made during the recession of the 1930s (Lehtonen & Peltola 2001, Peltola & Lehtonen 2001). The comparison between the recessions of the 1930s and the 1990s has shown that systems of social policy can probably never be made recession-proof, since they are financed by the public sector and partly through social security funds (see also Saari, in this volume). Both are at the mercy of the same economic fluctuations as the other economy of society. The durability of social security during the recessions depends especially on whether it is employment or the subsistence of the low-income population or something else that we want to improve (c.f. Riihelä et al., in this volume). It is a question of political choices. In Finnish economic policy, the economy of the 1990s' recession has been managed at the expense of the ones living on employment and social security, as was done in the 1930s.

#### **Appendix: The Data and Variables in Aho's Calculations (Figures 4.5 and 4.6, Table 4.1)**

Aho's data have been created in Statistics Finland by combining information from various administrative registers. The data include large representative samples of the population of the years 1999 (5 %), 1994 (5 %), and 1997 (8.56 %) and rich yearly data covering the period 1987 - 1998. All individuals in each sample can be followed up through the whole period.

The main sources of data used in this analysis are the following. Information on employment has been taken from the registers of employment pension funds (this insurance is compulsory and all employment relationships as well as entrepreneurial activity are registered). Information about unemployment and participation in active labour market policy measures comes from the register of labour administration (public employment services). In addition, various registers concerning education have been used.

The annual flow of the unemployed consists of individuals who have at least some unemployment or participation in labour market policy measures during the given year. The labour force in Table 1 includes all individuals who have been in gainful employment during the given year, or belonged to the flow of the unemployed, or are retired with unemployment pension.

The variable in Figures 4.5 and 4.6, describing the type of unemployment is based on the employment and unemployment history of the past four years (e.g. for the year 1990, the variable is based on the labour market career of the years 1987 - 1990). The categories are based on the time of belonging to the labour force (later TLF) during the four-year period, the proportion of open-market employment of TLF, and information on an eventual student status in secondary or tertiary education institutions. The categories are exclusive and based on the following criteria:

- 1) Short-term unemployment or labour market entrants:
  - proportion of employment 86-99% of TLF; or
  - not belonged to the labour force during the last year of the period (e.g. concerning the year 1990, not been in the labour force in 1989); or
  - have studied during the last year of the period.
- 2) Medium-term unemployment: proportion of employment 50-85% of TLF.
- 3) Long-term unemployment: proportion of employment 15-49% of TLF.
- 4) Chronic unemployment:
  - proportion of employment 0-14% of TLF; or
  - entitled to earnings-related unemployment benefit until retirement with unemployment pension.
- 5) Retired with unemployment pension during the last year of the period.

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## 5 The Survival of the Finnish Health Care and Social Service System During the Economic Depression of the 1990s

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### Abstract

The Finnish economic depression in the 1990s had effects on the demand for health care and social services. At the same time, the municipalities which were responsible for service provision, faced various economic difficulties due to depression and chose alternative ways of responding to the challenges. The provision of health and social welfare services is one of the major areas of municipal activity in Finland. Thus, changes in the service system reflect broadly general changes in well-being and welfare policies. This article presents findings from a study of changes in the service provision system and the underlying factors and processes during the economic depression. The study focuses on two questions: to what extent can changes caused by the economic crisis in the provision of and demand for health and welfare services be

interpreted, first, (1) as a turning point in the political and practical development of health and welfare services, and not only as a conjectural fall, and secondly, (2) as a result of long-term processes that just happened to become realised simultaneously with the economic crisis. In this article, we discuss the findings mostly from the point of view of the first question, concerning the scope and consequences of short-term processes during the recession. The overall conclusion is that the economic depression and short-term reactions thereupon served to reinforce long-term trends by providing arguments for the necessity of various changes. Therefore, adjustments to the service system largely remained a temporary fall. But in some respects, the recession marked also a turning point into the direction of a lower level of health care and social service expenditure and stricter control of the use of services.

Key words: Finland, recession, 1990s, survival of health care and social services

## **5.1 Introduction: short-term and long-term concerns in adaptation of the health and welfare service system to the economic depression**

In the 1990s, rather radical changes happened in the Finnish economy and in the well-being of the population, as described in detail by numerous studies on the economic recession (see the other articles in this collection). An extraordinarily deep economic recession started in 1991. The unemployment rate increased from 3 to 18 percent between the years 1990 and 1993, and still in 1996 it prevailed on a high level (16 percent). The EU average level of about 10 percent was not achieved until 2001. The GDP per capita (at constant prices) decreased by 15 percent in three years. Although some economic growth occurred after 1994, the GDP per capita in 1995 was below the figures of the late 1980s. However, the deep recession was followed by an economic boom almost unparalleled in the history in the late 1990s. Our article tells the story of decline, crisis and the beginning of a recovery from the perspective of health care and social services.

Along with unemployment, the fate of the welfare policy system was one of the most intensively discussed issues among politicians, the general public and mass media during the years of the economic depression of the 1990s in Finland. The extensive public provision of health care and welfare services has been one of the characteristic features of the Finnish (and Scandinavian) welfare regime (see e.g. Kautto *et al.*, 2001). Importantly, the municipalities have main responsibility for service provision in Finland, but the state subsidises municipalities relative to their demographic structure and overall

economic position. Still there has been a lot of variation between municipalities, when it comes to local solutions in service provision. In the 1990s, this variation could partly be related to the depth and extent of the economic depression in each municipality. The municipalities could choose different strategies in meeting the challenges of the depression, also in the sector of service provision. And finally, adaptation of the service system to the depression may have deep long-term effects on the political and economic foundations of the provision of health and welfare services, and thereby on the whole welfare policy regime, where services are an essential part.

This article aims at describing how the Finnish health care and social welfare system survived over the years of the depression. We shall first briefly describe the initial state of the system and some changes that were not directly related to the economic depression. After that we shall report findings from analyses of changes (a) in the overall framework of service provision, in (b) supply of and (c) demand for services, and (d) in specific features separately in health services and certain personal social services. Finally, (e) service adjustment will briefly be contrasted to developments in other countries, especially Sweden. In the concluding remarks, we shall identify such features of the Finnish service provision system that survived with relatively small changes, and of course also the features that were less viable. In this analysis, our focus is on the short-term dynamics of changes in service provision.

The findings come from the research project called "A temporary fall or a turning point? A study of changes in the system of health and welfare service provision and its capacity of responding to altering needs during the economic crisis". The central research question of the project was formulated as follows:

*To what extent can changes caused by the economic crisis in the provision of and demand for health and welfare services be interpreted, first, (1) as a turning point in the political and practical development of health and welfare services, and not only as a conjectural fall, and secondly, (2), as a result of long-term processes that just happened to become realised simultaneously with the economic crisis.*

Behind short-term changes, a number of long-term processes have been working in the field of health and social service provision (see Lehto and Blomster 1999 for detailed analyses from our project). The most important of those processes was a reform of the system of state subsidies to municipalities in 1993. As the municipalities have main responsibility for service provision, this reform had a deep impact on the service provision system. The reform had been prepared since the late 1980s, and it was more or less a coincidence (as far as there are coincidences in politics) that it was implemented during the deepest economic depression. The reform in itself and its preparation were a

much-disputed issue (see e.g. Haimi 2000 for a recent account), and it needed revision only four years later (1997; see Koski 1996). At the writing of these lines, a second revision of the system was being discussed (on the basis of the proposal by Pekkarinen, 2001). The basic goal of these reforms is to develop a fair and just system that would take account of the structural, economic and social differences between municipalities in order to support the weak ones more than the strong ones. At the same time, there was a tendency to move control of resources (and also responsibility for service provision) closer to the citizens and to the local level. In practice, then, the 1993 reform made the municipalities more independent of centralised normative regulation by the state in the provision of health and social services. Thus the reform also gave the municipalities more freedom in the way they adapted the service system to the economic depression.

## **5.2 The main features of the Finnish health and welfare service system before and during the depression**

Throughout the Nordic countries, municipalities or other local authorities are, together with the state, key actors in social policy, unlike in many other welfare states (see Kröger 1997 for further details). Municipalities are legally responsible for providing services for their residents. Depending on the nature of the service, a municipality may decide to provide the service itself, buy it from another provider, or unite with other municipalities to secure a better financing base in relation to the size of its population. Local authorities provide the majority of social and health care services themselves, and to a large extent are also responsible for their financing. The state channels subsidies to them to guide the provision and to ensure a certain level and quality of services, as well as to even out regional differences. In addition to changes in the state subsidy system, since the mid-1980s the relation between the central and local governments has been shifting, and following a long process of decentralisation and changes in legislation local authorities in the 1990s found themselves with considerably more independence in how services were arranged within their area.

Considerable autonomy in provision, funding and decision-making are believed to account for the large variations between the municipalities in the quantity and quality of services, and this certainly presents a major challenge to any attempts to describe developments on the national level. There are differences between municipalities and, within service production in individual municipalities, between different services. In addition to this variation, a number of administrative shifts have occurred, coupled with a wave of reforms concerning the position of the municipalities and their powers to decide on service provision. Local authorities were also faced with a very different economic setting at the dawn of the 1990s. The economic crisis naturally also hit the

municipalities, thereby affecting the options for service provision in many ways. Firstly, the economic situation and unemployment undermined municipal tax revenues. Secondly, as local authorities in Finland are partly dependent on state subsidies, the problems in state finances were also felt at the local level when cuts in subsidies were implemented. To balance this loss and the rising running costs of services, municipalities increased local taxes and user fees for health and social services.

Table 5.1 gives some basic background figures on the size and role of the local authorities in Finland by comparing the situation in 1990 to that of 1995. The table suggests that local authorities were quick to adjust their expenditures to changes in GDP, and then to re-structure their financing. As can be seen, the share of local authorities' expenditure as percentage of GDP remained about the same, whereas its share of total public expenditure decreased markedly. Subsidies played a lesser role in local authorities' total financing, while user fees increased their relative weight. Tax revenues in total financing increased.

*Table 5.1. The role of local authorities in the public sector in Finland in 1990 and 1995*

	Finland 1990	Finland 1995
Local authority expenditures, percent of GDP	19	19
Expenditures of local authority sector, % of public sector expenditures	41	32
Taxes, % of local authorities' revenues	56	56
State subsidies, % of local authorities' revenues	41	39
Fees, % of local authorities' revenues	3	5

Source: Kurri & Loikkanen 1998, collected from different tables.

Note: Expenditures are total expenditures, including capital expenditures, but excluding business firms owned by municipalities.

The changed circumstances at the local level also meant changes on the demand side. For instance, increased unemployment in Finland meant that the demand for childrens day care decreased. Furthermore, there were changes in the political balance, ideological changes concerning the role of public authorities, and calls for more citizen participation in the running of services. By and large then, the economic premises for local service provision altered considerably, but there is also a mixture of other reasons and justifications for the changes in the ways and means of service provision. These, too, probably influenced access to services during the period.

From a Nordic model perspective, Finland and Sweden have for long stood out as exceptionally "public" states in international comparison. This feature arises from their unique scope of publicly provided services rather than from an exceptional programme of cash benefits (see e.g. Kohl 1981; Castles 1998;

Birch Sørensen *et al.* 1998; Kautto *et al.* 2001). The nature of services differs from elsewhere, too; in comparison, there is a greater variety of public services that cater for a broader spectrum of the population. Access to services has been based on citizenship, and lately on residence, rather than on merit or prepaid rights, and services are provided according to need. To satisfy all needs, it has been the aim for services to be of a high quality and run by professional staff. With these characteristics, service provision in the Nordic countries can be said to be founded on the principle of universalism.

The main elements of the Finnish health care and social service system are health care, services for the disabled and the elderly, and services for children and families. In addition, special services for problem drinkers and drug users, etc. constitute a fourth main category. In each of these sectors, a major part of the service output is provided by the municipalities, either by local service production or by service provision by various federations of municipalities. There is, of course, also service provision by private producers and non-profit organisations (the “third sector”), but even there municipalities are major customers in purchasing the services for their inhabitants.

In one of the few existing reviews of the changes in the role of private sector in service provision in Finland in the 1990, Kauppinen *et al.* (2001) show that in the 1990s, the volume of private service provision increased rapidly in social service provision in particular, when described by the number of service units and staff members (see Table 5.2).

*Table 5.2. Number of service units and staff members working in private social and health services, Finland, 1990s*

	1990	1996	1997	1998	1999
Social services					
Units	741	..	1848	..	2617
Staff	8279	..	15441	..	19682
Health services					
Units	..	2200	2300	2450	2580
Staff	..	25600	28400	27000	29000

Note: An increasing proportion of staff are part-time employees.

Nevertheless, the share of private service provision is low. According to another study (Lith 2000), private service providers produced 18 percent of all social services, as measured by their contribution to the GDP. Most of this private input is provided by the third sector (civic organisations, foundations and other not-for-profit service providers). Only 4 percent of all social services were produced by private enterprises. In the field of health services, the respective share of private providers was about 20 percent, of which about a quarter was provided by the third sector. Despite the increasing trends in private service

provision, the public sector dominates the field with a share of 80 percent or more. Basically, then, the overall structure of the service provision system has remained unchanged.

In the 1990s, the changes in the volume of the public service sector have been described in biannual reviews of the health and social service sector (Uusitalo, Konttinen and Staff 1995; Uusitalo and Staff 1997; Uusitalo, Parpo and Hakkarainen 2000). Moreover, one of the reports in our project specifically concerns the effects of the economic depression on the service system (Lehto and Blomster 2000; see section 5.4 below). It is illustrative to compare the formulations of the summaries in the biannual reviews in consecutive years.

In 1995 (still in the midst of the economic recession) Uusitalo, Konttinen and Staff (1995, 191-192) wrote:

*“The service system has not so far suffered any major deterioration as far as clients are concerned. The local authorities have, however, raised their charges, and little scope remains, it would seem, for further savings of this kind. The demand for children’s day care has diminished due to the recession, and the cuts have primarily affected family day care. Considerable cuts have been made in home help for families with children and the services for the disabled and substance abusers purchased by the local authorities. ... The productivity of many services has improved in the course of the recession, at least when measured by the conventional indicators. Despite the staff reduction, the output has not fallen and has even increased.”*

Two years later, the first signs of recovery of the national economy after five years of recession were already in sight. Interestingly, the English-language summary of the 1997 review mentions the recession directly in one point only, when talking about the cuts in services for substance abusers. However, the review focuses on a number of changes that could be linked to the recession, but also to other processes such as reform of the state subsidy system for service provision in 1993 or long-term processes of restructuring the system in favour of outpatient care in all sectors (Uusitalo and Staff 1997, 16-17):

*“The results indicate that the share held by state financing [in the financing of service production, our addition] has rapidly contracted and that the shares held by municipalities and clients have increased. The structures of service provision have changed: inpatient treatment is now of shorter duration ... Home care services, however, have been drastically reduced. The methods used to organise services have also changed. .. In the case of children’s day care, there has been a significant reduction in family day care services, part-time kindergarten care and play activities. ... Home help services for families have been the target of particularly strong cut-backs.*

Finally, in the year 2000, being the seventh consecutive year with of economic growth in Finland, the recession was but a faint memory for the majority of the population. Still, unemployment rate was quite high, and hundreds of thousands of people suffered from the various consequences of the recession. The review from the year 2000 pays more attention to the recession, mainly because it contains two articles related to the present research project (Valtonen, 2000; Lehto and Blomster, 2000). In the introduction to the report, Uusitalo (2000,15; our translation) writes:

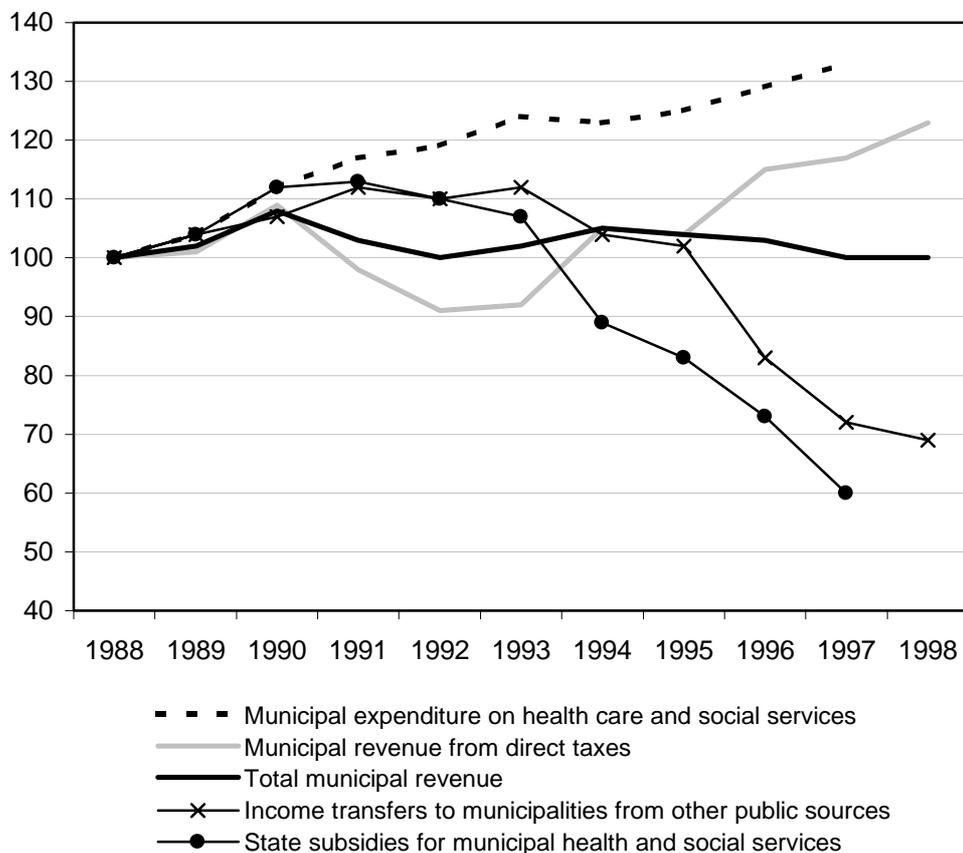
*“In order to curb the increase of state debt, public expenditure has been extensively cut down. .. The recession and the cuts in social security expenditure had a deep effect on the status of the welfare state. The basic features of the Nordic welfare regime have prevailed, but become less generous. Universalism has weakened, ..., the compensation provided by social security for loss of income has diminished.*

The English-language summary of the review of the year 2000 specifies the changes in the service system as follows (Uusitalo, Parpo and Hakkarainen 2000, 9):

*“... the situation in health and social services has improved somewhat in the past few years. The situation is the most problematic in elderly care and mental health services. The report also concludes that the differences between municipalities in social and health services have diminished rather than increased.”*

How would the development described in the quotations above be reflected in statistical reports? Lehto and Blomster (2000) show that the total expenditure on social and health service provision by municipalities mostly increased all through the years of the economic recession (see Figure 5.1 below). Only in 1994 was there a slight downward turn. The effects of the recession were more visible in the number of employees in the service provision system (Figure 5.2). Even there, the number of employees has risen after the recession to reach the pre-recession level in all but one branch of the service sector.

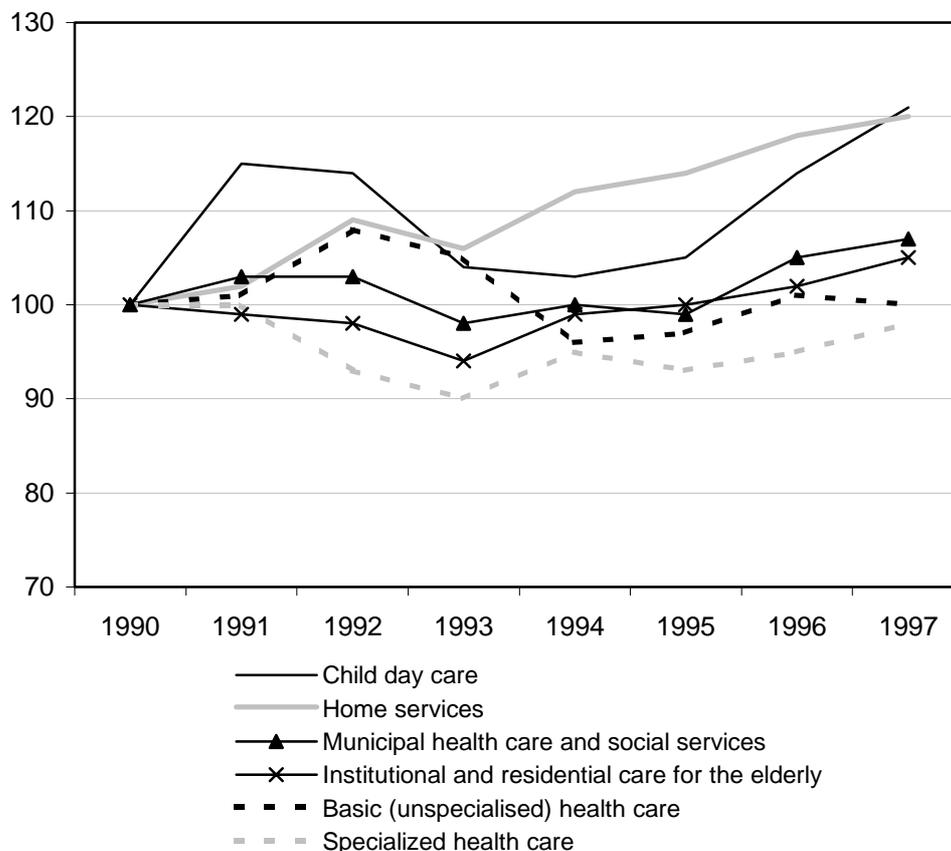
Figure 5.1. *The municipal expenditure on health care and social services and the main components of municipal revenue (index figures, deflated by a price index for municipal health care and social services, 1988=100)*



Source: Lehto & Blomster 2000, Figure 3.

Using the changes in GDP as a crude overall indicator of the economic recession, Figures 5.1 and 5.2 already suggest that the changes in the service provision system do not mechanically reflect the economic stages of the recession. A number of processes were involved in the transmission of macroeconomic fluctuations into specific changes in the service provision system. The six sub-studies of our project, to be presented below, each concern one such process.

Figure 5.2. The personnel employed by municipal employers in health care and social services 1990 - 1997 (index numbers, 1990=100)



Source: Lehto and Blomster 2000, Figure 4.

### 5.3 Changes in the municipal economy and its reflections in the framework of the health and social service system

A two-dimensional process worked in the field of social and health service provision during the economic recession. The economic depression hit also the Finnish municipalities, and their tax revenues and state subsidies declined. At the same time with the depression and the changes in economic resources, several changes took place in the administrative structure of health and social services.

Variation in municipal allocations (FIM/capita) for health care and social services is relatively large. In 1998, the lowest expenditure per capita was about 66 percent of the national average and the highest was about 27 percent above average. The changes in the distribution of expenditure and a municipality's position in the expenditure distribution are very slow.

One of the study questions (Valtonen and Rissanen 2000; Valtonen *et al.* 1999) was the existence of a link between the economic crisis and the health care and social services expenditures. Could a systematic crisis strategy be found among the municipalities? Especially, we were interested in the association between health and social expenditures and the economic path over the recession in the municipalities. The research question led us to consider various hypotheses about the determination of the municipal expenditures per capita on health and social services, and changes in these levels. At least five different hypotheses could be suggested:

*The need hypothesis:* Municipal expenditures are highest in such municipalities where also the need for these services is highest;

*The resource hypothesis:* The economic status, tax revenues, debt and state subsidies may have an effect on how much municipalities can allocate money to health care and social services;

*The structure hypothesis:* The expenditure levels can be explained by the existing (physical and organisational) structure of the health and social services in a municipality;

*The policy hypothesis,* a) state level: the expenditure levels and changes in them can be explained by the changes in the governance system (decentralisation of the decision-making and the changes in the state subsidy system) in the beginning of the 1990s, and b) the expenditure levels can be explained by the local municipal policies;

*The efficiency and productivity hypothesis:* the differences in the expenditure levels might be caused by differences in the efficiency and productivity of the service provision.

Of these hypotheses, the resource hypothesis is the real "recession hypothesis", that is, if the economic state determines the levels of health and social care expenditures, this hypothesis would find empirical support. During the depression, there was (and still is) a strong belief among decision-makers and the general public on the 'musts', or necessities, dictated by the economy. Of the other four hypotheses, it is known (Valtonen 2000) that none of them entirely explains the variation in the social and health care expenditures.

Because the differences in the health care and social service expenditure levels per capita are large between the Finnish municipalities, the social forces behind these differences must also be quite powerful. The significance of our hypotheses is that in each of them, the social forces causing the expenditure levels, and changes and differences in them, are located differently, e.g. in the

economy (global, national, local), government policy, municipal policy, deep inside the service system structures, or the population's needs. Depending on the chosen hypothesis, we also make a hypothesis about the space for local decision-making. The forces influencing the expenditure levels or differences therein may be, for instance, the state-level governing systems (laws, norms, guidelines, information etc.), and the national, or perhaps even the global, economy. From the perspective of the local decision-makers, these are given facts, which cannot be changed. Another alternative is that the decisive forces explaining the amount of resources allocated to health and social services could be located and identified at a municipal level.

A crisis strategy can be said to exist, if the municipalities react to the economic crisis in some consistent way. For instance, a dramatic worsening of the economic situation would lead to cuts in health care and social service expenditures. In principle, the municipalities can choose from three different strategies, which they can use as a response to weakening economic position (Heikkilä and Lehto 1992; Mattila *et al.* 1993): these are the *revenue*, *expenditure*, and *efficiency strategies*. The revenue strategy is the one where the response to the crisis comes from an attempt to increase the revenues (in our data, tax or debt) for the municipality. In the expenditure strategy, the municipality attempts to decrease its expenditure on various items (health and social expenditures, labour force, wages and salaries, etc.), and the third, efficiency strategy, the solution is to improve the efficiency of the municipal service structure. These strategies are assumed to follow a time sequence, where the time order of them is revenue, expenditure, and efficiency strategy (Mattila *et al.* 1993).

In our analysis, the essential test for the existence of a strategy was constructed with lagged variables: We assumed that the existence of a strategy would mean that the lagged variables describing the economic state of a municipality would explain the variation in the level of revenue and expenditure variables. The time needed to adapt to the changing economic situation was, supposedly, more than one year, and our data allowed us to lag the figures with two years.

We found a systematic *revenue strategy*. The worse the economic state of the municipality had been in previous years, the higher was the present debt burden. A similar effect was found in the case of the local tax rate: the worse the economic situation of a municipality had been in previous years, the higher was the present local tax rate. But, importantly, we did not find an *expenditure strategy*. Its existence was studied by analysing changes in social and health care expenditures (both together and separately), number of health care and social services personnel, and the total amount of health and social service wages and salaries. The overall result was that a systematic response from the expenditure side to changes in the economic state of the municipality could not

be found. The only systematic expenditure effect was noticed in health care expenditures, and even there the effect was very small.

There are two potential factors that modify the link between a municipality's economic status and its system of health care and social services: the political processes and the structures of health and social services. Especially the production patterns of welfare services are inelastic, and therefore their changes are slow. On the other hand, the recession hit some municipalities very hard, and it was feasible to anticipate that the consequent reactions would also have been thoroughgoing and immediate. Although the public sector in general reacted to the economic depression by cutting expenditure, this effect was not found in a systematic way in the municipalities. This result is clearly different from the general understanding of the effects of the economic crisis. The result does not mean that the decision-makers in the municipalities did not react to the crisis, but that the reactions were not a direct and systematic consequence of the economic state of the municipality. The mediation of the effects of the economic crisis went through the local decision-making processes, that is, local policies. Thus the explanations for the expenditure levels and changes therein should, more often than it has been thought, be searched from municipalities themselves (see, for instance, section 5.7 below). Explanations could be found in local policies, in culture, and in the structure of services provision.

#### **5.4 Changes in the supply of health and social services**

From a long-term perspective, a study of key policy documents before and during the recession (Lehto and Blomster 1999) showed that a number of changes in the service system resulted from changes already planned and decided in the 1980s, before the recession. Documents such as Government programmes, programmatic statements on social and health care services from the three major political parties, budget proposals and budget justification, preambles and preparation of draft bills, and the key documents illustrating the policies of the Government and the Ministry of Social Affairs and Health since 1987, were studied. Structural policy had been an issue in service industries ever since the 1960s, and in the 1980s it became the key policy issue in the field. The content of the reform of state subsidies for social welfare and health care (1993), linked both to the checking of growth and the acceleration of structural policy, had been prepared before anyone had heard of the recession. No changes were made to the content of the reform even though the political processing of the reform proposal and coming to force of the amendments took place in the midst of an economic crisis.

Thus, the social and health care service system was prepared, at least in theory, for transition from a period of growth to a period following the growth, even before the recession of the early 1990s. The idea of "completion" of the

service system – the building of a Nordic service system that could satisfy essential service needs – had surfaced as early as in the late 1980s' policy prospects for social and health care services. The focus of the arguments used in economic policy to argue for the end of the period of growth changed, quite smoothly, from labour shortage to money shortage in 1992. The much-publicised policy of preventive social and health care also dates back to time before the recession.

It may be that the recession merely opened up a possibility of adopting policies that had already been prepared before the recession. And, although the change in policy does seem rather more permanent than just a temporary swaying, brought on by the recession, there could be a new period of growth for both personnel and expenditure coming, following, e.g., recognition of new needs, changes in technology, or migration within Finland. It is probable, however, that the recession succeeded in imprinting Finland's policy on social and health care services with powerful arguments for effectiveness, productivity, rationalisation, prioritising and savings measures. There will be no going back to what was before, at least not in the near future.

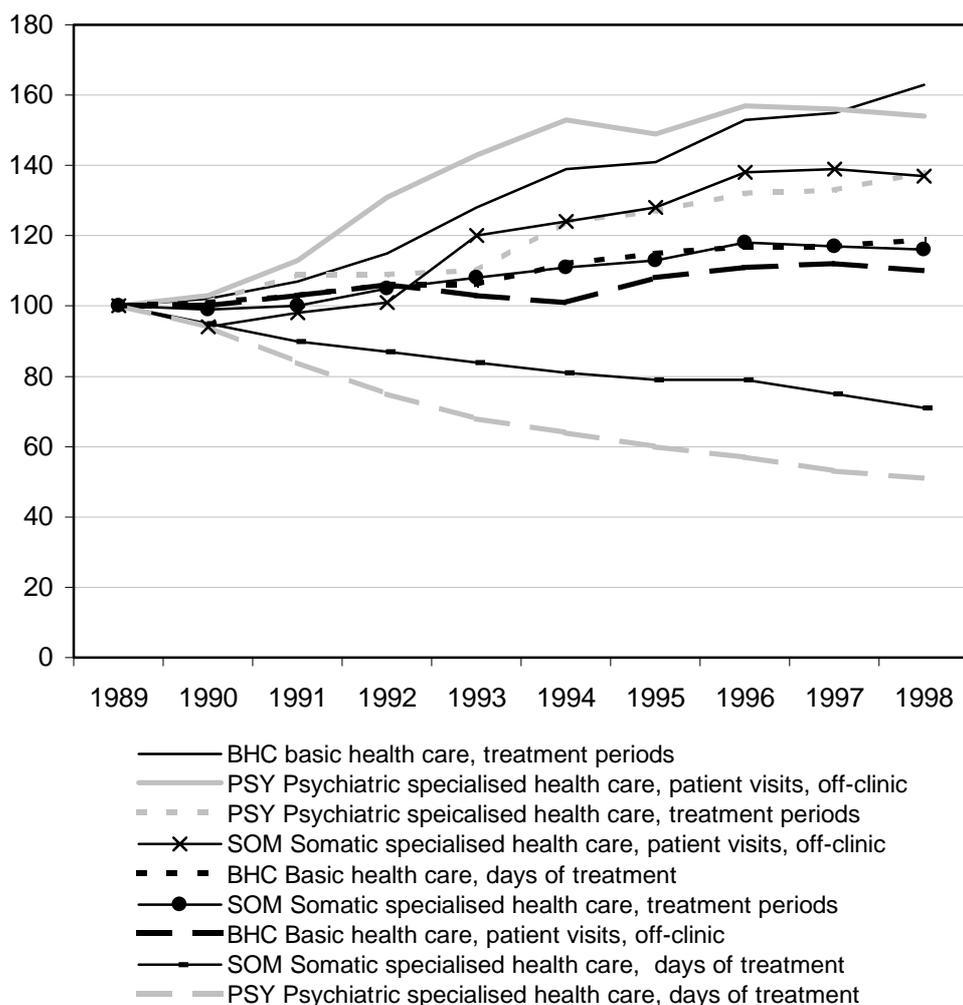
In another part of the study (Lehto and Blomster 2000), changes in the social and health care system were described on the basis of data on expenditure, financing (see Figure 5.1 above), personnel (see Figure 5.2 above), and service use in the different sub-sectors of both public (municipal) and private segments of the service system (see Figures 5.3, 5.4 and 5.5 below). The results indicated rather radical changes in the service system, some of which are contrary to the stated policy objectives that mainly emphasise a wish to safeguard the existing quality and accessibility of services. Hospital treating acute somatic diseases, and kindergartens continued the growth of their output throughout the 1990s, while sectors such as home care for the elderly, family day care for children, care for substance abusers and psychiatric care experienced a marked decrease in the supply of services (see sections 5.6 and 5.7 below for some details and discussion). It is evident that strong professions, strong institutions and influential user groups could protect their interests, whereas weaker professions, weaker provider institutions and marginal or excluded user groups lost in the tightening competition for the scarce resources. The political decision-makers and administrators could not implement in practice the balanced policy objectives they had issued.

Some changes in the health care system and at social welfare offices seem to be temporary adjustments to economic pressures, while other changes, including structural changes in the care for the elderly and child care, are expected to be more permanent. The private health care sector, funded largely by the public sickness insurance system, diminished clearly in the early 1990s. This could be attributed to the supplementary role of the private sector providing

flexibility for the whole system. During the recession, this flexibility meant larger cuts both in demand and public funding for the sector.

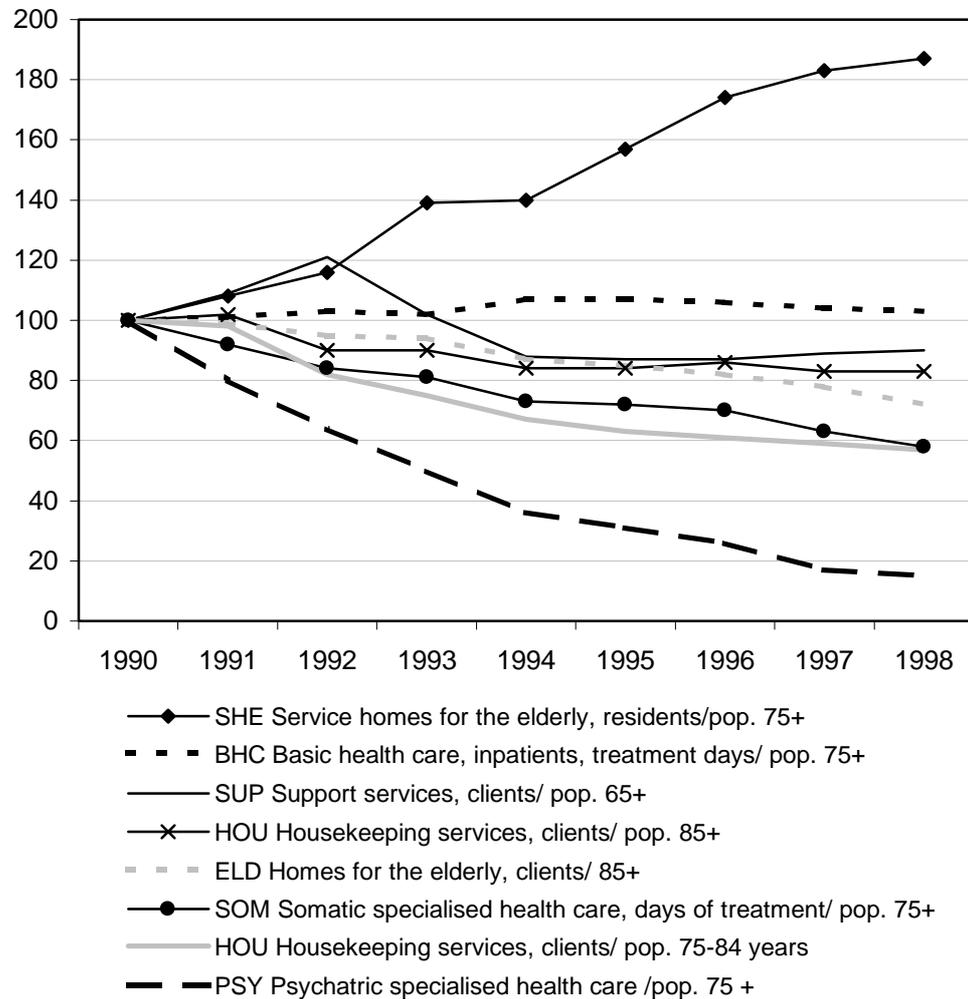
Compared with the expansion trend of the two decades preceding the recession, the social and health care systems at the end of the 1990s used about 10 to 15 percent less personnel and public money. To a large extent, this was reflected in *an increase in the roughly measured productivity* of the service providers. However, it also meant a *decrease in the universality* of sub-sectors such as care for the elderly as well as care for the mentally ill and substance abusers. Responsibility for financing these systems has shifted radically from the central government to municipalities and, to some extent, to the service users in the form of increased user fees.

Figure 5.3. Changes in the supply of hospital services (i) provided by municipal health care, and (ii) by private providers, as reimbursed by the General Health Insurance, 1989 - 1998 (index numbers, 1990=100)



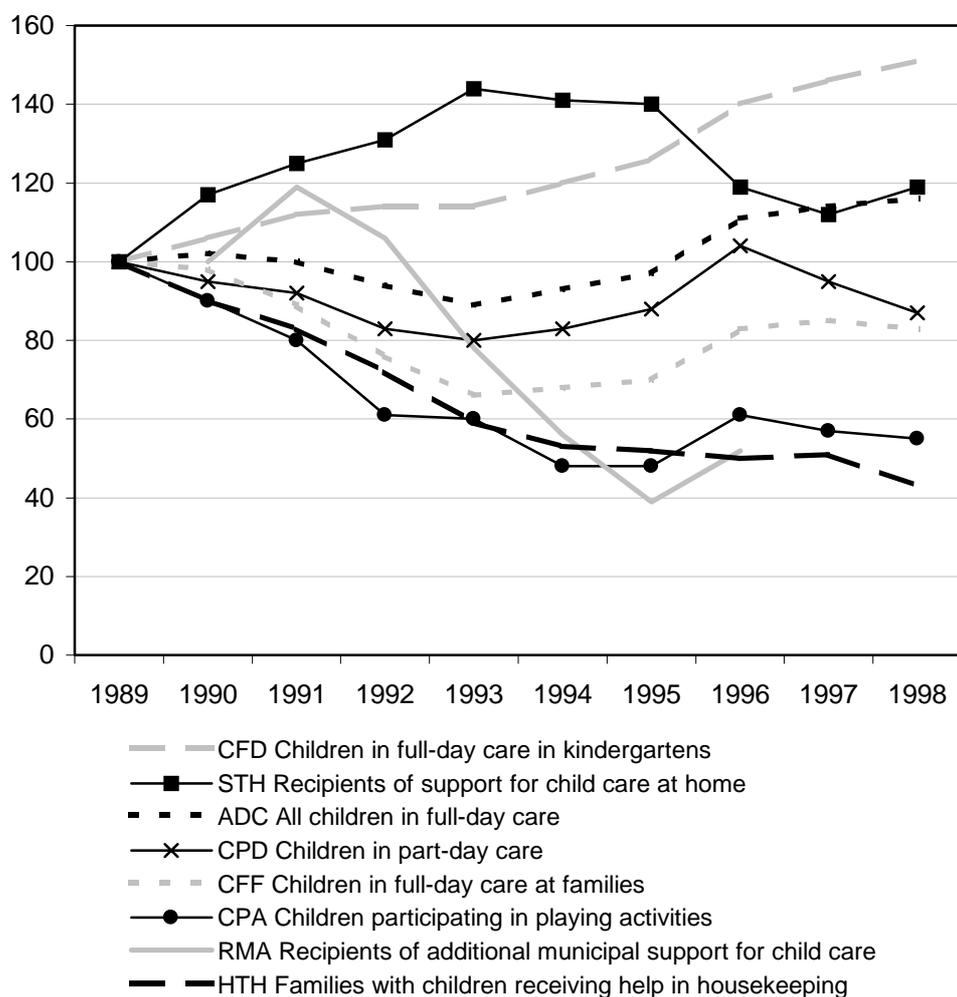
Source: Lehto and Blomster 2000, Figure 5.

Figure 5.4. Changes in the supply of services for the elderly: service provision per capita for different age groups 1990 - 1998 (index numbers, 1990=100)



Source: Lehto and Blomster 2000, Figure 6.

Figure 5.5. Changes in supply of services for children and families, 1989 - 1998 (index numbers, 1989=100)



Source: Lehto and Blomster 2000, Figure 7.

## 5.5 Changes in the demand for social and health services during and after the recession

It was and still is a popular belief among decision-makers and the general public that a deep economic recession would increase demand for health and social services. This would happen because of worsening economic and health conditions and increasing psycho-social stress. However, it turned out in our project that there is little theoretical and empirical basis for such a belief. In international and national research literature, attempts to define conceptual and methodological approaches to the study of demand for health and social services were few and provided no unified scheme for studying the specific

demand effects during the economic recession (see the review by Blomster 2001). In empirical analysis, the basic problem was that much of the information on demand for services actually comes through the service system, and not directly on living conditions, independently of the supply of services. There are, of course, questionnaire studies on living conditions that could provide independent information on demand factors. For instance in Finland, an extensive study on living conditions was conducted in 1994, in the middle of the recession (see Ahlqvist and Ahola 1996), but even there, specific studies on demand for health and social services were impossible to conduct. As Ahlqvist and Ahola put it in their preface,

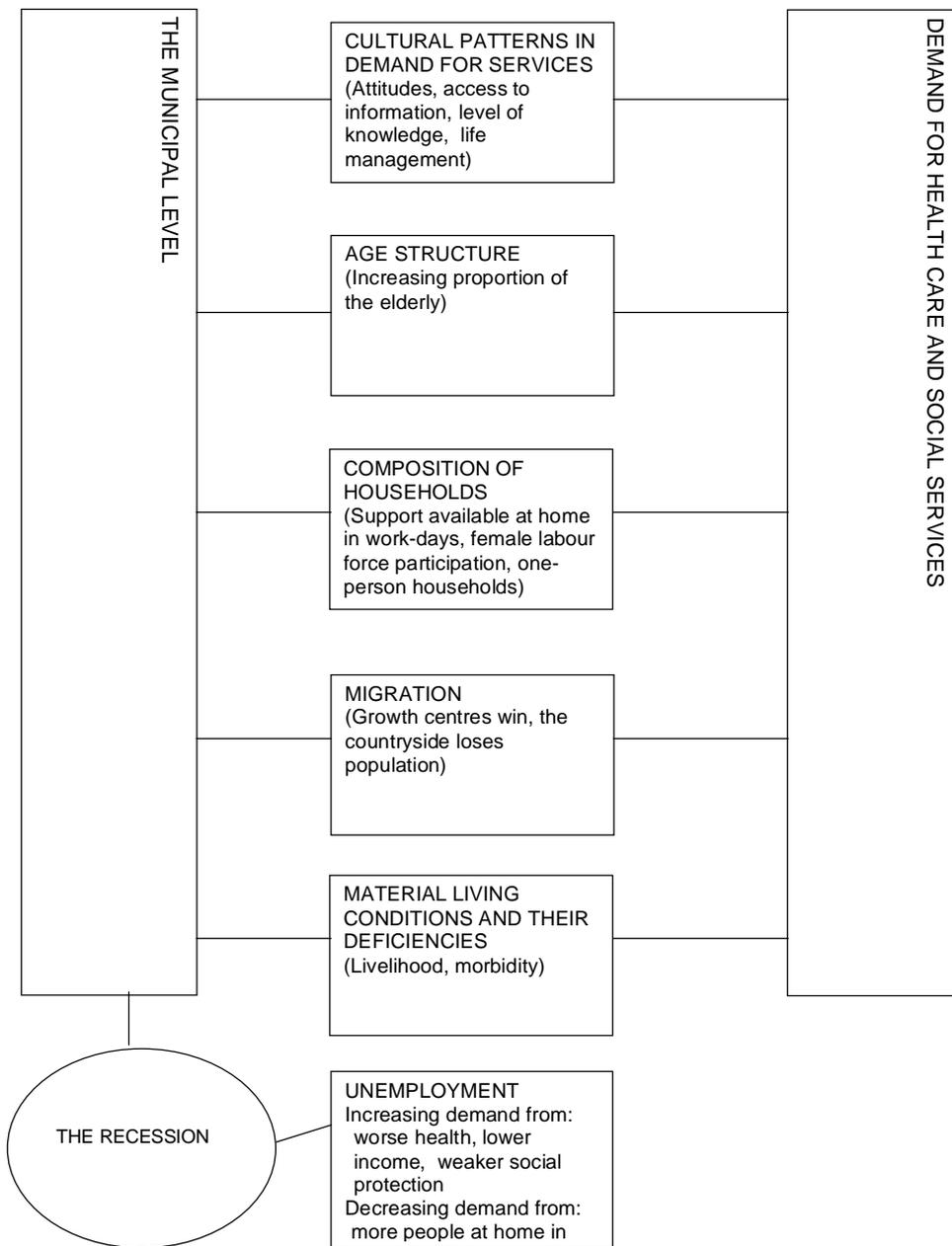
*A large general population survey hardly can catch the "great misery", poverty, economic distress, or suffering. The most deprived population segments were not included in the interviews. Those living in various institutions of care, treatment of punishment, were completely excluded. Homeless people could not be contacted. Those who suffer from great misery are excluded and therefore unwilling or incapable to participate in general population surveys. Those who participate easily disappear behind statistical averages (our translation).*

One of the articles in the 1994 study dealt with one issue related to the demand for services, namely an analysis of three types of resource as factors underlying life satisfaction and health (Suominen *et al.*, 1996). In that analysis, material living conditions, social support and networks, and the sense of coherence, were regarded as underlying factors. In the middle of the recession, material well-being and the sense of coherence turned out to be stronger explanatory factors than social support. In addition, the sense of coherence interacted with other factors and could be regarded as a major precondition for health and life satisfaction. This finding suggests that the unstable living conditions during the recession would have been reflected in the demand for health and social services first and foremost through changes in the sense of coherence that would then be felt in health and life satisfaction. Unfortunately, the existing data were too scarce for any more definite conclusions, and there is no follow-up with surveys on living conditions available over the years of recession.

The basic problem then remains: the lack of theoretical and empirical grounds for a demand analysis in the service sector. Indeed, most of the data that are often interpreted as indicators of demand actually concern the supply of services. In addition, it is well known that changes in supply also imply changes in demand. Despite all these problems, we dared to construct a heuristic model to identify a number of potential demand factors (see Blomster and Simpura 2001 for details and sources of data). The variation in these factors was then studied separately in four groups of municipalities, each group having had different fates in the course of the recession. The factors considered were

changes in material living conditions, migration, the size and composition of households, age structure, and cultural patterns in demand for services:

*Scheme 5.1. A heuristic model of the demand for health care and social services in economic recession*



*Material living conditions.* In earlier debates on the demand for health and social services in Finland (e.g. Rahkonen 1992), improving material living conditions were expected to lead to better health and thereby to a lower demand for services. On the other hand, the concomitantly increasing individualisation and

decreasing traditional collective support were expected to lead to increasing demand. During the recession, worsening material conditions should have produced increasing demand because of a worsening health status of the population and diminishing access to informal support. However, the empirical evidence did not support this hypothesis.

*Migration.* Problems may arise for the service system if the recession leads to migration that moves the population (and demand for services) from one place to another. It takes always a few years until the service system can adapt itself to the changed situation. In principle, municipalities with net inflow of migration should suffer from an excessive demand whereas those with net outflow would have a system that does not meet the actual demand for services (e.g., if young families move out, then kindergartens, schools and certain health services will be less needed). The existing data suggest that this indeed happened during and, in particular, after the Finnish recession.

*Size and composition of households.* The recession and the rising unemployment necessarily mean that there are more adult persons at home on workdays. This may improve access to informal care and support, and thereby lead to a reduction in the demand for certain health and social services. During the Finnish recession, this really had an effect on the demand for day-care services for children.

*Age structure.* On a municipal level, migration can speed up changes in the age structure. Older people are less inclined to move, and their livelihood is not so immediately based on employment. Therefore, if the recession puts younger people on the move, the age structure and the respective pattern of demand for services can change more quickly than before. Thus the recession can speed up those changes in the demand for services for the elderly that could be already anticipated because of the increasing proportion of the elderly in the population.

*Cultural patterns in demand for services.* Hard times may introduce new attitudes toward the use of health and social services. If the collective consciousness of a national crisis is widely shared, this may lead to an attitude where, under equivalent conditions, the population wants to use less services during the recession than before, just in order to ease the collective burden on the municipalities and the state. It is, however, very difficult to find empirical data to support such a hypothesis.

In our analysis, we looked more closely at four types of municipalities (the typology was developed in another part of the project, described in section 5.3 above). The groups were named on the basis of the success of the municipal economy during the recession. Two of the groups consisted mainly of urban municipalities. In the group of “problem municipalities”, demand for services for

children increased at the same time as the number of the elderly was growing. In the group of a “temporary fall”, a similar trend was visible, although in a less uncontrolled shape. The remaining two groups of municipalities (“those in rise” and “the success stories”) were predominantly rural. The municipal economy was relatively healthy there, but the migration induced by the recession led to a decreasing demand for services for children and young adults.

In sum, the most important demand factor induced by the Finnish recession was migration that was accelerated after the recession. From the point of view of the demand for health and social services, it led to bottlenecks in the municipalities with net inflow, and to ineffectiveness and suboptimal allocation of services in those with net outflow. In the latter case, the problems were largest in the municipalities that had just before the recession invested heavily on buildings and equipment with loan money. Importantly, these migration-related effects of the recession were felt more strongly after the recession than during it.

## 5.6 Health care and the economic recession

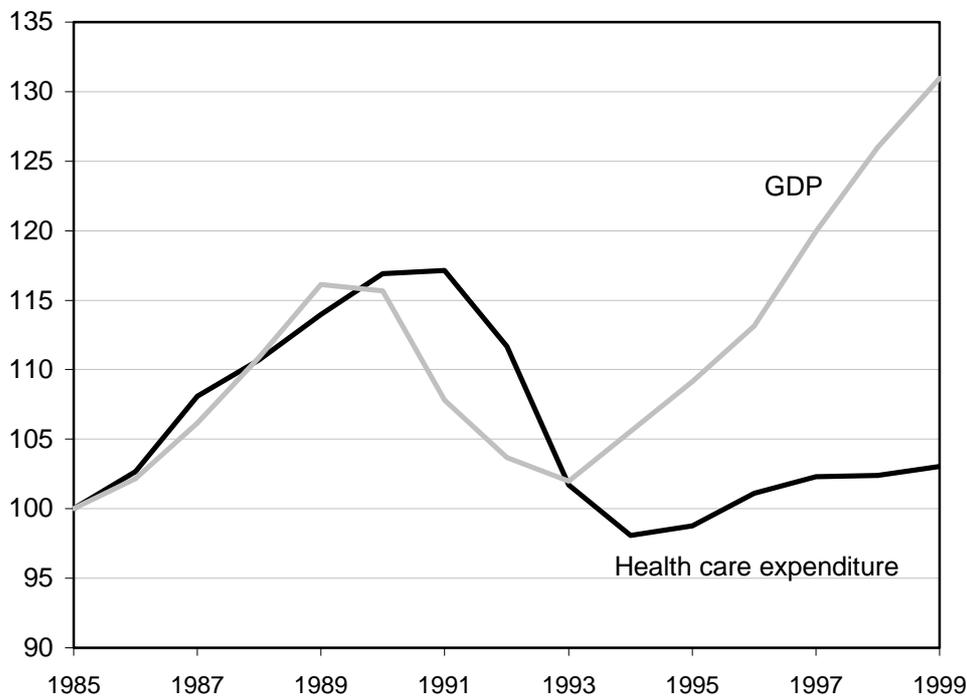
In our project, the study of adaptation of the health service system during the recession concerned changes in the determinants of the use of physician's services (Häkkinen 2001), equity issues in the use of hospital care (Keskimäki 2000, 2001) and changes in costs of use of medicines (Mikkola *et al.*, 2000). In addition, some other works provide relevant information (e.g., Arinen *et al.*, 1998, Häkkinen *et al.*, 1996, Häkkinen 1999, Valkonen *et al.*, 2000). The overall picture is one of survival. Häkkinen's (2001) conclusion is that Finland's tax-based and locally decentralised health care system adapted quite well to the radical changes experienced between the late 1980s and the mid-1990s. Keskimäki (2001) concludes that despite the cuts in health care expenditure in the provision of health care, the hospital system managed to increase the supply of services. An efficiency strategy was clearly in use. In the use of physician's services, inequity persisted with respect to income. In the use of hospital services, there were widening socio-economic discrepancies in the use of surgical services. When it comes to the use of medicines (Mikkola *et al.*, 2000), no specific effects related to the recession could be found. Expenditure on medicines increased rapidly even in the midst of recession, as more effective and more expensive drugs entered the market, and as the ageing population needed more and more medicines. Expenditure on medicines did not change differently in different socio-economic groups.

This overall picture of survival requires a few remarks, some background information and a number of specifications. Also in the health sector, the 1993 reform of the state subsidy system had deep effects. The reform aimed to enable municipalities to adopt a more active role of a purchaser instead of the previous provider/producer role. On the other hand, the reform did not alter the

municipalities' responsibility for providing health and social services. In specialised hospital care, in particular, the reform meant that the system changed somewhat from a public integrated model to a public contract model (Häkkinen 1999).

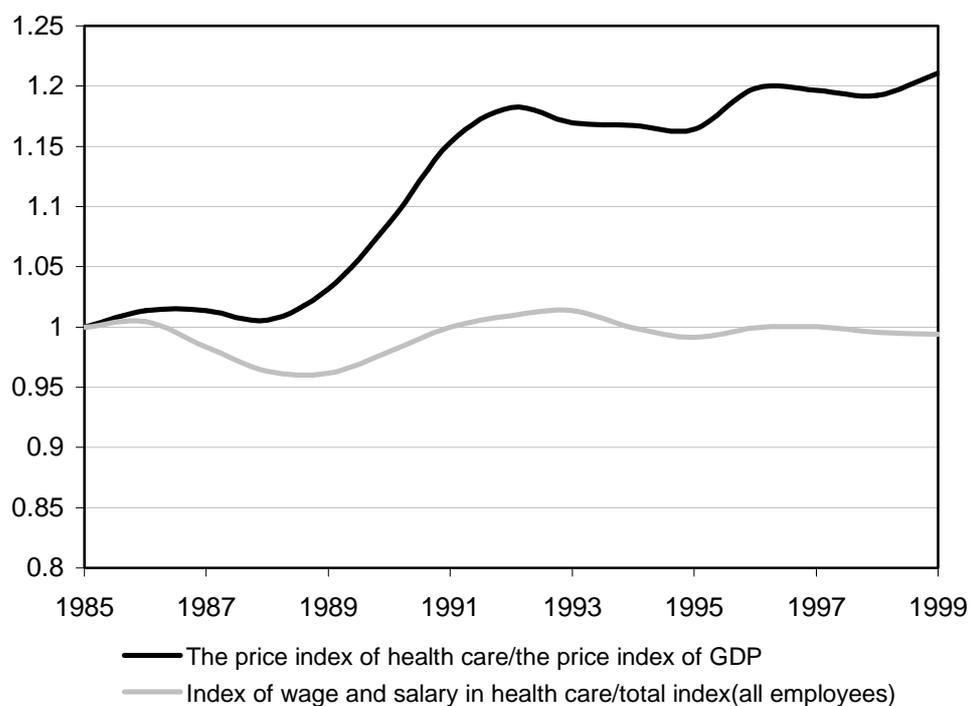
*The economy of health care provision.* The changes in the Finnish economy and health care system are also reflected in the commonly used indicators. The proportion of GDP spent on health services increased from 7.9 percent to 9.1 percent during the years 1990 - 1992. The increase was mainly due to a decrease in GDP itself, although in the first year of recession (1991), there was a one percent increase in the volume of health care (measured by health expenditure at constant prices). During the years 1991 - 1994, the volume of health care per capita decreased by 15 percent. After that, GDP has increased again, decreasing the proportion of GDP spent on health services to 6.8 percent in 1999. The low share of health expenditure is also due to the fact that the volume of health care has increased only by a few percent since 1994. In 1999 health care expenditure per capita at constant prices was still clearly lower than in the beginning of the 1990s (Figure 5.6).

Figure 5.6. *Health care expenditure per capita and GDP per capita at constant prices*



In addition to relative changes in volume, the GDP share of health care depends on changes of the relative price level of health care. The health sector is labour-intensive, and possibilities to substitute labour by machines are minor. On the other hand, the price of labour tends to increase more rapidly than the price of other inputs. Thus there is a common trend that health care prices will increase more rapidly than prices in the whole economy on average, which also tends to increase the GDP share. In Finland since 1985, the relative price level of health care has increased 20 percentage points faster than the GDP price index, although the relative wage level of health care personnel has remained rather constant in the long run. However, during the years 1988 - 1992, the development of relative wages of health sector personnel also affected to some extent the growth of the health sector's GDP share (Figure 5.7).

*Figure 5.7. The relative price and wage level in health care compared to the average level in the economy (1985=100)*



Through justification by the bad financial situation of the public economy, the share paid by households in financing health care was increased from 13 percent to 20 percent between the years 1990 - 1994. This increase stemmed partly from the abolition of a tax deduction for medical expenses from income taxes and partly from increased user fees and co-payments for health care services. At the same time, also some changes in the structure of services took place. The share of expenditure allocated to inpatient care decreased and the share of specialised and primary outpatient care increased. These changes are mainly due to closures of psychiatric beds. Contrary to the trend in the earlier

decades, in the 1990s the share of medicines increased (see Mikkola *et al.* 2000), and in 1994 about 13 percent of health care expenditure was used on drugs in outpatient care. This increase has continued later in the 1990s, and the share was 15 percent in 1999 (Kansaneläkelaitos (Social Insurance Institution), 2001).

*Hospital care.* During the years 1990 - 1995, the total number of hospital beds decreased by 10,000. In addition, there have been administrative changes: specialised somatic and psychiatric beds have been moved to primary care beds (i.e., beds not classified according to medical speciality). According to crude indicators, the productivity of somatic hospital care has increased in the 1990s. That is to say, more services were produced with less expenditure. In the same time, the average length of stay decreased which may also be a reason for a small decrease in occupancy rate. Also more sophisticated studies showed considerable improvement in productivity occurring simultaneously both at health centres (Luoma 2000) and somatic hospitals (Linna 1999). In hospitals at least, much of the increased productivity was due to technological advances. Much of the care given earlier in hospital inpatient wards is nowadays provided by outpatient facilities, a fact which tends to increase the total number of visits. Thus cuts in expenditure tended to be over-compensated by rising productivity.

*Ambulatory care.* Most of ambulatory care is provided at health centres (about 50 %), outpatient departments of specialised hospitals (about 20 %), in private practice or given by employers as a part of occupational care (about 30 %). During the years 1990-1994, the total number of visits to outpatient departments of somatic specialities increased by over 10 percent, while the amount of other visits decreased (Häkkinen 1999). Later, the total number of visits has increased again (on average about by 8 % between the years 1994 - 1999) in all sectors.

*Health care personnel.* During the years 1990-1994, the annual number of new doctors increased from 440 to 540. In 1995 the, annual number decreased to 390, which reduced the growth of the total number. In the 1990s, the number of new students in medical schools has decreased, but it has not affected the total supply until later in the decade. Between the years 1990 - 1995, the total number of working-age nurses increased by about 25 percent. This increase is mainly due to a great increase in training during the years 1991 - 1994, which was based on decisions made on the demand situation in the late 1980's and the year 1990. At that time, the lack of nurses was an acute problem in many hospitals. In the 1990s, the training of new nurses and practical nurses has not decreased, because education has been used as a short-term instrument to prevent unemployment. However, the unemployment rate increased also within the health sector (including doctors) from 1.7 percent in 1990 to 8.5 percent in 1994, although it is clearly smaller than average among all industries (3.4 percent in 1990 and 18.4 percent in 1994).

*Equity issues.* The equity aspect of Finnish health care has been evaluated by means of two dimensions (vertical equity in finance i.e. payments for health care should be positively related to the ability to pay; horizontal equity in utilisation i.e. those with equal needs should be treated equally), which are emphasised in the official documents of Finnish health policy (Häkkinen 1992). These dimensions are also used in international comparisons (Wagstaff 1999, van Doorslaer *et al.*, 1999; van Doorslaer 2000 )

In assessments of the distributional characteristics of the Finnish health care financing system before and after the economic crisis, a distinct pattern emerged. First, between 1987 and 1990 an improvement took place in the relative position of poorer households, as reflected by the shift from a slightly regressive to a slightly progressive payment system. This development ended with the onset of the recession, and was followed by a gradual return towards a more regressive financing system. In 1996, health care financing was somewhat more regressive than in 1987 (Klavus 2000). In international comparison of different health care systems, Finland is still grouped with other mainly tax-financed proportional or slightly progressive health care systems, while differing somewhat from the so called social insurance countries, where financing was more regressive (Wagstaff, 1999)

Consideration of the data on 1987 and 1996 reveals that total health care utilisation in Finland seemed to be related closer to the need for services than to the ability to pay (Häkkinen 1991; Arinen, *et al.*, 1998). But there were differences between income groups in the utilisation of various types of service: the utilisation of outpatient care provided by public municipalities, and the use of medicines were generally in line with the need (measured by indicators of morbidity), while the use of private outpatient services (private doctor's services and private examinations and treatments) was concentrated among the high-income groups. Inpatient care was used disproportionately by lower-income groups. For the total number of visits to a doctor, inequity in the utilisation of services prevails with respect to income. According to a recent international comparison, in addition to Finland, a significant pro-rich inequity prevails in physician contacts also in four other (Eastern Germany, the Netherlands, Sweden and the United States) of the ten countries included in the study (van Doorslaer, 2000). In Finland, especially private-sector visits were concentrated in high-income groups.

Socio-economic differences in the use of somatic hospital care have been studied in detail for the years 1988 and 1996 (Keskimäki 1997, Keskimäki 2000). Generally, socio-economic differences in hospital care were similar in both years. The worse-off used hospital care more than those with a higher social position. However, these differences were mainly due to the use of non-surgical hospital care. For surgical care, the well-off used more services than the worse-off. Between the late 1980s and mid-1990s, the disparity in surgery

use between the low and high social groups became somewhat more pronounced.

*In sum*, the Finnish health care system has undergone a real transition in the 1990s. Earlier, cost containment was not an important issue in Finland, since the former planning and state subsidy system was an example of global budgeting, which functioned effectively during the period of a steady growth in the economy. But in the 1990s, cost containment became an important issue also in Finnish health care. There are at least three aspects in which the changes in the Finnish health care differ from changes in other countries. Firstly, the implementation of a major reform (the 1993 state subsidy reform) was performed at the time of an economic crisis in the country. Thus the effects of the reform cannot be evaluated without taking into account the overall economic situation. Secondly, there have really happened major changes in health expenditure (a decrease by over 10 percent) and its financing (an increase in cost sharing by 8 percentage points). Thirdly, as a consequence of the reform and cuts in state subsidies, local governments (municipalities) have not only increased freedom in the provision of services but also more economic responsibilities for providing services.

Studies made immediately after the recession tell a story of the survival of health services during the recession. Productivity has increased and equity aspects have been maintained, and cuts in expenditure were even over-compensated by an increase in productivity. In addition, according to a recent Eurobarometer survey, about 78 percent of the Finns were satisfied with their health care system; this was the highest figure among all EU member countries (Eurostat 2000a). However, it remains to be seen what the long-term effects of adaptation to the recession will be in the improving economic conditions of the 2000s. Demands for increasing health expenditure are already loud among the medical profession, the population and politicians.

## **5.7 Municipal-level changes in the provision of social services**

On the local micro level, adaptation of municipalities to the economic recession took place most concretely when preparing annual budgets. This political and financial process was the object of the fifth sub-study (Heikkilä and Rastas 2000). By analysing six municipalities (cases), this case study aimed at examining how the economic depression impacted on municipal social services and how these services responded to the changes effected by the recession. It was assumed that the various sectors of social services differed in their so-called recession sensitivity. Thus, four sectors of social services were selected for a closer analysis: child day care, home help, social assistance as well as services for children and families.

The six municipalities chosen for the study differed in terms of their economic trends during the recession. During the period analysed (1989–1996), two municipalities had an upward trend (Eno and Pieksämäen maalaiskunta; marked A and B below), one faced a temporary fall (Tuusula; marked C below) and three were experiencing a downswing (Imatra, Jyväskylä and Kiuruvesi; marked D, E and F, respectively, below). Three of the municipalities (C, D and E) were urban, the other three (A, B and F) predominantly rural. The economic trends in the municipalities studied were based on the financial figures provided by the Ministry of the Interior, constructed in another sub-study of our project (see Valtonen & Rissanen, 2000, and section 3 above). In the present sub-study, the links between the municipal economies and social expenditure were investigated. In addition to the economic trends, the study discussed the socio-economic changes in 1989 – 1996 in the municipalities examined.

Based on the population-adjusted social services costs (Finnish marks/inhabitant), it is fair to say that *trends in social expenditure on average did not experience a temporary fall in all Finnish municipalities*, and neither was there a clear-cut turning point in this respect. Instead, social welfare expenditure was stabilised as a result of the recession, and increases in expenditure were clearly more moderate by the end of the period than at the beginning of it. Nevertheless, three separate trends were found in the municipalities studied. In two municipalities (C and E), social expenditure took a downturn after a steep increase. In municipalities D and B, the recession seemed to have caused a clear temporary fall, which was however different in the two municipalities. In municipalities A and F, social welfare expenditure jumped suddenly in 1993. There was no apparent link between the economic trends and social expenditure in the municipalities.

As regards services, the social welfare departments in the municipalities did not behave according to recession sensitivity assumptions. For example, the quantitative volume of child day care did not decline in all municipalities, but there was a clear decrease in day-care expenditure and the number of personnel. Thus, it would seem that the effectiveness of child day care clearly intensified due to the recession. In home help, only small alterations took place in the municipalities. Social assistance expenses increased steeply, as was expected and is generally known, but the differences in the levels between municipalities remained unaltered during the depression as well. In the services provided for children and families, there were differences between urban and rural localities. This expenditure did not seem to have increased during the period examined. However, a sharp increase in the need for child and family services by the end of the 1990s was stressed in the municipal interviews conducted.

Based on the qualitative interviews and documents supplied by the municipalities, the policy analysis of the recession strategies led to the

conclusion that similar patterns and logic of economic adaptation were employed in several municipalities. This pattern had the following five stages:

- (i) Waking up to oversized budgets;
- (ii) A hastily done realistic, or overly pessimistic, situation analysis and prognosis;
- (iii) Efforts to increase crisis awareness among elected officials and municipal employees;
- (iv) A radical action strategy aiming at adaptation; and
- (v) The rapid political implementation of the strategy

Thus, our qualitative material suggested that during the recession the municipalities had a fourth operating model in use along with the three traditional depression strategies (revenue, expenditure and efficiency strategies). This model can be called *a restructuring strategy utilising collective crisis awareness*. While this strategy incorporates ingredients from both the expenditure and efficiency strategies, its focus is on the pattern, logic and implementation of the adaptation strategies.

A major research question in this part of the project was a comparison of views on adaptation to recession based on municipal statistics, on the one hand, and on qualitative interviews, on the other hand. The two pictures thus received did not usually differ radically from each other. However, it was evident that the quantitative statistical presentation of the adaptation process was less dramatic than the picture drawn in qualitative interviews. The comparison of statistics and interviews also suggests that in many cases, the enforcement of local cuts and other measures had required even overly dramatic tones and operations to create collective crisis awareness. The main actors in this process were not the elected politicians, but civil servants in various leading positions in municipalities. The role of the politicians, then, was to support the civil servants, to confirm the decisions already agreed upon, and to calm down the voters by reassuring that there were no alternatives. Another important feature of the adaptation process on the municipal level was that even if the decisions were made as instant reactions to an immediate crisis, the solutions were there to stay for a long time. At the time of the interviews, many of the instant saving measures were still in force, five to seven years after the deepest bottom of the recession.

Finally, the findings reveal that after all, social and health services as well as education services were well-protected on the municipal level during the recession. Cuts were made, but they did not endanger the basic structures nor the basic activities of the services. In Finland, political and popular support for

the basic public services is strong, and there are structural features, too, that make it difficult to radically rearrange the service provision system (in this sense, the system is inelastic; see e.g. sections 3 and 6 above). With the present structures, even in the extreme conditions of an economic crisis, four sectors of municipal activities would very likely survive: school, social services, public health care and central administration.

## 5.8 Change in the service system from a comparative perspective<sup>62</sup>

In the preceding sections, we have examined changes in the Finnish social and health care system by pointing out crucial changes in certain service sectors. We now turn our focus to the macro-level and assess developments in the Finnish service system in a broad Western European comparison. In such a broad comparison we can (i) assess the magnitude of changes and (ii) consider whether Finland still could be characterised as a Nordic service country. As publicly arranged social care services are a distinguishing feature of the Nordic countries (e.g. Sipilä *et al.* 1997), we also compare changes in elderly care and childcare services<sup>63</sup> in Finland and Sweden. For space limitations, we shall here concentrate on expenditure development and use GDP shares and indexes as relative measures to facilitate comparisons. The studies have employed comparative Eurostat (ESSPROSS) data (see Eurostat 2000b for a presentation of data), that collect social protection spending in a uniform way. This database allows us both to separate expenditures on services (mainly consisting of health care, social services, housing and employment services), i.e. benefits in kind, from cash benefit expenditures, and to make more sector-specific comparisons.

*In a broad European comparison, Finland experienced major adjustment, but not a qualitative change.* Table 5.3 presents the development of expenditures on benefits in kind as percentage of GDP between 1990 - 1997, i.e. before, during, and after the economic crisis period in Finland. In the table, we have included six European countries that were most similar to Finland during the period. Measuring the service effort in relation to GDP reveals interesting developments in these six countries. First, all countries have higher expenditures in 1997 compared to 1990. Second, all countries experienced an increase in their service effort between 1990 and 1993, i.e. during the world-economic slump, and except for Germany, all countries had a smaller service effort in 1997 compared to 1993. These similarities should be contrasted to the

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<sup>62</sup> This section draws on Kautto (2001) and Kautto (2000).

<sup>63</sup> They form the core of social care services, whether measured in expenditures or numbers of people served.

fact that the countries experienced a very different GDP development during the period. Third, in terms of country similarities, in 1990 in a broad EU comparison, Finland was reasonably close to the other Nordic countries, so that the four Nordic countries were the four top investors in services. However, France was comparable to Finland, and coming to 1997 we notice that France and the UK have a higher service effort than Finland, while Germany is very close. One conclusion is that on the European scene, Finland has experienced the most pronounced changes in the light of expenditure data, but not large enough to make her qualitatively different from the other Nordic countries.<sup>64</sup>

*Table 5.3. Service effort (expenditures on benefits in kind as percentage of GDP) between 1990-97 in six European countries*

	1990	1991	1992	1993	1994	1995	1996	1997
Sweden	n.a	n.a	n.a	15.2	14.9	14.2	14.3	13.9
Denmark	10.4	10.9	11.1	11.4	11.3	11.2	11.1	11.0
Norway	10.0	10.7	11.3	11.7	11.6	11.2	10.6	10.5
<i>Finland</i>	<i>8.9</i>	<i>10.2</i>	<i>10.4</i>	<i>10.1</i>	<i>9.6</i>	<i>9.4</i>	<i>9.6</i>	<i>9.1</i>
France	8.7	8.9	9.2	9.7	9.7	9.7	9.8	9.7
UK	7.4	8.2	9.1	9.6	9.3	9.3	9.4	9.2
Germany	7.1	8.0	8.6	8.5	8.6	8.8	9.0	8.8

Source: The author's (Mikko Kautto) own calculations based on Social Protection Expenditures and Revenues 2000.

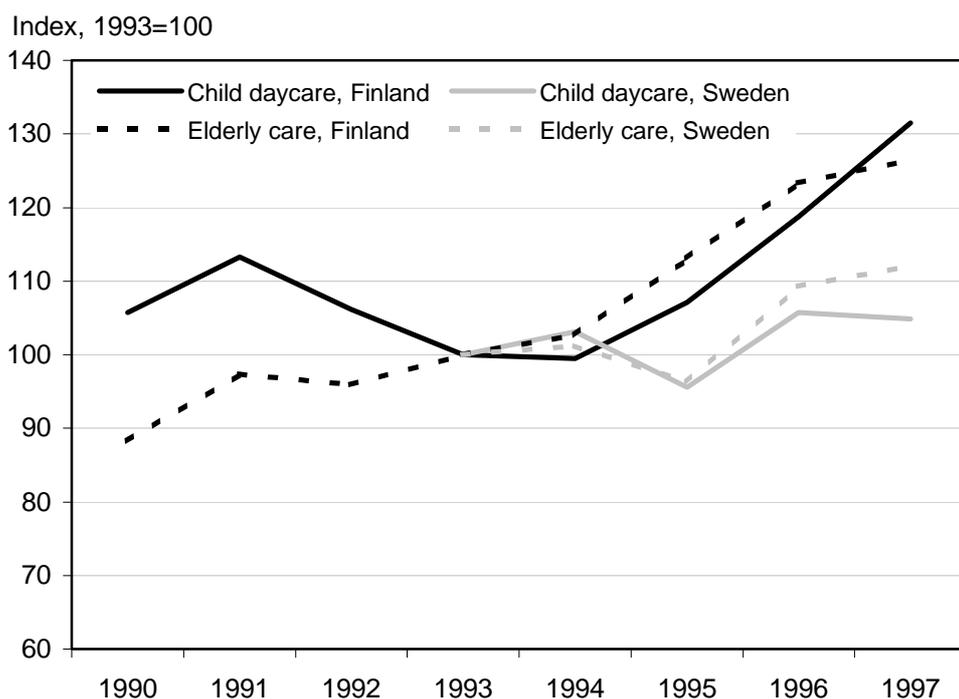
It would be tempting to interpret that the changes in some of the countries result mainly from changes in the working environment, above all in GDP and employment. Finland is particularly interesting in this respect: the GDP drop of close to 12 percent between 1990-93 is not visible as a rapid service effort increase, which thus indicates that major cutbacks were implemented in service expenditures during the period. To the extent this is an accurate interpretation of change during the nineties, it could be used as an example to testify that even dramatic changes in a country's working environment, combined with actual policy-changes, do not necessarily mean a turning point for the overall character of the welfare state.

*Relatively favourable development.* Turning now to a comparison between Finland and Sweden, it is reasonable to think that the service system in Finland faced a more severe challenge, given the deeper macroeconomic problems.

<sup>64</sup> With different methods (boxplots, hierarchical and k-means cluster analysis, scatterplots see Kautto 2001 (forthcoming)) it could be shown that the Nordic countries still in 1997 clustered together, but not in an exclusive way, as France, the UK and Germany could be identified in the same company. Overall, the Western European average for service effort in 1997 was on a higher level than in 1990. But still, such converging trends have not been able to wipe out the existing broad variation in service approaches and in welfare state redistribution strategies at large.

Surprisingly, the comparison of expenditure development in elderly care services and childcare services revealed more minor reductions in Finland than in Sweden. The large disparities in starting levels should be remembered here: different data sources give divergent pictures on the levels of service investments, but they all are unanimous that in the light of real expenditures, Sweden invested much more in services, both in 1990 and 1997.

Figure 5.8. *Development of expenditures on child day care and elderly care services in Finland and Sweden, 1990 - 1997, 1993=100*



Nevertheless, even limiting our attention to trends, we may grasp some systematic patterns in the development of the service systems in different countries (Figure 5.8). Concentrating on the period between 1993-97 for data discrepancies, we see that Finland has experienced a more pronounced relative resource increase *after* the recession, both for child day care and elderly care. The trends for Sweden are harder to interpret. There appears to be some fluctuation within a range of relative stability. In the figure we also see the worth of examining change for different services. In Finland, it seems that expenditure on elderly care have increased during the whole period. This may reflect that for this service area need factors account for expenditure's development more than the economic recession. No fall related to the recession can be detected. For

child day care expenditures, there seems to be a bump in the trend line, parallel to that of GDP development and mirroring unemployment trends.<sup>65</sup>

*In conclusion*, in the light of the expenditure developments, it seems that in Finland elderly care and child day-care services did not experience cutbacks as severe as could have been imagined given the problems in public finances. Compensating resource sources have not been examined here, and it is surely the case that at least the employees have been under more pressure, while service users have felt the savings measures in their purse as higher user fees, and residents as higher local taxes. The fact that trends for Finland appear more positive than for Sweden may only be an illusion created by the remarkably lower absolute levels at the beginning of the period. Even with Finland's relatively faster growth, considerable differences between the countries persist.

## 5.9 Conclusion: success in survival and partial restructuring

This article aimed to answer the basic research question of our project: To what extent can changes caused by the economic crisis in the provision of and demand for health and welfare services be interpreted, first, (1) as a turning point in the political and practical development of health and welfare services, and not only as a conjectural fall, (2) as a result of long-term processes that just happened to become realised simultaneously with the economic crisis.

Our findings suggest that *the development can be described as a temporary fall rather than as a structural and qualitative turning point*. A few reservations must, however, be made. First, a number of radical short-term operative changes took place, differently in different sectors of the service provision. In the long run, such changes, even if temporary at first sight, may have an effect on the structural developments of the service system. Secondly, our analysis concerns only the years of the recession and a couple of years thereafter. It is evident that some of the effects of the recession on living conditions and policies will be felt for many years to come, differently in different municipalities. Therefore, we have not yet seen all the changes in the service system and its environment that could be attributed to the recession.

Altogether, the task of labelling the development of the health and social service system during the recession resembles that of a broader analysis of the Nordic social and health policies in the 1990s (Kautto *et al.*, 2001). A large number of important changes were noticed but still the basic structure and the main

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<sup>65</sup> This trend is similar to Sweden, for which Szebehely (1998) reports that childcare expenditure over the 1990–1997 period had a slow decrease at the beginning of the decade followed by a gentle increase in the following years.

operating principles remained largely intact. The Nordic welfare regime kept its distinctive features through all crises. The question is, then, when does the number and scope of small but important changes accumulate into an overall qualitative change in the nature of the health and social policy system. Our conclusion is that such a qualitative change in the provision of health care and social services did not yet occur in Finland during the recession. In this sense, the Finnish health and social service system survived the recession successfully.

Our six sub-studies have given rise to a number of hypotheses on how the service provision system could have been affected during the recession. Correspondingly, a number of strategies could be outlined among which the actors (in the Finnish case, mostly municipalities) could choose in adapting the system to the recession. These hypotheses and strategies are summed up in Table 5.4 (notice that the hypotheses and the strategies are *not* necessarily in an one-to-one relationship between each other, e.g. 1-A, 2-B- etc-).

In our project, we could identify the use of the re-argumentation strategy (section 5.4 above, changes in the supply of services), fairly little signs of a living conditions strategy (section 5.5, demand for services), and certainly a revenue strategy but no expenditure strategy (section 5.3, reactions from the side of municipal economy on the service system). "A restructuring strategy utilising collective crisis awareness" was found in studying the accommodation of social services in six municipalities during the crisis (section 5.7; this is a mixture of the strategies of re-argumentation, restructuring and search for alternatives, as presented in Table 5.4), while the efficiency strategy was an essential part in changes in health service provision (section 5.6; see also sections 5.3 and 5.4). Finally, in the comparison between Finland and Sweden (section 5.8), the reactions of the Finnish service provision system bear some resemblance to the "wait-and-see" strategy building on the idea of path dependency.

*Table 5.4. Hypotheses on and strategies for adapting the health and social service system to the economic recession in Finland in the 1990s*

Hypotheses	Strategies
1. The temporality hypothesis  The recession makes only a small disturbance in the long waves of the service system development	A. The re-argumentation strategy  The recession makes it possible to use and intensify the arguments behind long-term policy goals.
2. The needs and demand hypothesis  The recession worsens the living conditions and therefore creates new demand for services	B. The living conditions strategy  Work for better employment and livelihood, and use services for a temporary amelioration of living conditions
3. The resource hypothesis  The recession cuts the resources that could be allocated to service provision	C. The expenditure strategy  Save wherever you can in the service provision system  D. The revenue strategy  Find new sources of revenue (e.g. customer fees)
4. The inefficiency hypothesis  The recession reveals gaps in the efficiency of the service provision system	E. The efficiency strategy  Improve the productivity of the service provision system
5. The structural mismatch hypothesis  The recession pushes job-seekers on the move and creates migration that will lead to an unbalance between demand and supply of services	F. The restructuring strategy  Try to reorganise services to meet the changing demographic structure resulting from migration
6. The policy response hypothesis  The recession opens a radically new set of choices for local and national policy-makers in the service provision system	G. The strategy of search for alternatives  Seize the opportunity to start with a clean slate and try to find innovative solutions
7. The path-dependency hypothesis  Even in the face of a shock such as an economic recession, the service provision system has inertia that directs it largely to follow the earlier developmental paths and solutions	H. The "wait-and-see" strategy  Trust in the system's ability to find solutions within the existing structures and principles, without any forcible rearrangements

When trying to identify the most popular strategies, no single approach became dominating. In many cases, the decision-makers deemed it necessary to act immediately, but their reactions did not follow any common formula. Rather, the decisions were tailored differently even in similar conditions, according to the underlying political and ideological power structures in the municipalities and special features of local economic conditions (see section 5.3, in particular). This resulted in a very scattered picture of reactions and strategies. Such multidimensionality does not become visible when using nation-wide indicators only. Also, the case study of adapting social services on a municipal level revealed a much more colourful and dramatic story than could be seen by standard quantitative and administrative indicators (section 5.7).

Still the nation-wide indicators are of interest, too. A comparison of service expenditure between Finland and Sweden during the recession in both countries (section 5.8) revealed differences in adaptation between the two countries. In Finland, the recovery of the service provision system immediately after the recession seemed to be more rapid than in Sweden. Still, differences between the countries in the baseline before the recession persist.

Altogether, our analysis emphasises the sustainability of the basic structures of the service provision system during a recession, and the system's capacity at a local level to adapt itself to changing conditions without destroying the basic operative principles. Although the success of this adaptation varied between the municipalities, *the overall picture is one of survival*. Many of the basic elements of the Finnish health and welfare service provision system survived, with some modifications, the deepest economic recession in the 20th century.

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## 6 Politics displaced, politics replaced, Elites' and citizens' talk on the economic crisis

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### Abstract

The economic crisis of the 1990s can be seen as a case study par excellence of the considerable shift which has taken place in politics globally in the last twenty years. It seems there has been a transfer of power from politics to economics: the power of state bound politics seems to be weakening while the power of the economy and international markets is enhanced. In this paper, we outline and analyse the economic crisis of Finland 1990's as a condensed period of such a political shift, and as experienced by two key actors involved in it - the decision-making elites and the "ordinary citizens". The specific focus is on these parties' perceptions of the political system, democracy and public discussion.

Our examination of individual citizens' interpretations parallel to those of the decision-makers verify the regime shift in Finnish politics during the 1990s. Unsurprisingly, the articulations of this shift take different forms amongst the two parties; yet, they convey the core characteristics of such "new politics". The crystallisation of the decision-makers' experiences could be phrased as "the politics of powerlessness". In contrast, the citizens' narratives are structured by a "discourse of inevitability". These perceptions ascertain the alleged disappearing act of traditional politics.

This paper aims at looking at the Finnish economic crisis as a political issue in political communication. The main aim here is to compare the political discourses of the political elites and citizens: how is politics understood in the crisis? We do this by looking at interviews of elites as well as interviews and opinion polls of citizens, and by trying to describe some forms of political talk that seem to emerge in the crisis.

We view the crisis as a system of political communication, consisting of the political elites, citizens and media, that acts as a mediation point of democratic activity and discussion in society. By describing forms of political communication in this trial we aim to see how the crisis is constructed as a political issue in Finnish politics. In this sense the economic crisis of the 1990s

is seen as a test case for democracy: how are citizen's life worlds and the decision-makers views of the crisis related to each other, do they meet or depart?

Political communication has an important role to play in modern liberal democracies. Democratic decision-making implies political discussion on various alternatives. The importance of political communication is emphasised by the sheer size of modern mass democracies. In modern mass democracies political communities exist in practice on the level of the language, or on the level of the imaginary. As Benedict Anderson's (1991) notion of national imagined communities implies, the members of these communities, or citizens, as we like to call them, can never actually meet face to face. They meet only on the level of language and through political communication in society.

The content and forms of political communication are in principle always open to new definitions. Any issue can potentially be defined as political and any issue can be left out of politics (see e.g. Palonen 1988, Yeatman 1994). Political identities are formulated through language as people adopt new concepts, ignore old ones and try to formulate their own position in society and in the political system.

The Finnish economic crisis is a prime example of the larger shift in politics as it was one of some twenty financial crises, experienced around the world in the context of a similar shift from regulated markets to the free flow of capital (Honkapohja, Koskela 1999). The crisis was enhanced by the collapse of the Soviet Union as the considerable trade between the two countries ceased abruptly. At the same time Finland turned politically to the West and the free market economies while applying for the membership in the EU. In this context the crisis is a part of a change of political regime from state controlled markets to market liberalisation, a shift of power from politics to economics (e.g. Amin 1997, Beck 1997, Hirst & Thompson 1996, Kantola 1999, McGrew 1997, Ryner 1997, Strange 1996).

On the whole, it seems like the crisis had also considerable political consequences. Since the crisis, the whole post-war regime based on welfare thinking has been questioned in political discussions (Kosonen 1998). In terms of everyday experiences of the citizens, it is can be stated that the economic crisis affected almost every Finn: not only in reference to their economic realities, but also when they were influenced by the above described shifts in political and in related socio-cultural values. The most notable issue that structured citizens' experiences – as well as divided them – was the question of (un)employment. Work/lack of work and the appreciation of both of the two conditions in society are crucial factors in defining one's "social place" and in Finland, it has been traditionally assumed that citizenship is constructed around the concept of work. The depth of citizen's experience can be understood by

looking at the unemployment rate, which rose from 3.5 % up to 20 % in just three years. Even though the crisis was also about deflation, growing international debt, post-industrial changes in production processes, etc., from the people's point of view the whole crisis was about unemployment. Suddenly it was not "them" that lived on welfare, it was "us" - everybody knew someone who lost his/her job during the recession, and since the risk of losing one's job was immense, the consumption rate went down, which only made the national situation worse (see e.g. Kettunen 1997, Kortteinen 1992, Julkunen 1997, and Valtonen 2000). As the established concept of citizenship begun to disintegrate, so did the general understanding of politics.

The aim here is to describe the forms of political talk that seem to emerge in the crisis: how do citizens and political decision-makers talk about the crisis? On one hand, our material consists of interviews of the political and economical elites during the crisis. On the other hand, it comprises of a re-examination of existing polls and surveys on citizen's opinions and values, as well as citizen interviews conducted in 1993 - 1994 and 1999 - 2000 around Finland. We have analysed the interviews by looking how the interviewed conceptualise the crisis and how they perceive politics, especially the social and economic policies, in the framework of the crisis. We first look at the elite interviews, we then examine the citizen interviews and finally, we make comparisons between the two.

We search for the main discourses concerning the crisis. Discourse analysis can be viewed as an attempt to trace down systematic relations between texts, discursive practices and wider socio-cultural practices. We look at the social reality as a field of power struggle and discursive competition of defining and signifying.

The use of language does not only mean that objects are described but also organised and given meaning to. Thus language is not separable from the reality described with it, but an action within which a certain kind of variation of reality is produced (see Laclau & Mouffe 1985). The economic crisis and the role of politics within it are constructed in language used in describing these phenomena. Any language use means exercising power, and discourses operate as compromises between interests of expression and cultural restrictions. As discourses are seen as constitutive and historical, their objects of knowledge are not defined beforehand, but the use of them describes the world within them. It should be also noted that discourses are not tied to certain groups. Accordingly, here we examine the crisis as realised in various forms of talk, or in interpretative frameworks for different social phenomena that include an interpretative position for both speakers and the audience.

## **Elites: expertise and efficiency**

The elite material consists of 27 interviews with the highest-level political decision-makers in Finland: politicians and government officials. They were interviewed in 1995; in the interviews these decision-makers try to tell what really happened in Finland in the beginning of the 1990s and how the new economic thinking was adopted.

The discursive world of the Finnish decision-makers in the financial crisis of the 1990s seems to conceptualise the crisis as a threshold to a brave new world, very different from the old system of a controlled economy and a strong nation state. Crisis is perceived as caused by the world outside, especially by the international changes. As “the whole world” is changing, Finland could not stay alone. Thus the change is depicted as an inevitable one that could not be resisted. As one of the decision-makers describes the financial liberalisation during the 1980s:

*We had to follow what happened in the world outside, especially in the banking world. Many times they were a way ahead of us, and we were forced to adjust ourselves to a situation, which was already a fact. That is not in itself a really amusing situation, but this is how it was.*

This interpretation does not leave much space for alternatives. The scale of the political system has been transformed from national to international without the Finns really having a say in it. In the key oppositions that the speakers use in order to describe the crisis, the market is favoured over the state, the economic over political and experts over politicians.

At the heart of the discourse of the new world lies economic efficiency as the dominating value. The new world seems to bring a fair economic world that puts everyone on the same line by forcing them to compete freely. Through this criteria the old left-right oppositions are replaced by new kinds of coalitions. The political lines are drawn between the old national industries and agriculture and the new international markets. The national as well as public economy are perceived often as inefficient, while the internationally competing parts of economy are seen as efficient and business proper.

There is of course some variation in the interviews. Every one does not agree on the reasons for the change or on the consequences of the change. Some, although very few, position themselves critically to this interpretation and see, for instance, that the old regime was not bad.

Everyone, however, seems to be compelled to take a stance in the new world and to formulate one's position in relation to the change. The critical voices, however, operate within this same framework and tend to end up with notions of

powerlessness and inability. They cannot find an alternative interpretation for the crisis that would help them to offer alternative interpretations.

### **Economic steering problem**

There seems to be two main ways of interpreting the crisis, namely the economic and the moral. Some speakers use more economic concepts and seem to analyse the crisis with a discourse based on an economic expertise. Others use a more moral discourse, which perceives the crisis as a moral failure.

The discourse of economic expertise becomes a central way of understanding the policies before the crisis and in the crisis. This interpretation prevails especially among those decision-makers who have a background as economists. It also seems that this discourse is dominating decision-makers who have been involved in the monetary policies before and during the crisis. As one decision-maker, an economist himself, reflects financial liberalisation:

*I understand that there were political discussions, because these were difficult matters. They were difficult even to us, when we were trying to think what is going to happen and in which order things should be done and how the middle phases are handled and all that. I understand that on the political side it is really difficult to discuss such issues, but I would have imagined that economists and banking economists and the rest of the professionals would have discussed.*

He makes a clear distinction between political discussion and professional discussion based on economic expertise. Thus he willingly gives up even the possibility of a political discussion in such “difficult” matters. His main problem is to understand how professionals, who are supposed to be able to discuss these matters, did not realise what was going on.

A discourse of economic expertise, then, emerges, stating that the crisis had not been a political one in the sense that there would have been alternatives in the policies. Instead, the economic discourse sets economic expertise superior to political discussion and as it comes to the self-criticism, the mistakes are not perceived as political but rather as intellectual and professional. Monetary policies are considered non-political, and they are seen also as more farsighted and responsible than a “political” point of view:

*The Central Bank should be able to be independent... the Central Bank is forced to do from the political point of view nasty decisions. It is, however, a stronghold for the politician, if someone makes these decisions, because it aims more to a long time stability that concentrates on the problems of the day.*

At the same the policies in the crisis are represented as thriving towards “neutral” solutions. Politics is replaced by management: there is ideally one best practise to be reached instead of various conflicting political alternatives. The main aim of policies is to find the right answers, and thus also the failures are more of an intellectual than of a political character.

### **The people went mad**

Another trait of the discursive world is the moral overtone of many political decision-makers as the crisis is described with moral judgements. This discourse is more common among decision-makers who have been involved with financial policies, but it can be read also in many other interviews.

The earlier “solely” Finnish economy is now characterised mainly by negative or disdainful terms such as being a “sandbox” for the children. The old regime is mainly seen in a negative light. The basic assumption in this discourse is not a nostalgia for the “good old days” but rather a belief in the ideas of inevitable progress. Basically, things in the past, “before” the crisis, are labelled as bad and things “after” as good. As a decision-maker explains the new situation:

*It was a virtual reality, when one imagines him/herself living in a healthy situation. A healthy situation will be reached, as we get rid of the national deals and all that. It is only painful for the people, to get them used to this real life after having such unhealthy subsidising politics.*

This moral judgement is passed on the “people”. Many decision-makers see that the “common men”, not the politicians or civil servants, are largely responsible for the crisis. As the financial markets were deregulated in the 1980s, the problem is not found, as studies have suggested (Honkapohja, Koskela 1999) in the failed monetary and financial policies. Instead, there is a strong moral overtone in regard to the people; they have sinned and failed. “The people went mad”; they became greedy and believed that they could become rich overnight.

Another characteristic aspect of the elite interviews is the common distrust on the rationality of the public life and democracy. Many decision-makers view the public and the media as unable to understand the economy and the issues at stake. To their mind, public life is emotional, irrational and filled with insensible argumentation: it stands almost diametrically to the cool, sensible rationality of the decision-maker. The interviewees do not put great faith on democratic processes and public discussion. As a leading politician describes the voters:

*Hehheh, ridiculous. First they punch you and take your power away and then they say that you have to lead the country. Hehheh,*

*ridiculous. Would the voters have some kind of responsibility on these issues? Hahahaha.*

The “common men” are not seen as very intelligent. Many of the decision-makers openly admit that one cannot speak in public in the way one really thinks. Instead, one has to simplify issues even using “irrational” argumentation, as the public would not be able to understand the real arguments.

The Parliament, as well as individual members of the Parliament, are viewed as creating considerable problems to decision-making. As one civil servant close to the core states:

*They blew it totally in the Parliament in September 1990. The Parliament had the idea that there is no reason to save, not even a tiny bit, which was then being done.*

The Parliament is seen as irrational and not ready to handle the necessary politics, because it might offend the voters. In this sense, elections are seen as a particularly harmful procedure as they pressurise politicians towards irresponsible behaviour.

Along with this moral judgement on politics, an interesting moral order linked to the change from the old world to the new one emerges: an order characterised with an opposition between a greedy, irresponsible, consensual, sick political past and the healthy, effective and realistic economic expertise of today. A new world has appeared, a world much harder and demanding than the old one, but at the same time a fair and healthy one. In the new order of things, politics seems to represent something artificial and biased, while the markets represent something that is characterised as normal and real life.

### **Citizens: resigned to the inevitable**

In order to grasp the changing dimensions of the citizens’ experiences, we have carried out secondary analyses on existing polls and surveys on citizen’s opinions. In addition, we have analysed citizen interviews conducted in 1993 - 1994 in seven locations around Finland, and carried out a new round of interviews in 1999 - 2000:

The interview data	The survey data
Theme and focus group interviews	Centre for Finnish Business and Policy Studies (EVA)
- Time: 1993-94, 1999	- 2300 interviews every 2 <sup>nd</sup> year (1987->)
- Locations: Rovaniemi, Kajaani, Joensuu & Liperi, Tampere, Somero, Lahti, Helsinki region	Statistics Finland
- 20 theme and 20 focus group interviews	- 4300 interviews years 1994 and 1996

### **“Survey citizens”: less similar, less empowered**

In the re-examination of the survey, the data was divided into three time-bound categories: the “economic boom” (1986 – 1991), “the crisis” (1992 - 1995) and the “new upswing” (1996 – 1998). It seems that the recession of the 1990s divided the country very clearly into more densely populated and industrialised regions of relative well-being, and into more rural ones of mere survival. For the latter, the economic crisis seems still to be an existing reality.

On grounds of the secondary survey data, it seems that the conformity of Finnish values has diminished during the crisis; however, the trend itself has been existing before the crisis, and only been strengthened during it. The crisis treated people differently, and that was shown in the surveys. The values of the young people have shifted from egoism and individualism towards collectivism and solidarity, which seems understandable in the times of great economical uncertainty. On the other hand, the solidarity towards the weak in the society diminished among the middle-aged: even higher education did not go hand in hand with values like tolerance and solidarity. Interestingly, the hardening attitudes towards the weak, as well as the immigrants, was notable in the well-off southern parts of Finland and not so strong in the poorer north and east.

There is also a strengthening feeling of powerlessness to be detected from the data. Grassroot activism of all kinds has diminished during the recession, and even if the economy would now experience in a new upswing, the activity of individual citizen has not been restored. Also the attitude towards traditional party politics grew less appreciative, even though it is possible to find a “party match” for the three most often stated cluster of values/attitudes. Sharing the basic values with a particular party did not bring with it a feeling that one had found his/her ideological base; quite the contrary in most cases. A majority of interviewees felt that there was no party to match their interests. Special attention has been put to the number of “cannot say” answers, for this is the only way to communicate one’s indifference in survey studies. It could be said that this is the option Finns tend to use when it comes to dealing with issues that leave them cold or distant. Still, it is not often used when it comes to politics or delicate questions.

The survey material is summarised in the table below to depict people’s attitudes towards national politics and issues of shared importance, as well as towards their own position as citizens:

## Secondary examination of survey data: Summary of the analysis

Before the crisis: "the economic boom"	During the crisis	After the crisis: "the new upswing"
Finland should <ul style="list-style-type: none"> <li>- become international</li> <li>- forget class differences</li> <li>- strengthen solidarity</li> <li>- trust authorities</li> <li>- remember nature</li> <li>- remember the importance of technology</li> </ul>	Finland should <ul style="list-style-type: none"> <li>- believe in Finnish values</li> <li>- believe in the EU</li> <li>- believe in entrepreneurship</li> <li>- create a national program/plan for the future</li> <li>- remember the importance of nature</li> </ul>	Finland should <ul style="list-style-type: none"> <li>- Believe in parliamentary democracy</li> <li>- Become international</li> <li>- Conserve national values in a realistic way</li> <li>- Accept change</li> <li>- Remember the importance of nature</li> </ul>
The 'ordinary citizen' <ul style="list-style-type: none"> <li>- we are doing fine, but we don't have power</li> <li>- we trust in the president and the army</li> <li>- the nature is important</li> <li>- technology helps us</li> </ul>	The 'ordinary citizen' <ul style="list-style-type: none"> <li>- we are not doing fine and we have no power</li> <li>- the people in the country /city are doing better than us</li> <li>- we are going to postpone big investments</li> <li>- the nature is importance</li> <li>- we don't like foreigners / immigrants</li> <li>- strong leaders help us</li> </ul>	The 'ordinary citizen' <ul style="list-style-type: none"> <li>- we are not doing well and we have no power</li> <li>- the political system is 'passé'</li> <li>- where is the welfare state?</li> </ul>

### The inevitable crisis, the unquestionable divisions

The above described broad framework of values supports our primary data, the so-called citizen interviews, which were gathered in 1993 - 1994 and 1999 - 2000 in seven locations around Finland. Both theme and focus group interviews were conducted and the interviewees were chosen to represent the variety of ways people experienced the crisis; both the unemployed and the employed were interviewed, as well as people who had experienced short-term unemployment or other forms of labour market –related insecurity.

It seems that the recession of the 1990s divided the country in several ways. First, there is the division into relatively well-off industrialised regions and rural/remote development regions of mere survival. Second, citizen's experiences were defined by the generation they represented (discursively and/or physically), as well as their status in the labour market. The scarcity of jobs; the temporary and permanent loss of employment; the constant fear of losing one's means of income (which often led to a competitive and depressing atmosphere in work places and at home) are topics echoed in almost every interview. However, for older interviewees this marked "the end of an era": the

times when work equals the centre of one's life are considered to be over, whereas for many younger people, the crisis has been almost a kind of a survival training.

### **Ways of talk on citizenry**

What we claim to have detected, based on the qualitative citizen interviews, is that the crisis was viewed as a phenomenon uninfluenced by conventional decision-making processes and unrelated to the concept of citizenship; it was an unpredictable irrevocable occurrence which brought about trouble and suffering to almost everyone. However, although the crisis seems to have been experienced as “a natural force”, it was lived through in different “climates”, or discursive modes. The following five main ways of speech, recounting citizens' positions during the crisis, emerged from the interviews, either when describing one's own situation or defining others' positions:

Case 1: Successful & Indifferent. This discursive group seems hardly to have been aware of the crisis, but experienced it as a distant storm, not as a personal crisis. Its citizenship and concept of politics was constructed in the discourse as non-existent in the traditional political sense: the “members” of the group may be active in their individual ways and for their private purposes, but their activity is functional, targeted towards specific and even opportunistic goals. This group seems to have replaced the concept of traditional politics with that of economic realities – and done so without caution:

*It's not a question of politics here, no system can maintain five hundred thousand unemployed and on top all these subsidiaries for agriculture, at some point they have to be abolished... so I just wonder how it will happen, will it be done by the government or will it happen so that salaries will be drastically lowered or social security cuts will be made very quickly... so what will happen... there would be some control within the EU at least...because these things have to go down... since there's no money.. money is such a tough consultant that one can't do anything about it. (M, 28 years, teacher, Central Finland, 1993)*

Case 2: Decent Moralists. The group was defined as experiencing constant insecurity, even if it remained financially safe throughout the crisis. The group's solidarity for their generation was strong, and this group in particular produced a negative discourse about “Generation X”, who were talked about in almost hostile tones. The interviewees using this line of discourse positioned themselves as the decent, hard-working citizens in the traditional sense of the term – the position from which they justified their moralistic evaluations of others.

*Well, it's in principle good that with the recession... it's positive that one at least one talks about unemployment and one is bravely unemployed. That's positive so overall speaking but I think it's dangerous that the young people, they've changed their values, and one accepts that unemployment is a part of life and one learns to regard unemployment benefits as some kind of a citizen's salary. (W 39 years, employment counsellor, Western Finland, 1999)*

Case 3: Betrayed & Bitter. The interviewees who constructed this discourse were defining themselves, and the group seemed to be constructed of older, unemployed people. The group was only randomly referred to in others' talk, as if there were surprisingly little need/will/courage to recognise this segment. This is an interesting trajectory, in that unemployment has in past decades been focused on in the public discourses as the problem of the uneducated, alienated, socially "unfit" people. This group perceived themselves as formerly decent citizens, whose loyalty had been greatly misused, and they had begun to doubt their possibilities to interest or influence "power elites". They were very pessimistic towards their own as well as the "nation's" future. Those who remained active geared their need and interest for political issues toward grass-roots, practical activities, such as voluntary work:

*We are now so old that we've been raised to believe that work is everything in life. It's the only important thing, and of course when it disappears then the whole foundation of one's life disappears, and unfortunately it disappeared when I was this old so that we haven't got that many possibilities to start over. (M 59, years, unemployed, capital city area, 1999)*

Case 4: Insecure, yet Persistent. Most of the people using this discourse described themselves as decent, work-oriented and entrepreneurial victims of the crisis. On one end of the scale of this discourse, there were ways of speech that indicated more indifferent and less traditional attitudes towards taking part in the working life. On the other end, there was a group of "thirty-somethings", well-educated people, who had a hard time entering the labour market in the middle of the crisis. These people had probably expected to find themselves in the "success segment", but at the same time, they developed tolerance and survival strategies for the future. Most of the interviewees saw themselves as more or less decent in the traditional political axis, but also such people were found, who defined their activity as directed to private interests, and who were thus negligent towards political citizenship.

*It was like what I learned, and maybe my entire generation was that nothing comes easily or for free, so that if I was in a situation where I would have to look for a job. (...) so that I learned that one has to try*

*for real and work hard too, and that's in fact very good. If that will stay for the rest of my life, I think it will help me that I haven't had it easy. (W 30 years, journalist, capital city area, 1999)*

Case 5: Alienated & Indifferent. This discursive case could be called the "Generation X": young students and unemployed with little work history. None of the interviewees belonged to this group by their own definition or by their "real" background. In the retrospective interviews of 1999, this group seem to have formed the main group of "others" from which distance was taken when reflecting one's experiences during the crisis. Simultaneously, it was recognised that this group was formed later, as a result of the crisis. This group was labelled as self-defined losers, as "bad citizens" in that not only do they disregard or ignore traditional citizenry and form a passive group in that sense, but also in that the traditional concept of work and entrepreneurial attitude bear hardly any meaning for them. Also interestingly, this group was considered to consist not only of uneducated, alienated, socially "unfit" people, but also of educated youth who had consciously decided to drop out of the traditional framework of the society.

### **Not unemployed but without salary**

Although the above described discourses seem to be largely defined by age and one's concrete employment situation, this outlook draws a very different picture of the Finns and the crisis than if painted with traditional socio-economic measurements. The "successful" and the "unsuccessful" citizens form various discursive alliances across those borders, when it pertains to the experiences and definitions of politics and community. The central question is not a plain, clear-cut generation gap. Rather, the crisis seems to have contributed in the production of a certain new understanding of politics -- which appears to be more easily adapted by those who have not internalised the concept of traditional political citizenry. The definitions and experiences of being "young", "middle-aged" or "old" seem to differ also regarding education, work situation and location (cities versus rural areas). The X-Generation as "the other" can be found not only in the speech of a 55-year-old from Helsinki but also by a 32-year-old from a country town:

*Surely the values have changed regarding YOUNG PEOPLE so that politics doesn't interest them at all anymore.*

The apparent concrete factor framing the different discourses on the crisis remains to be the concept of work – employment and especially the lack of. This is not a surprising observation in that the issue has been very practically present not only in mediatised statistics, but in people's everyday realities, in homes, at work, amongst friends or relatives, in their so-called ethnoscapes

(Appadurai 1996). On the other hand, the crisis seems to have created a fluid concept of being employed. There are no clear moral opposing poles of having or not having a job, as unemployment became mainstream and atypical work conditions became typical. It is not always the status relating to citizenry, but rather the financial standing that began to overshadow other issues. Discourses emerged about “brave unemployment” and the functionality of paid work in general. The obvious “others”, defined by work situation, were the long-time unemployed (in their own discourses) and the young alienated and indifferent (in discourses by most of the interviewed). A symptomatic comment could be interpreted in the statement of a long-term unemployed:

*I really didn't feel like I was unemployed, but rather without salary.*

The interviews draw a picture of the crisis era where everyone, in all fields of life, is affected – everybody has also experienced uncertainty and will continue to do so. In some cases, the interviewees even talk about the economic crisis as the “period of irrational fear”, during which “expectations for a catastrophe” belonged to the daily life. In this light, a possible interpretation about the discourses of the “other”, the Generation X, pertain to the alleged self-sought unemployment and alienation of the group. While others experienced inevitable uncertainty and went with the flow, this group was despised for taking a conscious stand in their “life politics”, managing their lives by remaining at the margins of the society.

### **Politics as shades of grey**

The discourses concerning inevitability, and the related uncertainty, are crucial regarding citizens' experiences and perceptions of traditional politics and decision-making. During the earlier interviews (1993 - 1994), the European Union membership process formed the framework of the talk; yet the data shows that it touched only marginally upon the citizens' everyday life worlds. Thus, their stance on the EU was sceptical if not unsure, even if they had decided for or against membership. Taking sides was more of a decision made according to citizens' general social ideologies, rather than one based on political campaigning or media coverage. The citizens were concerned about the perceived positive and negative impacts of EU membership on their daily lives. Accordingly, in these interviews unemployment overshadowed the EU question as the greatest problem for the future; and the related policies were perceived as the most disappointing measures by the decision-making elite:

*I think.. that EU has been utilised as a curtain to shadow the domestic politics .. its like when Thatcher invented the war .. we have this EU, so we don't have to deal with unemployment or any other problems in domestic politics, and this annoys me so much. Nobody wants to do anything to unemployment! Its as if it would be a good*

*thing to have all these people unemployed. (W 37 years, unemployed, Vantaa 1993)*

The retrospective context of the interviews of 1999 has produced discourses in which the crisis has already caused an irreversible transformation, and the references towards the future are few: if they emerge, they concentrate on for whom the crisis still exists and how the young will perceive the world from now on. The transformation has penetrated every level of the society, also regarding traditional politics. In the citizens' discourses, it seems as if, in this situation of inevitability, no different approaches and alternatives are needed. Thus, politics stands for slight variations of the same, and can attract mainly with identifiable personalities, not with resonating ideologies:

*(...) Something that might have happened [after the economic crisis] is the personalisation of politics, so that one is more interested what certain people say. The parties' political agendas, no one has the endurance to remain interested in those." (M, 31 years, researcher, Western Finland, 1999)*

*M: In the beginning of the 1980s there were some ideologies which were contrary... but now there's little political challenge, they run out of things to discuss in the electoral debates because all the parties have the same goals*

*W: Those over there, every opinion, is in the same government*

*M: Only different shades of grey*

*(M, 52 years, bailiff, and W, 49 years, administrative secretary, as quoted in Koski 2001)*

## **The choice of no alternatives**

The discourses described above seem to depict Finland where the economic crisis both displaced politics as we have known it and replaced it with the choice of no alternatives. The major unifying tendency appearing in the elite and the citizen interviews is the discourse of inevitability -- or, to borrow the term from Bauman (1999, 4), the credo of no alternative. As many Finnish social scientists have in the past decade often pointed out, this dogma of inevitability seems to exist in economic decision-making as reflected in the surrounding media coverage, which entails its own particular rhetoric and argumentative strategies. Inevitability has been seen both as a guideline for action as well as a legitimising principle that has dominated the discourses on recession (Blom 1999; Luostarinen 1993, Vartiainen 1993).

When looking at the elite interviews it seems like on the whole, the crisis produces a rather uniform interpretation on the crisis as an inevitable change from the old state-bound system to the new market-oriented world. It appears

as if politics is the great loser in the crisis. A discourse of inevitable change becomes a very strong one: there was nothing to be done in politics, the crisis was caused by greater forces from outside. A credo of no alternative prevails among the political decision makers, and politics becomes almost a dirty word causing trouble wherever it appears. At the same time, political differences and ideologies seem to lose their importance. They are to a large extent replaced with a moral discourse, which blames the human nature and does not analyse political actions. On the other hand, politics is replaced by an economic discourse, which sees the crisis as a result of an economic management problem. The position of citizens in this framework is to follow and accept decision-making processes passively, and this situation was internalised, at least as a discourse, in the citizen interviews.

### **Politics replaced**

Another central theme in the elite's and citizens' discourses is the sense of political powerlessness or powerlessness of politics in the interviews. As one hears the elite voices it becomes clear that politics understood as national politics is in a state of crisis. Politics is defined as old-fashioned and inflexible, and politicians as unable to understand what is truly taking place. The values of the new policy emerge from the hard facts of economics, from savings and efficiency.

A crystallisation of the citizens' experiences, then, would be that the crisis is considered as the factor, which has fundamentally transformed the atmosphere and attitudes in the Finnish society. In the interviews, it was constantly mentioned that there still exists a certain undertone of fear, and that many changes are permanent, regardless of the improved economic situation. In this context, the interviewees kept to their immediate experiences and conclusions drawn from them; they seldom mentioned political decision-making and changes connected to the official public sphere. Another curious characteristic of the discourse of change seems to be the absence of the cause, of the evil. There were surprisingly few accusatory comments, for instance, towards politicians, businesses, employers, or the like; no one was really given the responsibility in the discourses of change. Thus, these citizen interviews point clearly towards a shared understanding and – according to the inevitability discourse – a common resignation regarding the alleged power shift of economy over traditional politics:

*M: Politics has become a play with the slide rule, no matter if at the communal or national level, it's all decision-making about money. Decisions mean dividing economic benefits, taxation or other kind of*  
*W: surely the values have changed regarding YOUNG PEOPLE so that politics doesn't interest them at all anymore*

*M: well this world has become tougher and is still changing and... politics has lost its ideology and spirit I guess*

*W: and the political parties have become alike and these EU things have brought about this consensus .. ordinary people, doesn't matter if its communal politics or anything else – it's just in its own little box and no one is not really interested*

*(W 32 yrs, M 39 yrs, employment counsellors, Western Finland, 1999)*

This disenchantment with the political amongst both the elite and the citizens is a phenomenon that has evoked numerous scholarly explanations. Broadly, the phenomenon can be viewed, as Andreas Schedler (1997) phrases it, as a phenomenon of antipolitics which has emerged in several ways in contemporary societies. Schedler sees that a family of antipolitical ideologies has emerged in modern societies and these ideologies are many times connected with the concept of crisis: crisis of governability, crisis of the nation state, crisis of democracy and crisis of political parties (Schedler 1997: 2).

Antipolitical ideas suggest that politics has become close to useless and unnecessary. The political communication, elite and citizens discourses on the economic crisis in Finland seem to form a one variation of these themes. Politics is seen as impossible because there is really nothing we can do.

In the Finnish case, it looks like the crisis produces a rather uniform elite discourse which does not reflect the political differences linked to party ideologies and interest groups. The discourses on crisis present it as an uniform national phenomenon and do not politicise the crisis as a site of political struggle between various interest groups in society. Thus the discourse produces to a certain extent political powerlessness: the crisis does not seem to wake political action or formulate political discourses that would conceptualise the cleavages the crisis brings into the society.

From the elite's viewpoint, the talk on crisis takes the form of a governing talk, which tries to discipline the whole nation by using moral judgement. The reasons for this development can to a large extent be traced to the ideas of the market economy. These ideas resemble a larger shift Norman Fairclough sees in the language of governance. A new language seems to be appearing on an international basis. It transcends the boundaries between governmental and other types of organisation (Fairclough 2000: 76-79). As market economy has become the leading political theme and the ideology of economic expertise, as well as markets, take over political talk and are represented as the decisive authorities also in politics.

From the citizen's viewpoint, along the lines of Zygmunt Bauman (2001), the public space has been drained from a meaningful political talk; private problems are not truly and jointly translated into public issues, and public solutions are not

sought and jointly agreed for private troubles. (Bauman 2001: 106) As the link between the private problems and public political issues is broken, the crisis is losing its man-made character and starts to resemble a natural catastrophe, a thunderstorm that could not be avoided and solved by meaningful political action.

### **The media – in crisis as well?**

The current situation has also been interpreted as a “crisis for political communication” in which the role of the media as a public sphere has been emphasised, as other fora for structured information and identity-building -- namely, political parties, the nuclear family, the mainstream religion and so on -- continue to lose their meaning and influence. (Blumler & Gurevitch 1995: 2)

It has been claimed that the political public arena formed by the media has vanished hand in hand with the general trends of globalisation, privatisation and deregulation of the media industries (e.g. Goldsmiths Media Group 2000) and that journalists thus work in a very ambiguous situation where the newly emerged competitive and cynical mechanisms of journalism work to produce a general effect of depoliticisation, thus endangering true democracy. (e.g., Bourdieu 1998) The media is thus said to provide too little of the kind of information which would truly bridge the gap between the decision-making and the citizens.

On the other hand, it has been discussed that the media are too much involved; that they have transformed from being observers to being active participants in politics (e.g., Blumler & Gurevitch 1995). Both the interviews and the survey data indicate that the so called mediatisation of politics (e.g., Blumler & Gurevitch 1995 & 2000, Thompson 2000) has been noticed and internalised by the citizens. The idea that the media has become a central player, and that they - television in particular - trivialise and personalise the traditionally political can be seen in the citizen data. It shows that already before the crisis, the media are seen as too powerful and too full of information. During the crisis years, there is a shift in that the media are viewed as producing images instead of information. In the late 1990s, the citizens' attitudes towards the media emphasise the role of mass communication in political decision-making: it has become a part of that machinery.

Our project has, by definition, also researched the media during the crisis years (see e.g., Aslama, Kivikuru, Moring, Parikka & Valtonen in this publication). Our examinations of the crisis as well as other similarly oriented research elsewhere indicate that there exists a profound disjuncture between the popular (citizens') and the media framing of public issues, and that the public's limited interest in the official side of affairs resulted from a certain sense of powerlessness (see e.g., Neuman et al. 1992).

Broadly it seems like the relevance of public spaces and public communication is deteriorating in the crisis. The decision-makers emphasise the importance of public discussion in the crisis: they see it as an important arena of political action and try to appear there. Generally it looks, however, like the political elites view media in a rather negative light. Media are seen as irrational and even dangerous in the crisis. The media tend to focus on “wrong” issues and also tend to go along with “the people” creating emotional and even hysterical reactions to non-important issues. Thus, the elites do not seem to believe very strongly on the possibility of a rational public discussion in the media. Instead, the public is many times in the midst of the crisis perceived as a place of statements, which are aimed at disciplining the public and the people. Many times the public place is thus not a place for discussion and an arena for opinion building and democratic process but rather a threat to rational discussion and a façade for disciplined public appearances. (Kantola 2001)

In comparison, the citizens do not consider the media as a forum for discussion; but rather, a suffocating overflow of information was experienced. In this regard, the elites and the citizens agree: they both regarded the media incapable of addressing the right issues. Furthermore, when the elites clearly connect democracy, public discussion, and politics, the citizens could not make such a link. Instead, their experiences of conventional politics are blurred, narrowed, and politics has become more distant. Two specific realisations of this are indeed the discourses on economisation and mediatization of politics. (Aslama, Kivikuru & Valtonen 2001)

Therefore, the crisis raises important questions on the role of public communication in politics. The crisis seems to create to a certain extent a culture of political closure among the elites: public communication is perceived as irrational and harmful. This, of course, might be one factor leading to the erosion of politics and democracy. If public places are emptied of a relevant political communication, the lifeblood of democracy is in danger to be drained at the same time. From this point of view one could hope that the economic crisis is only an exception in the Finnish political communication and that the forms of political communication in the crisis would not prevail in the Finnish politics in a larger context and in later times.

Still, modern liberal democracies are based on constitutions stating that the power resides with “the people”. Democracy has, however, been a hard word for many of its proponents: a word of high ideals, but at the same time a word of hard practise. Politics displaced and replaced during and after the economic crisis of the 1990s may be viewed as a trial case for democracy; one whose witnesses -- the elites and the citizens -- seem to have partly given up in trying to possess democracy as we traditionally know it. On the other hand, a crisis, by definition and by its etymology, entails the possibility of a new beginning, a new search.

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## 7 Bridging the Gap: Financing of Social Policy in Finland, 1990 - 1998<sup>66</sup>

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### Abstract

During the 1990s, the simultaneous expansion of public debt and the number of persons exposed to risk resulted in major retrenchment in social policy, and the fundamental revision of financing structures in Finland, aimed at making finance sustainable in the long term. The aim of the chapter is to examine those transformations in Finland's model of financing social policy that might be considered to be of importance regarding the bridging the gap between the sustainable financing and tackling socially recognised risks. The chapter focuses exclusively on the design of financing (whereas other chapters in this collection provide the analysis from the consumption side).

During the 1990s, there was a wide gap between the fiscal resources available for an institutional social policy and the "social risks" to be met, in Finland. In absolute terms fiscal resources allocated to social policy have increased significantly: in fact, during the 1990s social expenditure expanded in a dramatic way, from FIM 131 billion in 1990 to FIM 188 billion in 1998. During this time, more resources were allocated in absolute terms to social expenditure in Finland than ever before. However, much of what was spent had been borrowed. To illustrate this, public debt increased from 14.5 percent of GDP in 1990 to 59.6 percent in 1994 (Economic Council 1999). On the other hand, the number of people exposed to social risks increased to a significant extent during the early 1990s due to (first and foremost) increasing unemployment and demographic change (ML 1999).

This triple effect – the simultaneous expansion of public debt, social expenditure, and the number of persons exposed to social risks – resulted in major retrenchment in both social, health and education services and social transfers, aimed at curbing further expansion, and the major revision of financing structures in Finland, aimed at making finance sustainable in a long run. The aim of this chapter is to examine those transformations in the financing

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<sup>66</sup> The views expressed here are strictly those of the author and do not reflect the official view of Ministry of Social Affairs and Health. I thank referees and Professor Lasse Oulasvirta for comments.

of social policy that might be considered to be of importance regarding the bridging the gap between the sustainable financing and the socially recognised risks, 1990 - 1998. The article focuses exclusively on the design of financing. It comprises no information on its changing environment, the nature of such a change or the adjustment of benefits and services. Such information on a “punctionalist” shift will be provided by other authors in this collection.

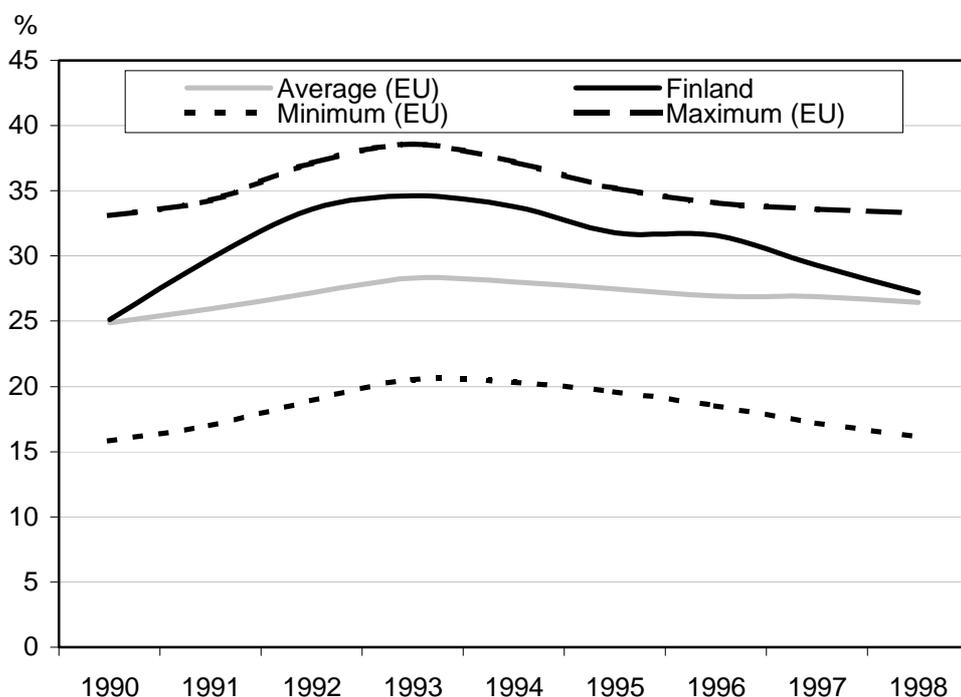
The chapter shall begin by enquiring about the structure of financing social policy in Finland. All data on financing structures are calculated by the author from raw data sets completed by the Ministry of Social Affairs and Health, based on conventional ESSPROS-classifications, which was available for the period 1990 - 1998. After an introduction of certain strategic choices, it then continues with the institutional analysis of the state as a stabiliser. Changes in employers’ and employees’ social security contributions are then discussed. That discussion is followed with the review on the state-municipality relationship. The chapter ends with a conclusion.

## **7.1 The financing structures of social policy**

The evolution of financing structure is a path-dependent phenomenon, where institutional lock-ins largely dictate subsequent choices. This is true also in Finland. However, in the course of the decades some adjustment into the changing circumstances has occurred. The structure of finance was during the post-war years (1950 - 1970) mixed in a rather peculiar way. The state was often responsible for insurance type benefits whereas the employers financed residence-based allowances, including national pensions and child allowances, and in certain cases social assistance. Services were financed by municipalities and regional organisations, which in turn were heavily subsidised by the state through ear-market grants for educational, health, and social services.

Restructuring occurred during the first half of the 1980s, when the employers withdrew from financing certain allowances (while remaining partly responsible in financing national pensions). The simultaneous expansion of public sector employment, financed mainly (albeit not exclusively) by the state and municipalities, increased the role of the state as an financier as it significantly increased its grants expenditure. During the latter half of the 1980s, the statistics do not reveal any major changes. However, no change can be interpreted as a major signal. The fact that the employers’ proportion did not decline is a powerful indicator of the economic development in Finland over that period. The economic boom – the longest ever experienced in Finland - allowed the state to re-allocate some of its economic burden to the employers. The proportion of social expenditure coming from GDP actually declined during the latter half of 1980s as the record-breaking economic growth made more resources available than the public sector was able to spend, fund or invest.

Figure 7.1. *The expansion of social policy in Finland in a comparative context. Finland, European average, European maximum, European minimum*



Source: Eurostat.

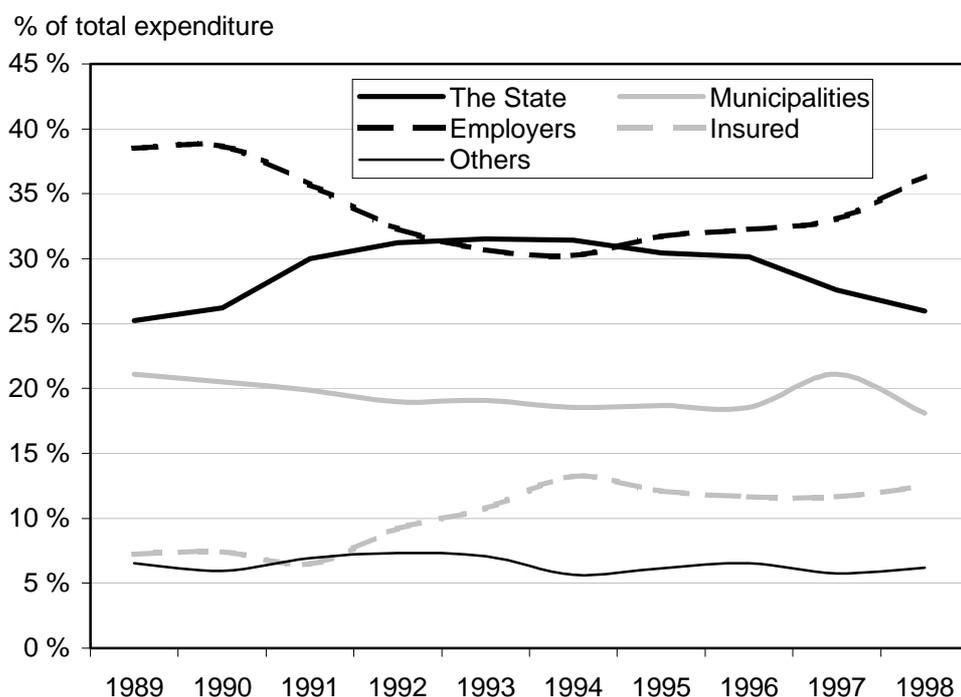
However, the 1990s reveal drastic changes (see Figure 7.1). The total social expenditure increased rapidly both in real terms and in the proportion of GDP (the impact of different definitions have been analysed in Saari 2001, chapter 6.2). Around 1990, social expenditure in Finland slightly exceeded the European average, at around 25 percent of GDP. This was due to high employment, good dependency ratio and relatively low wage levels in social and health services. During the recession, the expenditure significantly expanded in relation to GDP, reaching all time high in 1993, about 35 percent). In fact, Finland experienced one of the largest increases (roughly ten percentage points) in social expenditure ever recorded in mature welfare states. Nominal social expenditure increased from FIM 131 billion in 1990 to FIM 177 billion in 1994.

During the latter half of the 1990s social expenditure (national average) declined back to (and actually below) a European average, being about 26-27 percent of GDP. This resulted mainly from the rapid increase of GDP. The absolute amount of resources allocated to social policy has remained stable. In 1996, the allocation to social expenditure was FIM 185 billion, expanding only to FIM 189 billion in 1999. Simultaneously, the decrease in unemployment allowed

for some expansion of other elements in social expenditure. (For details, see MSAH 2001a.) However, retrenchment policies has also played a significant role in curbing the real expansion of social expenditure (some estimates, see Saari 2001a, chapter 6.2). Furthermore, the number of persons producing social, health and education services or consuming social transfers is still far higher than in 1990. Between 1990 - 1994, the number of persons over 15 simultaneously dependent on social policy increased from 1.2 million to 1.6 million, and has decreased only slightly since then. (Saari 2001b.) Consequently, despite the expansion of social expenditure at macro-level, the micro-level amount of resources per a person consuming social policy or producing services has not developed in a satisfactory manner; the adaptation of expensive technology makes things even less satisfactory.

Figure 7.2 provides illustrations on the internal structure of financing during the 1990s. To start with the employers, their share of total financing declined from two fifths to one thirds during the recession. However, this decrease has almost fully been compensated by the expansion of the insured's share from 8 percent to 14 percent over the same period. The proportion of the state in turn increased from one quarter in 1990 to one third in 1995; since then, the proportion has been declining back to the pre-recession level. The share of municipalities of total financing has also remained relatively stable, fluctuating around one fifth of social expenditure. (Detailed figures, with some revisions, are available in MSAH 2001a.)

Figure 7.2. The structure of financing in Finland, 1990 - 1998, percent of total expenditure



Source: MSAH.

The impact of the 1990s recession to the structure of financing social expenditure can be illustrated, first, by fixing the structure of financing, and second, by fixing the structure of expenditure. Observe that in most cases the financing package of individual benefits or services has not explicitly been fixed by an Act or a Decree. Rather, most often the acts and decrees have been written so that social security contributions of different financiers are the certain percentage of wage sum, or that the state pays a proportion equal to the non-earnings-related part of that particular benefit. However, implicitly, the internal structure of financing package is stable, to be altered only by an explicit, or, political decision. Consequently, one may argue that changes in the proportions of the financing structure to some extent reflect the expression of political will. However the whole package of financing is the function of both political will and changing circumstances that alter the division of labour between various services and benefits, financed and funded in different ways.

In Figure 7.3, it is estimated, how much more, or less, different financiers would have paid, had the financing structure of the every single benefit and services had been frozen in 1990. In other words, expenditure has been allowed to evolve but the financing model of the every benefit and service has been fixed in 1990. To put it another way, the gap between the actual structure of financing

per benefit and service and the fixed structure roughly reflects the simultaneous impact of the adjustment of distribution of benefits and services (in this respect, indirect political choices), and structural change around social policy affecting the proportional consumption of different benefits and services. Observe, furthermore, that sometimes different actors have agreed to alter a financing structure so that different transfers compensate each other. For instance, the municipalities agreed that the abandonment of their national pension contribution paid to SII (Social Insurance Institution) was compensated by the cuts in grants, aimed at covering the costs of services, from the state to municipalities. Such agreements make it unnecessary to evaluate the changes of individual transfers and services (as such results would be misleading), and allow focusing on the four main sources of financing at macro-level.

*Figure 7.3. The adjustment of financing social expenditure: an evolving expenditure structure, fixed the 1990 financing structure, millions*

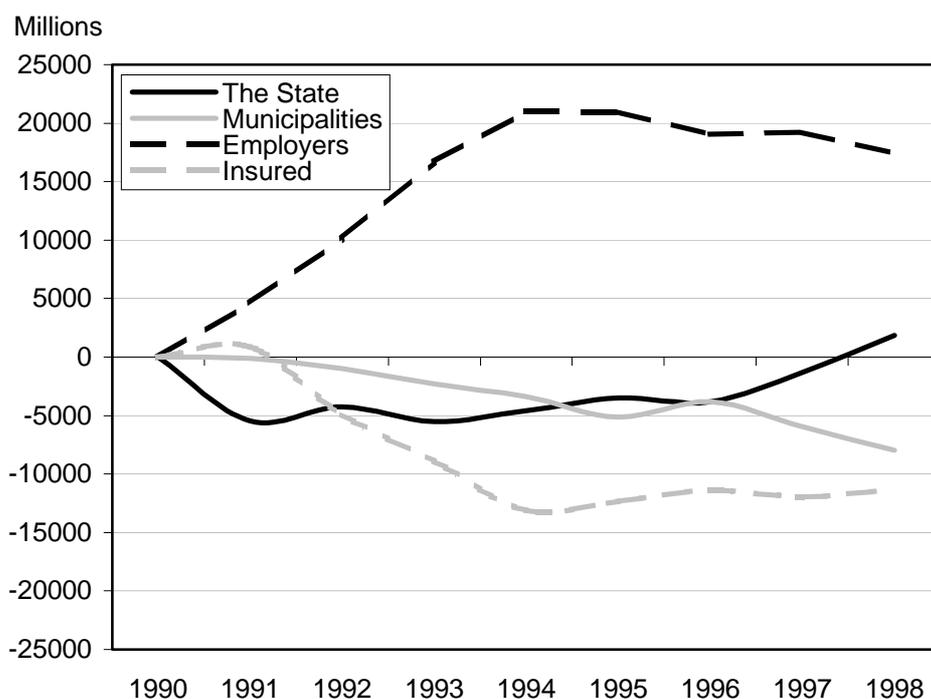


Figure 7.3 indicates that a major redistribution of the financing costs has occurred between potential financiers during the 1990s. A positive figure refers to lowering costs, which implies that this financier has been able to decrease its costs by this amount compared to the situation where the expenditure structure was not evolved. Negative numbers, in turn, refers to additional costs. The employers (including public employers) seem to have been able to shift their

potential costs to other financiers, mainly to the insured but also to other categories. (Or, more precisely, social change and the redistribution of responsibilities within and between benefits and services have shifted costs to other players). At its highest they would have hypothetically saved FIM 21 billion in 1994. A more detailed investigation (not shown in Figure 7.3) indicates that the costs have shifted in all categories; the largest shifts were experienced in old age and disability and, from 1993 onwards, in unemployment. Simultaneously, the insured have been losers in all categories. With the exception of sickness and health, and family policies, the state has increased its relative burden. In these particular cases, municipalities had to accept increased costs. These results are in line with expectations.

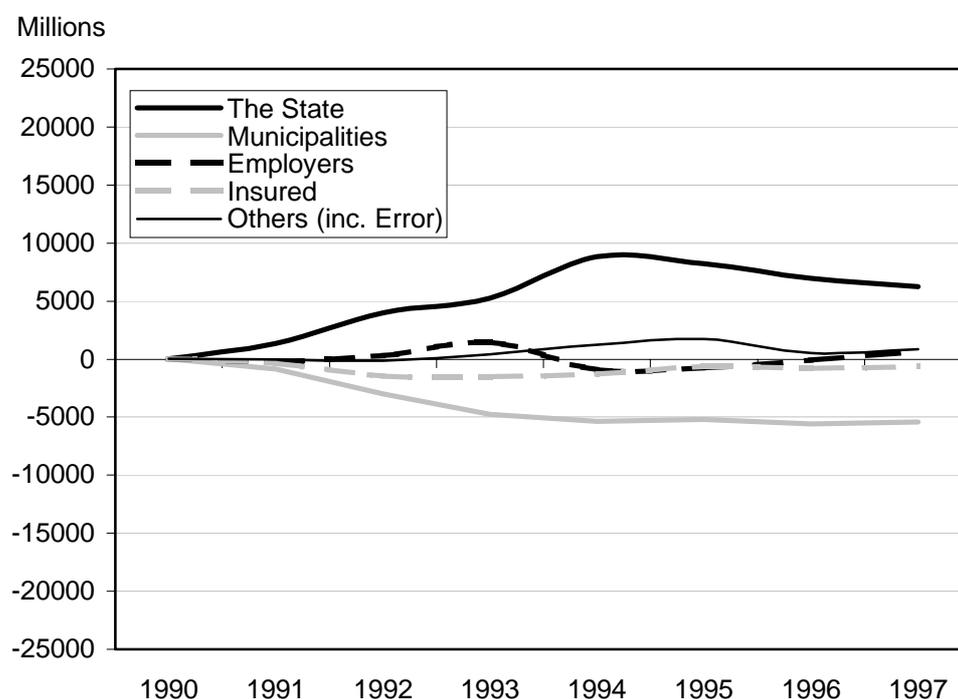
The calculations represented in Figure 7.3 simply shows that there have been major changes in the structure of financing social policy due both to political will (indirectly, through the redistribution of responsibilities) and to structural change around social policy. It does not provide any information on the relative importance of these two factors; instead, it simply illustrates that the increase in social expenditure varies between categories (governance structures), and within each category, the increase has often been allocated to those benefits, which have been financed by other players than employers. Often, this has been a deliberate choice; for instance, eligibility rules have often been changed so that access to those benefits which have been financed by employers (and employees) have been restricted. This is the case for instance in unemployment insurance where the qualifying period was extended from six to ten months in 1997, thereby restricting access to the benefits financed by employers and employees.

However, it may be of interest to know how much direct policy-making has altered the structure of financing under certain hypothetical circumstances. In order to find this out, the internal structures of benefits and services have been fixed to 1990, but the structures of financing have been allowed to evolve (see Figure 7.4). The annual increase of expenditure has then been distributed evenly between all the categories of services and transfers from childhood to old age, instead of allowing it to concentrate on unemployment. The evenly distributed increase of social expenditure distributed between all categories of benefits and services results in the increase of total expenditure to 43 percent in all individual benefit and service categories during the period under investigation. In reality the increase of expenditure was targeted to a few categories. For instance, the unemployment expenditure would have been FIM 11.1 billion lower, had the proportion of unemployment-related costs out of social expenditure remained as in 1990; furthermore, the state would have saved 54 percent of this amount.

The results indicate, very roughly, how much the changes of financing structure would have altered the proportions of financing in this hypothetical case, where

everything else but the structure of financing and total social expenditure would have remained as in 1990. Again, this is a zero-sum game. A decrease in the proportion of one financier must be compensated by the increase of another financier's burden. (Evidently, however, the zero-sum game is not necessary the case with an individual category of benefits.) The results show that within such a hypothetical environment the costs to the state would have been some FIM 9 billion lower than they actually were in 1994; that is, the changes in the structure of financing have decreased the state's expenditure by this amount. Simultaneously, in 1994 the costs of municipalities would have been some FIM 5.3 billion higher. Furthermore, the changes in the financing structures have increased the insured's expenditure by FIM 1.3 billion in 1994, whereas the employers have been able to shift costs to other financiers roughly by FIM 0.9 billion. In short, at the first phase of the recession, both the employers and the state have been able to shift some costs away to the insured and municipalities. In this game (and within this framework which excludes all other changes in the general funding of public expenditure), the state has been the major winner, and the municipalities the main loser.

*Figure 7.4. The adjustment of financing social expenditure: an evolving financing model, fixed the 1990 expenditure structure, millions*



However, the interplay of the changing socio-economic environment and the adjustment of financing structure causes some unexpected consequences. For

instance, in the case of the state the mainly structural element (fixed 1990 financing structure) increased the state's costs by FIM 4.6 billion in 1994, whereas the shifts in the structures of financing (fixed 1990 expenditure structure) simultaneously seem to have decreased its expenditure by FIM 8.8 billion, resulting in the hypothetical net gain of FIM 4.2 billion for the state. Such a counterbalancing outcome is rather exceptional, however. In the case of employers the structural change saved FIM 21 billion whereas the political element (the adjustment of financing structures) actually caused an additional cost of FIM 0.9 million, resulting the hypothetical net saving of some FIM 20 billion for employers. Municipalities lost in both cases; both social and legal changes increased their costs in these hypothetical environments.

The insured actually won a little bit in "hypothetical" politics. This is a counter-intuitive outcome of the interface between sickness and unemployment contributions: their unemployment contributions would have been much smaller but this would have partly been compensated by the dramatic increase in sickness expenditure, where the insured were significant financiers around 1990. The outcome is that the total burden of insured was smaller in the realised expenditure scenario. The insured, however, lost heavily due to structural change, because the increase in social expenditure was actually targeted to those risk structures, like unemployment and partly old age, where the insured were important financiers.

In sum, Figures 7.3 and 7.4 seem to indicate that the major proportion in the adjustment of finance can largely be explained by structural changes in the certain categories of expenditure, caused by the interface of socio-political benefits and services and the changing socio-economic environment, rather than by the direct political decisions aimed at changing the individual structures of financing. The crucial elements of change include evidently unemployment and ageing (changing demographic structure) but also changing composition of households and families play some role. For instance, Figure 7.4 implies that under the hypothetical conditions there has been no major changes in employers' total financing responsibility during the 1990s. Cuts in certain categories has been compensated by the increase in others. However, the changing environment has greatly decreased the absolute amount to be spent. This is mainly because households consumed, say, in 1995 different kinds of benefits and services than they did in 1990 both in terms of overall expenditure and different social risks.

The significant majority of expanding transfers were those financed by the state rather than employers and the insured; a closer look would show that they were mainly means-tested benefits. Their proportion of total transfer expenditure increased rapidly during the 1990s, especially in the two lowest quintiles, at the expense of earning-related and universal benefits (see Saari 2001a, chapter seven). In transfers, the impact of direct fiscal revisions has in fact been a rather

modest compared to structural changes affecting to relative proportions. In services, the revisions of fiscal structures play a more significant role. This has mainly been due to the revision of the state's grant system in 1993 and 1997. Next, I will discuss certain strategic choices; then, the rest of the Chapter will be devoted to investigating changes illustrated in Figures 7.3 and 7.4 in a more detailed manner.

## **7.2 Towards the sustainable structures of financing: the strategy of the 1990s**

Organisations with their large information processing capabilities are far more sensitive to changes in institutional incentive structures around them than are the individuals who are making their decisions in a more irrational manner. Therefore, it is the organisational level where the design of institutional framework matters most; furthermore, changes in "institutional incentive structure" have enormous impacts to the evolution of social transfers and services and related costs. Taking this into account, it is surprising that most public attention has until recently been devoted to household level incentives, where the fiscal consequences of any adjustments are in fact minor. In most cases, we have been dealing with millions FIM rather than billions FIM that are at stake when dealing with institutional incentives.

During the 1990s, the major adjustment of financing structures resulted in an extensive political co-operation and national consensus. This is due to the high degree of collectivisation and internal self-organisation in Finnish economic and policy, which makes it possible to co-ordinate the long-term interests of competing partners. Most reforms of financing have in the end been completed on the basis of tripartite agreements between the social partners and state authorities; sometimes, the confederation of municipalities has also played a significant role.

There have been three general objectives in designing fiscal structures in the 1990s: the space available allows only a brief description of the first two, as I wish to focus the rest of this section to the third.

1. Stabilising public finance in a medium term. In a Finnish tradition, the surplus of public finance has been a generally accepted objective of fiscal policy from the 1960s onwards, even at the expense of commitment for (public or subsidised) employment. The stability of public finance was given an even stronger priority during the first half of the 1990s whereas the latter half of the 1990s, employment policies gained some ground as the public economy has reached surplus. Even now, however, paying back the debt was the policy priority, rather than employment or the extensive reform in social policies.

2. The international competitiveness in a globalising world has been considered as a priority that has had a certain impact of the design of financing. While the so-called devaluation-inflation cycle has been a key component of this policy, the structures of finance has also been adjusted in order to maintain competitiveness. This issue has been on the agenda from the oil crises onwards. The 1990s have even increased its role in designing social policy as the competitiveness of global (information technology) markets and the importance of investment flows have become more important as a part of broader growth strategy (see MF 1998).
3. There has been a need to clarify the internal logic of the design of financing so that, first, rights and responsibilities are linked in legitimate ways and the whole package would be a better “carrying capacity” in a long run. Simultaneously, there have been a broad consensus over the fundamental principles of the Finnish social policy, based on universal coverage, collective solutions, equality, and so on (STM 2001).

Financing strategy has evolved in the course of the 1990s as a part of incomes policy agreements and the governments programmes. Crucial points were in incomes policy agreements of the early 1990s, when it was agreed on certain reforms in financing social policy and major retrenchment in fiscal policies. Most crucially, it was agreed that employees would have a greater responsibility than earlier in financing the earnings-related transfers. In 1993, a new Grant Act became effective as a part of a new Municipality Act, which allowed greater autonomy for municipalities. Simultaneously, a new Act (734/92) on user's charges was implemented. Lipponen's rainbow government's programme in 1995 further revised the benefit and service structure by revising the grant system and certain benefit structures (including national pensions and sickness insurance).

In short, as an outcome of these agreements the insured and the employers (including municipalities and the state as employers) have increasingly become responsible for earnings-related benefits (or the earnings-related elements of larger packages), the state (beside the state's pensions) on residence-based allowances and on grants to municipalities, and municipalities on social, health, and (to a lesser extent) educational services. This strategy has by and large been implemented during the 1990s, although there are some exceptions. In relation to earnings-related benefits, the state still carries some responsibility over farmers' and entrepreneurs' earnings-related pensions (legitimised mainly by a demand for a rapid social transformation and difficulties in financing these pensions). Furthermore, the state was to remain responsible for financing those proportions of earnings-related benefits, which were equal to non-earnings-related allowance aimed at facing the same risk.

Despite the general principle that employers should not be liable for the flat rate benefits, due to the fiscal constraint employers are still partly responsible on the financing of national pensions. These benefits have from 1996 onwards been granted only for those who do qualify for any other pension or whose pension is otherwise low.<sup>67</sup> The municipalities, which finance social, health and educational services by local taxes (and grants from the state) have also been considered as responsible on financing transfers which complementary to social and health services. They also are responsible in financing (and administering) social assistance. In what follows, some more detailed information is provided in the key elements of financing complex.

### **7.3 Central government finances**

In both down and upturns it is the state whose fiscal policies are crucial in stabilising the funding of social expenditure. Its relative proportion of total financing declines significantly during the upturn whereas in recessions the opposite has regularly been true. As explained in a detail elsewhere in this collection, the state's debt soared from FIM 57 billion to FIM 420 billion in 1998; the major part of the debt accumulated between 1991 - 1994. Furthermore, due to the structure of taxation those progressive taxes and levies raised by the state decreased significantly during the recession, whereas municipalities relying on flat rate taxes suffered proportionally speaking less. The structure and performance of this particular model of financing was a fundamental matter to be considered in the context of reform-making policies during the 1990s.

In order to maintain its function as a stabiliser, the state extended its tax base by revising the tax deductions, by raising income tax rates, and by reforming the capital and VAT taxation. The main short-term objective of abandonment or decrease of certain tax deductions (especially housing and family related ones) during the early 1990s was simply to extend the tax base. However, on the other hand, the long term objective was, first, to differentiate tax and social policies from each other, and, second, to make transfers more transparent for the public and for the decision-making.

Raising income tax rates was completed through the postponement of the inflation revision of income tax brackets in the state's taxation (and through the introduction of new insured's social security contributions). In 1992 - 1994 income taxation was tightened as no index revisions of the state's tax brackets were implemented. From 1994 onwards, inflation has been lower than the

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<sup>67</sup> The revision of the national pension Act, §25b which came in force 1.1.1994, adjusted national pension law so that the amount of pension is linked into the years of residence in Finland. This alteration was done in order to minimise the risk of welfare tourism to Finland as a part of integration process.

revisions, indicating the lowering of income taxation. That has been the case in particular from 1997 onwards.

In tax policy, two major reforms ended the wave of tax reforms that were initiated during the Holkeri government (1987 - 1991). Both were the indirect consequences of the liberalisation of financial markets and the unification of Europe. Capital tax reform differentiated income and capital taxes from each other, applying the flat rate tax of 25 percent to all capital income sources, thereby eliminating previously existed different tax distortions in capital taxation. The lower tax rate was considered as a competitive advantage (and a necessity because of the free movement of capital). Lipponen I government increased the tax rate from 25 percent to 28 percent, and Lipponen II from 28 to 29 percent. The primary aim of VAT reform was to extend the tax base of consumption taxes by making services, primary and construction industries liable to VAT, thereby raising additional revenues for the state. VAT of 22 percent was applied to most commodities, 12 percent to transportation, restaurants, movies, drugs and books, and 5 percent to TV licences: health, social and educational services as well as finance and insurance services, (and the transition period, primary production) were not liable to pay VAT.

Regarding the change in the state's social expenditure a key concept is the budgetary framework defined as a part of budgetary proceedings. The long term political objective of Esko Aho's centre-right government (1991 - 1995) was to maintain the total budget expenditure below the total expenditure level of the budgetary year 1991. According to their plan, the volume of central government expenditure was projected to return to its 1991 by 1995, that is, before the next election. In order to achieve this objective - which itself had no theoretical foundations - more emphasis was given for the medium term planning in ministries, thus extending the planning cycle. This new institutional structure, introduced in 1991, allowed government to impose expenditure ceilings for the three years following the budget (OECD 1995, 72-73) and this practice has been continued ever since.

The EMU-convergence requirements were another factor of importance in stabilising the public economy. As explained earlier, it has been the state, rather than communities or funds, which have stabilised the public economy through deficit financing, resulting a huge deficit to the state's sector. However, simultaneously, there have been significant surpluses in funds and some fiscal surplus in municipalities. From 1993 onwards, public economy (including deficit and general public liabilities) was treated as a totality in the state's budget proposals. It is suffice to say here that the Maastricht criteria were widely considered as "constitutional" boundaries for fiscal policies. Right or wrong, they existed and set the unconditional external constraints for fiscal policies (for a detailed discussion on budgetary processes and the EMU-criteria, see Saari 2001, chapters 5 and 10; also Pochet 1999).

The budgetary framework and the EMU-criteria made economy and fiscal policy more predictable in the sense that the organisations, like international investors, lending to the government had a rough idea on forthcoming fiscal policies. From this point of view, the fiscal policies have been a great success. From the point of view of municipalities, households, and trade unions and other relevant organisations is different, at least in the short term. For them, this policy aimed at rapidly stabilising the state's economy and fulfilling the Maastricht criteria indicated that further cuts were to come in the future. This generated uncertainty, atypical labour contracts, and decreased private consumption. The jury is still out to decide whether the long term positive consequences of this institutional structure to social policy were larger than possible negative consequences in a short term; in all cases, the answer is beyond my competence.

It is not the task of this article to quantify the cuts in the state's social expenditure (this has been done elsewhere, see Saari 2001a, chapter 6). Suffice it is to say that they were both necessary and exceptionally large. No doubt, without them and related agreements in the early 1990s, the institutional model of social policy would have collapsed. The necessary decisions that made possible to maintain the present institutional structure of social policy were made around the end of 1992 as a part of broader stabilisation pact. An alternative path would have been a more fragmented model. As the cuts would have been targeted to earnings-related benefits, these benefits would to some extent have been supplemented by private insurance. Also the role of means-tested benefits would probably have been significant in this projection. (see Saari 2001a, chapter 5.) Furthermore, due to political and corporatist resistance, the cuts were not as large as the Ministry of Finance and OECD insisted in 1992 - 1994.

More interesting than estimating these cuts it is to review, how the public administration adjusted its behaviour in order to minimise the amount of retrenchment. Beside actual cuts, there are different ways to maintain the budgetary framework intact. First, many ministries have funds, which are not directly included in the budget and which are a sort of safety valves for public finances to be used to cover some running costs. In the state's pension policy, the Ministry of Finance did not significantly use its rights to accumulate pension funds, in contrast to the case of local and private pensions. In 1990, the state introduced a funding principle in its pensions. In 1990 - 1995, virtually all pension security contributions were used, due to budget deficits, to cover running costs. In 1997, this transfer amounted to FIM 6.0 billion, which was actually higher than the annual contributions to the fund (Valtiokonttori 1997).

Within SII, the National Health Insurance fund had been used to cover National Pension Insurance expenditures in 1994 - 1996. At its highest, in 1996, some FIM 1.6 billion was shifted. However, in 1999, FIM 281 million was transferred

back to National Pension Insurance Fund. Simultaneously, the value of investment in national pension insurance and national health insurance declined in 1991 - 1995 from FIM 826 million to FIM 759 million, and FIM 243 million to FIM 87 million, respectively. There are also certain funds in private pension systems and earnings-related unemployment insurance, which have been merged in order to comply with some administrative rules. There has been a merger wave especially in unemployment funds, where the state has gradually increased the size of the smallest fund liable to the state's grant, thereby forcing labour unions to with a few exceptions administrate these funds, to merge them.

Secondly, strictly legal creative accounting methods were applied in order to maintain the budgetary framework intact. They include transferring a certain percentage of VAT directly to SII instead of circulating the resources through the budget from 1993 onwards. This amounted first to FIM 1.8 million in 1993,<sup>68</sup> but increased rapidly to FIM 2.4 billion. In addition, work injury insurance companies also pay direct transfers to SII in order to compensate the costs caused for the public sector from work injuries. Furthermore, please note that all social security contributions paid by employees or citizens, including those paid by the state's employees, are directed to pension and unemployment funds and SII (in the cases of health insurance contribution and national pension security contribution) without circulating them via the state's budget. This practice already existed before the recession. However, as Figures 7.2-7.4 indicated, their importance increased rapidly during the 1990s, consequently providing another way to expand social expenditure without expanding the budget framework.

Thirdly, the ministries are able to shift costs between them by redesigning the division of tasks and the cost. As already mentioned, the state's social expenditure has been divided between the number of ministries. During the recession, housing costs were allocated to the Ministry of Environment, (the state's) pension costs to the MF, and student allowances (and related benefits) for the Ministry of Education. The costs of active labour market policies were on the responsibility of the Ministry of Labour. MSAH carried the responsibility over the other categories of state's social expenditure. One of MF's implicit objectives has been to minimise the growth of the state's expenditure by controlling the cost expansion of MSAH: however, the civil servants of MF have had a more positive attitudes towards educational and active labour market policy expenditure, which are easier to be interpreted as 'investments'.

During the recession years it was the budget of MSAH, which was under exceptionally detailed surveillance. Therefore, the expenditure in other ministries was easier to adjust in a positive way by re-designing the structure of

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<sup>68</sup> In 1993, this amount was equally divided between National Pension Insurance and National Health (Sickness) Insurance. From 1995 it has been allocated exclusive to pensions.

redistributive systems so that costs are transferred to other ministries or other financiers. A housing allowance increased the expenditure of the Ministry of Environment, a student allowance increased the expenditure of the Ministry of Education, and active labour market policies increased the expenditure of Ministry of Labour. A special case was the introduction of a means-tested unemployment allowance titled “labour market subsidy”. It was located to the Ministry of Labour instead of MSAH, which remained responsible for the financing of the basic unemployment allowance (and non-earnings-related element of unemployment insurance). Finally, the grant system comprises similar properties aimed at transferring costs from MSAH to the Ministry of the Interior in 1993. In this particular case, FIM 3.1 billion reserved for social, and health services was transferred from MSAH to the general grant administrated by the Ministry of the Interior. Notice that in social expenditure statistics this change decreased the state’s social expenditure.

All of these revisions occurred in the middle of the deepest recession. While the structural factors do play a major role, the outcome also was partly intentional. Social relevant expenditure was increasingly allocated to those ministries that were under less strict surveillance. Consequently, from 1991 to 1999, the MSAH’s proportion of the state’s budget decreased from 31 percent to 20 percent. In nominal terms, the MSAH’s expenditure increased from FIM 39 billion in 1990 FIM 53 billion in 1994; since then, it has decreased due to either direct cuts, decrease in unemployment, the reallocation of resources, or the expansion of the individuals’ social security contributions down to FIM 42 billion in 1999. (MSAH 2001a, 138.)<sup>69</sup> Simultaneously, that is, between 1995 - 1999, expenditure for student financial aid and labour market subsidy (support) has clearly expanded, and despite fluctuations housing allowance expenditure has generally speaking increased. All these allowances are fully state-funded, resulting in the increase in related categories of the state’s budget.

#### **7.4 Employers’ and employees’ social security contributions**

The employers’ social security contribution is in Finland as in other countries an umbrella concept that covers numerous social security contributions (SSCs). In Finland, the SSCs consist of earnings-related pension SSC, unemployment insurance SSC, statutory work accident insurance contribution, national pension SSC and sickness (health) insurance SSC. It is worth noting that employers

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<sup>69</sup> As an example of reversed policies, one may mention the abandonment of sickness and child deductions in state’s (and well as municipalities’) taxation, which in turn increased the state’s social expenditure. Furthermore, the municipalities’ responsibility on the supplementary parts of national pension was transferred to the state. Here, the municipalities’ share in the financing of national pension insurance declined from 24.4 percent in 1995 to 0.4 percent in 1997.

also still pay contributions to the universal benefits such as national pensions although their importance as financier has clearly declined.

As a rule the different sectors of the economy (and their sub-sectors) pay different amounts in different SSC. As a totally, however, the total costs are coordinated in a way that the lower contribution in one SSC is compensated by a higher contribution in another SSC. This has been made possible by the negotiated economy model where all major parts of social expenditure and their financing structures are sufficiently closely interlinked. Furthermore, there has been a broad consensus on the objective of the policy-making; namely, social security contributions should be designed so that their negative consequences for employment and competitiveness can be minimised (see, also, Suominen 1997). Evidently, the different sectors (private and public) of the economy, and units with different structure of production costs (labour and capital incentive sectors, and industries versus services) have diverging interpretations and interests in these respects.

The main consequence of the recession was the expansion of employees', wage earners' and pensioners' social security contributions. Incomes policy agreements shifted the proportional costs of SSCs from employers to employees. The *pension security contribution* of pensioners was the innovation of the recession. It is the contribution, which is paid by the people who receive the benefit concerned. In most pragmatic purposes, such a contribution is another way to maintain the government's promise to keep the gross level of pension intact, while simultaneously to adjust its net level. (Furthermore, it was widely agreed that that pensioners and employees should bear equal costs on the adjustment of pension expenditure). Observe the rapid increase of this politically inflammable rate in the course of the first recession years, as well as the rapid decrease after the recession. Another major innovation emerged with the *sickness insurance contribution* where an additional contribution was decided to collect from those persons (employees and pensioners) who had a little bit over the average taxable income. The rate itself is clearly higher for pensioners who actually are not entitled to the sickness insurance benefits.

The *unemployment insurance contribution* was introduced for wage earners in 1993. By and large, it was a counter-cyclical institutional structure of unemployment benefit, which generated additional costs for employers during the recession that caused most problems in the financing of social policy. The costs for employers expanded rapidly in relation to a wage sum, from 0.6 percent in 1990 to 4.50 percent in 1995. Wage earners' SSC increased up to 1.87 percent of wage sum in 1995. Since then these contributions have been halved in relation to a wage sum. This has been due to decreasing unemployment rather than the reforms in financing. In 1999, the so-called a buffer fund was established, aimed at counter-balancing unemployment social security contributions during economic downturns. The buffer fund was the

result of extensive bargaining between labour market organisations and the integral part of national employment strategy under the EMU-framework, which does not allow devaluation as the means of competition policy (see, Pochet 1999).

The social insurance element of social policy is partly funded. Quite exceptionally, due to historical reasons, some funding also exists in national pensions and sickness (health) insurance, both of which were universal benefits until the 1997 reform. The actual importance of the funds was during the 1990s modest, only a few percents of annual costs. They act mainly as a sort of buffer funds. In addition, there are some "principled" considerations. In practice these long-term investments to power plants and (mainly state owned) industries, with low returns echo essentially the history of Finland's industrialisation policy.

Private earnings-related pensions have partly been funded since 1961 onwards whereas in the state's and municipalities' pensions funding was introduced in the late 1980s. By and large, the structure of pension funding was adjusted in changing circumstances by allowing a certain amount of deficit to occur in contributions. Pension companies and funds are collectively responsible on pensions, indicating that other companies must cover the cost of bankruptcies. According to the agreement completed between the labour market partners and the state during the early years of the recession, the annual increase of pension security contributions has been financed with equal contributions by employees and employers. Evidently, in the long run, this significantly increases the relative proportion of earnings-related pensions which is financed by the employees.

The portfolio share of the state's bonds in (private) pension funds' promissory notes increased from 6.2 percent in 1992 to 42.9 percent in 1996. In other words, the state was borrowing money from the pension funds (or pension funds were lending money to the state) that has to be paid back from general revenues (OECD 1997, 86-87). In fact, if no major changes had occurred in investment policy, before the year 2000 four fifths all their investments would have been in the state's bonds. This might have indicated - *ceteris paribus* - that the future generations would pay the pensions of the baby boom generations not only via social security contributions but also through taxation. However, during the boom of late 1990s the pension funds (companies) rapidly revised the structure of their portfolios and invested in stocks, which during the years 1998 and 1999 generated very high returns.

Rather than by recession itself, which merely increased costs (and resulted in a bankruptcy of one pension company) the major changes in funding were caused by the new opportunity structures, which emerged in global financial markets. Consequently, pension insurance funds have redirected their portfolio from conventional loans to Finnish industries and the state's bonds to international stock markets. In addition, the Finnish membership of the

European union has caused some organisatory or institutional changes to injury insurance and earnings-related pensions (which in Finland are classified into the first pillar of pensions) aimed at protect these institutions from life insurance directives (79/267/ETY, for details, see Saari 2001a, chapter 9).

## **7.5 Transfers from the state to municipalities**

From the 1970s until the 1993 revision, the grant (matching) system for running costs comprises four major elements: a general grant for municipalities, grants for social and (basic) health services, grants for educational services, and grants for regional organisations (mainly regional hospitals). In addition, there was an independent grant system for investments and several smaller, earmarked grants for specified purposes. The key mechanism through which the grant system functioned was 'capacity-classification system', which classified municipalities into ten classes according to their taxable income and certain other criteria.

In principle, the lower the amount of taxable income, the higher the matching rate and larger the transfer from the state. Such a classification relied on the criteria that were prepared every year by a special committee. Both grants and classification system were under the pressure of political adjustment and rent seeking. (See Helin & Oulasvirta 2000.) Furthermore, the annual increase of the allocated resources was largely determined in a plan concerning the development of the social and health services, accepted annually by the Government. By and large, this system functioned on the basis of accepted costs: if a municipality (or a regional organisation) was able to receive the state's approval for certain expenditure, it also was liable for an earmarked matching grant. Consequently, broadly speaking more municipalities were able to generate acceptable costs, the more resources was transferred from the state to municipalities.

The outcome of this grant system was to some extent unintended: differences in outcomes between municipalities were large and as there were not logical incentive structures that would have promoted effectiveness. During the late 1980, a large consensus emerged that this system did not function in an appropriate way. This was mainly because the expansive period was over at that time and planning organisations were not suitable for the promoting of the restructuring: for that purpose, more autonomous municipalities seemed to be more efficient. Secondly, the framework aimed at promoting the expansion of social and health services was not suitable under the condition of recession. The system triggered, it was argued, semi-automatic participation from the state whenever the regional and local authorities spent resources. Incentives to reduce costs or to improve efficiency in health and social services were virtually absent.

In 1993 - 1997, a major revision occurred in the state - municipality relationship. Regarding the financing, three major changes occurred in that reform. First, in the course of transition, "capacity-classification system" (kantokykyluokitus, in Finnish) in a general grant system was allowed to erode as the emphasis was transferred towards a non-matching grant system with new equalising criteria. Capacity-classification system was gradually replaced (and completely abandoned in 1997) by the system aimed at maintaining the differences between municipalities' revenue within certain limits. Secondly, the direct transfers for municipalities replaced the transfers for regional organisations (joint authorities of municipalities, mostly established for special health care and vocational schools). These regional organisations lost their autonomy, as far as funding is concerned (with the exception of users' charges directly paid for them).

Finally, there was a shift from earmarked grants to general non-matching grants in social, health and educational services, based on the structural features of the municipalities' population and regional structure. These structural features are thought to reflect different expenditure needs in municipalities. In a formula, the age structure plays a crucial role in social and health services; unemployment plays a significant role in social, and disability in health care grants. Also certain additional criteria exist, aimed at compensating exceptional circumstances in northern Finland and the islands. (In education, the grant is unit based, meaning every student is worth a certain amount adjusted to special circumstances in municipalities). Additional grant systems exist for libraries etc. After the reform municipalities got a right to direct grants allocated to social and health services to any purpose they wish as long as their fulfil the requirements of laws.

In the 1993 reform, social and health related grants to municipalities was assumed to remain intact, that is, in principle the later implemented cuts in transfers were not legally related to the reform. To be successful and sustainable in economic terms, implementing such a reform under exceptional consequences requires relatively long transition period. Otherwise, it simply was not realistic to assume that municipalities - not to mention regional organisations - would have been able to cope with a transition period as the 'unexplained' differences which had been accumulating over the two decades were remarkable large. On the other hand, the recession itself required a rapid transformation period which would have made it possible for autonomous municipalities to develop their survival strategies, suitable for local conditions. The outcome was the compromise: certain criteria were designed to compensate the exceptionally large changes in a grant system through the general grant system whereas the grant system for social, health and education system were based upon the quantifiable criteria. In other words, although certain general rules of game were implemented, exceptional procedures were

made available for the municipalities suffering from exceptional circumstances and historical curiosities (like the over-investments in institutional care).

The social and health grants from the state to municipalities have experienced the largest decline and their share of municipalities' total expenditure has subsequently declined that particular sector of activity. Because the accounting structure has been revised several times during the 1990s, it is impossible to calculate in an accurate way over time the actual share of state out of municipalities' total health and social expenditure (see also Helin & Oulasvirta 2000). However, reasonably accurate estimate, in terms of state's proportions out of municipalities' net social and health expenditure, implies that the proportion of grant of net expenditure has decreased from 41.4 percent of gross social and health costs (or from 48 percent of net social and health costs) in 1993 to 24.2 percent of gross social and health costs in 1998. Calculated in this way, there has been a major transition in terms of the state's responsibility. Cuts have been made in different ways; occasionally, grants have simply been cut, in some cases the index has been frozen or the index-formula has been altered, in other cases the cuts have compensated other changes in the state-municipalities' relationships. (The Ministry of Social Affairs and Health, unpublished information provided by Department for Health and Social Services.)

Before any conclusion will be put forward, observe that the figures provide no information on transfers from municipalities to the state, or on the changes in municipalities' tax structures. Cuts in grants are often associated with the subsequent lowering of transfers paid to the state. In addition, several changes that have decreased municipalities expenditure have been compensated by adjusting grant systems. I have already mentioned changes in tax deductions, which the increase of municipalities' tax was compensated by cutting social and health grant by FIM 2.3 billion in 1994. Beside it, such changes include changes in certain supplementary elements of pensions, social security contributions, home care allowance, and social assistance; most of them occurred during the latter half of the 1990s, especially after the Lipponen's I government came into power.

Secondly, the 1992 Act on user's charges has made it possible for municipalities (and regional authorities) to increase their direct income from customers. Their proportional importance has not increased in the 1990s. (Anyway, not after 1992; no comparable information is available for the years 1990-1992). In social services, the proportion is the largest in old age care and whereas in health services the proportion is the highest in dental. In both cases, roughly one fifth of total costs are covered by user's chargers. In many other items, including day care and health care (in general), the proportion has varied between 10-15 percents. (All unpublished data from Kuntien taloustilasto/STM). However, user's charges nevertheless played crucial role in adjusting health

care into a changing circumstances; furthermore, the rate of increase in these charges was well above the consumer price index.

Finally, what is crucial in understanding the fiscal affairs of municipalities is the remarkable increase of local tax revenue after the end of the recession period of 1991 - 1993 (see Helin & Oulasvirta 2000). Such an expansion has resulted from both the increases in returns in municipalities' income and property tax, and community taxes. To put it simply, the tax basis has been expanding and the companies have made lucrative profits, which has resulted positive revenue income. Especially those municipalities which with a high proportion of personnel from information technology companies have experienced a massive increase in their revenue income from the share of the national corporate tax revenue. Despite certain mechanisms (1996-) aimed at redistributing revenues between municipalities so that wealthier municipalities are liable in paying the certain percent of above-than-average-per-head tax revenues to a common pool, to be further distributed to poorer municipalities with lower per head revenue income, the differences between municipalities' fiscal positions were nevertheless large during the 1990s.

All things considered, the amount of the net cuts was only a few percent of local governments' total expenditure. (Saari 2001a, chapter 7.) In fact, the major problem was not cuts per se but the lack of expected and steady increases in municipalities' income in all types of municipalities and the simultaneous unpredictability of the state's grant policy. From decision-makers' point of view, the steadily increasing costs made policy-making even difficult. Furthermore, the new institutional incentive structure of the grant system reformed 1993 has affected the behaviour of the municipalities by making their decision-making more independent from that of the state and related planning apparatus (Oulasvirta 1997). Needless to say, the new incentive structure also made the cutting of grants politically less costly for the central government.

## **7.6 Conclusion: the lessons of the 1990s**

The history of finance is the essential part of social policy history. Therefore, in this chapter, trends and strategies in the financing of social policy have been investigated. The following conclusions can be made on the most crucial elements:

- Most of the changes in the structure of financing are due to a changing structural environment, rather than the adjustment of individual benefits' or services' financing structures. Direct political decisions are not the main cause for changes in the structures of financing. Instead, it is the increase in the consumption of certain benefits and cuts in the production of certain services that explain most changes. No information is available regarding

the extent such an adjustment policy based on structural change was the outcome of intentional policy-making.

- The adjustment of financing structures was an essential part of the broader adjustment policy of the 1990s. Retrenchment policy exclusively based on the cuts in transfers and services, without simultaneously adjusting the structures of financing would not have sufficed; the government, labour market organisations and municipalities could not have been able to maintain the institutions of social policy without such an adjustment in financing.
- This adjustment was eventually made possible by the double process of integration. Integrated decision-making model, based on social corporatism, which emphasises long term gains rather than short term interests made it possible to transfer costs from certain partners to others while simultaneously restricting opportunities for cost-shifting. This limited cost shifting, which itself is the necessary part of social policy, was made possible by integrated approach to social policy where transfers, services, taxes and certain fringe benefits are co-ordinated both in terms of financing and consumption. In my view, integrated models of both decision-making and social policy seems one of the key explanations for the success of the 1990s in maintaining the fundamental basis of social policies' institutional structures intact.

All in all, the institutional structures of financing and the number of persons exposed to social risks required equal political attention during the recession. The new institutional design of financing structure emerged in the early 1990s as a part of complex adjustment process, where the limited fiscal resources were bridged with the rapidly increasing number of people exposed to social risks. In many cases, the implemented reforms of financing has had more important long term consequences to the institutional structure of social policy, than the implemented reforms in transfers and services.

The outcome of this complex reform process is broadly speaking satisfactory by (m)any standards. Or to put another way, to my knowledge not a single observer has claimed that the existing model of the financing of social policy would be worse than the one that existed in 1990, whereas such comments are quite regularly heard on the institutions of transfers and social and health services. There has been a gradual improvement in the structure of social policy financing in terms of carrying capacity and internal rationality, and there is no reason to assume that the improvement achieved will be reversed in the nearest future. Quite the contrary, the years from 1998 onwards (a period which is outside the scope of this article), during the Lipponen's second government, have witnessed some significant reforms in the financing of unemployment security and sickness (health) insurance that to some extent have completed

the transformation of responsibilities that began in 1991 - 1992. Further reforms are perhaps still needed in the financing models of pension policies and grant systems, as well as in the interfaces of transfers and services packages. (on strategies, see MSAH 2001b.)

As already stated, the reforms of financing has had more important long term consequences to the institutional structure of social policy, than reforms in transfers and services. However, it is the number of persons exposed to social risks and related efforts aimed at curbing the expansion of expenditure that has been the main objective of public attention. Less visible and rather technical (sometimes extremely complex) issues related to financing have often been revised without major public debate. Furthermore, most studies on social policy still deal exclusively with the consumption side. To my knowledge, no systematic academic training and comprehensive textbooks on the financing of social policy are available in Finland. Assessed from the point of view of social policy's long-term sustainability, the structure and content of public debate, academic training, and text books all seem, for the time being, to be quite distorted in this respect. Also, taking into account the nature of future challenges for social policy, more systematic efforts for investigating, and popularising, the structures of financing are needed by social politicians. The topic is too important to be held by economists alone.

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## **II Labour market**

8. Employment and output growth in the 1990s
9. The Internationalisation of the Finnish Economy and Labour Market Adjustment – An Analysis using Finnish Employer-Employee Data for the Years 1988 – 1996
10. Unemployment and Early Retirements of the Finnish Aged Workers in 1989 - 1996
11. Evolution of Inequality in the Finnish Labour Market, 1988 - 1996



## 8 Employment and output growth in the 1990s

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### Abstract

The Finnish economy experienced dramatic changes in the early 1990s. The collapse of the economy in 1991 resulted in a 12 percent decline in GDP over the years 1991 - 1993, leading to a significant fall in the demand for labour and a rise in unemployment. The study contributes to the discussion on possible changes in the functioning of the Finnish economy by scrutinising the stability of the employment-output relation. The empirical analysis, based on aggregate variables from the period 1975 - 1996, suggested that the relationship between aggregate-level employment and output growth remained relatively stable throughout the investigation period. The examination of the panel data on 452 Finnish municipalities regrouped into 85 areas implied that the contemporaneous relation between changes in employment and output growth temporally disappeared in the early 1990s. The study found that there are differences in the employment-output relation between different regions and the existing differences can be partly explained by differences in industrial specialisation.

Jel Classification: C23, J23, E24, R11

Keywords: employment, unemployment, output growth, regional data, Finland

### 8.1 Introduction

The Finnish economy underwent dramatic changes in the 1990s. The collapse of the economy in 1991 resulted in a 7 percent decline in GDP. In 1992 and 1993 GDP dropped further by 3 and 1 percent, respectively. In total, GDP fell about by 12 percent within three years. This led to a significant fall in the demand for labour. In the three years from 1990 to 1993, the demand for labour declined by almost 20 percent. The total number of employed persons fell by 450 000 and, as a result, unemployment rose from 3.5 to about 18 percent. The response of wages to the shock was considerably smoother. Although real wages also declined during the recession, relative change was much smaller

than that in employment. During the recession years (1991 - 1994), nominal wages continued to rise by about two percent per annum. In short, the labour market reacted to the shock mainly via the adjustment of quantities, not via the adjustment of prices.

The Finnish unemployment shock of the early 1990s had much in common with earlier shocks faced by other industrialised countries. Following the typical pattern seen elsewhere, the shock was ignited by the collapse of a domestic credit boom, causing stock and real estate market crashes, to be followed by speculative attacks against the fixed exchange rate and the resulting high interest rates. An additional feature that added to the burden and depth of the recession in Finland was the collapse of the Soviet trade, which in just two years wiped out about 15 percent of Finnish exports.<sup>70</sup> Since 1994 economic growth has been rapid with an annual GDP growth rate of around 4 percent. This has resulted in a fall in unemployment to around 9 percent. However, the level of aggregate employment is still about 10 percent lower than before the recession.

The welfare losses of the economic recession of the early 1990s can be measured in various ways. One way to calculate such losses is to compare actual output to potential output. The Bank of Finland's estimates on potential output suggest that the combined losses - from 1991 to 1997 - have been around 100 mrd FIM. Although the concept of potential output (or output gap) remains vague and may give rise to mixed interpretations, the figure 8.1 illustrates the depth and uniqueness of the recession. Furthermore, it prompts an important question: did the economic recession of the early 1990s change the way the Finnish labour market operates?

There is some evidence to show that changes have occurred in the functioning of the labour market. For example, Kiander and Pehkonen (1999) report that the equilibrium rate of unemployment rose from 5 percent in the 1980s to about 8 percent in the 1990s. The authors associate the rise with changes in the tax wedge. Honkapohja and Koskela (2000) report findings that indicate an increase of about 7-8 percentage points in equilibrium unemployment rate. Kiander (1997) and Hämäläinen (1998) argue that the wage elasticity of labour demand increased clearly in the 1990s. The wage elasticity for the 1970s and 1980s was  $-0.3$ , whereas for the early 1990s it was already  $-0.8$ .<sup>71</sup> Linden

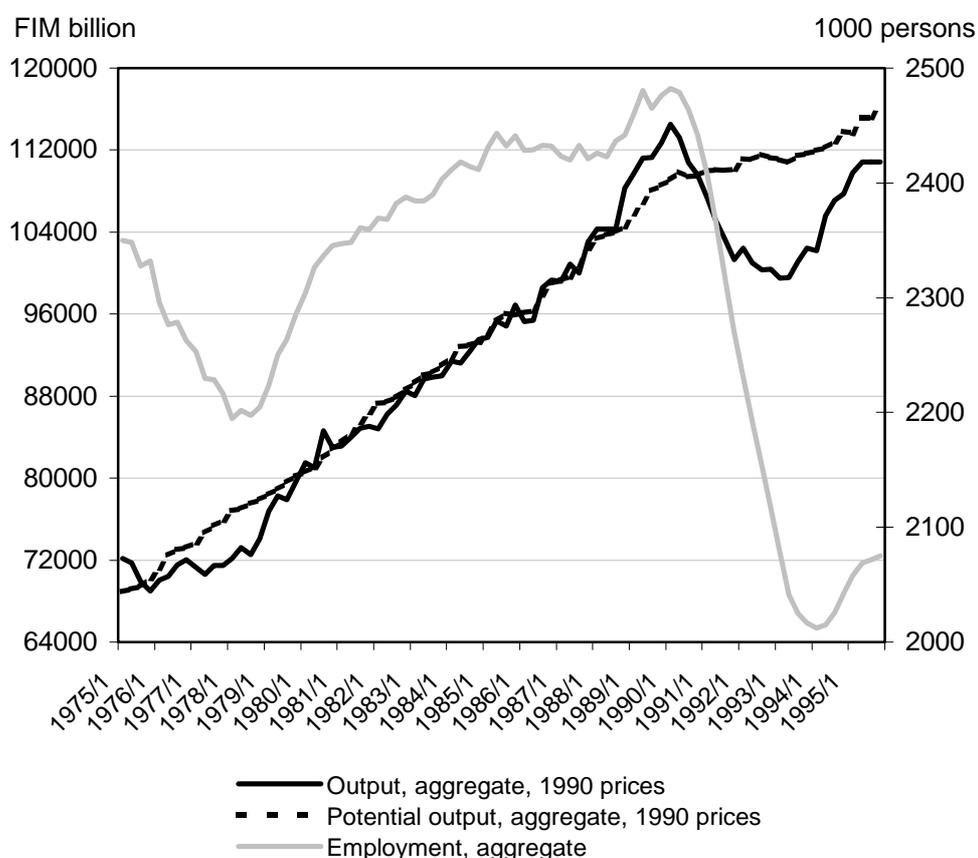
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<sup>70</sup> See, e.g., Kiander and Vartia (1996) for a detailed account. See also Perry and Schultze (1993) for an interesting comparison of recessions in the U.S.

<sup>71</sup> It is unclear how the increase in wage elasticity reflects the change in the structure of employment growth. In 1975-90 the growth in employment was due to increase in public sector employment, whereas after the recession private sector has been the main source of employment growth. This structural change is, of course, one potential explanation for possible shifts - temporary as well as permanent - in the aggregate level employment-output relation.

(1996), in turn, shows that the relationship between unemployment and output growth was much stronger in the late 1980s than in the early 1990s. In 1991-93 a decrease of one percent in output resulted in an increase in unemployment that was only half of the corresponding impact of the late 1980s. Furthermore, Tyrväinen (1996) argues that changes took place in wage-wage links in Finnish manufacturing after the collapse of the Finnish economy in 1991. According to the study, wage-wage links that have been tight in the long-run, wages in the high-pay branches and low-pay branches having followed a common path, are about to loosen.

Figure 8.1. Output and potential output in Finland, 1975 - 1996



This study contributes to the discussion on possible changes in the functioning of the labour market by scrutinising an economic relation which holds considerable interest from the policy point of view, i.e. the relationship between employment and output growth. The study examines whether this basic relationship has survived the turbulent period of the early 1990s. The question is important since it has been argued that economic growth is producing less employment than it did before the recession.

For example, Vihriälä and Virén (1997), who find that the relationship between unemployment and output growth varies between recoveries and recessions, argue that the ongoing recovery is not sufficient to bring unemployment back to the level of the late 1980s. Romppanen and Valppu (1998), in turn, conclude that in Finland more output growth is required to keep employment constant than in, e.g., the US or the UK. According to their estimates the constant employment output growth rate in Finland in 1995 was about 2,5 percent per annum. In the US, the corresponding figure was about 1 percent. Toivonen (1996) reports similar results for Finland. According to his estimates the constant employment output growth rate in Finland is about 2,7 percent per annum.

Although these studies are important contributions to the discussion on jobless growth and on the level of structural unemployment in Finland, they provide only limited information on whether the employment-output relation truly altered during the 1990s. Some light has been shed on this issue in recent studies by Pehkonen (2000), Kauhanen and Pehkonen (1998) and Sauramo (1999), who focus on the stability of the employment-output relation at the aggregate level and in Finnish manufacturing, respectively. According to these studies no substantial changes in the employment-output relation have taken place: output growth produces employment in a same way that it did in the late 1980s. There is, however, some evidence that the relation altered in the early 1990s, but that the change was only temporary. The evidence is, however, rather weak and thus the issue requires closer scrutiny.

The purpose of this study is twofold. First, we examine the relations by using macro level time series data. In particular, we examine the stability of this relation by employing recursive estimation methods. The analysis is based on quarterly data on the aggregate economy from the period 1975 - 1995. The second and novel aim of the study is to investigate what differences, if any, exist in the output-employment relation between the Finnish regions and, if such differences are found, whether they can be explained by differences in regional production structures.

The remainder of the study is organised as follows. In Section 8.2, we outline the models used and discuss the data. The results on the stability of the macro relation are reported in Section 8.3. Section 8.4 reports the results on regional differences in the employment-output relation. Section 8.5 concludes the paper.

## 8.2 Models and data<sup>72</sup>

In the time-series context the two most frequently used employment-output equations are of the form<sup>73</sup>

$$(1) \Delta \ln N_t = \beta_0 + \beta_1 \Delta \ln Q_t + \varepsilon_t$$

$$(1^*) \ln N_t = \beta^*_0 + \beta^*_1 \ln Q_t + \beta^*_2 \text{Trend} + \varepsilon^*_t$$

where it is assumed that  $\beta_0, \beta^*_2 < 0$  and  $\beta_1, \beta^*_1 > 0$ . At the given output growth rate, the parameters  $\beta_0$  and  $\beta^*_2$  provide estimates on the level of the shift in employment, induced by increased efficiency in production as well as changes in wage pressures and the pricing behaviour of firms. In (1), the ratio of  $-\beta_0/\beta_1$  provides an estimate for an output growth rate that keeps employment stable. In (1\*),  $-\beta^*_2/\beta^*_1$  provides the corresponding estimate.

Equation (1\*) can be seen as a static, simplified log-linear labour demand equation where the influence of the omitted variables is captured by a deterministic trend. In the empirical work we allow for adjustment costs (short-run dynamics) by estimating (1\*) in an error-correction form. That is, equation (1\*) is reformulated as

$$(1') \Delta \ln N_t = \lambda_0 + \lambda_1 \Delta \ln N_{t-1} + \lambda_2 \Delta \ln Q_t + \lambda_3 \ln N_{t-1} + \lambda_4 \ln Q_{t-1} + \lambda_5 \text{Trend} + \varepsilon_t$$

where  $\lambda_0, \lambda_1$  and  $\lambda_2$  measure the short-run impacts and  $\lambda_4 / \lambda_3$  and  $\lambda_5 / \lambda_3$  the long-run impacts.

These macro-relations given in (1) and (1') are estimated using quarterly data on the aggregate economy for the period 1975.1 - 1996.4. Due to changes in the data collection methods introduced by Statistics Finland, preliminary figures for 1997 and 1998 are problematic and hence this information is not utilised. Employment (N) refers to total employment, measured by the number of employed persons. Output growth is measured by GDP growth (in 1990 prices). The data source is Statistics Finland. The stability of these relations is examined by employing recursive estimation methods.

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<sup>72</sup> The models, data and results are reported in Pehkonen (2000) and Kangasharju and Pehkonen (2001).

<sup>73</sup> See, e.g., Romppanen and Valppu (1998), Pehkonen (1992), Ilmakunnas (1989) and Gordon (1993). It should be noted that the stability of the employment-output relation is connected with the question of the determination of employment and that of the aggregate production process. In this study our aims are far more modest: we are solely interested in the stability of the employment-output link, and of possible changes in it. Furthermore, we do not give a causality interpretation to this relation.

In the case of the regional level data the empirical employment-output equation is of the following form:

$$(2) \Delta \ln N_{it} = \gamma + \gamma_t + \gamma_{1t} \Delta \ln Q_{it} + \gamma_{1t} \Delta \ln Q_{it-1} + \gamma_{2t} \Delta \ln N_{it-1} + \mu_{it}$$

where subscript  $i$  refer to a region and  $t$  to time. The equation broadens a general, static employment-output relation by allowing for a lagged impact from output to employment and by including the lagged employment as an additional explanatory variable. Our approach allows for possible effects of omitted and unobserved variables that may vary across either cross-sections or time periods. To alleviate the consequences of excluded covariates (observed or unobserved), we use panel data methods to take into account both time invariant (but cross-sectionally variant) and time-varying (but cross-sectionally invariant) effects.

Apart from time-invariant effects there may still be time-varying effects that affect the employment-output link each year. These effects can controlled by the use of time dummies and, where considered possible, the use of interaction terms between the time dummies and the slope coefficients. If the time dummies or interaction terms are statistically significant, we may conclude that the link between employment and output has not been a stable one.

The empirical analysis is based on regional level data, in which the regions correspond to NUTS4 level regions in the EU. The regions - a total of 85 - are formed from 452 municipalities. The investigation period runs from 1988 to 1996, and thus includes the era of rapid employment growth of the late 1980s, the unemployment shock of the early 1990s and the years of recovery in the mid 1990s. Employment refers to the number of employees in an area, i.e. to the number of jobs. The output variable is the regional gross domestic product (RGDP). The data source is Statistics Finland.

### 8.3 Macro analysis

The results for the period 1976.3 - 1996.4 are reported below in Equations (I) - (II). The estimation method was recursive OLS.

The results of Equation (I) imply stability of the short-run employment-output relation. There is only one quarter (1987.3) where the relation appears to break. Diagnostic tests suggest that (I) describes the underlying data-generating mechanism with reasonable accuracy.<sup>74</sup>

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<sup>74</sup> See Pehkonen (2000) for details.

The results of the long-run employment-output relation depicted in equation (II) show some instability. In particular, the relationship appears to break down in 1989.3 - 1990.4. As a whole, however, the results did not imply that there has been a dramatic change in the employment-output relation in the 1990s. To sum up, both specifications indicated that the relationship between employment and aggregate output growth remained relatively stable throughout the investigation period.

$$(I) \Delta \ln N_t = -0.008 + 0.60 \Delta \ln N_{t-1} + 0.13 \Delta \ln N_{t-2} + 0.20 \Delta \ln Q_t \\ (5.92) \quad (5.33) \quad (1.36) \quad (6.66) \\ + 0.10 \Delta \ln Q_{t-1} + \text{seasonals} \\ (2.75)$$

$$(II) \Delta \ln N_t = -0.62 + 0.66 \Delta \ln N_{t-1} + 0.13 \Delta^2 \ln N_{t-2} + 0.25 \Delta \ln Q_t \\ (2.65) \quad (14.9) \quad (1.80) \quad (9.05) \\ - 0.15 \ln N_{t-4} + 0.16 \ln Q_{t-4} - 0.00114 \text{ Time} + \text{seasonals} \\ (3.48) \quad (3.91) \quad (3.60)$$

Recursive estimations, based on (I) and (II) provided detailed information on the parameters of the relationship between employment and output. The short-run coefficients - those for lagged employment (measuring persistence) and output growth - showed no variation in time. In the short-run an increase of one percentage point in the growth rate of output increased employment by 0.2-0.3 percent, the long-run impact being very close to 1 percent.

There were signs of temporary changes in the relationship. The coefficients for constant and trend, that capture the impact of technological change and enhanced efficiency on employment, increased considerably in 1991. Both specifications implied that between 1987 and 1990 the exogenous decline in aggregate employment was about 2.0-2.5 percent annually. The output elasticity estimate of 0.9 implies that it took about 2.5 % annual growth in GDP to keep employment steady.

During 1991 - 1993 the estimates for the exogenous decline in employment were higher, varying from 2.6 % to 2.9 % (Eq I) and 3.4-3.7 (Eq II). This increase was accompanied with a higher output elasticity of employment, which rose from 0.9 % prior to 1991 to around 1.0 % - 1.2 % during 1991 - 1993. Lower trend estimates from 1994 onwards suggest that there were

overreactions in the labour market in 1991 - 1993.<sup>75</sup> This is good news for future employment, although the output growth rate that keeps employment unchanged still appears to be somewhat higher than it was in the late 1980s.

From the policy point of view another important finding relates to the adjustment process, i.e., how fast changes in the growth rate in aggregate output affect employment. Both specifications implied that time lags may be considerable. According to the results, only one-fifth of the total effect occurs within the same quarter. The error-correction model indicated that it takes almost one year to accomplish 50 percent of the total effect. Tentative calculations suggest that – due to rather small immediate impact coefficients, long lags and exogenous (technically induced) decline in employment - it takes about one year of four percent economic growth after a one-year period of zero growth before employment stabilises and about two years before the pre-shock employment level is recovered.

## 8.4 Regional analysis

### 8.4.1 Stability of the employment-output relation

Equation III depicts the results of the basic regional model (cf. Equation 2). Note that the value for constant includes time dummies and that for output includes interaction terms.

$$(III) \Delta \ln N_{i,t} = -0.02 + 0.57 \Delta \ln N_{i,t-1} + 0.15 \Delta \ln Q_{i,t}$$

The time dummies played an important role in explaining the data. The importance of the interaction terms was less clear, although the joint significance of these terms cannot be rejected. These results implied that the time effects that capture the exogenous (annual) shift in employment at the given output level are far more important than the variables that capture changes in the correlation between employment and output.

According to the results employment declines, on average, about 2 percent per annum if there is no growth in output. This varies, however, from +5 percent in 1994 to –7 percent in 1991. Between 1991 - 1992 the estimate varies between -4 and -7 percent. In 1994, the estimate turns temporarily positive. In 1995 - 1996 the estimates are again negative, around -2 percent per annum. These results are in line with the view that the extent of labour scrapping during the early years of recession was excessive.

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<sup>75</sup> Recursive estimates are reported in Pehkonen (2000).

The link between changes in employment and output appears, on average, to be rather strong, the estimate being 0.35. It, however, varies between  $-0.47$  in 1992 and 0.98 in 1996. The results reflected the turbulence of the early 1990s, which showed up as a disappearing relation between changes in employment and in output in 1991 - 1992 and as the gradual recovery of this relation in 1993 - 1996.

#### **8.4.2 Regional variation in the employment-output relation**

To examine regional variations in the employment-output relation, we compared three groups of regions, all representing distinct parts of Finland as well as different groups of regions in terms of their economic performance. The first group consists of the Capital region and the province of Ahvenanmaa. The second group consists of the Eastern and Northern parts of Finland. The third group of regions is located in Southern and Western Finland, and can be called Middle Finland, both in terms of economic performance as well as location. The number of regions in the three groups is 7, 34 and 44, respectively.

The division of the data into the three groups showed up relatively well in the results. The exogenous change in employment was slightly stronger for the Eastern-Northern group of regions than for the other two groups. This suggested that the exogenous change strengthens as the share of agricultural production and the public sector increases. Similarly, there were differences in the slope coefficients between the groups of regions. Although we can equalise the slope coefficients for the Capital region and the Eastern-Northern group, this cannot be done for Middle Finland; the test for similarity of the coefficients in the latter case is 7.62. The results indicated that employment reacts to change in output more strongly in the manufacturing-oriented Middle Finland group of regions than elsewhere. The coefficient for the Middle Finland group was 0.198 and that for the other regions 0.139.

Output growth was measured by sectors and the slope coefficients were equalised between the Capital and Eastern-Northern regions. The results indicated that, firstly, the estimate on exogenous change in employment for the Capital region is slightly lower than that for the Middle Finland or Eastern-Northern regions. The exogenous change in employment did not differ statistically between the latter two groups, however. This suggested that the exogenous change in employment is the lowest in the regions oriented towards private services.

Secondly, the sectoral disaggregation of the output variable decreased the overall impact of output on employment. The sectoral contributions were calculated by weighting the coefficients with their corresponding proportions of output. The sum of the contributions is 0.083 for the Capital and Eastern-Northern regions and 0.102 for Middle Finland. These two aggregates showed

us how much employment grows when a one-percent growth in total output results from sector growth where the growth rate of each sector relative to the others equals its relative size (share of total). It seems that these two regions do not differ much from each other at the aggregate level.

There were, however, substantial differences in the impacts of the output growth between the regions at the sectoral level. The breakdown suggested that private services play a major role in determining the correlation between changes in employment and output for both the Capital and Eastern-Northern as well as Middle Finland group; the contributions were about 50 % and 66 % of the total impact, respectively. In the case of Middle Finland the second largest contributor was industry (its impact is 21 % of the total). For the Capital region and Eastern-Northern Finland the respective estimate was only one half of that (12 % of the total), public services being the second main contributor (34 %) in those groups. Note that this breakdown by sector showed a potential only; it did not reveal how much output growth in each sector actually increases employment in that sector relative to the other sectors.

Finally, there were regional differences in the composition of sectoral contributions. Investigation of the relative shares and coefficients of the different sectors indicated that in the Capital region and Eastern-Northern Finland private services has the highest contribution because of both its large share of output and its high employment potential (high coefficient). In contrast, in Middle Finland private services has the highest contribution due more to its high employment potential than share of output.

## 8.5 Conclusions

There is some evidence to show that the economic crisis of the 1990s led to changes in the way the labour market functions. It has been suggested, *inter alia*, that the real wage elasticity of labour demand increased substantially, wage-wage links between different branches of industry weakened and that there was a rise in the equilibrium unemployment rate of the economy.

The purpose of this study was to contribute to the discussion on possible changes in the functioning of the labour market by scrutinising employment-output relations that are of considerable interest in this respect.

We can summarise the results of the study as follows. First, the parameters of the employment-output relationship obtained from the aggregate data show stability, although certain signs of instability in the long-run coefficients can be detected. Second, the time lags between employment and changes in the rate of output growth may be considerable. On average only one-fifth of the total

effect occurs in the same quarter, and it takes about 2 years to accomplish 80 percent of the total effect.

Three basic features emerge from the regional level analysis. First, the turbulence of the economic development of the early 1990s is clearly evident in the results: the link between changes in employment and output disappears in 1991 - 1992 and, in 1994 the exogenous change in employment at a given output turns out to be positive. Second, there is evidence of a tendency towards normality. The results for the last year of the sample, 1995 - 1996, are in line with a priori beliefs as to a typical employment-output relation. Third, although the findings of the correlation between changes in employment and in output are, to some extent, sensitive to model specification, all the specifications imply a similar pattern in the development of the employment-output link over the investigation period.

As far as the regional features of the data are concerned, we find certain divergent signs. The exogenous change in employment is slightly stronger for the Eastern-Northern group of regions than for the other two groups. This suggests that the exogenous change becomes stronger as the share of agricultural production and the public sector increases. In contrast, the exogenous change in employment is the lowest in the regions oriented to private services.

Similarly, there is certain evidence of differences in the slope coefficients between the groups of regions. In particular, the results of the aggregate model indicate that employment reacts to a change in output more strongly in the Middle Finland group of regions than elsewhere. The disaggregated analysis implies substantial differences in the relation on the sectoral level between the Middle Finland and elsewhere. Private services play a major role in determining the correlation between changes in employment and in output in both groups, contributing about 50 % and 66 % of the total, respectively.

It should be noted that the differences observed between the regions as well as over time are relatively small and may reflect a number of alternative factors, including the quality of jobs and/or the migration process. Furthermore, the sensitivity observed in the results may reflect, in part, the turbulence of the period. Similarly, its brevity may have affected the reliability of the estimation methods. Thus, any policy implications of the results are premature. This calls for further empirical investigation with more disaggregated data, including control variables such as the regional wage level, and modelling of spatial dependence of regional employment growth.

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## 9 The internationalisation of the Finnish economy and labour market adjustment - An analysis using Finnish employer-employee data for the years 1988 – 1996

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### Abstract

This study examines how the internationalisation of firms and foreign ownership have affected the structure of labour demand and labour market adjustment in Finland before, during, and after the recession. The internationalisation of firms is measured by export intensity (the ratio of exports to overall sales). The dynamic approach suggests that an increase in export intensity has a positive effect on employment among workers over 29 years of age and in the lower level educational groups examined. Furthermore, fluctuations in real sales have a larger influence on employment in firms operating only in domestic markets compared with export-oriented firms within these age and educational groups. Changes in output also have a greater impact on labour demand in DOCs (domestically owned companies) than in FOCs (foreign-owned companies).

### 9.1 Introduction

The internationalisation of Finnish firms has been increasing rapidly in recent years. At the same time the share of foreign ownership of firms in Finland has risen smoothly. Yet we know only a little about how these developments have affected the demand for labour in Finland. What kind of effect have the observed trends in internationalisation of firms had on domestic employment and the structure of the employed labour force before, during, and after the recession? What is the connection between foreign ownership and labour market adjustment in Finland?

In order to address these questions<sup>76</sup>, we make use of company-worker data sets<sup>77</sup> from Statistics Finland over the period 1989 - 1996. We focus on labour

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<sup>76</sup> At the moment there are also some theories for these questions, but many key issues still remain unresolved. See e.g. Forre and Salvanes (2001). Therefore, it is necessary to explore what the data tells us, before we can form a comprehensive theory. This paper tries to be a first step in that direction.

market adjustment by studying how foreign ownership and the internationalisation of firms have influenced the structure of the employed labour force and labour demand in Finland. This is done by gross job flow calculations and by dynamic analysis.

The remainder of the paper proceeds as follows. In the next section, we introduce basic definitions of gross job flows. Section 9.3 presents the analysis of gross job flow comparison between DOCs and FOCs in trade. In Section 9.4 we describe our econometric approach briefly and we report and interpret the estimation results. Finally, Section 9.5 concludes.

## 9.2 Job Flow Concepts<sup>78</sup>

The concept of a job is well known, but interpretation of job flow calls for accurate definitions. Thus, by a job we refer to an employment position filled by a worker. With this remark in mind, we determine the following job flow concepts for DOCs<sup>79</sup>:

- (1) JCR: (Gross) job creation rate of DOCs at time  $t$  equals employment gains summed over all DOCs that expand or start up between  $t-1$  and  $t$  divided by total employment of DOCs averaged over  $t-1$  and  $t$ .
- (2) JDR: (Gross) job destruction rate of DOCs at time  $t$  equals employment losses summed over all DOCs that contract or shut down between  $t-1$  and  $t$  divided by total employment of DOCs averaged over  $t-1$  and  $t$ .
- (3) NET: Net growth rate of DOCs is the difference between JCR and JDR.
- (4) JRR: (Gross) job reallocation rate of DOCs is the sum of JCR and JDR.
- (5) EJR: Excess job reallocation rate of DOCs equals JRR minus the absolute value of NET.

The excess job reallocation rate is a measure of simultaneous job creation and destruction. Assuming that the net growth rate is constant, excess job reallocation rate increases when the job reallocation rate gets higher. The

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<sup>77</sup> A brief description of these data sets is presented in the data appendix.

<sup>78</sup> A study by Davis, Haltiwanger and Schuh (1996) contains a detailed discussion on the measurement issues of job flows.

<sup>79</sup> These concepts can easily be applied to FOCs by replacing the acronym DOC with FOC.

measures of job flows are calculated for workers of various<sup>80</sup> education levels and work experience groups.

### 9.3 The analysis of gross job flow comparison between DOCs and FOCs in trade

A number of studies<sup>81</sup> indicate differences in the characteristics of DOCs and FOCs. The heterogeneity of technologies used in production is one widely recognized explanation for these perceived differences in characteristics. For example, if a FOC exploits a technology developed by its foreign parent, this FOC may require a different combination of employee skills from a Finnish-owned company. So, the structure of the employed labour force of DOCs is likely to differ from that of FOCs in Finland.

Figure 9.1. Job creation, job destruction, net growth and excess job reallocation rates for DOCs and FOCs

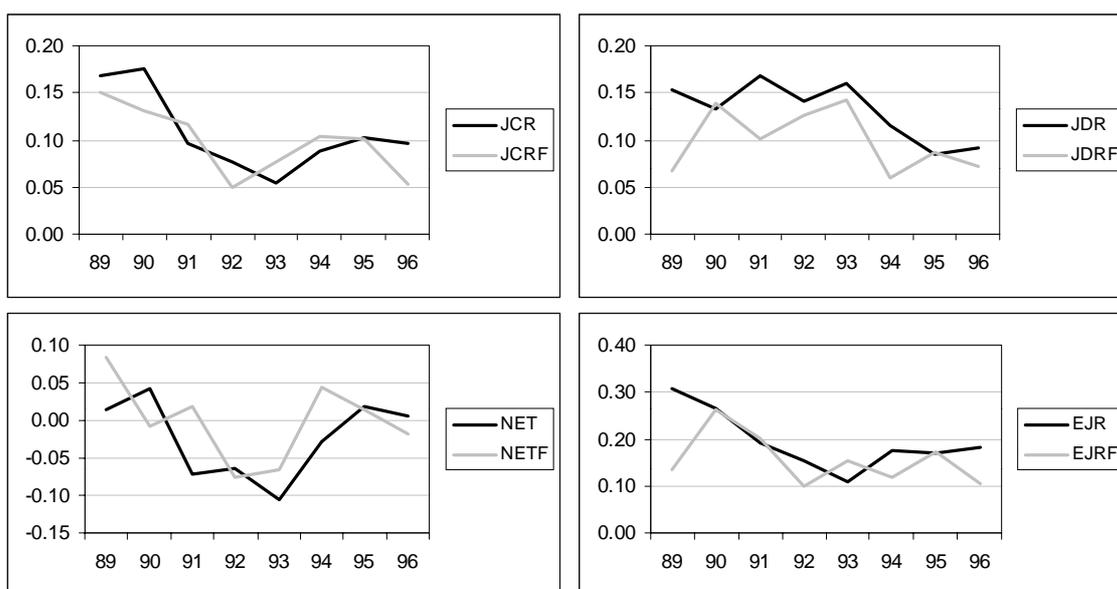


Figure 9.1 presents annual job creation, job destruction, net growth and excess job reallocation rates for DOCs and FOCs (JCRF, JDRF, NETF and EJRF) within the Finnish Trade sector from 1989 to 1996.<sup>82</sup> The average rate of job destruction in DOCs has been perceptibly higher than that in FOCs over the investigation period. As a result of the lower job destruction rates in FOCs relative to DOCs, the net growth rates have been higher in FOCs compared

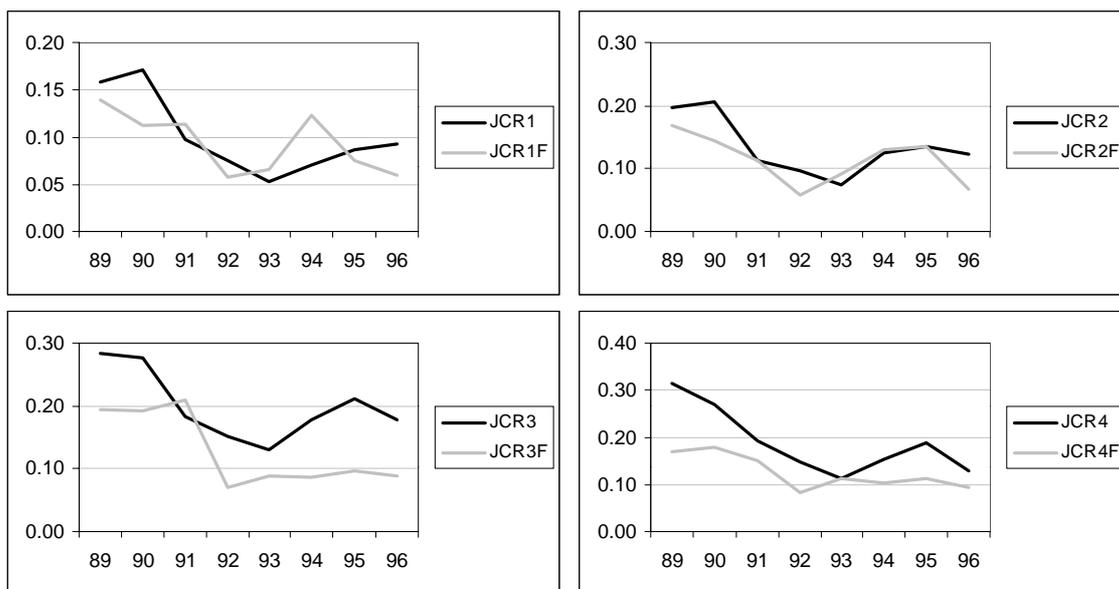
<sup>80</sup> See data appendix.

<sup>81</sup> See e.g. Howenstine and Shannon (1996), Maliranta (1997) and Feliciano and Lipsey (1999).

<sup>82</sup> The calculated job flow rates are based on sample of firms (see data appendix).

with DOCs during the deep recession of the early 1990s.<sup>83</sup> Thus, there were marked differences in net employment changes of domestically owned and foreign owned companies in 1991 and in 1994. Furthermore, the average rate of excess job reallocation has been more intensive in DOCs than in FOCs before, during and after the recession.

Figure 9.2. Job creation rates for DOCs and FOCs by education



The differences in the job creation rates between DOCs and FOCs were highlighted only after studying the job creation flows within different education and work experience groups (see Figures 9.2-9.3). The underlying rate for creation of jobs for the population of employees with higher education (i.e. employees with lower university, non-university and higher university degrees) in FOCs is lower than that in DOCs. On the other hand, the job creation rate for the least experienced has been higher in FOCs than in DOCs during the recession.

<sup>83</sup> Ilmakunnas and Maliranta (2000) provide some evidence for this view in Manufacturing.

Figure 9.3. Job creation rates for DOCs and FOCs by work experience

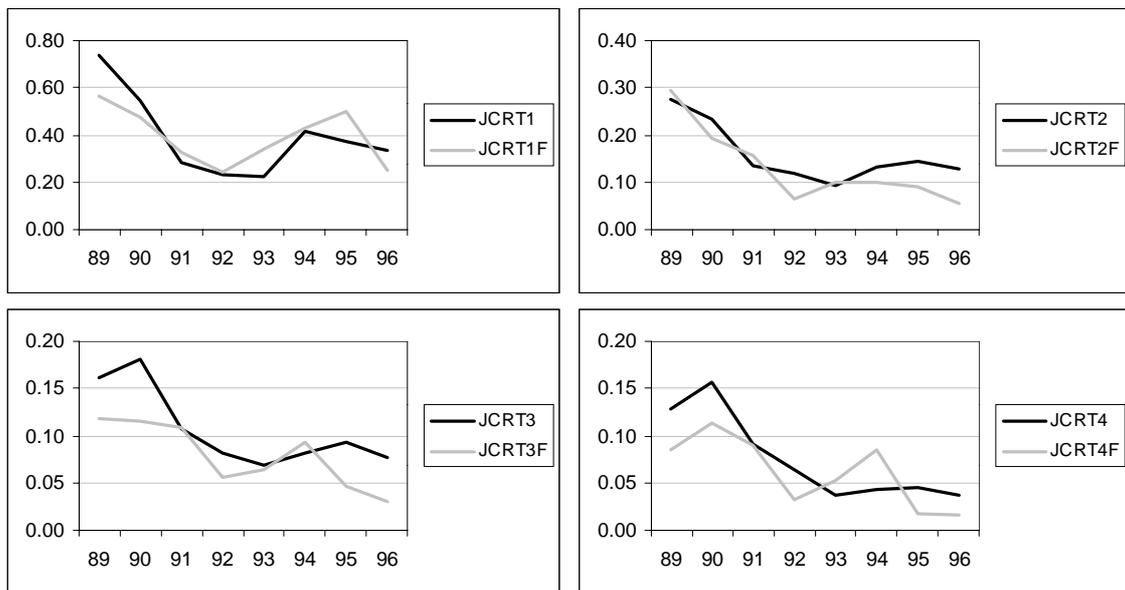
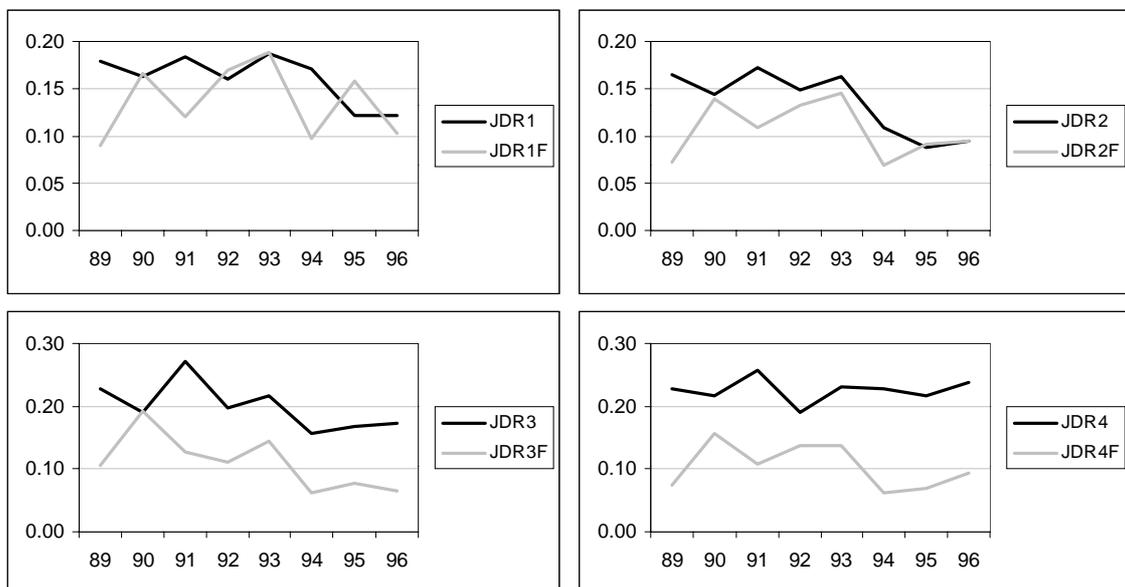


Figure 9.4. Job destruction rates for DOCs and FOCs by education



The results of the job flow calculations suggest that, during the recession, the rate of job destruction has been more intensive in DOCs than FOCs in all the educational and work experience groups examined in this paper (Figures 9.4-9.5). So, employment in FOCs declined relatively less than in DOCs within all the educational and work experience groups too (see Figures 9.6-9.7). In particular, among employees with less than 10 years work experience or

employees with higher education, the differences between DOCs and FOCs in both the job destruction and net growth rates have been considerable.

Figure 9.5. Job destruction rates for DOCs and FOCs by work experience

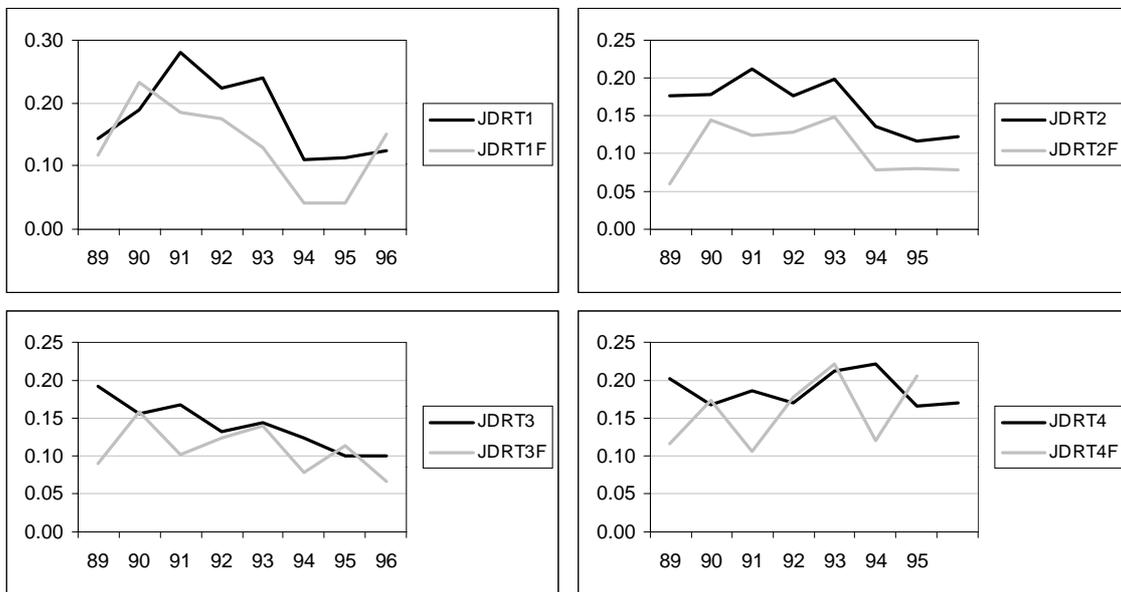


Figure 9.6. Net growth rates for DOCs and FOCs by education

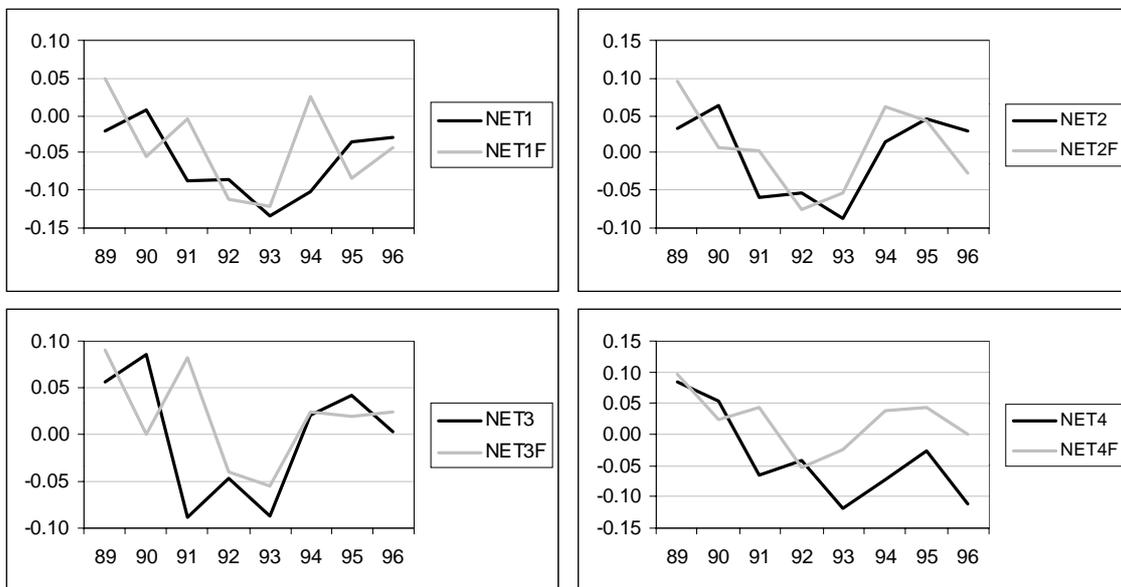
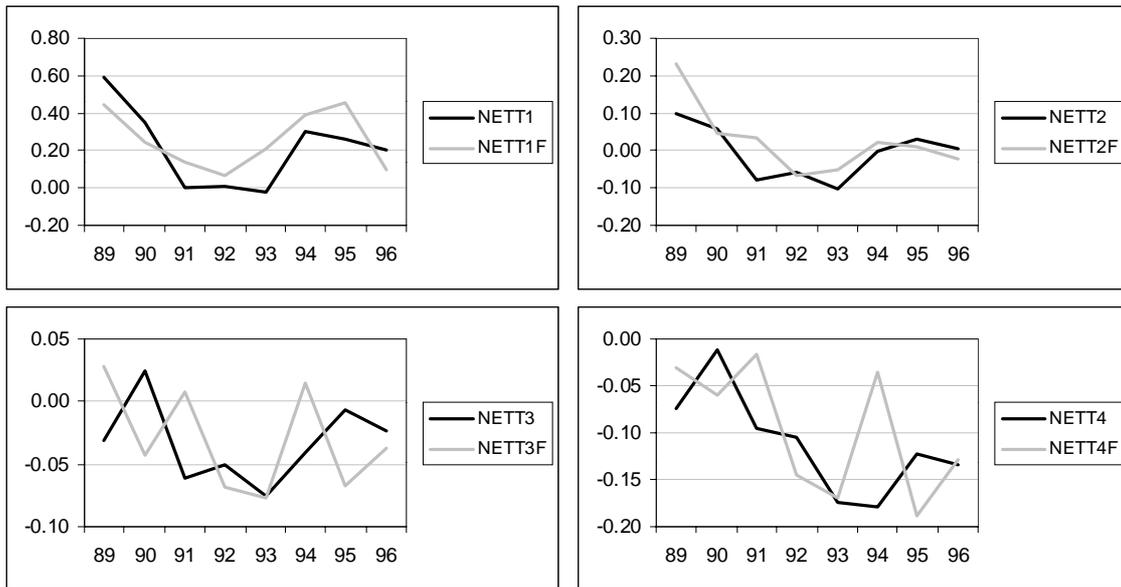
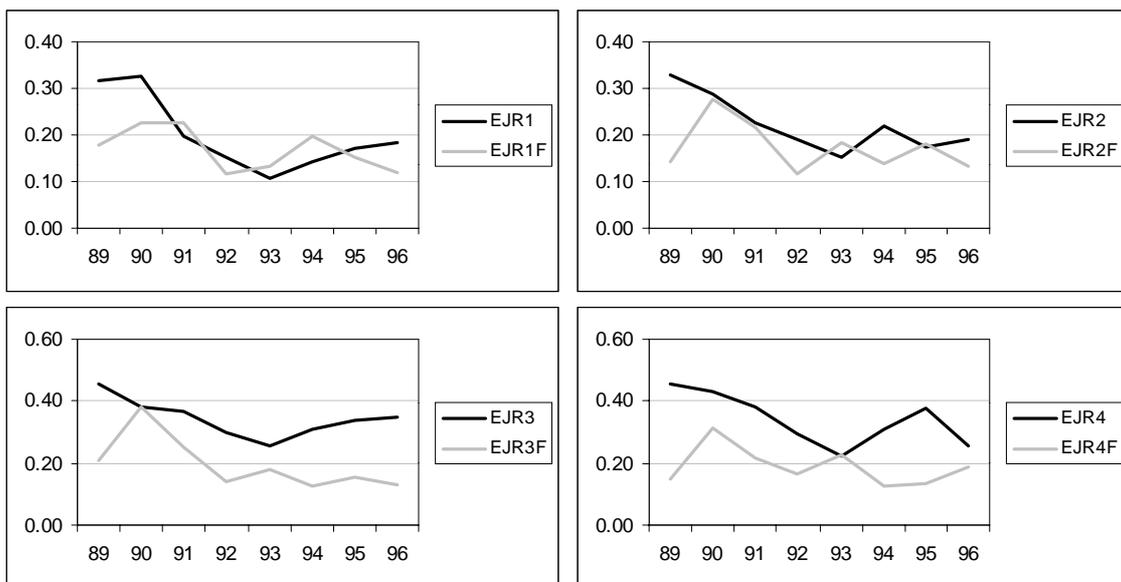


Figure 9.7. Net growth rates for DOCs and FOCs by work experience



For employees with higher education, simultaneous job creation and destruction is more intensive in DOCs than FOCs, as is shown in Figure 9.8. The excess job reallocation rate is also higher in DOCs than FOCs among employees with less than 25 years work experience (Figure 9.9). Moreover, there are considerable differences between DOCs and FOCs in the excess job reallocation rates for the least experienced employees.

Figure 9.8. Excess job reallocation rates for DOCs and FOCs by education



The net employment change of FOCs was positive both for employees with less than 25 years work experience and for employees with higher education in 1991. In 1994, the net growth rate of FOCs for the more highly educated employees increased, too. Conversely, the net growth rates of DOCs were negative in 1991 and in 1994. In 1991, only the least experienced employees managed to keep their vacancies within DOCs at the same level as one year before. The decline in demand for the least and highest educated employees explains the negative net employment change of DOCs in 1994.

Figure 9.9. Excess job reallocation rates for DOCs and FOCs by work experience

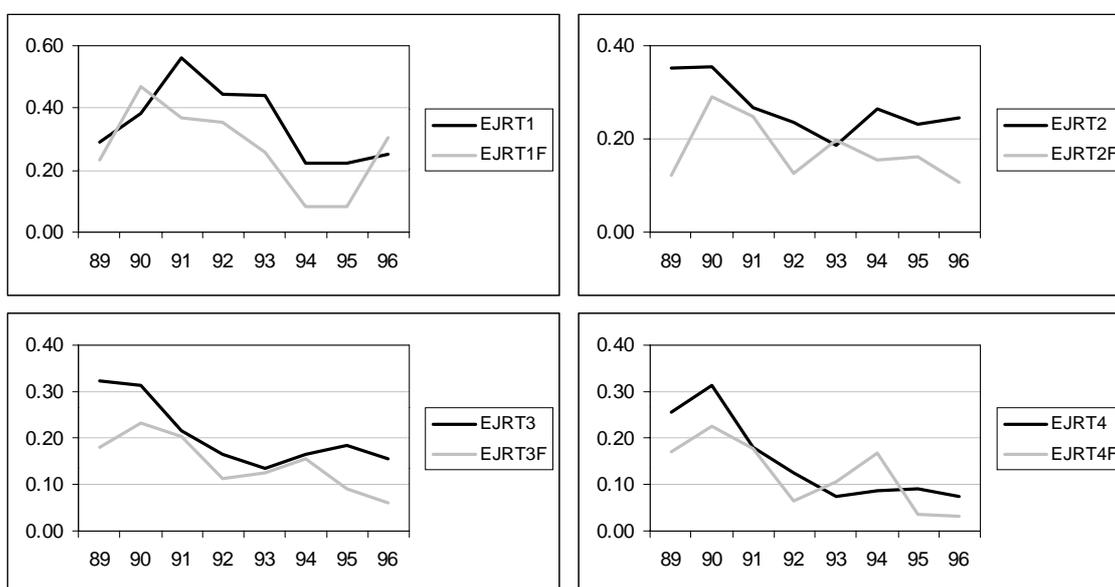


Table 9.1. The structure of the employed labour force in DOCs and FOCs: Trade Sector, percent

Period	Trade					
	1989-1990		1991-1994		1995-1996	
Owner	Finnish	Foreign	Finnish	Foreign	Finnish	Foreign
under 30 years	30.6	27.8	25.0	19.9	24.6	17.6
30-39 years	26.2	34.3	27.2	35.9	27.4	35.7
40-49 years	26.9	25.8	29.9	29.9	29.3	29.5
over 49 years	16.2	12.2	17.9	14.3	18.7	17.2
Basic education only	42.3	27.8	39.1	24.2	35.2	21.3
Vocational certificates	51.2	52.7	53.9	53.9	57.8	54.2
Lower Univ. and non-Univ.	4.5	12.6	5.1	13.8	5.4	15.0
Higher Univ. degrees	2.0	6.9	1.9	8.1	1.6	9.5

Table 9.1 depicts the structure of the employed labour force in DOCs and in FOCs. The structure of employees in FOCs has been different from that of DOCs in the overall trade sector. FOCs have employed relatively more labour with a higher level of education, as well as workers aged 30-39 years. The findings concerning the job flow calculations and the structure of the employed labour force indicate that, in the trade sector, inward FDI is likely to have brought new skill-biased technologies to Finland.

## 9.4 Effects of foreign ownership and internationalisation of firms on labour market adjustment

In the previous section we established that changes in both net employment and the structure of the employed labour force have been different in FOCs and DOCs in the trade sector. This implies that FOCs could employ relatively more skilled labour or workers aged 30-39 years than DOCs in other sectors in addition to trade. In order to study these differences we estimate disaggregated dynamic employment models across heterogeneous workers within the four main sectors of the Finnish economy (i.e. in manufacturing, construction, trade and business services). We also investigate by a dynamic approach how the internationalisation of firms has affected the structure of labour demand and labour market adjustment in Finland. Furthermore, we examine whether or not the labour demand behaviour of export-oriented firms differs from that of firms operating only in the domestic markets.

### 9.4.1 The Empirical Models

The basic log-linear AR(1) equation used to analyse the impact of internationalisation of firms on employment is the well-known partial adjustment model:

$$(1) \log N_{it} = \mu_i \log N_{i,t-1} + \psi_{0i} Z_{i,t} + \alpha_i + \alpha_t D_t + \varepsilon_{i,t}$$

where  $\mu_i$  is the stable root of the Euler equation,  $Z_{i,t}$  denotes the vector of logarithms of the exogenous variables,  $\alpha_i$  refers to the firm effect,  $D_t$  defines the time dummies and  $\varepsilon_{i,t}$  is the error term (assumed serially uncorrelated).

Assuming that  $Z_{i,t}$  follows an AR (2) process we can derive the following equation:

$$(2) \log N_{it} = \mu_i \log N_{i,t-1} + \psi_{0i} Z_{i,t} + \psi_{1i} Z_{i,t-1} + \alpha_i + \alpha_t D_t + \varepsilon_{i,t}$$

The usual least squares methods (OLS, within etc.) are not consistent, because the lagged dependent variable is correlated with the error term. So, estimation

is carried out by GMM (Generalized Method of Moments), using lagged variables as instruments. GMM exploits the idea that the disturbances in the equations are uncorrelated with the instruments. The GMM estimator sets the calculated correlation of the instruments and disturbances as close to zero as possible, according to a criterion provided by a weighting matrix.

#### 9.4.2 Results and interpreting findings

The employment models are specified in levels but estimated in first differences in order to eliminate the unobserved firm effects. To estimate the employment models we exploit both the first-differenced and combined GMM estimators. In combined estimation, GMM-SYS, the level equations are used jointly with the difference equations.

The validity of the GMM estimator depends on the absence of serial correlation. Because the models have been transformed to first differences, first-order serial correlation is expected but not second-order. Thus we present tests for lack of first-order (M1) and second-order serial correlation (M2) in the residuals. The Sargan test for overidentifying restrictions is also reported and the null hypothesis of the test suggests that instruments used in the GMM estimation are jointly valid. The Sargan test is also a test for specification of the estimated model. Test statistics are based on White heteroskedasticity consistent covariance matrices. A low p-value concerning a parameter or a test suggests that the null hypothesis of a regressor or a test being zero should be rejected.

The estimates presented in Tables 9.2-9.7 are chosen by statistical performances across two estimators. The first-differenced GMM estimator by Arellano and Bond (1991) seemed to produce more reliable parameter estimates than the GMM-SYS estimator. So, the reported results are mainly due to first-differenced GMM estimation.<sup>84</sup>

#### The basic models

In Tables 9.2-9.3 we show the parameter estimates for the basic equations (1) and (2) using the different samples of firms concerning heterogeneous groups of workers (i.e. age and education). The AR(1) and AR(2) models appear to constitute a moderate representation of employment dynamics in each age group. Unfortunately, the estimations of the corresponding models in the heterogeneous education groups lead to less satisfactory results, at least for employees with higher education. Therefore, we mainly focus on results of models classified by age groups. Furthermore, we consider wages in different age or education classes as the control variables for heterogeneous skill and

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<sup>84</sup> Computations with Ox 2.10 (see Doornik et al. 1999).

work experience within the groups examined. Thus, we exclude analysis concerning wages.

*Table 9.2. The basic models of employment by age groups*

Age	under 30 years		30-39 years		40-49 years		over 49 years	
	AR(2)	AR(1)	AR(2)	AR(1)	AR(2)	AR(1)	AR(2)	AR(1)
<i>ind.variables/ models</i>								
n(-1)	0,458	0,401	0,329	0,334	0,446	0,391	0,515	0,533
	[0,002]	[0,001]	[0,037]	[0,006]	[0,050]	[0,018]	[0,001]	[0,000]
w	0,041	0,012	-0,436	-0,587	-0,441	-0,541	-0,287	-0,323
	[0,793]	[0,934]	[0,024]	[0,004]	[0,002]	[0,000]	[0,029]	[0,011]
w(-1)	0,079		-0,010		0,011		0,001	
	[0,330]		[0,940]		[0,908]		[0,993]	
q	0,894	0,811	0,447	0,654	0,335	0,556	0,377	0,500
	[0,000]	[0,000]	[0,001]	[0,000]	[0,033]	[0,000]	[0,017]	[0,000]
q(-1)	-0,087		0,247		0,228		0,141	
	[0,669]		[0,102]		[0,071]		[0,313]	
EX1	0,324	0,155	0,421	0,243	0,513	0,299	0,439	0,391
	[0,228]	[0,438]	[0,033]	[0,058]	[0,023]	[0,037]	[0,031]	[0,009]
EX1(-1)	0,111		0,004		0,028		-0,027	
	[0,223]		[0,956]		[0,737]		[0,767]	
Sargan	[0,243]	[0,155]	[0,231]	[0,220]	[0,636]	[0,465]	[0,019]	[0,039]
M1	[0,000]	[0,000]	[0,008]	[0,000]	[0,001]	[0,000]	[0,000]	[0,000]
M2	[0,276]	[0,484]	[0,481]	[0,462]	[0,938]	[0,384]	[0,120]	[0,115]
Observations	6704	6704	6887	6887	6856	6856	6464	6464
Firms	1476	1476	1519	1519	1513	1513	1416	1416

In Table 9.2, the coefficient of export share (EX1) is always positive and it is statistically significant at 10 % critical level among workers over 29 years of age. An increase in the export intensity also has a positive influence on employment for employees with only basic education and for workers with vocational certificates (see Table 9.3). However, the Sargan test suggests that the applied instrument set is inadequate in the models for workers with only basic education. The lagged export share (EX1(-1)) is instead completely insignificant in all the statistically plausible models in Tables 9.2 and 9.3. Moreover, M2 statistics provide evidence to suggest that the assumption of serially uncorrelated errors is inappropriate both in the AR(1) and AR(2) models for employees with higher university degrees.

Table 9.3. The basic models of employment by education

Education <i>ind.variables/ Models</i>	[1]		[2]		[3]		[4]	
	AR(2)	AR(1)	AR(2)	AR(1)	AR(2)	AR(1)	AR(2)	AR(1)
n(-1)	0,542	0,564	0,268	0,223	0,118	0,104	-0,019	-0,089
	[0,011]	[0,001]	[0,130]	[0,264]	[0,494]	[0,440]	[0,901]	[0,517]
w	-0,213	-0,337	-0,284	-0,478	0,160	-0,014	-0,054	-0,094
	[0,333]	[0,097]	[0,444]	[0,227]	[0,332]	[0,925]	[0,567]	[0,292]
w(-1)	-0,064		0,025		0,115		0,059	
	[0,747]		[0,906]		[0,059]		[0,218]	
q	0,182	0,488	0,490	0,717	0,247	0,651	-0,025	0,310
	[0,378]	[0,001]	[0,003]	[0,000]	[0,081]	[0,000]	[0,855]	[0,006]
q(-1)	0,390		0,274		0,382		0,296	
	[0,088]		[0,180]		[0,004]		[0,013]	
EX1	0,507	0,333	0,591	0,303	0,122	-0,100	-0,207	-0,148
	[0,033]	[0,029]	[0,028]	[0,050]	[0,553]	[0,493]	[0,262]	[0,339]
EX1(-1)	-0,070		0,058		0,003		-0,161	
	[0,405]		[0,464]		[0,967]		[0,044]	
Sargan	[0,050]	[0,019]	[0,265]	[0,195]	[0,792]	[0,120]	[0,539]	[0,440]
M1	[0,000]	[0,000]	[0,004]	[0,000]	[0,313]	[0,037]	[0,904]	[0,650]
M2	[0,885]	[0,383]	[0,613]	[0,762]	[0,069]	[0,480]	[0,001]	[0,001]
Observations	6736	6736	6919	6919	5656	5656	4249	4249
Firms	1484	1484	1528	1528	1232	1232	921	921

In particular, for employees over 39 years of age, the change in export share has greater impact on employment than for workers under 40 years of age, in both the short term and the long term. The output elasticity of labour demand is higher for younger workers (i.e. employees under 40 years of age) than older employees (i.e. workers over 39 years of age). Furthermore, employment for employees under 30 years of age is considerably more sensitive to fluctuations in real sales.

### Differences in employment behaviour across DOCs and FOCs

To test the differences in the labour demand between DOCs and FOCs we determine a dummy variable F. F is zero, when a firm is classified as DOC (i.e. firms with under 50 % foreign ownership), and is one in all other cases. This dummy is then interacted with all the right hand side variables and the model is estimated as before.<sup>85</sup>

<sup>85</sup> Bond and Meghir (1994) provide an elaboration of this approach.

Table 9.4. Employment regressions by age groups with FOCs interactions

Age	under 30 years		30-39 years		40-49 years		over 49 years	
	AR(2)	AR(1)	AR(2)	AR(1)	AR(2)	AR(1)	AR(2)	AR(1)
<i>ind.variables/ models</i>								
n(-1)	0,385	0,398	0,382	0,354	0,468	0,450	0,532	0,503
	[0,002]	[0,000]	[0,004]	[0,001]	[0,012]	[0,004]	[0,000]	[0,000]
w	0,020	-0,022	-0,406	-0,584	-0,442	-0,543	-0,342	-0,355
	[0,896]	[0,878]	[0,023]	[0,002]	[0,001]	[0,000]	[0,009]	[0,004]
w(-1)	0,056		0,034		0,019		0,058	
	[0,470]		[0,785]		[0,837]		[0,414]	
EX1	0,237	0,127	0,320	0,199	0,447	0,278	0,285	0,332
	[0,373]	[0,516]	[0,143]	[0,147]	[0,045]	[0,053]	[0,155]	[0,025]
EX1(-1)	0,093		-0,008		0,026		-0,006	
	[0,266]		[0,916]		[0,734]		[0,940]	
q	0,795	0,749	0,397	0,593	0,323	0,484	0,407	0,453
	[0,000]	[0,000]	[0,002]	[0,000]	[0,011]	[0,000]	[0,007]	[0,000]
q(-1)	0,009		0,231		0,232		0,069	
	[0,957]		[0,053]		[0,039]		[0,575]	
n(-1)*F	0,147	0,012	-0,106	-0,012	0,075	-0,003	-0,130	-0,011
	[0,208]	[0,505]	[0,627]	[0,496]	[0,662]	[0,889]	[0,516]	[0,717]
w*F	0,325	0,399	0,406	0,229	0,206	0,076	0,673	0,133
	[0,149]	[0,076]	[0,043]	[0,232]	[0,189]	[0,606]	[0,041]	[0,513]
w(-1)*F	0,026		-0,153		0,087		-0,399	
	[0,907]		[0,644]		[0,687]		[0,135]	
EX1*F	0,421	0,261	0,503	0,907	0,163	0,679	0,644	1,063
	[0,616]	[0,739]	[0,527]	[0,264]	[0,804]	[0,264]	[0,477]	[0,121]
EX1(-1)*F	-0,155		-0,301		-0,397		-0,477	
	[0,504]		[0,172]		[0,040]		[0,027]	
q*F	-0,172	-0,197	-0,219	-0,137	-0,106	-0,049	-0,355	-0,087
	[0,138]	[0,094]	[0,039]	[0,171]	[0,196]	[0,538]	[0,029]	[0,396]
q(-1)*F	-0,039		0,104		-0,052		0,231	
	[0,766]		[0,627]		[0,708]		[0,158]	
Sargan	[0,235]	[0,190]	[0,131]	[0,136]	[0,363]	[0,203]	[0,047]	[0,019]
M1	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]
M2	[0,590]	[0,713]	[0,737]	[0,317]	[0,837]	[0,435]	[0,070]	[0,155]
Observations	6704	6704	6887	6887	6856	6856	6464	6464
DOCs and FOCs	1476	1476	1519	1519	1513	1513	1416	1416
FOCs	156	156	160	160	158	158	152	152

These results are presented in Tables 9.4-9.5. The first seven coefficients in the AR(2) models refer to DOCs, while the remaining seven parameters estimate the difference of the coefficients on each of the variables across DOCs and FOCs. For example, according to the AR(1) model, the effect of output on employment is higher in DOCs (0.749) than FOCs (0.749-0.197=0.552) for the youngest workers.

The coefficients indicating differences in real logarithmic sales ( $q$ ) between DOCs and FOCs regularly have the negative values in Table 9.4. However, as we can see from Table 9.4, these differences are not constantly significant and the models concerning workers aged over 50 years are misspecified. Nevertheless, according to models classified by age groups, the results suggest that an increase in real sales has a bigger influence on employment in DOCs than in FOCs, at least for workers under 40 years.

*Table 9.5. Employment regressions by education with FOCs interactions*

Education	[1]		[2]		[3]		[4]	
	AR(2)	AR(1)	AR(2)	AR(1)	AR(2) <sup>a,b</sup>	AR(1) <sup>a,b</sup>	AR(2) <sup>a,b</sup>	AR(1)
<i>ind.variables/ Models</i>								
n(-1)	0,408	0,530	0,311	0,269	0,878	0,891	0,844	-0,107
	[0,018]	[0,000]	[0,038]	[0,102]	[0,000]	[0,000]	[0,000]	[0,353]
w	-0,222	-0,334	-0,319	-0,523	-0,328	-0,239	-0,198	-0,027
	[0,271]	[0,087]	[0,357]	[0,173]	[0,001]	[0,000]	[0,003]	[0,773]
w(-1)	-0,084		0,054		0,146		0,136	
	[0,650]		[0,800]		[0,060]		[0,004]	
EX1	0,364	0,277	0,487	0,288	0,141	0,147	0,060	-0,263
	[0,113]	[0,067]	[0,056]	[0,062]	[0,077]	[0,060]	[0,470]	[0,053]
EX1(-1)	-0,066		0,055		0,076		0,023	
	[0,406]		[0,489]		[0,181]		[0,641]	
q	0,293	0,470	0,451	0,630	0,073	0,099	0,166	0,145
	[0,079]	[0,000]	[0,002]	[0,000]	[0,080]	[0,001]	[0,050]	[0,129]
q(-1)	0,367		0,251		0,033		-0,065	
	[0,057]		[0,146]		[0,420]		[0,400]	
n(-1)*F	0,116	-0,007	-0,128	-0,002	0,037	0,002	0,029	0,004
	[0,419]	[0,705]	[0,570]	[0,873]	[0,453]	[0,891]	[0,524]	[0,838]
w*F	0,409	0,246	0,444	0,196	-0,007	0,035	-0,100	-0,060
	[0,073]	[0,195]	[0,028]	[0,202]	[0,921]	[0,587]	[0,359]	[0,778]
w(-1)*F	0,220		-0,186		0,097		0,127	
	[0,370]		[0,610]		[0,250]		[0,127]	
EX1*F	0,198	0,670	-0,035	0,593	-0,129	-0,031	-0,087	0,579
	[0,764]	[0,307]	[0,964]	[0,413]	[0,335]	[0,788]	[0,542]	[0,293]
EX1(-1)*F	-0,329		-0,443		0,204		0,051	
	[0,174]		[0,022]		[0,139]		[0,587]	
q*F	-0,213	-0,136	-0,224	-0,110	0,008	-0,019	0,055	0,009
	[0,054]	[0,168]	[0,034]	[0,178]	[0,832]	[0,584]	[0,350]	[0,939]
q(-1)*F	-0,129		0,132		-0,062		-0,070	
	[0,395]		[0,573]		[0,218]		[0,136]	
Sargan	[0,023]	[0,042]	[0,172]	[0,199]	[0,337]	[0,294]	[0,004]	[0,683]
M1	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,000]	[0,009]
M2	[0,729]	[0,468]	[0,906]	[0,573]	[0,949]	[0,932]	[0,542]	[0,350]
Observations	6736	6736	6919	6919	6123	6123	4708	3860
DOCs and FOCs	1484	1484	1528	1528	1111	1111	848	848
FOCs	158	158	160	160	141	141	127	127

The employment regressions in the four educational classes examined across DOCs and FOCs are reported in Table 9.5. The models for different educational groups seem to provide unsatisfactory results again: the AR(2) model for employees with higher university degrees and both models for workers with only basic education show signs of misspecification. Thus only the AR(2) model for workers with vocational certificates indicates reliably that the impact of output on employment is higher in DOCs than FOCs.

In addition to misspecification of models, the lack of proper classification of multinational corporations (MNCs) can be an explanation for rather small (and partly insignificant) differences in labour demand between DOCs and FOCs.<sup>86</sup> In practice, FOCs are MNCs, but DOCs include both domestic-owned multinationals and firms operating only in the domestic markets. By comparing FOCs (or domestic-owned multinationals) to purely national firms, we shall probably observe the bigger gaps in labour demand across FOCs (or domestic-owned multinationals) and domestic-owned non-Multinationals.

### **The differences in labour demand between export-oriented firms and purely domestic firms**

The AR(1) models in Tables 9.6-9.7 depict the differences in employment behaviour across export-oriented firms (EOFs) and firms operating only in the domestic markets. EX refers to a dummy variable, which is zero in the case of purely national firm. Thus, the first set of parameters relates to the purely domestic firms. The second set of coefficients shows the difference variable between export-oriented firms and purely national firms of the effect of the parameters on each.

Fluctuations in real sales have a larger impact on employment for workers over 29 years of age in purely domestic firms compared with export-oriented firms (Table 9.6). It is just the opposite for the youngest employees: the AR(2) model implies that a rise in output has a lesser effect on employment in firms operating only in the domestic markets than in export-oriented firms.

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<sup>86</sup> See Doms and Jensen (1998) and Pfaffermayr and Bellak (2000).

Table 9.6. *Employment regressions by age groups with EOFs interactions*

Age <i>ind.variables/ models</i>	under 30 years		30-39 years		40-49 years		over 49 years	
	AR(2)	AR(1)	AR(2)	AR(1)	AR(2)	AR(1)	AR(2)	AR(1)
n(-1)	0,640	0,382	0,244	0,228	0,218	0,276	0,280	0,366
	0,000	0,003	0,122	0,045	0,345	0,052	0,092	0,010
w	-0,004	0,020	-0,472	-0,605	-0,466	-0,538	-0,368	-0,386
	0,979	0,892	0,020	0,002	0,002	0,000	0,010	0,003
w(-1)	0,112		0,007		-0,063		-0,015	
	0,220		0,958		0,575		0,822	
q	0,894	1,031	0,525	0,681	0,450	0,648	0,491	0,624
	0,000	0,000	0,000	0,000	0,005	0,000	0,006	0,000
q(-1)	-0,185		0,228		0,349		0,324	
	0,350		0,174		0,019		0,029	
n(-1)*EX	-0,180	-0,002	0,027	0,007	0,055	0,007	0,091	0,008
	0,022	0,833	0,761	0,175	0,609	0,152	0,335	0,291
w*EX	-0,030	-0,047	0,212	0,171	0,169	0,148	0,228	0,133
	0,713	0,508	0,001	0,002	0,005	0,004	0,004	0,046
w(-1)*EX	-0,134		-0,049		0,013		-0,026	
	0,131		0,548		0,898		0,775	
q*EX	0,019	0,025	-0,106	-0,086	-0,083	-0,075	-0,112	-0,064
	0,629	0,483	0,001	0,002	0,007	0,005	0,005	0,053
q(-1)*EX	0,098		0,021		-0,016		0,000	
	0,067		0,709		0,823		0,999	
Sargan	[0,105]	[0,018]	[0,424]	[0,455]	[0,535]	[0,350]	[0,103]	[0,063]
M1	[0,000]	[0,000]	[0,010]	[0,000]	[0,027]	[0,000]	[0,003]	[0,000]
M2	[0,226]	[0,944]	[0,561]	[0,824]	[0,158]	[0,495]	[0,651]	[0,330]
Observations	6704	6704	6887	6887	6856	6856	6464	6464
Firms	1476	1476	1519	1519	1513	1513	1416	1416
EOFs	881	881	890	890	890	890	853	853

Table 9.7. Employment regressions by education with EOFs interactions

Education	[1]		[2]		[3]		[4]	
<i>ind.variables/ Models</i>	AR(2)	AR(1)	AR(2)	AR(1)	AR(2) <sup>a,b</sup>	AR(1) <sup>a,b</sup>	AR(2) <sup>a,b</sup>	AR(1)
n(-1)	0,417	0,456	0,411	0,185	0,218	0,079	-0,160	-0,221
	0,043	0,001	0,014	0,334	0,132	0,465	0,204	0,063
w	-0,184	-0,314	-0,300	-0,492	0,164	-0,016	-0,016	-0,059
	0,411	0,112	0,417	0,192	0,242	0,902	0,880	0,541
w(-1)	-0,054		0,165		0,184		0,021	
	0,779		0,425		0,012		0,727	
q	0,264	0,506	0,479	0,763	0,284	0,716	0,139	0,199
	0,151	0,001	0,008	0,000	0,051	0,000	0,307	0,144
q(-1)	0,427		0,224		0,240		0,059	
	0,063		0,298		0,066		0,631	
n(-1)*EX	-0,022	0,007	-0,095	0,004	-0,319	0,001	0,020	-0,010
	0,737	0,198	0,340	0,362	0,001	0,929	0,868	0,483
w*EX	0,264	0,229	0,148	0,106	-0,008	0,069	0,012	0,042
	0,000	0,000	0,006	0,027	0,901	0,288	0,831	0,492
w(-1)*EX	-0,066		-0,149		-0,178		0,067	
	0,443		0,107		0,043		0,478	
q*EX	-0,127	-0,112	-0,072	-0,053	0,003	-0,038	-0,009	-0,024
	0,000	0,000	0,008	0,028	0,915	0,248	0,775	0,436
q(-1)*EX	0,039		0,097		0,131		-0,038	
	0,471		0,148		0,018		0,528	
Sargan	[0,079]	[0,017]	[0,195]	[0,094]	[0,617]	[0,076]	[0,670]	[0,569]
M1	[0,000]	[0,000]	[0,001]	[0,000]	[0,016]	[0,002]	[0,693]	[0,296]
M2	[0,800]	[0,325]	[0,830]	[0,902]	[0,601]	[0,575]	[0,000]	[0,000]
Observations	6736	6736	6919	6919	5656	5656	4249	4249
Firms	1484	1484	1528	1528	1232	1232	921	921
EOFs	884	884	894	894	756	756	606	606

For workers in the lower level educational groups (see Table 9.7), a change in real sales has a smaller influence on employment in purely national firms than in export-oriented firms. The models for employees with higher education suggest that the demand for labour is similar in firms operating in domestic markets only and in export-oriented firms. Thus, if there is a fall in output, the purely domestic firms contract jobs more vacancies than export-oriented firms.

Our empirical findings are partly explained by the scale effect<sup>87</sup> and by financial factors. FOCs and export-oriented firms are larger on average than DOCs and purely domestic firms. Moreover, financial constraints are believed to be an important influence on employment (Nickell and Nicolitsas 1999). Financial pressure is probably not as high in FOCs and export-oriented firms than in DOCs and purely national firms.

<sup>87</sup> See Piekkola (1998).

## 9.5 Conclusions

This paper investigates how both the internationalisation of firms and foreign ownership have influenced the structure of labour demand and labour market adjustment in Finland before, during, and after the recession.

Globalisation has meant that FOCs and domestic-owned MNCs account for a significant and growing share of total sales and employment in Finland. This development has affected both the number of employees and the structure of the employed labour force in Finland. In trade, the average rate of job destruction in FOCs has been considerably lower than that in DOCs over the investigation period. As a result of the higher job destruction rates in DOCs than in FOCs the net growth rates have been lower in DOCs than in FOCs during the recession of the early 1990s. Thus, there were perceptible differences in net employment changes in Finnish-owned and foreign-owned companies within the trade sector in 1991 and in 1994. Furthermore, the average rate of excess job reallocation has been more intensive in DOCs than in FOCs before, during and after the recession.

A decrease in export intensity has a negative effect on employment among workers over 29 years of age and in the lower educational level groups examined. In other words, a rise in internationalisation of Finnish firms by export-orientation dampens the negative effect of skill-biased (or age-biased) technological change. On the other hand, if all firms increase output, the export-oriented ones seem to prefer the youngest employees and workers with higher education relatively more than purely domestic firms. Furthermore, fluctuations in real sales also have a greater impact on labour demand in DOCs than in FOCs. So, we conclude that the internationalisation of the Finnish economy has probably balanced the effects of economic fluctuations in the Finnish labour markets.

### Data Appendix

Our primary data source is the panel data of Statistics Finland over the period 1989-1996. This unbalanced panel data is obtained by combining employment statistics data with the Financial Statements Statistics and with the supplementary data from the Register of Enterprises and Establishments. Our analysis is based on those companies which employed over 14 persons per year and reported data for at least 5 consecutive years.

We have used a sample of 316 firms with operations mainly in the trade sector for the Job Flow Comparison across DOCs and FOCs. The companies are defined as FOCs (50) if they are foreign-owned over four years. A company is considered to be a

foreign-owned subsidiary if a foreign-owned company or consortium of foreign-owned companies holds more than 50 % of an affiliate's equity share capital. We use DOC to refer to a Finnish-owned company that experienced no change of ownership during the investigation period.

Our employment equations are estimated using a panel of 848-1528 companies from the construction, manufacturing, trade and other services sectors depending on age or education groups examined. Because of the estimation method the first period of estimation is 1991.

Both the education code and work experience were composed of four classes.

Education: 1) basic education only, 2) vocational degrees, 3) lower university and non-university degrees, and 4) higher university degrees.

Work experience groups: 1) less than 5 years work experience, 2) from 5 to 9 years work experience, 3) from 10 to 25 years work experience, 4) over 25 years work experience.

Work experience was calculated as follows: age of an employee-6-years of education.

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## 10 Unemployment and Early Retirements of the Finnish Aged Workers in 1989 – 1996<sup>88</sup>

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### Abstract

This paper contains an empirical analysis of gross job flows in the context of the great depression of the early 1990s in Finland. The establishment-level job flows in 1989 - 1996 are characterised in terms of employees' age and education. The outflow of workers from employment occurs mainly through unemployment, unemployment pensions or disability pensions. The purpose is to examine how the pressures for change, caused by depression and restructuring during the 90s, were reflected in the use of the aged labour force. The study shows that the aged workers had a considerably higher propensity to lose their jobs than Finnish employees in general. Approximately 50 percent of the jobs held by people aged 55-59 vanished in the first half of the 90s. The unemployment pensioners and disability pensioners tend to have shorter educational histories than the Finnish workers in general. Firm and industry-level factors are also important in explaining the withdrawal. There is persistence in high levels of job destruction, especially in manufacturing, that may relate to skill-biased technical change. The total withdrawal from employment does not depend on firm size. However, on a disaggregated level disability pensions and unemployment benefits appear as substitutes that are used depending on which one is least costly for the firm. Firms' share of pension payments depend on the firm size and the chosen pension scheme. Firms use the method which is least costly. Therefore, large firms channel their older workers to unemployment or unemployment pensions and small firms to disability pensions. It is also shown that the availability of social security payments increase the likelihood of withdrawal from employment irrespective of firm size. There is no particularly high negative effect on job destruction of aged emerging from the higher social security payments in the large firms.

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## 10.1 Introduction

The motivation to the elaboration of gross job and worker flows in the Finnish economy can be understood from the point of view of the large and growing economic literature on the relative demand shifts between unskilled and skilled workers during the 1990s and by the extraordinary deep recession in Finland<sup>89</sup>. This is related to the growing concern of the early labour market exits of aged employees. Böckerman and Piekkola (2001) have discovered that there are strong signs of persistent decline in demand for employees with only basic education and for the most experienced employees (i.e. employees with 25 years of experience or more). This was seen most likely as a reflection of the fact that the skill requirements for the employees had risen due to continuous technological upgrading. Depression has contributed to the job destruction of aged, but does not explain the phenomena. The great Finnish depression of the early 1990s constitutes an excellent opportunity for the elaboration of gross job flows during extreme business cycle fluctuations.

It is proposed that the early pension schemes and the unemployment pension tunnel provided a soft channel for companies to let their older employees go and to concurrently cut-off costs and reorganise in the deep recession. Additionally, it is put forward in some articles that large employers might have favoured unemployment pension in comparison with disability pension (Romppanen 2000). The reason is that before year 2000 large employers carried full burden of disability pension costs. The costs from unemployment pension fall only after a long period of unemployment and are not fully deductible. Higher cost and the increasing risk of disability for the aged is seen to encourage employers to keep their labour force young. It is possible that the older workers underwent only the destructive part of the “creative destruction” made famous by Schumpeter (1942) and were left outside of the job-creating element. The persistence of high job destruction for older workers, also after the recession, indeed requires other explanations besides the deep recession. The favouring of younger workers could be the fashion especially in industry sectors, where production technologies develop expeditiously. (See also Hytti 1998 and Ahituv & Zeira 2000).

This study disaggregates gross job and worker flows by industry and by employees' age in the Finnish economy over the period of investigation from 1989 to 1996. Accordingly, worker flows between employment, unemployment, disability- and unemployment pension channels are examined. In addition to job flows from employment, flows back to working life are examined as well. This study extends present literature on European restructuring and retirements. Former studies have mostly been done at the firm level or by using census

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<sup>89</sup> Atkinson (2000) provides a summary of the literature.

data<sup>90</sup>. We also explain job flow rates by various average firm-level individual and firm characteristics, including firm size, social security payments, capital intensity and liquidity constraints. The average wages in firm are decomposed those based on experience, education and unobserved human capital of the workers.

This study consists of in six parts. The sectoral composition of the study follows Ilmakunnas and Maliranta (2000), beyond narrow “manucentrism”. Thus, the study includes a number of service sectors from 1988 to 1996<sup>91</sup>. The second section creates an insight into the Finnish unemployment benefit and early pension system and third section describes the data and methods. The fourth and fifth section includes the empirical analysis of gross job flows (i.e. job creation and destruction) in the context of the great depression of the early 1990s. The sixth section concludes and draws the main conclusions.

## 10.2 Institutional Setting

In this section we describe the Finnish public benefit compensations for the people who retire or become unemployed before the age of 65, the old age pension limit. The system comprises of unemployment benefits, disability pension and unemployment pension. We include in our study people who receive i) unemployment benefits ii) unemployment pension benefits or iii) disability pension benefits. The division of pension recipients and unemployed by type of benefits are shown in appendix, table A1. In 1998 about 55 percent of the age group 60-64 received disability or unemployment pension benefits. The Finnish government mostly finances all the benefits, but part of the pension benefits (ii and iii) are funded by the firms and earnings related unemployment benefits (part of i) are paid by unemployment benefit fund held by labour unions. The share of the benefits paid by the firms depends on the size of the firm.

The first benefit mentioned is the unemployment benefit, which is paid on a fixed rate basis. In the case where worker is covered by an unemployment benefit fund, the unemployment benefit is earnings-related for the first 500 days of unemployment (Pyy-Martikainen, 2000)<sup>92</sup>.

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<sup>90</sup> Hytti 1998 provides a review of the existing findings on the factors affecting early retirement in Finland.

<sup>91</sup> Piekkola and Böckerman (2000) provide the comprehensive tabulation of gross job and worker flows over the period of investigation.

<sup>92</sup> The receivers of unemployment benefits have to fulfil a so-called ‘period of employment condition’ (työssäoloehto). That condition is fulfilled when the unemployed person has been working 26 weeks during the last 24 months’ period before unemployment started. After 500 days, a 6 months’ period of employment is required in order to renew the benefits. After 1997

The two main paths for early retirement in Finland open through longer period of unemployment or decreased working ability. People of 60 years of age who have received unemployment benefits for 200 days during the last 450 days, or who have received the maximum amount of earnings related unemployment benefit, are entitled to unemployment pension. A special feature of the unemployment pension is that the people who turn 57 years during the unemployment period, i.e. when unemployment starts at the age of 55, are entitled to an extension of unemployment benefits until they turn 60 and start to draw unemployment pension. In other words, they do not have to fulfil the renewal limit to have an extension of unemployment benefits after 500 days of unemployment. This feature is the so-called “unemployment retirement tunnel”. Before 1997 “the tunnel” was open for individuals aged over 53 years and 1 month and before 1990 the age limit for unemployment pension was 56 years. (Hakola 1999) The employer contributes to the unemployment pension funding since the employees reaches the age of 60 and the amount of firm’s contribution increases with firm size.

An individual who is suffering from reduced working ability because of an illness, a handicap or an injury is entitled to disability benefits. Reduced working ability is the most common cause for early retirement in Finland. Almost one quarter of Finnish 59-olds received disability benefits in the year 1998. (Ministry of Social Affairs and Health 2000; OECD 2000). Both unemployment pension and disability benefits are considered “fully effective”. Thus, the time between the pension-qualifying event and the official retirement age, the so-called post-contingency period, is also accrual time for the old-age pension which starts at the age of 65 in Finland. The future time’s pension accumulation level is usually tied to the wage of the latest job. This, in fact, might cause a disincentive to accept a new job with a lower wage than the one before the unemployment period and to constrain further the job creation of the unemployed. (Hakola 2000).

The individual early retirement pension is a special type of disability pension paid to someone between 58 and 64 with a long working career, whose working capacity has been significantly reduced. Before 1995, the age limit was 55 – 64 years.

### **10.2.1 Employer’s excess of the pension costs**

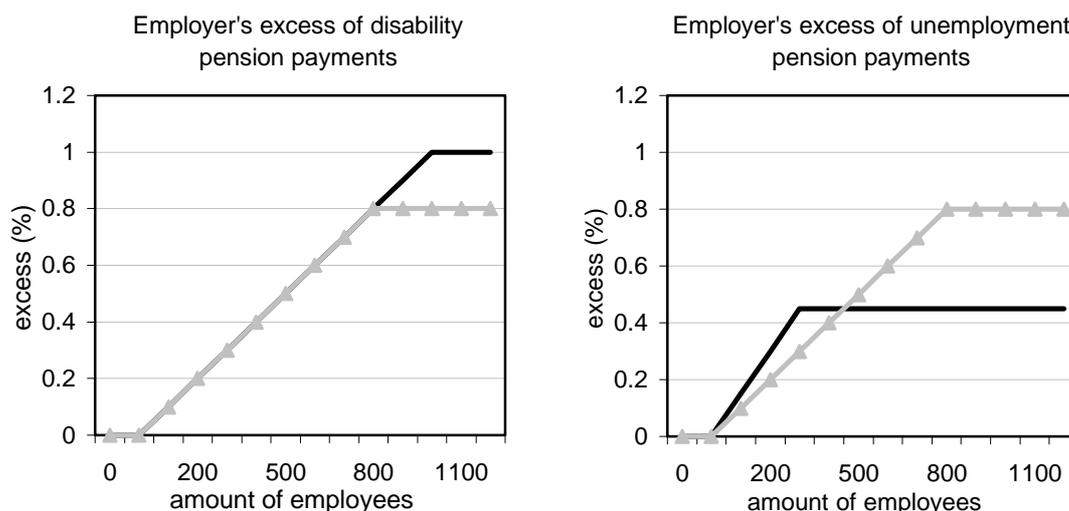
From the point of view of the firm it is not insignificant how workers use the early retirement channels. The employer’s excess of the pension costs is the part of the pension payments, which are deductible to employer. The amount of those costs depend on firm size (see figure 10.1). Therefore, there is a rationale for

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the renewal condition was extended to 10 months (in two years) and, before 1994, the basic daily benefit was paid for the whole period of unemployment, without restriction.

firms to use, if possible, the retirement channel which is less costly. One of the key findings of the paper in hand is that this kind of selective channelling of workers actually happens. Since the beginning of the year 2000, the employer's excess of the early pension payments is harmonised (like shown in figure 10.1). (Työeläke 1999)

Figure 10.1. Employer's excess of early retirement payments



### 10.3 The Data and The Measures of Gross Job and Worker Flows

This study applies longitudinal data of all employees and establishments in the industries studied over the period starting from 1988 to analyse job flows in 1989-1996. Employment Statistics constitutes the backbone of this study<sup>93</sup>. Employment Statistics cover information on employment status in the second week of December for the entire population. There were 19,618,318 observations over the period from 1988 to 1996. In what follows, we measure withdrawal in and out of workforce and not only the employment change. The gross flows of jobs and workers are measured as the number of jobs created or destroyed, or workers moving in and out of establishments (i.e. hirings and separations of workers). This means that the measure of the job creation rate (JC) is calculated as follows:

$$JC_t = \sum_i (H_{it} - S_{it})^+ / ((\sum_i E_{it} + \sum_i E_{i,t-1}) / 2), \quad (1)$$

<sup>93</sup> Huovinen and Piekkola (2000) have more detailed description of the data. Kyyrä (1999) and Korkeamäki and Kyyrä (2000) also provide a documentation of the applied data.

where  $E_{it}$  denotes employment in firm  $i$  at year  $t$ , and  $H_{it}$  is the number of workers at the establishment at time  $t$  who were out of workforce at time  $t-1$  and  $S_{it}$  is the number of workers at the establishment at time  $t-1$  who are out of workforce at time  $t$  and the superscript “+” refers to positive changes. We calculate equal figures for unemployment, and unemployment and disability pensions. The number of employees is measured by the average of period  $t$  and  $t-1$  employment. In other words, to convert time- $t$  job creation and destruction measures to rates, job creation and destruction are divided by the average of employment at  $t$  and  $t-1$ . This is done in order to achieve several technical advantages over more conventional growth rate measures (see, for example, Davis, Haltiwanger & Schuh 1996, 189-190). Hirings may relate to employment of those under unemployment, unemployment pension or disability pension and similarly for separations.

Unlike the conventional growth rate measures, which divide employment change by lagged employment and range from  $-1.0$  to  $\infty$ , the applied growth rate measure ranges from  $-2.0$  to  $2.0$  and the growth rate measure is symmetric around zero. For example, job creation receives the value of 2 if the plant is newly established and all workers were formerly out of workforce (period  $t-1$  employment is zero). Job destruction receives the value of 2 if plant is closed and all workers run out of workforce into unemployment. This average measurement also removes part of the bias induced by transitory movements of the economy.

The measure of the job destruction rate (JD) is calculated as follows:

$$JD_t = | \sum_i (H_{it} - S_{it})^- | / ((\sum_i E_{it} + \sum_i E_{i, t-1}) / 2) \quad (2)$$

Thus, the job destruction rate is defined as the absolute value of the sum of hirings less separations when negative in flows in and out of workforce, divided by the average number of employees. The superscript “-” refers to negative changes.

The definitions of job creation and destruction mean that the withdrawal rate (WIR) is simply the difference of the measures of job creation and destruction:

$$WIR_t = JC_t - JD_t = HR_t - SR_t \quad (3)$$

where hirings  $HR_t$  and separation rates  $SR_t$  use the same denominators as job creation and destruction rates.

The excess worker reallocation rate (WRR), equal to half of churning, equals worker reallocation (the sum of hirings and separation rates) less job reallocation rate (the sum of job creation and destruction rates):

$$WRR_t = 0.5 (HR_t + SR_t - JC_t + JD_t) \quad (4)$$

At firm level this is equal to the difference between separation rate and job destruction rate. This is a particularly useful estimate at withdrawals, since it measures the extent to which persons exits and enter employment keeping total employment in the firm the same. One reason for “recycling” of unemployed is the use of contract workers and another the expiration of unemployment benefits after 500 days.

The measures of underlying job creation and destruction, and worker flows of the Finnish economy by employees’ education and age groups are calculated for the main industries of the economy. The sectors are defined as follows: (i) manufacturing, (ii) construction, (iii) trade, and (iv) business services. The public sector is excluded from the analysis as in a number of earlier studies on gross job and worker flows. The education code was reduced to four groups following Vainiomäki (1999); (i) only basic education, (ii) vocational certificates, (iii) lower university and non-university degrees, and (iv) higher university degrees. The age code in the calculations is more focused on the aged labour force. Therefore, the first group includes all the workers (i) 49 or younger, whereas the rest of the groups are divided into five-year sequences; (ii) 50-54 (iii) 55-59 (iv) 60-64 and (v) 65+.

The job destruction and creation in selected firms in Section 10.5 are based on 5,361 firms covered in the sample of financial statistics collected by Statistics Finland. Average job flows in firm  $j$  are explained by the firm average of following variables:

- *Annual wages  $W_{it}$* : Real compensation (wage) for person  $i$  divided by months worked and multiplied by 12, and deflated by the consumer price index (1990=1.00) in Employee Statistics. Logarithmic wages are in the analysis decomposed into compensations from experience, education and unobserved human capital and into firm-level payments, see Piekkola (2000, 2001) for details.
- *High Educated/Employees*: The share of employees with bachelor’s degree (lower university and non-university degrees) or higher
- *Capital  $K_j$  per Annual Employment  $L_j$* . Accumulated investment with 15 percent depreciation for machinery and 7 percent for other capital from 1987 using initial stock values in Financial Statistics per average number of salaried and hourly employees in firm  $j$  over the course of the calendar year in Financial Statistics.
- *Borrowing ratio*: Expenditures on interest-bearing debts divided by cash-flow (Nickell and Nikolitsas, 1999, use all long-term interest payments). The

borrowing ratio is set at the minimum to zero or at the maximum to four if it deviates more than five standard deviations from the estimated value.<sup>94</sup>

- *Market share*: Real sales relative to sales at the two-digit industry level (NACE95).

## 10.4 Withdrawal from Employment

Figure 10.2 represents the withdrawal rates (WIR)<sup>95</sup> between 1989 - 1996 using data from four Finnish industries (manufacturing, construction, trade and business services). Changes are calculated for four age groups. It is seen that withdrawal was concentrated on the aged segment of workforce. Approximately 50 percent of the jobs held by people aged 55-59 vanished in the first half of the 90s. In both 1992 and 1993, more than 16 percent of the working individuals aged 55-64 ended up in unemployment. Figures 10.3 a-d show job destruction by age in different industries.

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<sup>94</sup> The OLS regression using borrowing ratio as regressand yielded  $R^2 = 0.019$  with the following explanatory variables: unobserved individual effect, education effect, hirings effect, seniority effect, seniority squared effect, real sales per capita, short-term loans per capita, interest-bearing debt per capita, return on capital, dividends per capita, exports per capita, total factor productivity, market share and 32 industry dummies (see definitions later). 1.7 percent of observations receive the maximum value 4 for the borrowing ratio (426 observations out of 25,016).

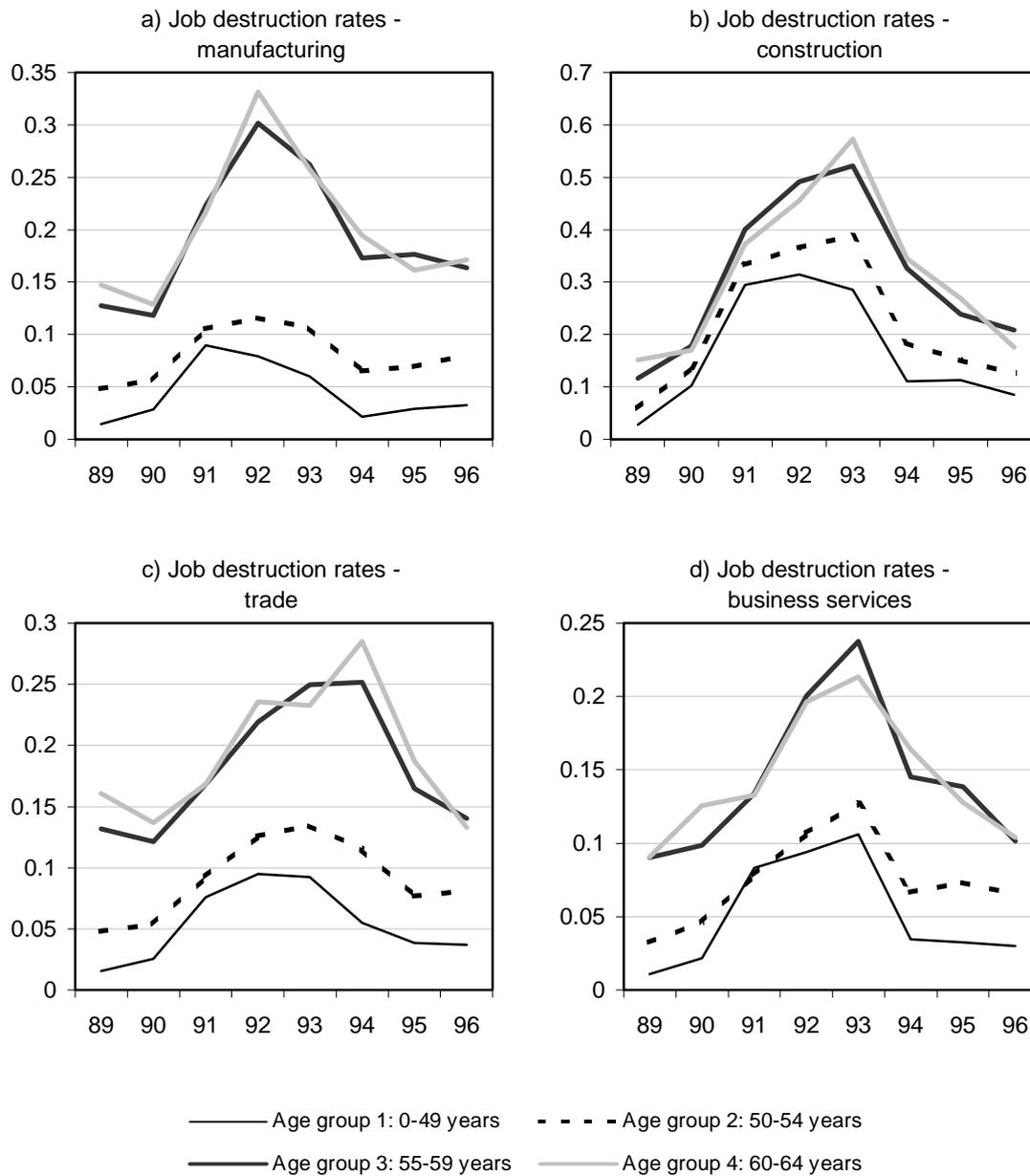
<sup>95</sup> The difference of job creation– and job destruction rates.

Figure 10.2. *Withdrawal from employment in Finland 1989 - 1996*



To some extent, the calculations confirm that the treatment of aged labour differs in relation with the sector of industry. Although the aged workers met higher job destruction and lower creation rates in every sector, there were differences in the magnitude of that phenomenon between sectors. In manufacturing and trade, separations were mostly concentrated on the older employees. Manufacturing sector's aggregate job destruction rate has been below 11 percent while workers aged 55-59 have encountered job destruction rates of 15-25 percent during the depression 1992 - 1994. A contrary development was experienced in construction sector, however, where workers were laid off in masses but more evenly from all age groups than in the other sectors. After 1994, in the majority of firms, the amount of recruits of young unemployed has been larger than the amount of young workers who have been laid off. At the same time, job creation rates for older age groups remained relatively low. In the beginning of recovery (1994) improvement in job creation was experienced, but unlike the younger age groups, the net employment rate for older unemployed remained negative. When looking at age group 3's (55-59) figures (figure 10.3, one finds that in trade sector the job creation was minimal while most of new jobs were created in construction and business service sectors. Some new jobs were created also for the last two age groups (60-64 and 65+ years old), especially in business services sector.

Figures 10.3. Job destruction rates by age and industry



We can see that the probability of retiring through disability pension increases with age (see figure 10.4).

Figure 10.4. Job creation and destruction by age and industry; disability pensioners

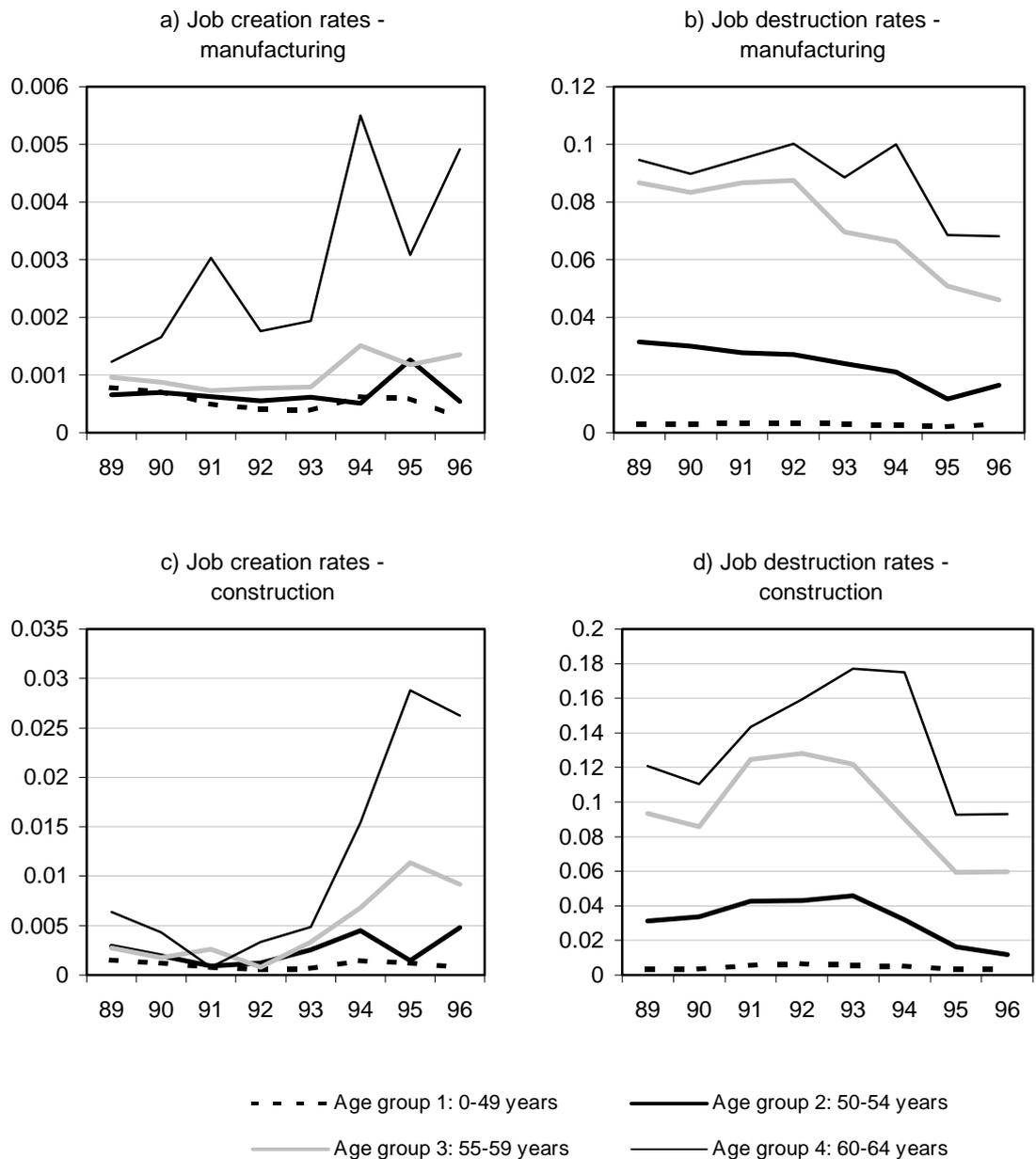
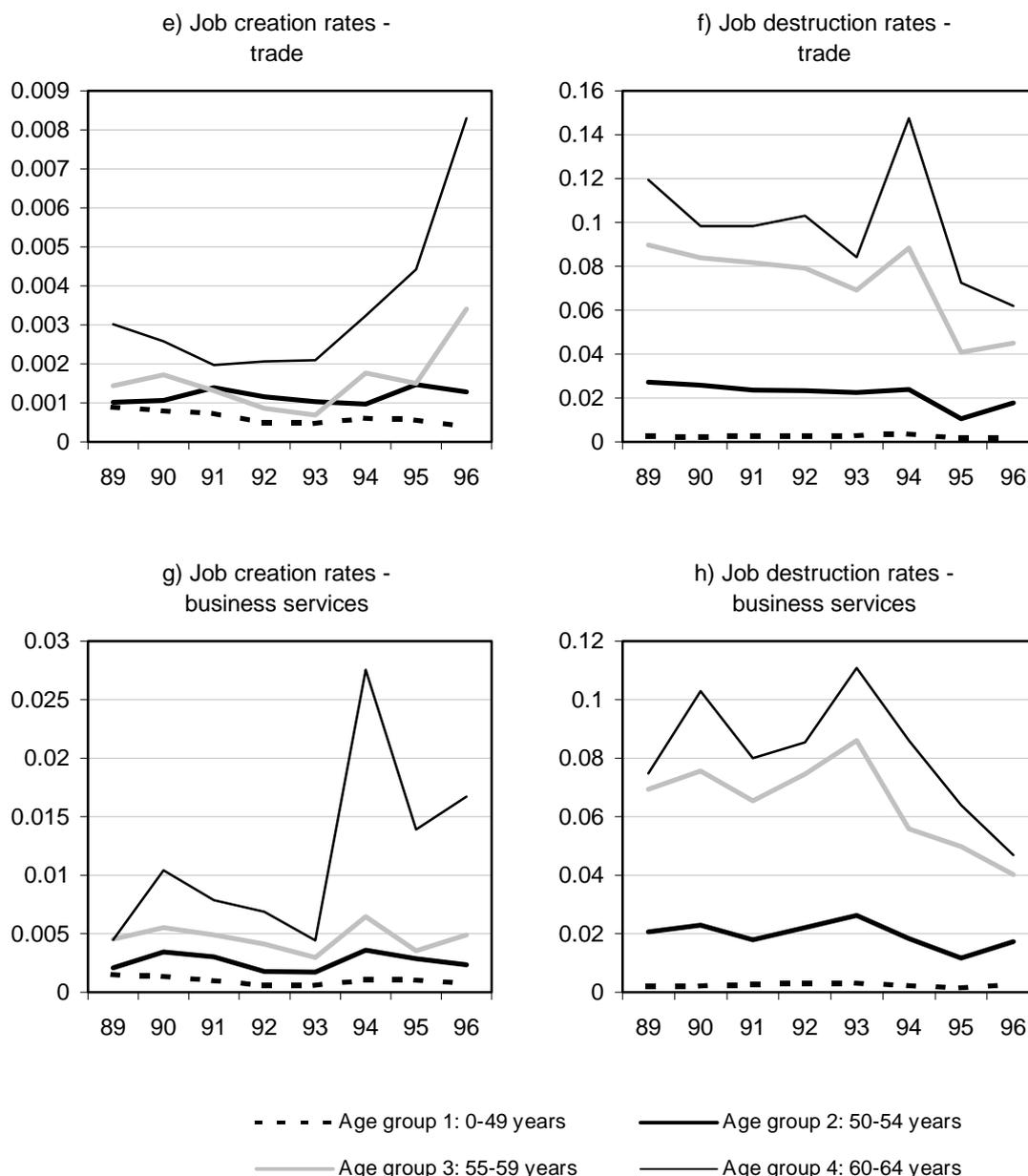


Figure 10.4. Job creation and destruction by age and industry; disability pensioners (continued)



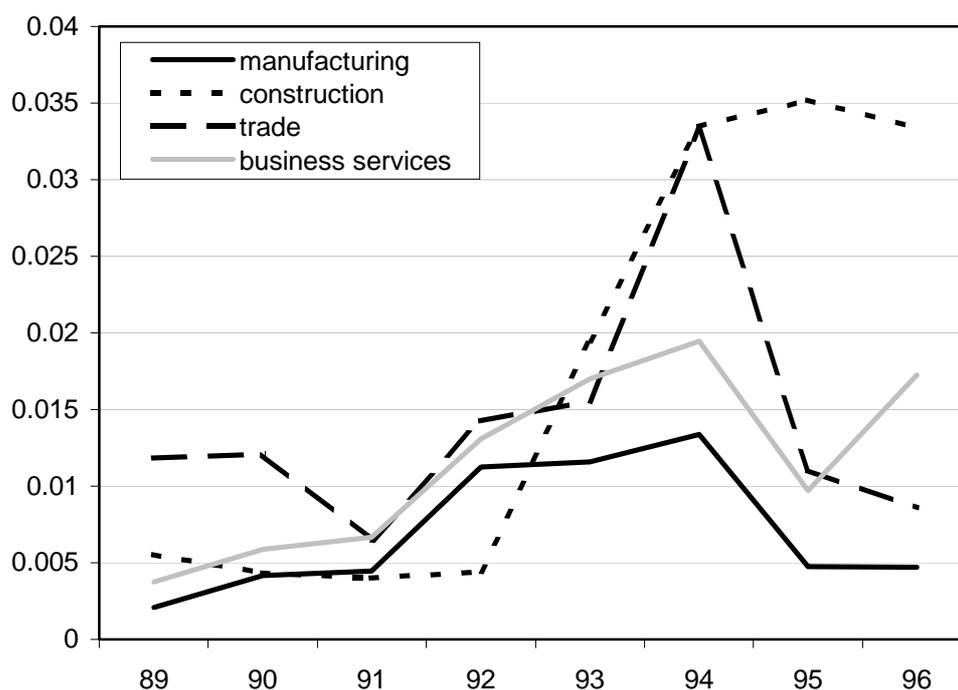
For age group 1 (0-49 years old) the amount of disability pensioners is low, but when the age of 50 or higher is reached, the job destruction rates in disability pension become substantial. Disability pensions are most common in the construction sector. The second largest source of disability pensioners is the manufacturing sector. Supposedly, these sectors include more jobs where the physical stress is appreciable. Controlling firm characteristics in the econometric analysis in section 10.5, we also find that business services contribute to

disability pensions. Since the period of darkest recession, job destruction through disability pension has turned into decline in every sector. Overall, disability pension flows still seem to be fairly non-cyclical.

Job creation rates for disability pensioners in all the sectors have been rather low although some improvement was experienced in 1994 and 1995. For some reason the age group 60-64 has a higher job creation than 55-59 olds.

The share of unemployment pensioners has been quite low in the age group 60-64 during the depression, as the job destruction rate has only been around one or two percent<sup>96</sup>. Unemployment pension follows longer periods of unemployment, and, as the heavy increase in unemployment only began in 1991 the number of unemployment pensioners started to increase one or two years later (as can be seen in figure 10.5). It is also worth noting that the construction sector's figures do not differ from other sectors' job destruction rates in unemployment pension flows as they do with unemployment flows.

Figure 10.5. *Withdrawal in age group 60-64 by industry; unemployment pensioners*



<sup>96</sup> The unemployment pensioners' eligibility age is 60, therefore an examination for younger age groups is not carried out.

Unemployment flows follow the economic cycles quite closely, both in manufacturing and business services. We see net employment creation in both industries in 1994 when the GDP growth turns positive after three years of recession in which GDP dropped by 12 % altogether. There was also a recovery of employment flow in the business sector. The increase in unemployment in 1994 is on major part explained by the lengthening of unemployment periods that we do not measure here. It is evident that unemployment (and disability benefits in particular) do not exactly follow economic cycles. In particular, there seems to be no substantial improvement in employment flow since the recession. This also relates to the permanently negative employment creations throughout the period for the aged workforce that did not drastically deteriorate in the recession. Furthermore, the impact of the recession years on disability and unemployment pension figures may be delayed and become more evident outside the time span of this study.

#### **10.4.1 Unemployment, early pensions and establishment deaths**

We have also analysed separately the role of establishment deaths and their effect on job flows. The total unemployment flows arose mainly from establishments which survived the depression without closing down. Only a very small fraction of job destruction and creation emerged from death or birth of a company. As the recovery started in 1994 the role of births and deaths became more prominent especially in the trade sector. The Finnish trade sector went through a strong re-structuring process during the 90s, which partly explains the considerable job destruction through plant or firm “deaths” in that branch. The brackets are used since in this case it is more likely that job destruction is due to movement from smaller establishments to larger and more efficient ones. In the construction sector the role of firm deaths was more important than in other sectors. During the time of recession, half of the job destruction was derived from close downs.

There is one more interesting phenomenon found in the manufacturing sector. The ratio unemployment pensioners/unemployed is higher in firm deaths than in continuing ones. During the depression the ratio disability pensioners/unemployed is also higher in firm deaths than in continuing firms.

#### **10.5 Withdrawal and Firm Characteristics**

In this section, the total data of employees is matched to the firm sample of Financial Statistics held by Statistics Finland. The purpose is to examine what kind of characteristics, including the quality of personnel and social security payments, describe firms where withdrawal takes place. The original sample of Financial Statistics consists of 6,092 firms. The final data has 5,361

observations, of which there is job flow information from 5,220 firms. We use as weights the sample weight multiplied by the average number of employees (corrected for the loss of small firms due to only one year of entering data, which are thus omitted; see the third column). The employee data in the selected 5,361 firms cover 3,099,342 observations and 791,437 persons. (8,021,902 person-year observations from total data on employees work at least one year in these firms; for a closer description, see Piekola 2000).

Empirical formulation follows Abowd, Kramarz and Margolis (1999), called ‘the person effects first’ -approach. Using econometric techniques we explain average firm-level withdrawals and excess worker allocation. The estimation equation for various withdrawal rates such as the average excess worker reallocation  $EWR_j$  in firm  $j$  is:

$$EWR_j = b_1 x \beta_j + b_2 \alpha_j + b_3 u \eta_j + b_4 \kappa_j + \varepsilon_{jt} \quad (5)$$

Where  $x \beta_j$  is the average predicted effect of work experience and time dummies,  $\alpha_j$  is the average of unobserved individual effects,  $u \eta_j$  is the average of the education/sex effect,  $\kappa_j$  measures the firm-level factors: skilled share of labour, quasi rent, borrowing ratio and market share, and  $\varepsilon_{jt}$  is a statistical error. The average of the unobserved individual effects,  $\alpha_j$ , and the average of the education effect,  $u \eta_j$ , are from the following wage equations

$$\ln(w_{ijt}) = \theta_i + \psi_j + \beta x_{it} + e_{ijt}, \quad (6)$$

$$\theta_i = \alpha_i + u \eta_i + \varepsilon_i, \quad (7)$$

where the wage is first explained by time-varying person characteristics:  $\beta x_{it}$  contains time dummies, a dummy indicating whether person  $i$  has switched jobs and experience up to the fourth power.  $\theta_i$  is the individual fixed effect,  $\psi_j$  the firm-specific payment (left unexamined here), and  $e_{ijt}$  represents a statistical error term. The estimation proceeds by first estimating (6) where the wage also includes interactions of person average and firm characteristics (interactions of average experience, seniority, firm size (average number of workers) and industry dummies). The model is estimated in deviations from the individual means. This is done to purge the person fixed effects. The subsequent error term includes, in addition to the original error  $e_{ijt}$ , the projection of the firm effects on the interaction variables. The person average of the original error  $e_{ijt}$  (the difference between observed and predicted wages) is the person effect  $\theta_i$ . The estimation of (7) is used to divide the person effect into the education/sex effect  $\eta_i$  for group  $u$  and to unobserved effect  $\alpha_i$  using the variance of  $\theta_i$  as the

weight. Hence, compensations for unobserved human capital  $\alpha_i$ , consist of high wages of the individual throughout his/her work career not explained by experience, sex or education.

The results derived from the regressions are illustrated in tables 10.1-3. The mean values of variables used are shown as table A.2 in Appendix. Job Creation is calculated for firms that on average hired more unemployed than shedded labour into unemployment. The majority of firms, two-thirds, shedded more labour into unemployment than recruited unemployed (job destruction figures cover there firms). In table 10.3, firms are divided analogously into two categories. Only 10 percent of firms recruit disability pensioners more than create them. It is also clear that only few enter the labour force again once under unemployment pension scheme. Table 10.2 shows employment change for the around 250 firms instead of job destruction figures, since basically the figures are the same (the net employment change was negative in almost all firms, i.e. job creation is zero).

### **10.5.1 Withdrawal into Unemployment or Pensions**

The figures in table 10.1 include the job flows into and out of the employment, including unemployment and both unemployment- and disability pensions.

Column 2 shows job creation and column 4 job destruction between employment and non-employment for age group 55-59. A large majority of the latter consists of unemployed entering the unemployment pension tunnel, leading to unemployment pension at the age of 60. Table indicates that job creation of unemployed and job destruction into unemployment both decrease with variables indicating compensations on unobserved human capital, the share of educated workforce and capital intensity. Skill-intensive firms neither employ unemployed nor contribute to unemployment. In skill-intensive firms, including large firms (having on average higher capital intensity and skilled workforce), excess worker mobility of unemployed people is low (fifth column). The unobserved human capital and the share of educated decrease excess worker reallocation. This implies that it is less common to replace unemployed with another unemployed person. The most important conclusion is that the skill-intensity of the firm, such as higher share of educated, lowers withdrawals.

It is interesting to note that in firms with high average compensations on education payments worker reallocation is large (i.e. education effect has positive sign). The excess demand for skilled caused by "skill-biased technical change" may have lead to the remuneration of educational degrees but has also raised worker mobility. This has resulted to low unemployment for higher educated, whereas the low educated stick out as the main group drawing disability or unemployment pensions.

We can see from firm-size dummies in table 10.1 that vast differences do not exist in firms of different size in job creation nor destruction for young or aged persons (compare columns 1 and 2 or 3 and 4), when looking at the total flow from employment. Figure 10.6b shows that job destruction for all age groups is only slightly decreasing with firm size.

In figure 10.6 firms are divided first into 4 firm-size categories and each category is divided into 20 classes that each contain 5 percent of the workforce in that firm-size category. Figure 10.6c for aged and figure 10.6d for all age groups in total show that job destruction into disability benefits is strongly decreasing with firm size. Similarly, the use of unemployment pension tunnel is increasing in firm size (not shown). The generous use of individual early retirement for the elderly in small firms matches the use of unemployment pension system in large firms.

What are the other factors that are related to firm size effect in flows to pensions? One possible factor is the higher social security payments in large firms, that unambiguously increases job destruction in the estimations. There is a social security payment factor in the model. It interacts weakly with the firm-size dummies both for total flows (including unemployment and early pensions) and flows of aged individuals. Above average social security payments create more job destruction for aged in large and very small firms.

A firm-size effect should also emerge in large firms, as they are better able to co-ordinate personnel policy and to minimise social security payment expenditures. In large firms, unions and employers might together create savings in labour costs by channelling the aged high-wage earners to the unemployment pension tunnel (which is silently accepted by unemployment officials). However, in our calculations this is not controlled and we do not find this to create any firm size effect.

The second last column of table 10.1 shows that excess worker reallocation is significantly lower in small firms<sup>97</sup>. This indicates that in small firms it is less common to replace a person by an unemployed person. From columns 3 and 4 it is seen that liquidity constraints and high borrowing ratio raise job destruction of the unemployed. Liquidity problems also create some excess worker reallocation. Longitudinal effects are potentially even larger than the cross-sectional effects studied here, since in the recession period borrowing ratio doubled.

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<sup>97</sup> Excess worker reallocation measures the replacement of workers in and out of workforce in excess of the size of personnel.

Table 10.1. *Estimates of withdrawal from employment*

Dependent variable Variable	Job creation		Job creation age 55-59		Job destruction	
	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
Average Predicted Effect of x Variables (xb)	-0.002	(0.1)	0.018	(0.3)	-0.009	(0.7)
Average Unobserved Human Capital ( $\alpha$ )	-0.040	(4.4)	-0.046	(1.6)	-0.044	(6.1)
Average Education Effect ( $u_{ij}$ )	0.047	(2.2)	0.093	(1.4)	0.041	(2.5)
High Educated/Employees	-0.086	(6.2)	-0.084	(2.0)	-0.071	(6.3)
Log(Capital/L)	-0.003	(2.4)	0.000	(0.1)	-0.003	(3.4)
Borrowing ratio	-0.006	(1.3)	0.013	(0.9)	0.014	(5.0)
Market Share	0.000	(1.2)	0.001	(0.9)	-0.001	(4.7)
Average employees < 7	0.005	(0.5)	-0.019	(0.6)	0.032	(3.7)
Average employees 7-19	0.001	(0.1)	0.018	(0.6)	0.009	(1.2)
Average employees 50-99	-0.025	(1.7)	0.004	(0.1)	0.011	(1.2)
Average employees 100-499	-0.021	(1.5)	0.000	(0.0)	0.019	(2.7)
Average employees > 500	-0.022	(1.5)	-0.013	(0.3)	0.006	(0.9)
Consumer goods	-0.013	(1.3)	0.022	(0.9)	0.014	(2.8)
Pulp and paper, chemical	-0.006	(0.9)	-0.004	(0.2)	-0.001	(0.3)
Non-metallic mineral products	0.013	(1.4)	0.018	(0.8)	0.040	(6.0)
IT manufacturing and services	-0.003	(0.4)	-0.005	(0.2)	0.002	(0.4)
Energy and Water	-0.030	(1.6)	-0.019	(0.4)	-0.023	(2.6)
Construction	0.105	(12.9)	0.107	(4.5)	0.093	(19.0)
Trade, Hotels, Restaurants	-0.023	(3.5)	0.002	(0.1)	-0.011	(2.5)
Non-business services	-0.007	(0.7)	-0.036	(1.2)	-0.015	(1.9)
Social security	-0.084	(0.7)	0.305	(1.0)	0.262	(3.6)
Social security, Employees < 7	0.163	(1.2)	0.030	(0.1)	-0.360	(3.5)
Social security, Employees 7-19	0.100	(0.8)	-0.331	(1.0)	-0.085	(0.9)
Social security, Employees 50-99	0.365	(2.0)	-0.398	(0.9)	-0.074	(0.7)
Social security, Employees 100-499	0.191	(1.1)	0.015	(0.0)	-0.230	(2.7)
Social security, Employees > 500	0.241	(1.2)	0.022	(0.0)	-0.127	(1.3)
Sample size	1485		938		3759	
Coefficient Degrees of Freedom	26		26		26	
Root Mean Squared Error	0.9349		2.1252		1.0582	
R <sup>2</sup>	0.2754		0.0590		0.2461	

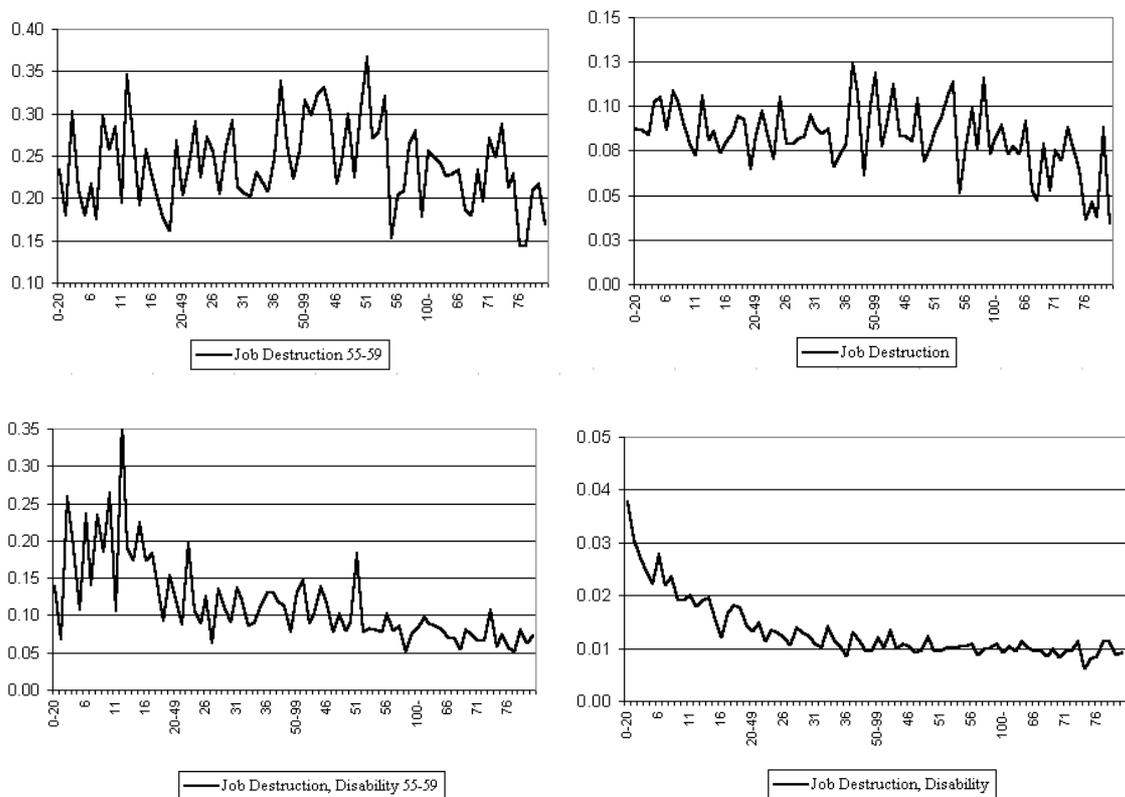
All estimations are ordinary least squares using sample times firm employment weights. Metal and machinery is the reference industry (excluding IT industry).

Finally, we can see that firms which create high job destruction for aged into unemployment and pensions are located in certain industries: consumers goods, non-metallic mineral products and construction. In all the figures job creation and destruction are significant in construction. Not only the job reallocation (the sum of job creation and destruction) but also excess worker reallocation is exceptionally high.

Table 10.1. *Estimates of withdrawal from employment (continued)*

Job destruction age 55-59		Excess worker reallocation		Excess worker reallocation age 55-59	
Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
-0.044	(0.8)	-0.014	(4.4)	-0.002	(0.4)
-0.104	(3.7)	-0.015	(8.6)	-0.010	(3.5)
0.036	(0.6)	0.010	(2.6)	0.001	(0.2)
-0.182	(4.3)	-0.020	(7.6)	-0.002	(0.4)
-0.003	(0.7)	-0.001	(3.8)	-0.001	(1.7)
0.023	(2.2)	0.001	(0.9)	0.003	(2.4)
-0.001	(1.9)	0.000	(2.5)	0.000	(0.7)
-0.033	(0.8)	-0.007	(3.6)	0.003	(0.9)
0.027	(0.9)	-0.003	(1.7)	-0.001	(0.2)
0.071	(2.3)	-0.002	(1.0)	-0.004	(1.1)
0.034	(1.4)	-0.001	(0.4)	0.002	(0.6)
-0.002	(0.1)	-0.002	(1.2)	0.001	(0.3)
0.049	(2.8)	0.000	(0.2)	0.000	(0.1)
-0.025	(1.5)	0.001	(0.9)	0.003	(1.5)
0.053	(2.3)	0.002	(1.2)	0.003	(1.2)
-0.012	(0.5)	-0.003	(2.0)	0.001	(0.5)
-0.095	(3.1)	-0.007	(2.8)	0.002	(0.5)
0.101	(5.8)	0.028	(21.8)	0.017	(8.8)
-0.032	(1.9)	-0.003	(2.8)	-0.001	(0.8)
-0.081	(2.9)	0.014	(7.5)	0.004	(1.4)
0.531	(2.0)	0.000	(0.1)	0.012	(0.4)
0.786	(1.7)	0.000	(0.0)	-0.086	-(1.9)
-0.532	(1.4)	0.000	(0.0)	-0.028	-(0.9)
-0.551	(1.4)	0.000	(0.0)	0.072	(1.7)
-0.366	(1.2)	0.000	(0.0)	0.009	(0.3)
0.176	(0.5)	0.000	(0.0)	0.014	(0.4)
3184		5245		4123	
26		26		26	
3.5350		0.3203		0.4271	
0.0828		0.2420		0.0461	

Figure 10.6. Job destruction of 55-59 olds by firm numbers in four firm size groups



### 10.5.2 Unemployment Pension Flow and Disability Benefits

Table 10.2 shows job creation and destruction into unemployment and table 10.3 for disability benefits:

Table 10.2. *Estimates of withdrawal into unemployment pension*

Dependent Variable	Net Change of Employment age 55-59		Net Change of Employment age 60-64		Excess Worker Reallocation		Excess Worker Reallocation age 60-64	
Variable	Coefficient	t- value	Coefficient	t- value	Coefficient	t- value	Coefficient	t- value
Average Predicted Effect of x Variables (xb)	-0.009	(1.2)	0.053	(0.5)	-0.003	(0.6)	-0.091	(1.7)
Average Unobserved Human Capital ( $\alpha$ )	0.002	(0.8)	0.079	(1.8)	-0.007	(3.4)	0.014	(0.6)
Average Education Effect ( $\nu\eta$ )	-0.018	(2.5)	-0.253	(2.5)	0.001	(0.1)	-0.044	(0.8)
High Educated/Employees	0.014	(2.2)	0.389	(4.2)	0.007	(1.6)	0.061	(1.2)
Log(Capital/L)	0.000	(0.5)	0.002	(0.3)	0.000	(0.9)	-0.001	(0.3)
Borrowing ratio	0.001	(1.0)	0.000	(0.0)	0.000	(0.5)	-0.001	(0.1)
Market Share	0.000	(0.6)	0.000	(0.8)	0.000	(0.1)	0.000	(0.2)
Average employees < 7	0.003	(0.9)	-0.189	(3.3)	0.024	(10.8)	-0.011	(0.4)
Average employees 7-19	0.002	(0.4)	-0.150	(2.5)	-0.002	(0.7)	-0.046	(1.4)
Average employees 50-99	0.003	(1.0)	0.073	(1.9)	-0.001	(0.4)	-0.034	(1.7)
Average employees 100-499	0.004	(2.1)	0.104	(3.5)	-0.001	(0.8)	-0.024	(1.5)
Average employees > 500	0.004	(2.0)	0.097	(3.4)	-0.002	(1.3)	-0.041	(2.8)
Consumer goods	-0.002	(1.2)	-0.002	(0.1)	0.001	(1.3)	-0.006	(0.6)
Pulp and paper, chkyical	-0.001	(0.6)	-0.008	(0.5)	0.001	(0.9)	-0.001	(0.1)
Non-metallic mineral products	0.000	(0.1)	0.025	(1.0)	0.000	(0.1)	0.002	(0.1)
IT manufacturing and services	-0.003	(1.3)	-0.199	(4.5)	-0.004	(2.1)	-0.006	(0.3)
Energy and Water	0.000	(0.1)	0.029	(0.5)	0.000	(0.1)	0.001	(0.1)
Construction	-0.002	(0.9)	0.001	(0.0)	0.001	(0.8)	-0.009	(0.7)
Trade, Hotels, Restaurants	-0.003	(2.0)	-0.008	(0.4)	0.001	(1.1)	-0.001	(0.1)
Non-business services	-0.004	(1.8)	-0.007	(0.2)	0.002	(1.0)	-0.011	(0.6)
Social security	-0.028	(2.3)	-0.011	-(0.1)	-0.005	-(0.6)	0.016	(0.2)
Social security, Employees < 7								
Social security, Employees 7-19								
Social security, Employees 50-99								
Social security, Employees 100-499								
Social security, Employees > 500								
Sample size	242		173		242		229	
Coefficient Degrees of Freedom	21		21		21		21	
Root Mean Squared Error	0.1193		2.5744		0.0822		0.8754	
R <sup>2</sup>	0.1288		0.3068		0.5097		0.1250	

It can be seen from table 10.2, that the model explains around 13 percent of the employment pension flows and the number of firms with unemployment pension flow is limited to around 250. As a matter a fact, firm characteristics (table 10.3) appear to explain substantially more, around 30 percent, of disability pension flows (number of firms is around 2400).

Table 10.3. *Estimates of withdrawal into disability pension*

Dependent Variable	Job Creation		Job Creation, age 55-59	
	Coefficient	t-value	Coefficient	t-value
Average Predicted Effect of x Variables (xb)	-0.012	(0.7)	0.231	(1.0)
Average Unobserved Human Capital ( $\alpha$ )	-0.015	(1.6)	-0.023	(0.2)
Average Education Effect ( $u_1$ )	0.013	(0.5)	-0.552	(1.8)
High Educated/Employees	-0.036	(2.5)	-0.021	(0.1)
Log(Capital/L)	0.003	(2.0)	0.016	(0.9)
Borrowing ratio	-0.004	(1.1)	-0.070	(1.5)
Market Share	0.000	(0.2)	-0.010	(0.7)
Average employees < 7	0.033	(3.4)	-0.048	(0.4)
Average employees 7-19	0.005	(0.4)	-0.009	(0.1)
Average employees 50-99	-0.005	(0.5)	-0.031	(0.3)
Average employees 100-499	0.002	(0.2)	0.026	(0.2)
Average employees > 500	-0.039	(2.7)	-0.345	(2.2)
Consumer goods	-0.003	(0.3)	-0.081	(0.7)
Pulp and paper, chkyical	-0.002	(0.3)	-0.012	(0.2)
Non-metallic mineral products	-0.006	(0.6)	-0.081	(0.6)
IT manufacturing and services	0.007	(1.0)	0.227	(2.6)
Energy and Water	0.006	(0.2)	0.261	(1.0)
Construction	0.020	(2.8)	0.018	(0.2)
Trade, Hotels, Restaurants	0.008	(1.3)	-0.005	(0.1)
Non-business services	-0.002	(0.1)	-0.151	(1.2)
Social security	0.046	(0.5)	-0.482	(0.5)
Social security, Employees < 7	0.025	(0.2)	3.546	(2.5)
Social security, Employees 7-19	0.074	(0.6)	0.379	(0.2)
Social security, Employees 50-99	0.050	(0.4)	0.092	(0.1)
Social security, Employees 100-499	-0.203	(1.0)	-0.868	(0.4)
Social security, Employees > 500	0.868	(3.3)	9.903	(2.9)
Sample size	184		138	
Coefficient Degrees of Freedom	26		26	
Root Mean Squared Error	0.2911		2.9109	
R <sup>2</sup>	0.4009		0.3037	

All estimations are ordinary least squares using sample times firm employmentweights. Metals and machinery is the reference industry (excluding IT industry).

We can see that large firms stand out as firms where a large share of unemployment pensioners emerges. This is most likely a result from the employers' non-harmonised excess of pension costs described in section 10.2. One should also add to these figures the unemployed that first enter the unemployment pension tunnel and are registered as unemployed and included in the unemployed in table 10.1. Unemployed at age 55-59, have a high probability of receiving unemployment pension at age 60. Hence, column 4 of table 10.1 also characterises the (future) unemployment pension flows. We can see that social security payments also have a negative effect on the number of employees entering the unemployment pension tunnel before age 60.

Table 10.3. *Estimates of withdrawal into disability pension (continued)*

Job Destruction		Job Destruction age 55-59		Excess Worker Reallocation		Excess Worker Reallocation age 55-59	
Coefficient	t-value	Coefficient	t-value	Coefficient	t-value	Coefficient	t-value
0.023	(11.0)	-0.176	(4.5)	0.001	(0.7)	-0.009	(1.9)
-0.002	(2.1)	0.011	(0.5)	-0.003	(4.9)	-0.003	(1.3)
0.000	(0.1)	0.067	(1.6)	0.000	(0.3)	-0.006	(1.2)
-0.007	(4.1)	-0.100	(3.3)	0.000	(0.5)	0.002	(0.4)
0.000	(0.6)	0.000	(0.1)	0.000	(2.0)	0.000	(0.7)
-0.001	(1.4)	-0.005	(0.7)	0.000	(1.8)	0.002	(2.5)
0.000	(2.5)	0.000	(0.5)	0.000	(0.8)	0.000	(0.3)
0.018	(10.2)	0.012	(0.3)	0.003	(3.5)	0.003	(0.7)
0.008	(7.4)	0.095	(5.0)	0.001	(2.1)	0.007	(3.1)
-0.001	(1.1)	0.001	(0.0)	0.000	(0.2)	0.001	(0.3)
-0.002	(1.8)	-0.026	(1.5)	0.000	(0.2)	0.000	(0.2)
-0.001	(1.3)	-0.027	(1.5)	0.000	(0.4)	0.000	(0.1)
0.002	(3.3)	0.025	(2.1)	0.000	(0.0)	-0.001	(0.5)
0.000	(0.9)	0.006	(0.6)	0.001	(2.4)	0.003	(2.6)
0.001	(1.4)	0.011	(0.8)	0.000	(0.9)	0.001	(0.5)
0.001	(1.3)	-0.001	(0.1)	0.000	(0.7)	0.001	(0.4)
0.003	(2.6)	-0.013	(0.6)	0.001	(1.2)	0.004	(1.5)
0.005	(8.3)	0.023	(1.9)	0.000	(1.0)	-0.001	(1.0)
0.001	(2.4)	0.001	(0.1)	0.000	(0.2)	-0.001	(0.8)
0.002	(2.1)	-0.001	(0.1)	0.001	(2.6)	0.000	(0.2)
0.008	(0.8)	0.125	(0.7)	0.002	(0.4)	0.015	(0.6)
0.057	(2.7)	0.538	(1.3)	-0.021	(2.0)	-0.022	(0.5)
-0.006	(0.5)	-0.176	(0.9)	-0.002	-(0.3)	-0.020	(0.8)
0.006	(0.4)	-0.184	(0.7)	0.001	(0.1)	-0.009	(0.3)
0.005	(0.5)	-0.035	(0.2)	0.001	(0.1)	-0.008	(0.3)
-0.004	(0.3)	-0.207	(0.9)	-0.004	-(0.5)	-0.003	(0.1)
3091		2912		3276		3051	
26		26		26		26	
0.1329		2.3693		0.0750		0.3016	
0.2943		0.0601		0.0320		0.0178	

From Table 10.3 firm characteristics explain a surprisingly high share of job destruction into disability pensions; 40 percent of job creation and 30 percent of job destruction. This is surprising since, after all, disability should relate to a person rather than to firm characteristics.

The amount of disability pension entries is substantially larger for small firms. Job destruction in disability pensions is around 2 percent points higher in small firms (less than 7 employees). This is double the average destruction rate (2 percent). This is somewhat less for the aged group 55-59. The fact that disability pensioners emerge largely from small firms is also well founded, since the burden in disability pension payments for the small firms is lower than for the large firms.

The share of social security payments from total sales has a positive effect on job destruction only in small firms. Furthermore, we can see that the disability

pension probability is increasing with compensations on experience and social security payments, and decreasing with the share of educated workforce. We can conclude that a typical older person receiving disability benefit has been working in a small firm that has relatively high social security payments relative to sales and wage profile is not very steep. This firm is located in either the consumer goods producing industry, in energy and water industry or in construction.

The job destruction to disability pension usually leads most of the employees permanently out of the workforce. There is, however, clear evidence of firms of size less than 7 employees and largest firms to recruit those with disability benefits. The recruitment of large firm may reflect the fact that the burden of disability benefits is still relatively high compared to unemployment pensions.

From column 4, it is noted that the estimated model explains relatively low share of disability pensions of those aged 55-59, compared with disability pensions in all age groups. This might be because for workers from 55 (nowadays 58) to 65 years of age, there is a new way to enter the disability pension. This is called individual early retirement (which in our data is included in disability pensions), and is easier to enter than the disability pension. In addition, health problems or handicaps become more common among the older age groups and this might give explanation power towards personal factors rather than firm characteristics. Disability pensioners are now more concentrated in industries where the real risks of disability are the biggest: construction, energy and water. *Firm-size difference* appears to be lower for aged. One reason for this is that disability cost payments extend only to the age of 64, i.e. the cost difference between small and large firms decreases the older the disabled person is.

## 10.6 Conclusions

We show that withdrawal of aged from workforce has been persistent throughout the period 1989 - 1996. Especially during recession years, the job destruction rates for the aged workers have been substantially high. The aged workers had a considerably higher propensity to lose their jobs than Finnish employees did in general. Approximately 50 percent of the jobs held by people aged 55-59 vanished in the first half of the 90s. This is because the withdrawal rate from employment was more than 16 percent in years 1992 - 1994 for individual aged 55-64 (see Figure 10.2). The aforementioned retirements appeared especially in construction and manufacturing sectors. The demand for older workers remained weak for the whole decade. The persistence of high job destruction for older workers, especially in manufacturing, may relate to skill-biased-technical change.

We find that the total flow from work into unemployment and pension systems does not depend on firm-size, not even for the aged. The low labour force participation ratio of aged is explained by persistent high job destruction in all the firms, while the cost of alternative pension schemes depend on firm size and affects the choice of the channel. Unemployed, unemployment pensioners and disability pensioners may also be studied as a whole when considering the low labour force participation ratio of aged.

The retirement channel and job destruction in the form of unemployment- and disability pensions is closely related to firm size. Our basic finding is the concentration of job destruction into unemployment pension in large firms, and disability pensions in small firms. Firms adjust employment through channels that are less costly, like it was expected. The “large-firm-effect” relates to the attractiveness of the “unemployment pension tunnel” for both employers and employees. Firms start to contribute to the unemployment pension payments only when the unemployed enter the unemployment pension scheme at the age of 60. Furthermore, the employer’s share of the unemployment pension costs is lower than in disability pension. For the same reason small firms use disability pension relatively more than large ones. The firm characteristics turn out to be important explaining disability pension entries of under 55 year old individuals rather than over 58 year olds. This is because a special feature of disability pension, individual early retirement, becomes available when workers turn 55 (58 after 1995) and might confuse the calculations<sup>98</sup>. Finally, in all firms high social security payments contribute to job destruction. In this respect, there is no clear firm-size difference. Furthermore, there is no particularly high negative effect emerging from the higher social security payments in the large firms.

It is seen that skill-intensity of the firm, such as higher share of educated, lowers withdrawals. In firms where primary-age workers have deeper wage profile, i.e. higher compensations from experience, primary-age workers withdraw more frequently into disability pensions, while opposite happens for older workers. The withdrawal rate into unemployment and unemployment pensions do not instead depend on wage profile. It is interesting to note that in firms with high average compensations on education payments worker reallocation and withdrawals are more extensive. The excess demand for skilled caused by “skill-biased technical change” may have lead to the remuneration of educational degrees but has also raised withdrawals of higher educated with high incomes. This has, however, not resulted to high unemployment for higher educated, whereas the low educated stick out as the main group drawing disability or unemployment pensions.

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<sup>98</sup> Our variable indicating flows to disability pension includes the individual retirements.

Table A.1. Pension recipients and unemployed by type of benefits 1998

	Age 55-59	Age 60-64	Age 65+	
	Percent of population (in the age group)			
Employed	50.8	19.4	2.0	
Unemployed	9.3	1.3	0.0	
Receiving a pension	24.1	78.3	98.0	
Total	84.2	99.0	100.0	
Pensions	Percent of pensioners (in the age group)			Percent of all
Old age	6.8	16.3	91.8	63.6
Early old age	0.2	6.9	5.3	4.7
Disability	71.9	30.1	0.0	19.8
Individual early retirement	6.8	16.9	0.0	3.6
Unemployment pension	0.0	21.7	0.0	4.0
Part-time pension	6.7	2.5	0.0	0.9
Special pension for farmers	7.7	5.6	2.9	3.4
Total	100.0	100.0	100.0	100.0

Source: OECD, 2000.

Table A.2. Summary statistics: mean, standard deviation

Variable	Mean	Standard Deviation	Mean Small Firms	Standard Deviation Small Firms	Mean Large Firms	ST Large Firms
Firm Size	412	12472	9	64.8	923	24154
Real Wages	106274	438139	100668	469973.5	109887	578695
Excess Separations	0.10	1.07	0.09	1.12	0.10	1.40
Separation Rate	0.17	1.49	0.16	1.55	0.18	1.91
Hirings Rate	0.33	3.99	0.28	2.91	0.40	6.61
Job Destruction All	0.08	1.20	0.09	0.97	0.07	1.71
Job Destruction 55-59	0.23	3.66	0.23	4.55	0.23	3.83
Net Change of Employment						
Unemployment pension	-0.0001	0.02	-0.0001	0.02	-0.0001	0.01
Net Change of Employment						
Unemployment Pension 60-64	-0.0018	0.53	-0.0042	0.90	-0.0008	0.16
Job Destruction All Disability Benefit	0.012	0.17	0.023	0.237	0.009	3.01
Job Destruction 55-59 Disability Benefit	0.096	2.46	0.181	4.168	0.076	2.69
Experience	21	63	20	71.2	21	75
Average Predicted Effect of x Variables ( $\xi\beta$ )	0.76	2.70	0.70	3.32	0.79	2.87
Average Unobserved Human Capital Effect ( $\alpha$ )	0.13	2.79	0.08	3.34	0.16	3.01
Average Education Effect ( $\nu\eta$ )	10.68	1.86	10.69	1.82	10.68	2.69
Average Firm Intercept ( $\phi$ )	-0.06	6.93	-0.07	7.83	-0.06	1.78
Skilled Workers/Employees	0.15	2.64	0.16	2.90	0.16	3.44
Log(Capital/L)	6.71	21.19	6.08	19.07	7.25	28.56
Market Share	2.73	103.42	0.14	29.44	5.93	208.89
Borrowing ratio	0.29	6.76	0.27	5.75	0.30	10.40
Social Security	0.06	0.75	0.07	0.91	0.06	0.90
Return on Equity	0.29	49.03	0.41	78.40	0.23	11.35
Profits/Employees/100	0.28	61.26	0.31	42.51	0.32	124.64

Calculations use as weights the sample weight times the average number of employees, as regressions. Wages, opportunity income, valued added, net profits and exports per labour and quasi rent in thousands of 1990 FIM. Small firms have on average less than 20 employees and large firms have on average over 100 employees.

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# 11 Evolution of inequality in the Finnish labour market, 1988 – 1996<sup>99</sup>

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## Abstract

Using a large panel of Finnish males, we study how the recession of the early 1990s hit different worker groups and affected inequality in the labour market. Despite large employment losses the cross-section dispersion of wages is found to be almost constant, while differences in layoff and hiring rates between groups have been changing over the early 1990s. To bring these divergent patterns together, we analyse the evolution of inequality in the cross-section distributions of life-time labour values derived from a search model. We show that the recession caused welfare losses in all worker groups and increased inequality.

## 11.1 Introduction

This article examines how the recession of the early 1990s hit different worker groups and affected inequality in the Finnish labour market. In terms of employment losses the recession was exceptionally severe. Despite this the wage distribution has exhibited remarkable stability over the recession years as average real wages have been roughly constant and wage dispersion stable (see e.g. Uusitalo, 1999). The divergent patterns of employment and wages raise the question whether these patterns can be considered in a coherent way and how they have together affected inequality in the labour market. In this study the evolution of inequality among workers is studied by computing *life-time welfare* measures which provide a way of taking into account uncertainty about future wage changes and employment opportunities.

Regulated labour markets with centralised wage setting – such as the Finnish one – are often viewed to be inefficient but egalitarian. Union wage setting makes wages rigid downwards and negotiated wage increases are dispersed evenly across worker groups, making relative wages sticky. Standard economic

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<sup>99</sup> This article summarises the main results of a study by Kyyrä (2000). I am grateful to Richard Blundell, Seija Ilmakunnas, Heikki Loikkanen, Ossi Korkeamäki and Riitta Latvio for their comments and help. Financial support from the Academy of Finland and Yrjö Jahnsson Foundation is gratefully acknowledged.

models, however, imply that negative shocks on labour demand will lead to larger employment losses if labour market institutions prevent wage adjustments. The flexibility that allows relative wages to change in response to a shift in the relative demand potentially increases wage differentials between worker groups, leading to higher wage inequality in the labour market. On the other hand, the change in relative wages dampen down the negative shift in the relative employment of workers hit most severely by the shock. This reduces the likelihood of unemployment and hence the risk of even higher income losses due to unemployment. In the rigid labour market unemployed workers have also lower chances of finding a job, which leads to longer periods out of work and to higher individual costs of unemployment. This in turn may lead to wider welfare differentials between employed and unemployed workers.

This kind of reasoning suggests that inequality inferences using cross-section income distributions may be very different from the inferences based on lifetime welfare measures. Computing welfare measures which not only incorporate the current income stream but also the likelihood and values of future positions in the labour market (including unemployment) may thus provide some new insights about labour market inequality. In this paper we follow the so far narrow empirical literature which uses dynamic structural models to study inequality in the labour market.<sup>100</sup> Using search theory we aim to integrate the observed patterns of wages and labour market mobility over the period 1988 - 1996 when measuring labour market inequality.

The model adopted is an augmented version of the equilibrium search model of Burdett and Mortensen (1998) as developed by Bowlus and Robin (1999). The model is concerned with the behaviour of risk-neutral workers who are maximising the expected present value of future income stream. Workers are otherwise identical but differ in experience and education. They upgrade their skills by moving into higher experience groups through a stochastic process, so the structural parameters of the model for a given worker are changing with experience. Each worker is assumed to be facing a known distribution of wage offers with associated jobs, from which he randomly samples wage offers both on and off the job. Firms are assumed to set wages monopsonistically, but the demand side which generates the wage offer distribution is not explicitly modelled. As jobs are identical apart from the wage associated with them, employed workers are willing to move into higher paying jobs whenever the opportunity arises. Wages can also decrease due to negative wage shocks (wage offers which cannot be rejected), and exogenous demand shocks occasionally destroy existing jobs throwing workers from employment into unemployment.

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<sup>100</sup> Contributions of the structural dynamic approach to labour market inequality literature contain Flinn (1997), Cohen (1999), and Bowlus and Robin (1999).

Events the worker faces in the labour market arrive at random time intervals. At any point in time, the worker is assumed to take current labour market conditions as given and constant over time when choosing his search strategy. With these simplifying assumptions, modelling sequential search behaviour of the worker reduces to a simple dynamic programming formulation with stationary value functions. This allows us to derive value functions for different positions in the labour market (i.e. the expected present value of future income stream given the current labour market state). Computing these present values, or life-time labour values, provides a way to incorporate the evolution of wages and that of the likelihood and values of moving across different labour market states. In this sense the structural dynamic search models may offer a useful tool to measure the degree and nature of inequality in a labour market with large worker flows.

We use a large administrative panel of Finnish males covering the period 1988 - 1996 to estimate the model. The data is large in size as it contains practically all males who have been employed in the private sector during the sample period. We compute monthly measures of wage distributions and worker flows between employment and unemployment for various education and experience groups. Following Bowlus and Robin (1999), we estimate the structural parameters of the model by matching sample moments and recover the (unobserved) wage offer distribution nonparametrically from the observed distribution of wages of currently employed workers. The parameters and wage distributions are estimated separately for different worker groups in each one-month cross section over the period from January 1988 to November 1996. Given the parameter estimates and wage distributions, we then compute empirical counterparts of the expected present values. By examining the evolution of inequality in the cross-section distributions of these present values, we can study how changes in the labour market environment have affected the distribution of expected welfare outcomes.

The plan of the paper is as follows. The next section introduces the theoretical model to be used. Section 11.3 describes the data and explains how the needed variables are constructed. Section 11.4 discusses the estimation of the structural parameters of the model. Section 11.5 gives an overview of the Finnish labour market trends over the sample period and reports the estimation results. The final section concludes.

## **11.2 Labour values in a dynamic search model**

The supply side of the labour market is populated by a large number of risk-neutral workers who live forever. Workers are otherwise identical but differ in

experience.<sup>101</sup> Let the number of experience groups in the labour market be  $I$ . Workers with experience level  $i \in \{1, 2, \dots, I - 1\}$  have an instantaneous transition rate  $\mu_i$  to the next experience group. The entry rate into the labour market is  $\mu_0$ , and the transition rate into retirement is  $\mu_I$ .<sup>102</sup>

The labour market studied is characterised by search frictions in the sense that it takes time for workers to collect information about job opportunities. Each worker in the market is either employed or unemployed. Workers search for a job that pays a higher wage while employed and for a job with an acceptable wage when unemployed. The arrival rate of wage offers depends both on worker's experience level and the state he is currently occupying. We assume that unemployed workers with experience level  $i$  receive wage offers at rate  $\lambda_i^0$ . To make both upward and downward wage changes possible, it is assumed that there are two sorts of alternative offers for employed workers: some that they are free to reject and some that they are compelled to accept. Let the arrival rate for the former type of offers be  $\lambda_i^1$  and that for the latter type be  $\lambda_i^2$ , so that the overall arrival rate to employed workers with experience level  $i$  is  $\lambda_i = \lambda_i^1 + \lambda_i^2$ . We do not require the wage offers of the former type to be from outside the current employer, so the wage can increase (but not decrease) also on the current job. Moreover, job-worker matches in experience group  $i$  are destroyed at exogenous rate  $\delta_i$ , leading to a transition from employment to unemployment.

Firms are assumed to set wages monopsonistically. As workers search randomly among employers and they are identical within experience groups, a wage offer to a worker with experience level  $i$  can be viewed to be a realisation of a random draw from the known wage offer distribution of his experience group, characterised by cumulative distribution function (c.d.f.)  $F_i$ . Under these assumptions the behaviour of workers is, outside of experience upgrading and wage shocks, characterised with the standard job search model with search on the job (see e.g. Mortensen, 1986). Thus, the optimal search strategy which maximises the expected present value of future income stream has the reservation wage property: all wage offers above or equal to the reservation wage are accepted, and all offers below are rejected (if possible). While employed the current wage serves as the reservation wage. Since firms which offer wages below the reservation wage of unemployed workers in experience

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<sup>101</sup> In the empirical analysis the data is stratified by education as well.

<sup>102</sup> It should be stressed that the allocation of individuals into the experience groups is based on age in our empirical analysis, and ageing is certainly not a Poisson process. However, we still retain the simplifying assumption that workers are moving across experience groups according to a Poisson process in order to maintain the stationarity of value functions. Note also that workers will exit the labour market eventually despite the infinite time horizon.

group  $i$  are unable to attract any workers from the group, the lowest wage offered to workers with experience level  $i$  is the group's reservation wage  $\underline{w}_i$ .

Given the framework outlined above, the expected present value of future income stream for an unemployed worker in experience group  $i$ ,  $V_i$ , can be expressed as the solution to the continuous time asset pricing equation

$$rV_i = b_i + \lambda_i^0 (E_{F_i} [W_i(\tilde{w})] - V_i) + \mu_i (V_{i+1} - V_i), \quad (1)$$

where  $r$  is the discount rate,  $W_i(w)$  is the expected present value of future income stream when employed at wage  $w$ ,<sup>103</sup> and  $b_i$  is the value of non-market time, including unemployment benefits net of search costs. In other words, the present value of unemployment is made up of the value of non-market time, the likelihood and value of receiving a job offer, and the likelihood and value of being upgraded to the next experience level. Note that the unemployed worker who moves into the higher experience group is assumed to remain unemployed.

Similarly, the expected present value of future income stream for a worker with experience level  $i$  who is currently employed at wage  $w$ ,  $W_i(w)$  solves

$$\begin{aligned} rW_i(w) = & w + \lambda_i^1 (E_{F_i} [\max\{W_i(\tilde{w}), W_i(w)\}] - W_i(w)) + \lambda_i^2 (E_{F_i} [W_i(\tilde{w})] - W_i(w)) \\ & + \delta_i (V_i - W_i(w)) + \mu_i (E_{F_{i+1}} [W_{i+1}(\tilde{w})] - W_i(w)), \end{aligned} \quad (2)$$

where we assume that when the worker enters the next experience category he will instantaneously receive an offer, which cannot be rejected, from the wage offer distribution of his new experience category. The present value of employment consists of the current wage, the likelihood and value of becoming unemployed, the likelihood and value of being upgraded to the next experience level, the likelihood and value of receiving an alternative job offer and the likelihood and value of experiencing a wage shock (i.e. receiving a wage offer which cannot be rejected). For the value of retirement, we make the simplifying assumption that

$$E_{F_{i+1}} [W_{i+1}(\tilde{w})] = V_{i+1} = 0. \quad (3)$$

This assumption can be justified by claiming that retirement income is simply postponed earnings and is therefore already included in the gross wage summation.

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<sup>103</sup>  $E_{F_i}[\cdot]$  indicates the expectation over the support of  $F_i$ , and the tilde above  $w$  refers to a random draw from  $F_i$ .

By definition, the reservation wage  $\underline{w}_i$  solves  $W_i(\underline{w}_i) = V_i$ , i.e. working at a wage equal to  $\underline{w}_i$  and being unemployed are associated with the same expected present value of future income stream. Evaluating (2) at  $w = \underline{w}_i$  yields

$$(r + \mu_i + \lambda_i) \mathcal{V}_i = \underline{w}_i + \lambda_i E_{F_i} [W_i(\tilde{w})] + \mu_i E_{F_{i+1}} [W_{i+1}(\tilde{w})]. \quad (4)$$

Let us define

$$\Psi_i(w) \equiv E_{F_i} [\max\{W_i(\tilde{w}) - W_i(w), 0\}], \quad (5)$$

which in turn implies

$$\Psi_i(\underline{w}_i) \equiv E_{F_i} [W_i(\tilde{w})] - V_i, \quad (6)$$

with  $\Psi_{i+1}(\underline{w}_{i+1}) \equiv 0$ .<sup>104</sup> Now we can rewrite (4) as

$$(r + \mu_i) \mathcal{V}_i = \underline{w}_i + \lambda_i \Psi_i(\underline{w}_i) + \mu_i \Psi_{i+1}(\underline{w}_{i+1}) + \mu_i V_{i+1}, \quad (7)$$

and combining (2) and (4) yields

$$(r + \mu_i + \delta_i + \lambda_i^2)(W_i(w) - V_i) = w - \underline{w}_i + \lambda_i [\Psi_i(w) - \Psi_i(\underline{w}_i)]. \quad (8)$$

Note that (7) and (8) contain essentially the same information as do (1) and (2), the only difference being that  $b_i$  is substituted out and replaced by  $\underline{w}_i$ . Although (7) and (8) may seem to be somewhat more vague to interpret, they are useful for estimation purposes. Indeed, given the terminal condition (3) and the estimates of structural parameters, reservation wages and  $\Psi_i$ , present value terms  $V_i$  and  $W_i$  can be computed by solving the system of forward difference equations (7) and (8) by backward induction.

In the sequel,  $V_i$  and  $W_i$  will be referred to shortly as (life-time) unemployment and employment value respectively. Moreover, (life-time) labour values is used for short when we wish to refer to both  $V_i$  and  $W_i$  simultaneously.

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<sup>104</sup> For an unemployed worker in the experience group  $i$ ,  $\Psi_i(\underline{w}_i)$  represents the expected increase in life-time welfare (in terms of the present value of future income stream) associated with randomly picking a wage offer from  $F_i$ . Analogously, for a worker employed at wage  $w$ ,  $\Psi_i(w)$  equals the expected increase in life-time welfare resulting from obtaining a random wage offer greater than the current wage. In practice,  $\Psi_i(\underline{w}_i)$  and  $\Psi_i(w)$  are simply viewed as a kind of nuisance terms that need to be estimated in order to compute estimates of  $V_i$  and  $W_i(w)$ .

### 11.3 Data

We use the worker data of the Integrated Panel of Finnish Companies and Workers (the IP data), which is described in detail in Korkeamäki and Kyrrä (2000). Information on workers in the IP data comes from the Employment Statistics, which is a major administrative database of Statistics Finland, covering effectively all people with a permanent residence in Finland. The worker panel of the IP data includes practically all persons who have been employed by a private-sector employer during the period 1988 - 1996 (at least at the end of one year between 1988 and 1996). In practice the IP data contain labour market history information for almost two million persons over the period 1987 - 1996.

Our empirical analysis is performed on a monthly basis. We restrict each one-month cross section to cover males between the ages of 16 and 65 who have not been employed by a non-profit corporation nor been in work in the public sector (excluding job placement periods) during the period 1988-1996. Workers who have been self-employed during the period are also excluded. Each cross section is then stratified by education and experience. Education is categorised as follows: comprehensive school (9 years or less), lower vocational (10-11 years), upper vocational (including high school graduates, 12-13 years), and the lowest level of university or higher.<sup>105</sup> Experience is computed as age minus 7 minus years of education, and the categories to be used are: 5 years or less, 6-15 years, 16-25 years, and more than 25 years.

To examine the evolution of wages and labour market transitions, we need information on individual wages and labour market states on a monthly basis over the sample period. The data contain information on the starting and ending dates of job spells, unemployment spells and job placement periods. Using this information we construct monthly codes which tell us the labour market state of the individual at the end of each month over the sample period. Individuals are classified to be employed, unemployed (including temporary laid off), retired, outside the labour force or employed by labour administrative measures (i.e. on a job placement programme).<sup>106</sup>

When a worker is employed we need his monthly wage. Unfortunately, we have information on earnings on an annual basis only. As such the best we can do is to use the average monthly wage obtained by dividing the annual earnings by months worked. For job spells lasting over several years, we use the average

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<sup>105</sup> Workers whose education code has changed during the observation period are added to the sample only after the reception of the final degree.

<sup>106</sup> In the theoretical model workers are either employed or unemployed. However, to be able to sort out transitions into and out of the labour force in our empirical analysis, we need a more detailed classification of labour market states.

monthly wage of a given year only to compute the wage rate on the job during that year, allowing for the wage rate to change from December of one year to January of the next year. The resulting variation around the turn of the year will be used in detecting wage changes on the job. When computing monthly wages from annual earnings, we face difficulties in differentiating between distinct wage rates in cases where a worker has more than one job spell in the same year. When this separation problem appears, we attempt to separate different wage rates by using longitudinal information on earnings over the consecutive years. In some cases this procedure does not solve the problem, however. Since information on hours worked is not available, wages and earnings are used interchangeably in the text. All wage figures are converted into 1996 money by using the Consumer Price Index of Statistics Finland.

Due to some inaccuracies in the wage data and a lack of information on working time, there are some observations with an extremely low or high monthly wage in the data. To deal with outliers in the wage data, we therefore trim the cross-section distributions of monthly wages. The trimming values are determined separately for each education-experience group in each one-month cross section. We first require that all monthly wages have to be at least 3000 FIM, and then we trim the data by excluding the lowest and highest 3 percent of cross-section wages for a given group. However, we do not drop out of the sample those employees with a wage outside the acceptable range, but we will not use their wages when computing wage figures.

## 11.4 Estimation procedures

From Section 11.2 we know that with the estimates of structural parameters, reservation wages and  $\Psi_i$  in hand, one can compute estimates for life-time employment and unemployment values,  $V_i$  and  $W_i$ , using equations (7) and (8). To estimate these unknown terms we follow a simple estimation approach of Bowlus and Robin (1999) which circumvents complex estimation procedures by using empirical flow rates, wage functions and sample moments. This is a very simple way of generating the required estimates as it does not require much more than sorting the data and computing frequencies and cumulated sums. Derivation of the required expressions is a less simple task, however. As such the estimation procedures are described only briefly here. A detailed exposition of the methods can be found from Bowlus and Robin (1999) and Kyyrä (2000).

Below we discuss the estimation procedures for a generic experience group in a single period conditional on the education level. Actually, the estimations are performed separately for each of 16 education-experience groups over all one-month periods. Since workers are not allowed to change their education group, we use subscript  $i$  to separate different experience groups only.

To begin with, note that the estimators of wage mobility parameters and  $\Psi_i$  will depend on the wage offer distribution  $F_i^o$ . Instead of making an attempt to directly estimate  $F_i^o$ , we follow an alternative approach and exploit flow conditions implied by the theory to derive a relationship between the wage offer distribution and the observed distribution of wages received by currently employed workers. It is important to make a distinction between the wages *offered* to job searchers and wages *earned* by employed workers.

Given an initial allocation of workers to firms and denoting the stock of employed workers in group  $i$  as  $L_i$ , the number of employed workers with experience level  $i$  receiving a wage no greater than  $w$  is  $G_i(w)L_i$ , where  $G_i$  is the cumulative distribution function of wages for employed workers in experience group  $i$ . In a short time interval some of them lose their jobs, some move into the next experience group, and some receive and accept an offer higher than  $w$ . These workers together form the flow of workers out of jobs paying  $w$  or less. The flow into such jobs consists of unemployed workers who receive a wage offer no greater than  $w$ , employees in the lower experience group who receive an experience upgrade and draw a wage offer no greater than  $w$ , and employees with experience level  $i$  paid over  $w$  who experience a negative wage shock that drops their wage at or below  $w$ .

These worker flows into and out of different parts of the wage distribution can be expressed as functions of the structural parameters and the wage offer distribution. By use of these flow conditions, we can derive a particular relationship between the wage offer and wage distribution. Assuming that  $G_i$  does not change over time this relationship is given by

$$F_i(w) = \frac{(1 + \kappa_i)G_i(w)}{1 + \kappa_i G_i(w)}, \quad (9)$$

where  $\kappa_i \equiv \lambda_i^1 / (\delta_i + \mu_i + \lambda_i^2 + \theta_i)$  and  $\theta_i \equiv \dot{L}_i / L_i$  is the rate of growth of the employed stock of experience group  $i$ . Given the estimates of  $\kappa_i$  and  $G_i$  we can recover the wage offer distribution using the relationship outlined in (9). This relationship will be of use when deriving expressions below.

Next we turn to the estimation of the transition rates between employment and unemployment. The hiring rate  $\lambda_i^0$  is estimated by computing the fraction of unemployed workers with experience level  $i$  at the end of one month who are employed at the end of the next month. Similarly, the fraction of employed workers with experience level  $i$  at the end of one month who are unemployed at the end of the next month serves as the estimator of the layoff rate  $\delta_i$ . Since we do not consider transitions into and out of the labour force, individuals outside the labour force at the end of either month are excluded when computing flow

rates.<sup>107</sup> To be consistent with our theoretical model, we exclude also workers who will be in the higher experience group at the end of the next month. Moreover, we make a difference between workers employed by labour administrative measures and those working in the open labour market by omitting transitions between unemployment and job placement programmes when computing flow rates.

Since  $\theta_i$  is a function of  $\dot{L}_i$ , we estimate  $\dot{L}_i$  as a change in the stock of employed workers with experience level  $i$  from one month to the next month. Once again, we exclude workers who are outside the labour force at the end of either month when computing the estimate of  $\theta_i$ . To estimate  $\mu_i$  we simply use the inverse of the average length of time individuals in experience group  $i$  have left in their experience category. Workers with the highest level of experience are assumed to retire at the age of 65. The monthly discount factor  $r$  is just set at .01.

Bowlus and Robin (1999) show that wage mobility rates  $\lambda_i^1$  and  $\lambda_i^2$  can be estimated by computing how many workers are experiencing wage changes through time. We define the promotion (demotion) rate as the fraction of employed workers in group  $i$  experiencing a wage increase (decrease) in a given time interval. However, we do not observe wage changes on the job on a monthly basis. In addition the establishment identifiers referring to the employer, which are used in detecting job-to-job transitions, are attached to workers only at the end of each year. We therefore compute the annual promotion and demotion rates by comparing wage rates and establishment identifiers associated with two consecutive Decembers.

As a first step, we select workers employed in December of one year who were employed also in December of the previous year. Since we are interested in job-to-job transitions and wage changes on the job, we exclude workers whose employment spell was interrupted by a period out of work during the year, as well as workers with a missing establishment identifier in either year. Workers who changed their employer during the year are then identified by comparing the two establishment identifiers.<sup>108</sup> These individuals are further classified to be promoted or demoted, depending on whether their wage increased or decreased from December to December. Since promotions are allowed to occur also within the current employer, we further add workers with no change in the establishment identifier but who display an over 20 percent wage increase to

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<sup>107</sup> We are unable to separate periods on labour market training courses from periods out of the labour force, so that workers moving between the training courses and unemployment become classified as moving into and out of the labour force.

<sup>108</sup> We use establishment identifiers instead of company identifiers as they are not so sensitive to change due to changes in the ownership, legal status or sector of the employing company.

the number of promoted workers. The relatively high threshold value for on-the-job promotions is chosen to sort out regular wage increases and temporary wage increases associated with annual bonuses or changes in working hours. We then compute the annual promotion (demotion) rate as the fraction of workers who became classified as promoted (demoted). To obtain monthly rates, we then simply divide the annual rates by 12, assuming the wage mobility rates to be constant within the calendar years. This procedure is obviously subject to several drawbacks but it is perhaps the best we can do with the available data.

We denote the monthly promotion and demotion rates as  $p_i$  and  $d_i$  respectively. It can be shown that the estimates of  $\lambda_i^2$  and  $\lambda_i$  can be obtained by solving the just identified system:

$$\lambda_i = \frac{\kappa_i^2 p_i}{(1 + \kappa_i) \ln(1 + \kappa_i) - \kappa_i}, \quad (10)$$

$$\lambda_i^2 = \frac{\kappa_i^2 d_i}{(1 + \kappa_i) [\kappa_i - \ln(1 + \kappa_i)]}, \quad (11)$$

where

$$\kappa_i \equiv \frac{\lambda_i^1}{\delta_i + \mu_i + \lambda_i^2 + \theta_i} = \frac{\lambda_i - (p_i + d_i)}{(\delta_i + \mu_i + \theta_i)(1 - p_i / \lambda_i) + d_i}. \quad (12)$$

for  $\lambda_i > p_i + d_i$ . In other words, given  $p_i$ ,  $d_i$ , and the estimates of  $\delta_i$ ,  $\theta_i$  and  $\mu_i$ , one can choose some initial value for  $\lambda_i$  to compute  $\kappa_i$  using (12). Substituting the obtained value of  $\kappa_i$  into (10) yields the next value for  $\lambda_i$ , which is then used to generate a new value for  $\kappa_i$  and so on. This simple algorithm converges quickly to a fixed point of  $\lambda_i$ , after which the final estimates of  $\kappa_i$ ,  $\lambda_i^2$  and  $\lambda_i^1$  can be computed.

To estimate the reservation wage  $\underline{w}_i$ , we use the lowest wage in the cross-section wage distribution of experience group  $i$  after trimming. The final step involves the estimation of  $\Psi_i$  which can be expressed as

$$\Psi_i(w) = E_{G_i} \left( \frac{r + \delta_i + \mu_i + \lambda_i + \kappa_i(r - \theta_i)}{[r + \delta_i + \mu_i + \lambda_i + \kappa_i(r - \theta_i)G_i(\tilde{w})]^2} \max\{\tilde{w} - w, 0\} \right), \quad (13)$$

where the expectation is taken with respect to  $G_i$ . By replacing  $G_i$  and the structural parameters in the right-hand side of (13) by their estimates, we can estimate  $\Psi_i(w)$  at different values of  $w$  from the cross-section data by taking the

sample means over employed individuals in experience group  $i$ . To estimate  $G_i$ , we use the empirical c.d.f. of wages for experience group  $i$ . By using the empirical counterpart of  $G_i$ , we get rid of imposing any particular shape on the wage distribution (and hence on the wage offer distribution).

Once the estimates of  $(r, \lambda_i^0, \lambda_i^1, \lambda_i^2, \delta_i, \mu_i, w_i)$  and  $\Psi_i, i = 1, 2, \dots, I$ , are substituted into (7) and (8), one can compute the empirical counterparts of life-time labour values,  $V_i$  and  $W_i(w)$ . For a given cross section there are only 16 unemployment values, one for each education-experience group, whereas employment values are computed for all individuals in work (excluding those dropped due to the trimming of the wage distribution). When computing life-time labour values, workers are assumed to take the structural parameters and wage distributions as given and fixed over time. By implication, the life-time labour values computed at a given point of time are measures of expected present values of future income stream in the case where the current labour market conditions are assumed to hold forever. In a recession period, for example, this means that record high unemployment, the high job destruction rate and the poor chances of finding a job when unemployed are taken as the facts that will not change in the future. It follows that the life-time labour values evaluated at the time of the deepest recession will give a too pessimistic picture of the future. Analogously, the life-time labour values corresponding to the boom period of the late 1980s tend to give a too rosy picture of what is ahead in the coming years. Thus one should not pay much attention to the absolute values of life-time labour values but focus on *relative* differences between workers.

## 11.5 Empirical results

In this section we report the observed patterns of labour market transitions in terms of layoff and hiring rates and describe how wages have changed over the observation period. This is followed by a description of the evolution of labour market inequality based on our computations of life-time labour values.<sup>109</sup>

### 11.5.1 Labour market trends

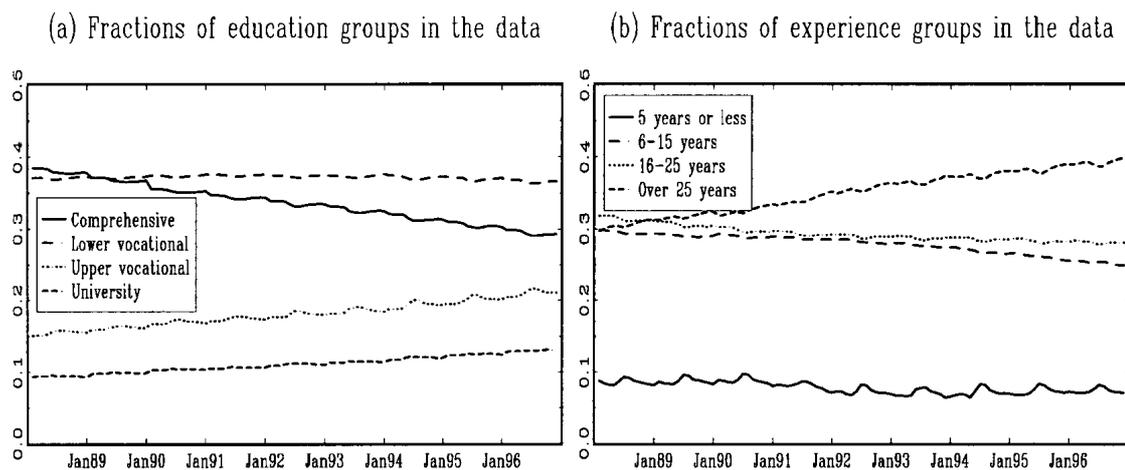
We begin by looking at changes in the sample composition over the observation period. Figure 11.1 shows the fractions of education and experience groups in the cross-section populations of employed and unemployed workers. We can see a clear shift towards higher levels of education: the fractions of workers with upper vocational and university education are steadily growing, whereas the fraction of those without any degree is strongly declining. In contrast, the

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<sup>109</sup> We do not present all parameter estimates of the model in this context. Additional details can be found from Kyrrä (2000).

fraction of those with lower vocational education is found to be roughly stable over the observation period. Ageing of the large postwar generation is also clearly seen as the fraction of workers with over 25 years of experience is rapidly increasing. Sample shares of other experience groups in the data are found to be smoothly declining over the whole observation period.<sup>110</sup>

Figure 11.1. Composition of Data



Figures 11.2a and 11.2b represent the unemployment rates for different education and experience categories. The unemployment rate is computed as the ratio of unemployed workers to the sum of unemployed and employed workers at the end of a given month. We exclude workers who are employed by labour administrative measures from the stock of the employed, although they are classified as employed in the official statistics. The cyclical pattern from full employment of the late 1980s to the deep recession of the early 1990s is dramatically reflected in the graphs. As expected, highly educated workers have in general lower unemployment rates than their less educated counterparts, and seasonality in unemployment rates declines with education. Unemployment rates for the two least educated groups are practically identical up until 1992, after which the difference between the unemployment rates increases strongly over the rest of the observation period. Moreover, the relative level of unemployment between workers with lower and upper vocational education also

<sup>110</sup> The fraction of the least experienced workers in the later part of the observation period is attributed also to the sampling design underlying the worker panel of the IP data. Recall that to be included in the data, it was required that the individual is associated with a company or establishment identifier of the private-sector employer at least in one of the years between 1988 and 1996. Consequently, young workers who have entered the labour market in the latter part of the sample period but did not find a job from the private sector by the end of 1996 are excluded from the data by construction.

increases during the recession years. In terms of unemployment levels, the early 1990s has been thus marked by increasing educational differentials.

Except for the last years of the sample period, unemployment among workers with the lowest level of experience is clearly at a higher level than unemployment in other groups. There are no observable differences in the unemployment rates between more experienced groups prior to 1991. Note that a sharp drop in the unemployment rate for the group with the lowest level of experience is largely due to the underlying sampling design. The unemployment rate for workers with 6 to 15 years of experience exhibits a similar drop, though less dramatic. Contrary to the other groups, whose unemployment rates begin to decline when the economy turns on a growth path (in 1994), the unemployment rate for workers with over 25 years of experience remains at the recession level.

Layoff rates ( $\delta$ ) in Figures 11.2e and 11.2f exhibit countercyclical patterns, while hiring rates ( $\lambda^0$ ) in Figures 11.2c and 11.2d are procyclical. Levels of the transition rates have changed dramatically during the 1990s, reflecting the severity of the recession that hit the economy. As one might expect, both the level and seasonality of layoff rates declines with education and experience. While the patterns of layoff rates for the two most experienced groups are somewhat identical, the layoff rate for workers with 5 years or less of experience is clearly highest on average and exhibits strong seasonal variation. Differences in hiring rates between education and experience groups become significant in the latter part of the recession period and remain so over the rest of the sample period. In general, more educated and less experienced workers have had better chances of finding a job when unemployed during the early 1990s.

Characteristics of the layoff and hiring rate distributions are shown in Figure 11.3. The distributions are defined over 16 education-experience groups, assuming that workers are identical within the groups and weighting each cell by the number of observations in the relevant cell.<sup>111</sup> The time patterns of the 10th percentile, median and 90th percentile of the distributions are given in the upper panels. The lower panels show the patterns of between-groups inequality in the distributions, measured by the coefficient of variation (CV) and the 90/10 percentile ratio.<sup>112</sup> It appears that the recession has smoothed down differences in the likelihood of becoming unemployed between worker groups, leading to a

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<sup>111</sup> In case of layoff (hiring) rates the number of workers in the cell who are employed (unemployed) at the end of the month serves as the weighting variable. It follows that the distributions in Figure 11.3 are defined over the different populations which should be kept in mind.

<sup>112</sup> Coefficient of variation is a relative measure of variation, and it is defined as the sample standard deviation divided by the sample mean.

more compressed distribution of layoff rates. In contrast, dispersion in the hiring rate distribution increases over the observation period. But note that the sharp increase in hiring rate dispersion during the last years of the period is of a spurious form. It is driven by the least experienced group whose hiring rate increases to a false level due to the underlying sampling design.

Figure 11.2. Unemployment, Hiring and Layoff Rates

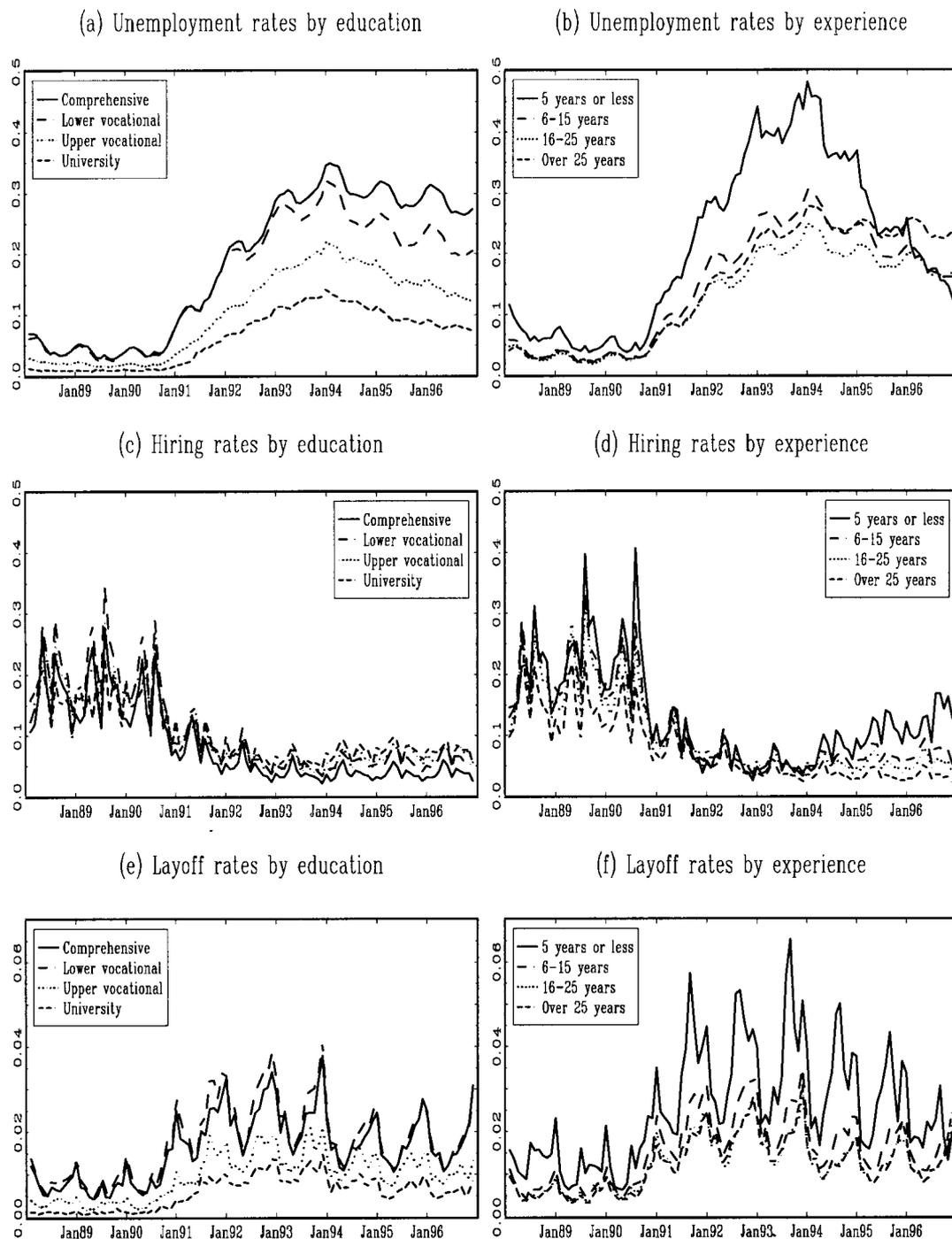
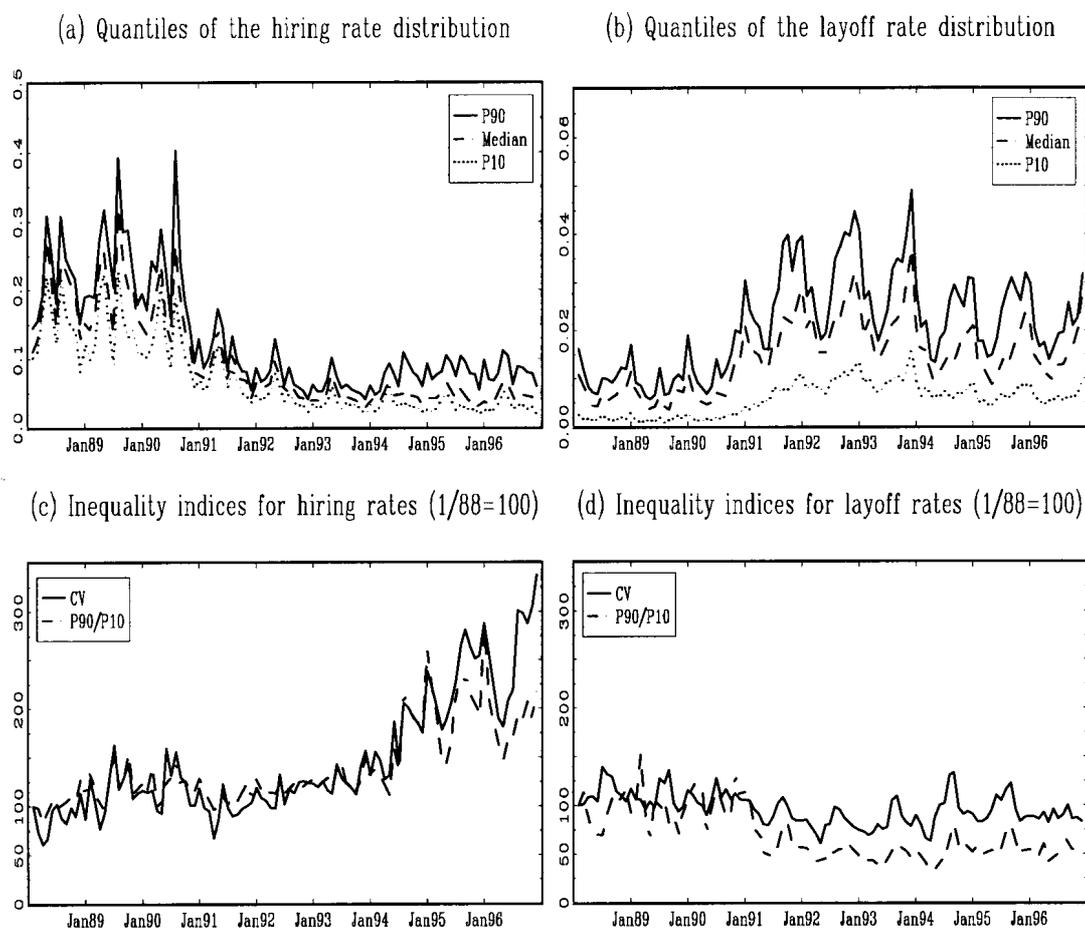


Figure 11.3. Distributions of Hiring and Layoff Rates



Since large-scale job destruction during the recession moved masses of people from employment into unemployment, one might suspect that changes in the composition of the underlying populations are responsible for the observed patterns. However, if we eliminate this composition effect by fixing the cell weights at their averages over the observation period, the pattern of inequality will not change essentially in either distribution. Thus the variation in the relative shares of different groups in the data is not the driving force behind the observed trends. Overall, since there exist notable differences in the hiring rates in the latter part of the observation period, we may say that some groups of workers have remained unemployed for a much longer time than other groups during the recession.

Next we turn our attention to wages. Figures 11.4a and 11.4b show mean wages by education and experience respectively.<sup>113</sup> Mean wages are first

<sup>113</sup> Spikes around the turn of the years are attributed to high labour turnover at that time and to the fact that we allow for the wage rate on a given job to jump discontinuously from December of one year to January of the next year.

growing until they turn on a stable or decreasing path in response to the recession, after which they exhibit an increasing path again. Less educated and more experienced workers seem to be faced with relatively smaller declines, if any, in their real wages during the recession. It is important to note that these observed reductions in monthly wages are potentially attributed to temporary declines in working hours during the recession period. This is because we were not able to control the variation in working time when computing monthly wages. Against this background, one might say that the response of average wages to the demand shock has been very limited, especially as the reductions have occurred only in the worker groups of the smallest size. Furthermore, there are no significant differences in mean wages between workers at the two lowest levels of education, while higher education yields clearly higher wages. Educational differentials exhibit a smooth declining trend over the whole period. Returns to experience are generally positive, though there is no clear differences between the two most experienced groups.

Figures 11.4c and 11.4d represent the lowest wages for different education and experience groups.<sup>114</sup> Recall that the lowest wages serve as our estimates of the reservation wages ( $\underline{w}$ ) in the value function calculations. For most groups the lowest wage exhibits a declining or stable trend up until 1994 when it begins to increase in almost all groups. The decreasing pattern of the lowest wage of the most educated workers is strikingly sharp, though the starting level is also quite high. Interestingly, the lowest wages of other education groups converge to a given joint level, from which they start to diverge again (with a different ranking) once the recovery takes place. The lowest wage for the least experienced group is approximately constant over the whole observation period.<sup>115</sup> Note that the response of the lowest wage of workers with over 25 years of experience to the recession is much weaker than that of other groups, even though the development of unemployment in this group has been relatively depressing.

Trends in wage differentials should be contrasted with the patterns of corresponding differentials in unemployment rates and the transition rates behind unemployment. It is remarkable that educational differentials in wages are shrinking at the same time when the relative unemployment of less educated workers is strongly increasing. Moreover, the wages of workers with

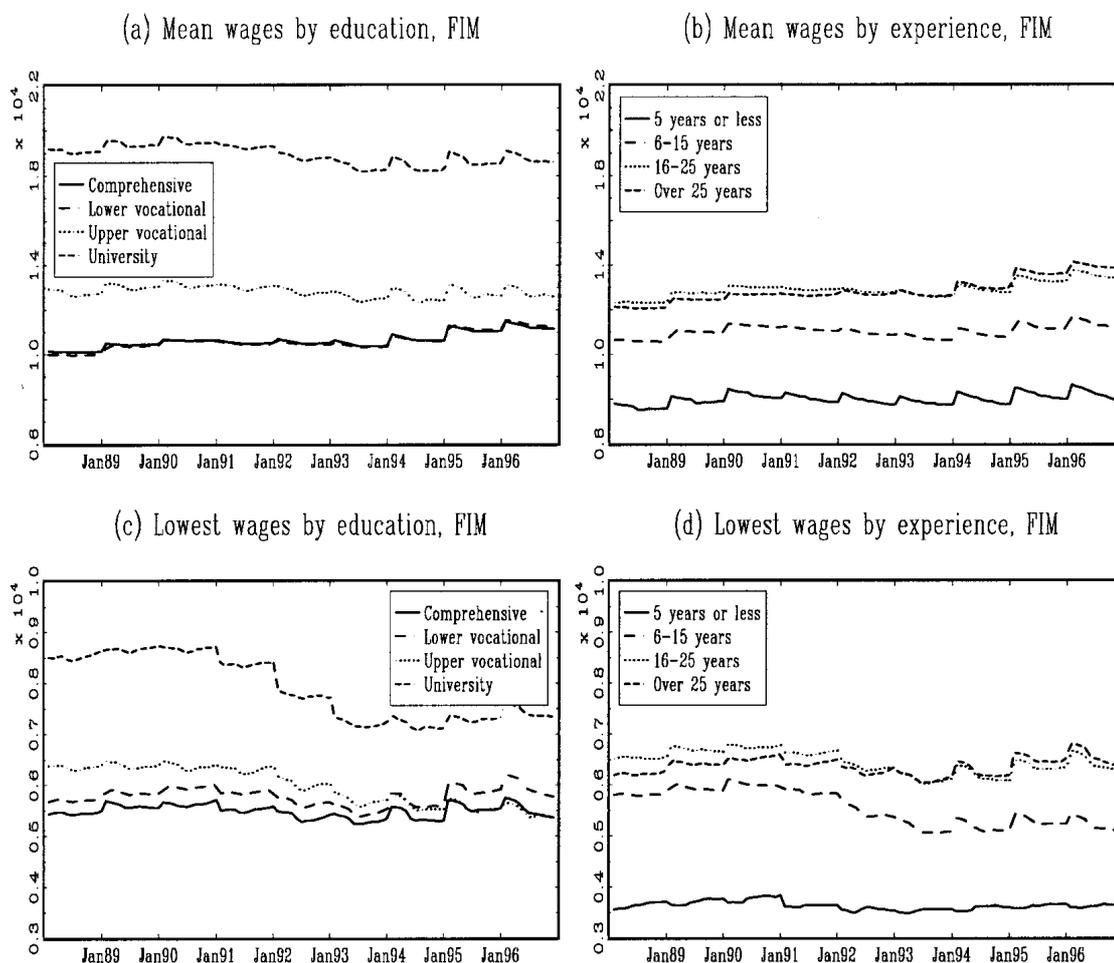
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<sup>114</sup> One should keep in mind that the measure of the lowest wage is sensitive to the ad hoc trimming procedure, so the patterns of the lowest wages must be interpreted with caution. However, changes in the threshold values for the trimming procedure affect mainly the absolute levels of lowest wages, whereas the effect on their time patterns and ranking across the groups is quite moderate.

<sup>115</sup> It should be stressed that the lowest wage of the least experienced group is quite low compared to minimum requirements, reflecting perhaps a large degree of measurement error or part-time working for this group.

over 25 years of experience seem to be very insensitive to the unemployment figures of the group.

Figure 11.4. Mean and Lowest Wages

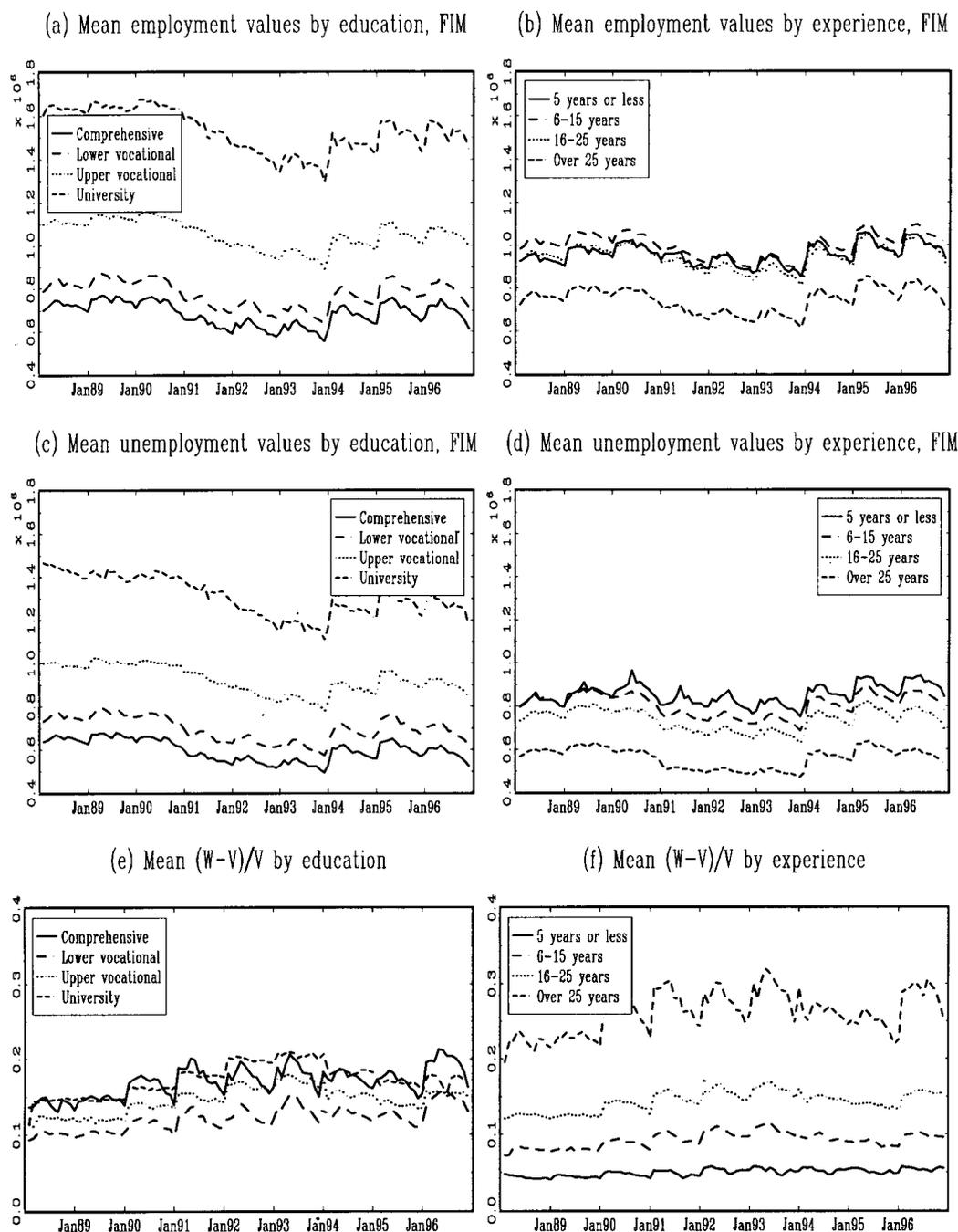


### 11.5.2 Welfare differentials

Time series of estimated value functions for different worker categories are described in Figure 11.5. One should bear in mind that there are only 16 unemployment values ( $V$ ), one for each education-experience group, whereas the employment values ( $W$ ) are computed for all individuals in work (excluding those dropped due to the trimming of the wage distribution). Recall that variation in employment values stems from two sources: from variation in the

structural parameters *between* the groups and from variation in wages *within* the groups.<sup>116</sup>

Figure 11.5. Mean Labour Values



<sup>116</sup> The set of structural parameters for experience group  $i$  of workers with a given education level is  $(r, \lambda_i^0, \lambda_i^1, \lambda_i^2, \delta_i, \mu_i, w_i, \theta_i)$ .

As expected, higher education yields substantially higher life-time employment values. In addition to higher wages more educated workers face a lower risk of unemployment and when unemployed they find a new job more easily than their less educated counterparts.<sup>117</sup> Because of a shorter horizon, life-time labour values are clearly lowest among the most experienced workers. The recession is clearly reflected in the graphs as both the employment and unemployment values drop for the period 1991 - 1994. It appears that the welfare losses caused by the recession are lowest among workers with 5 years or less of experience as their mean labour values have decreased less than in other groups during the recession. The improvement of the relative position of the least experienced group with respect to other experience groups is further reflected in the changing ranking of the mean labour values.

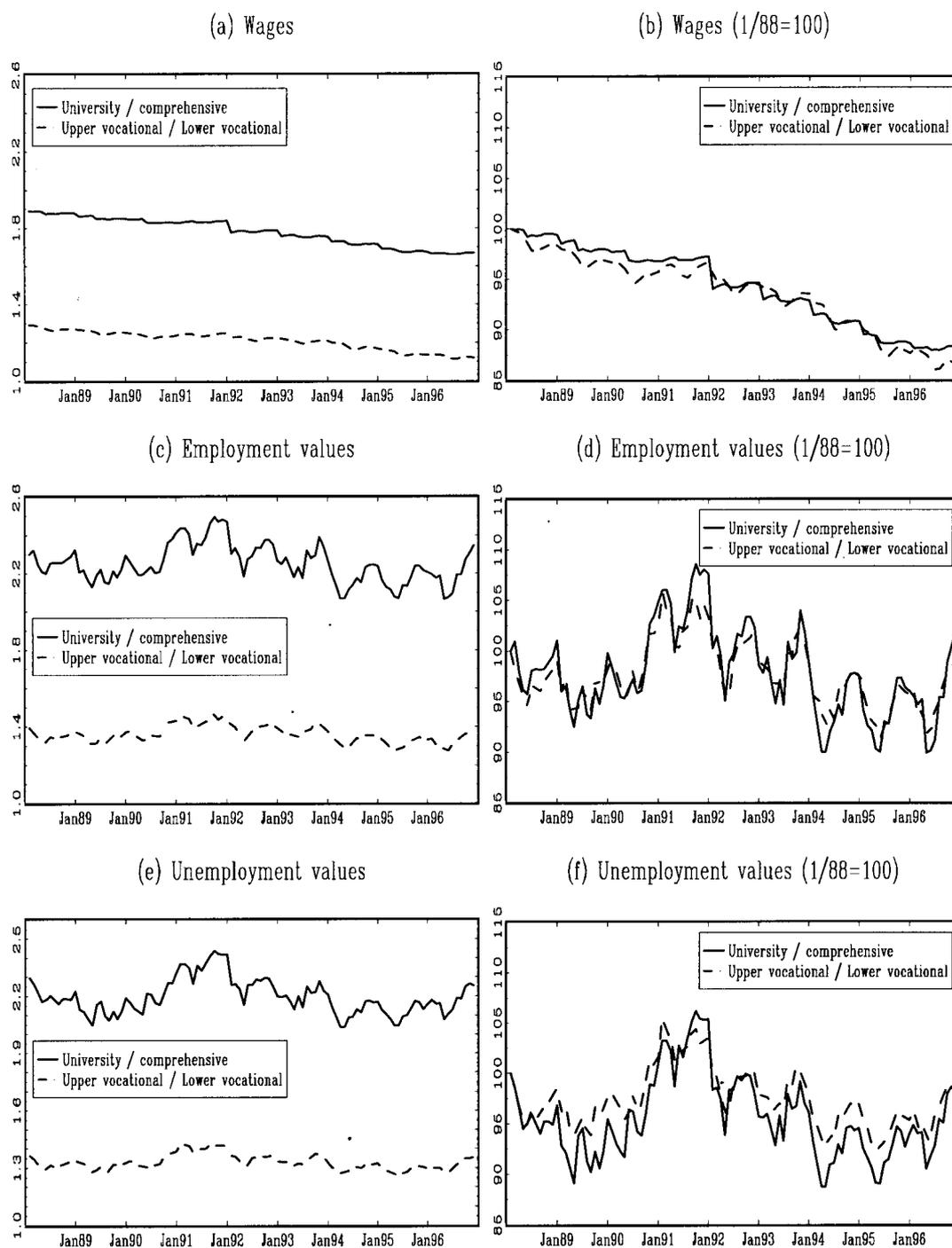
Figures 11.5e and 11.5f describe how much the current job accounts for the life-time value of employment by depicting the mean shares of employment values exceeding the corresponding unemployment values. These figures may be viewed as measures of the discrepancy between the expected life-time welfare of currently employed workers and that of currently unemployed workers. Resulting from wage mobility and labour turnover, differences between the employment and unemployment values are relatively small. Not surprisingly, the importance of the current job increases strongly with experience – the shorter the horizon, the higher is the weight of current income stream in the present value calculations. In terms of group-specific average wages, the difference corresponds roughly to 10 monthly wages for workers with over 25 years of experience and 5 to 7 monthly wages for less experienced workers. With respect to education, there are no large differences across groups, albeit workers with a university degree display a somewhat smaller welfare difference. Overall, it seems that the welfare discrepancy between employed and unemployed workers has increased a little bit during the 1990s, especially within education groups and among workers with over 25 years of experience.

It is important to emphasise that our assumption of the layoff rate being independent of job duration may be problematic if recently hired workers are in reality more likely to be laid off than more tenured workers. If this is the case, an unemployed worker who finds a job is faced with a high risk of falling back to unemployment which in turn reduces the value of his new job. In this sense the welfare differentials between employed and unemployed workers may be underestimated and should be interpreted with caution. Anyway, it is interesting to note that these relative welfare differentials (especially by experience) are roughly identical to those found by Bowlus and Robin (1999) from the U.S. data.

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<sup>117</sup> Highly educated workers are also younger on average.

Figure 11.6. Educational Differentials



As pointed out earlier, educational differentials in wages have been decreasing over the period under investigation. This is further illustrated in Figures 11.6a and 11.6b which show the ratios of average wages between education groups. The difference in the average wages between the most and least educated groups, as well as the difference between workers at the lower and upper levels

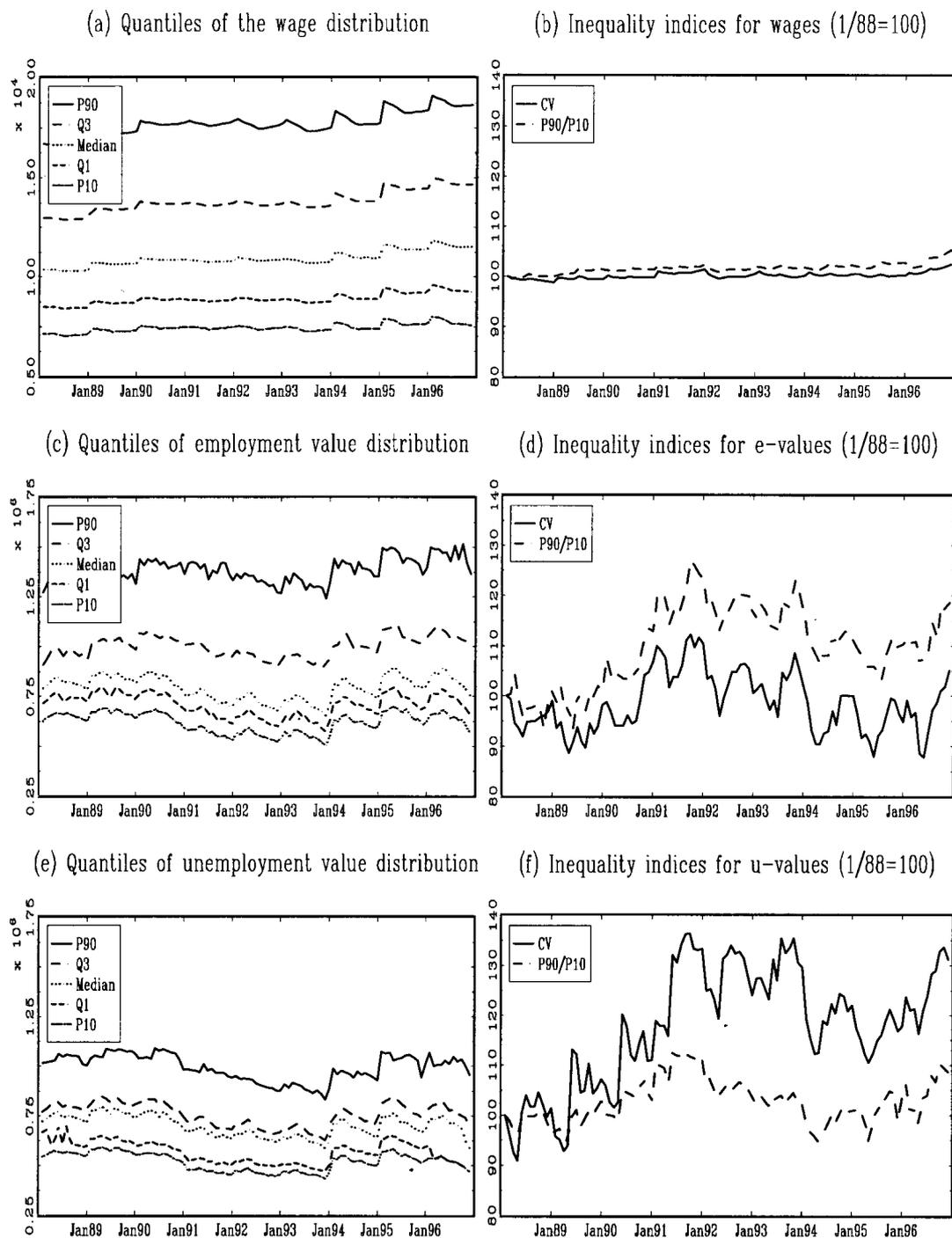
of vocational education, decreases smoothly over the observation period, with an overall decrease of over 10 percentage points. This might be seen to be in accordance with the standard view that an increase in the relative supply of skills depresses the skill premium. It is still remarkable that the patterns of educational differentials do not exhibit any signs of response to the recession despite the fact that the demand shock has affected various education groups quite differently.

Figures 11.6c – 11.6f depict the similar ratios for average employment and unemployment values between education groups. Interestingly, educational differentials in labour values display increases for the recession period, but these are approximately offset by the following decreases which bring the educational differences back to their initial levels. Closer investigation reveals that similar patterns of educational differentials in both wages and employment values exist also within the experience groups. Thus the divergent patterns of educational differentials in labour values are driven by the changing differentials in the structural parameters across education groups, which in turn may be attributed to inflexibility of the wage structure. Overall, it seems that the adjustment to the (asymmetric) demand shock has occurred mainly through the transition probabilities, that is, through the incidence and average duration of unemployment. In particular, the impact of decreasing educational differentials in wages on the educational differentials in welfare measures is offset by changes in the transition probabilities across groups. Note also that educational differentials in labour values are generally slightly higher than the corresponding differentials in wages.

### **11.5.3 Wage and employment value inequality**

Figure 11.7 presents various quantiles of wage and labour value distributions as well as indices of associated inequality measures. Absolute values of the inequality measures are shown in Figure 11.8. The unemployment value distribution is defined over unemployed workers, whereas the underlying population for two other distributions consists of employed workers. When comparing the patterns of employment value and wage distributions, one should take into account the changing sample composition over time and its different impact on these two distributions. Recall that the fraction of workers with over 25 years of experience and that of workers with the highest levels of education are increasing strongly over the sample period. Since highly educated workers tend to be located at the higher end of both distributions, the increasing share of them in the data is likely to affect trends in both distributions to the same direction. However, since more experienced workers tend to earn high wages but the employment values decrease with experience by construction, the increasing presence of the most experienced group is mainly affecting the opposite parts of employment value and wage distributions.

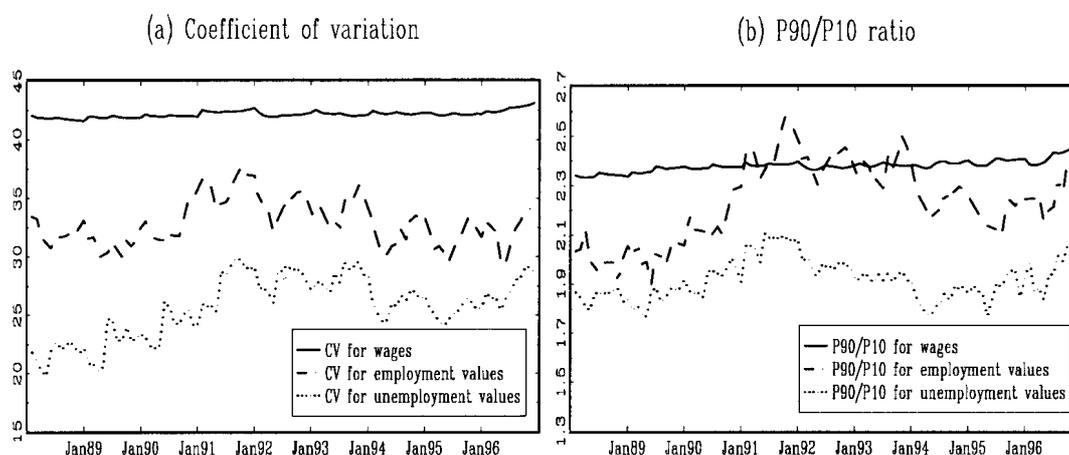
Figure 11.7. Distributions of Wages and Labour Values



The overall pattern of wages in Figure 11.7a seems very sluggish: the distribution is slowly shifting upwards without observable changes in dispersion. Figure 11.7b confirms us that the dispersion of wages has been approximately constant over the observation period. Consequences of the recession are

clearly seen from the distributions of employment and unemployment values, both of which shift down for the recession period, reflecting reductions in the expected life-time welfare. A relatively smooth pattern of the highest percentiles of the employment value distribution over the recession years is attributed to increasing numbers of highly educated workers in the labour market. Since the upper end of the employment value distribution consists almost entirely of workers with upper vocational or university education, the increasing presence of them weakens the negative impact of the recession on the upper end of the distribution by increasing the mass around the mean values of groups with the highest employment values.

Figure 11.8. *Inequality Indices for Wages and Labour Values*



Two alternative measures of variation give somewhat different insight about the pattern of employment value inequality. When measured by the 90/10 percentile ratio, it seems that the recession period is marked by an increase of some 20 percent in employment value inequality, after which the employment value distribution compresses a little bit. On the other hand, the CV suggests a less dramatic trend without persistent changes in inequality, albeit it also displays some increase in employment value dispersion for the recession period. Slight differences in the inequality patterns of employment and unemployment value distributions are driven by divergent trends in the composition of the unemployed and employed stocks.<sup>118</sup>

In terms of the CV, employment value inequality is some 20 percent lower than the corresponding wage inequality on average, while there is no clear difference

<sup>118</sup> If we reconstruct the unemployment value distribution by weighting education-experience groups by the number of employed workers instead of the number of unemployed workers in the cells, we will observe an inequality pattern for the unemployment values similar to that of the employment values.

during the early 1990s when measured by the 90/10 percentile ratio. In any case it is interesting to note that Bowlus and Robin (1999) find inequality in employment values to be only half of wage inequality in the U.S., pointing to a much larger discrepancy in the variation between the two distributions. Compared to our results, their findings imply that wage inequality in Finland is approximately half of that in the U.S., but the levels of employment value inequality are very close to each other in both countries, having been perhaps some 15 percent lower in Finland at the end of the 1980s and vanishing thereafter. It seems that a higher degree of wage and employment mobility in the U.S. labour market can compensate for higher wage inequality, leading to relatively low levels of life-time welfare inequality compared to more rigid labour markets. This observation is consistent with the cross-country findings of Flinn (1997) and Cohen (1999), both of which use life-time welfare measures to compare inequality levels between the labour markets.

*Table 11.1. Inequality Indices in 1988, 1993 and 1996 by Education and Experience*

	Wages			Employment values		
	1988	1993	1996	1988	1993	1996
<u>Education</u>						
Comprehensive	28 (2.0)	27 (2.0)	28 (2.1)	11 (1.3)	12 (1.4)	12 (1.4)
Lower vocational	27 (2.0)	26 (1.9)	26 (2.0)	8 (1.3)	10 (1.3)	10 (1.3)
Upper vocational	37 (2.6)	38 (2.6)	41 (2.9)	10 (1.3)	11 (1.3)	10 (1.3)
University	42 (2.7)	43 (2.8)	46 (3.0)	13 (1.3)	14 (1.4)	13 (1.3)
<u>Experience</u>						
5 years or less	35 (2.4)	36 (2.5)	35 (2.7)	24 (1.7)	24 (2.0)	21 (1.8)
6-15 years	35 (2.2)	36 (2.2)	36 (2.3)	29 (2.0)	30 (2.0)	27 (1.9)
15-25 years	42 (2.3)	42 (2.4)	41 (2.4)	32 (2.0)	33 (2.1)	31 (2.0)
Over 25 years	41 (2.2)	42 (2.3)	42 (2.3)	30 (1.6)	31 (1.8)	33 (2.0)

Notes: Each cell of the table contains the annual average of the CV and the annual average of the 90/10 percentile ratio (in brackets).

Turning to inequality within groups, Table 11.1 shows inequality measures for wages and employment values within education and experience groups at three different points in time: in 1988 (a boom year), 1993 (a recession year) and 1996 (a year of recovery). It is found that dispersion in wages is generally much lower among less educated workers than among their more educated counterparts. With respect to experience, the levels of within-group wage inequality are more similar across different groups. Wage inequality exhibits increasing trends among workers with a university degree and those with upper vocational education, while wage inequality in the less educated groups has not changed notably from 1988 to 1996. The increasing trend in wage dispersion among workers at the higher levels of education may partly reflect their increasing numbers in the labour market as new entrants in the labour market are likely to be paid less than workers in the same group on average. On the

other hand, dispersion in the quality of higher education may be increasing over time since increases in the amount of higher education have been carried out essentially by introducing new study schedules. With respect to experience, the inequality patterns in wages do not display clear trends over time. Recall that dispersion in wages as a whole was found to be relatively stable over time. Thus it seems that increasing wage inequality within the groups of highly educated workers has compensated for decreases in educational differentials.

Levels of inequality in employment values within education groups are much lower than the corresponding inequality levels in wages. It is interesting to note that the ranking of the inequality levels in employment values is very different compared to the inequality levels in wages: more educated workers display much higher wage inequality, while there are no clear differences in the levels of employment value inequality between education groups. In particular dispersion in employment values within the two most educated groups is only one fourth of the corresponding wage dispersion within these groups when measured by the CV. This means that variation in the structural parameters of the model with respect to experience compensates for high wage inequality within the more educated groups. Over time inequality in employment values has perhaps increased (in terms of the CV) among workers with lower vocational education, whereas there are no clear trends within the higher educated groups. Employment value inequality within experience groups is in general higher than within education groups but is lower than the corresponding wage inequality.

## 11.6 Conclusion

We begun our empirical analysis with the description of the patterns of wages and labour market transitions for various categories of private-sector males over the period 1988 - 1996. As expected hiring and layoff rates have been changing dramatically over the period. The recession was found to have smoothed down differences in the likelihood of becoming unemployed, leading to a more compressed distribution of layoff rates. In contrast, dispersion in the hiring rate distribution has been increasing over the observation period. In terms of unemployment rates, the early 1990s was found to be marked by increasing educational differentials.

Except for the recession years, average wages were found to be increasing slowly with smoothly decreasing educational differentials. It appeared that less educated and more experienced workers have faced with relatively smaller declines, if any, in their real wages during the recession years. While variation in wages has slightly increased within highly educated groups, wage inequality as a whole has not changed notably over the observation period. Overall, the respond of wages to the demand shock has been very limited, especially as the

wage adjustments have occurred only in the worker groups of the smallest size. Thus, the adjustment seems to have occurred mainly through the transition rates between employment and unemployment, i.e. the incidence and average duration of unemployment.

To put the patterns of wages and transition probabilities together, we used search theory to derive value functions for different positions in the labour market. Along the lines of Bowlus and Robin (1999), we then analysed the evolution of inequality in the cross-section distributions of life-time labour values. We found the average levels of employment values to have shifted down for the recession period in all worker groups, indicating losses in the expected levels of life-time welfare. These losses caused by the recession turned out to be mainly temporary, however. The average welfare discrepancy between employed and unemployed workers was found to be slightly increasing over the early 1990s, especially within education groups and among workers with over 25 years of experience. Contrary to the wage patterns, we found educational differentials in life-time labour values to be increasing during the recession period. Thus, the impact of decreasing educational differentials in wages on the welfare differentials has been offset by changes in the transition probabilities across groups.

We found also some evidence that the recession period was marked by increasing inequality levels, though it remains a little unclear to which extent these increases disappeared during the period of recovery. Inequality in life-time employment values was found to be only slightly lower than the corresponding wage inequality, which is in contrast to the recent findings from the U.S. data. While wage inequality in Finland is approximately half of that in the U.S., employment value inequality seems to be very close to the U.S. level.

The use of dynamic structural modelling gives us a coherent way to consider the different forces affecting inequality in the labour market. In particular it provides a way to associate changes in the labour market environment with the distribution of expected welfare outcomes. However, there are also some cautionary points in our approach. First, the model on which our analysis relies is obviously a very stylised one, ignoring a number of real-life features of the labour market. Second, our measure of life-time welfare omits taxes and income transfers, both of which are used to decrease welfare differentials. This is a relevant concern especially in the Finnish case as income transfers can occasionally account for a substantive part of household income and their impact is heavily dependent on the current labour market state, household composition and other incomes. One should bear this point in mind especially when comparing our results with the findings from the U.S. data. Third, the worker groups used were very broadly defined, suggesting that aggregation might hide some sorts of underlying inequality patterns from us. The results presented in this study should be interpreted in the light of these remarks.

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### **III Income distribution and poverty**

12. On the Social History of Unemployment and Poverty in Finland 1860 – 2000
13. Economic Crisis of the 1990s: What Happened to Regional Convergence and Inequality, and Housing Market Phenomena in Boom and Bust?
14. Income Inequality in Finland during the 1990s
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## 12 On the Social History of Unemployment and Poverty in Finland 1860 – 2000

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### Abstract

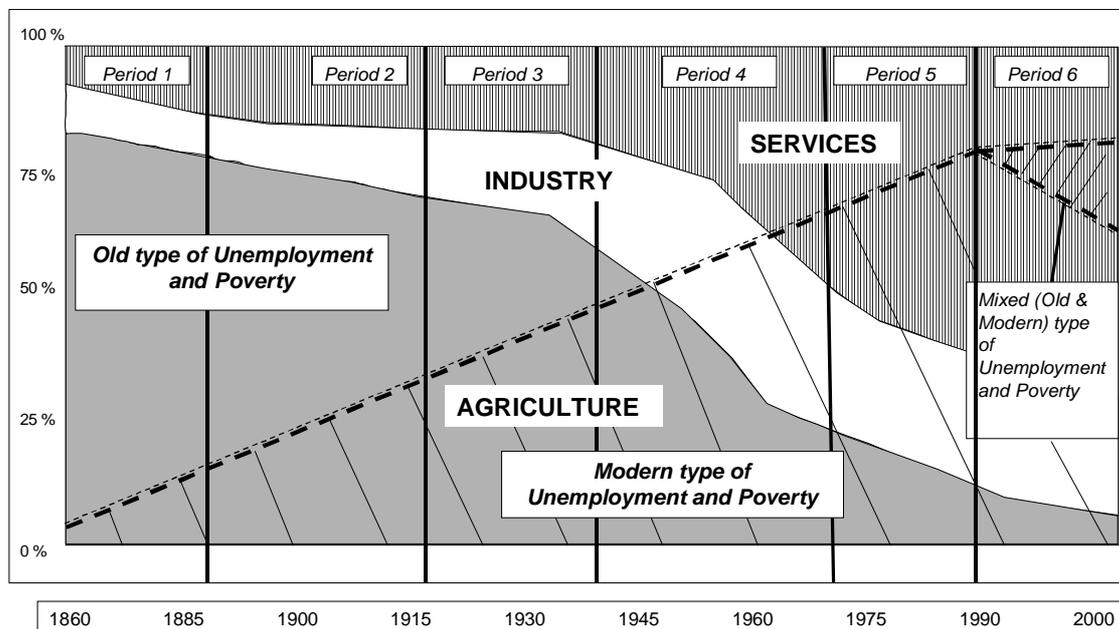
Finland's material standard of living is far higher at the beginning of the 21<sup>st</sup> century than it was during the famine years in the 1860s. People no longer starve to death. Humans have 'conquered nature', but poverty still remains. Poverty has changed from an old type, with fixed ties to the production and social order of an agrarian society, into a modern type, where the relation to wage work in the post-industrialized society and the welfare state are the determining factors. This change has roots in economic growth and the overall change in the distribution of the economically active population working in the primary, secondary and tertiary sectors of industry. However, this process includes a number of other changes as well as the permanent elements, which stress the need for a more accurate study of a combination of structural and subjective factors.

Combining structural, cultural, political and functional perspectives, we study changes in the construction of poverty and unemployment through six time periods: the famine years of the 1860s, the period of transition at the turn of the 20<sup>th</sup> century, the 1930s depression, the period from the war to the 1970s, the contemporary welfare state and the crisis of the 1990s. Special attention is given to the question of the so-called social underclass<sup>119</sup>, as an extreme manifestation and mode of poverty. Our main points are, that in the long run mass poverty has changed into mass unemployment and seems to have taken a special form in the last decade of the 20<sup>th</sup> century (see figure 12.1), and in addition to the economic-structural changes of society and the social policy adopted, the factors of culture and social action in each period have had great significance in the formation of poverty, unemployment and the social underclass. The recession of the 1990s had many similarities even to the Great Famine Years, such as the construction of extensive poverty in a modern way, using the means of social policy and isolation of the social underclass.

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<sup>119</sup> Social underclass is used in this article as a term which refers to a population group with an exceptionally unfavourable and relatively permanent social position as well as to the standard of living, employment, income, education, health, housing standard, way of life etc. compared with the average population, linked with poor prospects and few opportunities for participation, including the position of being the object of a repressive coercive power and social policy.

Figure 12.1. *Periods of Finnish Unemployment and Poverty and Structure of Industry 1860 - 2000*



Sources: Statistical yearbook of Finland 1870-2000, Statistics Finland.

## 12.1 The Great Famine Years in the 1860s: the catastrophe of mass poverty

The Great Famine Years of the 1860s have a special meaning in Finnish historical awareness and the Finnish mentality similar to that of the 1840s famine in Ireland or the 1930s depression in the United States.<sup>120</sup> The famine is part of the memory of the collective past and has strong associations with the family histories of individuals. It provides an extreme example of poverty and misery, a mirror serving as a point of comparison for communal and individual disasters, and it represents a turning point heralding the birth of something new and significant.<sup>121</sup> The Great Famine Years exemplify the ultimate escalation of the social problems of agrarian poverty: extensive, deep, and lasting economic crisis, famine and disease, culminating in 1868, when mortality rates increased five-fold. The population loss between 1866 and 1868 was about nine percent.

<sup>120</sup> Morash, Christopher 1995, *Writing the Irish Famine*, Clarendon Press, Oxford, 1-4; Watkins, T.H. 1993, *The Great Depression: America in the 1930s*, Back Bay Books, Boston.

<sup>121</sup> Häkkinen, Antti, Vappu Ikonen, Kari Pitkänen and Hannu Soikkanen 1991, *Kun halla nälän tuskan toi: Miten suomalaiset kokivat 1860-luvun nälkävuodet*, WSOY, Helsinki, 250-272.

The increase in mortality occurred particularly in the countryside, in the country's eastern and central regions, and hit infants and old people, mainly of the working class population, especially hard.<sup>122</sup> Shortages of foodstuffs caused by failed crops and the increasing price of food resulted in mass impoverishment, starvation, disease and migration.<sup>123</sup>

The crisis of the famine years was exceptional because of its depth, not because of its uniqueness. Periodic crop failures in cycles through years or decades, difficulties in food distribution, hunger and epidemic diseases and the resulting high mortality characterized the Finnish agrarian community. War was often the third factor contributing to the devastation.<sup>124</sup> 'Risk society' has reflected the basic conditions and framework of life in the countryside. Although the crises began with unfavourable natural circumstances, those circumstances were transformed into social phenomena at the point when the right to food became problematic, when the freeholders raised the price of foodstuffs, lowered wages, dismissed their workers, restricted the benefits of the so-called barter economy and, at least initially, refused to organize food distribution and fended off those seeking help. The poverty of the famine years forced the issues of ownership and the right to food. The policy in which work was demanded as a precondition of aid and aid was organized as a system of workhouses, was one of the main reasons for the catastrophe in circumstances where personal and structural reasons prevented the poor from fulfilling the demands of reciprocity, and the organizers often lacked the resources, will and skill to carry out their duties.<sup>125</sup> A large part of the population lived constantly at the minimum subsistence level where even minor crop failure resulted in a critical situation, and they remained so defenceless that their scant livelihood might be threatened by non-economic factors.<sup>126</sup>

The social order was locally based on the system of so-called legal protection, i.e. a patriarchal, family-based cultivation and control system founded on land ownership and supported by a strong system of norms and control. Power was

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<sup>122</sup> Pitkänen, Kari J. 1993, Deprivation and Disease: Mortality during the Great Finnish Famine of the 1860s, Publications of the Finnish Demographic Society 14, Helsinki, 88-89, 116, figures 6.1 and 6.2; Pitkänen, Kari 1992, The Patterns of Mortality During the Great Finnish Famine in the 1860s, Acta Demographica 1992, 94-97.

<sup>123</sup> Häkkinen et. al. 1991.

<sup>124</sup> Ibid. 11-35.

<sup>125</sup> Häkkinen, Antti 1994, Vaikuttivatko väärät hätäaputoimet vuosien 1867-1868 suureen kuolleisuuteen? in Karonen, Petri (ed.) 'Pane leipään puolet petäjäistä', Nälkä- ja pulavuodet Suomen historiassa, Suomen historian julkaisuja 19, Jyväskylän yliopisto, Historian laitos, 62-82; Turpeinen, Oiva 1986, Nälkä vai tauti tappoi? Kauhunvuodet 1866-1868, Historiallisia tutkimuksia 136, SHS, Helsinki, 177-179.

<sup>126</sup> Häkkinen et. al. 1991.

hierarchically concentrated on the landowners, but it also obligated them to provide for the livelihood of the people within their sphere of authority. In return, the members of the community had to commit themselves to serve their masters and participate in the production process.<sup>127</sup> The system had proved inefficient and contradictory already before the 1860s. Even though it no longer functioned properly its inherent power relations were still enforced.<sup>128</sup> On the local level the contradictions resulted in constant, but single and limited conflicts, which threatened to crumble the ideological basis of the system.<sup>129</sup> Under the system, indigent people who were able to work were forced to work in the agricultural production process in one way or another. The elderly with no providers, children and the disabled lived with families who took care of them, permanently or temporarily, on the basis of the so-called rotation system. Poor relief, relief work, almshouses, begging and workhouses complemented the system.<sup>130</sup>

The tragedy of the famine years shook the foundations of the agrarian community. Marking the end of a long development trend, the crisis revealed and brought to a head a whole battery of problems: the underdeveloped production process, the lack of capital, the miserable state of the infrastructure, the primitive nature of both the division of labour and the market, and problems of administration and communication.<sup>131</sup> The hunger crisis also shook the practices maintaining the legal protection system. The collective crisis broke the networks of the unofficial aid system, important for the survival of many individuals. When the system provided by the community failed, the poor were left with two avenues of survival. They could stay within the sphere of the local community and trust the shelter provided by the poor relief system, or they could move out in search of bread and work. The former choice represented sticking to the sphere of social relationships and the institutions of the system of legal protection. Leaving spelled transgressing local mental and physical limitations, casting oneself on the mercy of unknown circumstances, and

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<sup>127</sup> Pulma, Panu 1994, Maatalousyhteiskunta ajautuu kriisiin, in Jaakkola, Jouko, Panu Pulma, Mirja Satka and Kyösti Urponen, *Armeliaisuus, yhteisöapu, sosiaaliturva: Suomalaisen sosiaalisen turvan historia*, Sosiaaliturvan keskusliitto, Helsinki, 59-61.

<sup>128</sup> Soininen, Arvo M. 1974, *Vanha maataloutemme: Maatalous ja maatalousväestö Suomessa perinnäisen maatalouden loppukaudella 1720-luvulta 1870-luvulle*, *Historiallisia tutkimuksia* 96, SHS, Helsinki, 382-415.

<sup>129</sup> Kallio, Reino 1982, *Pohjanmaan suomenkielisten kylien oltermannihallinto*, *Studia Historica Jyväskyläänsia* 23, Jyväskylä, 147-159, 277-285; Häkkinen, Antti 1989, *Rikos, rikollinen ja oikeus 1800-luvun Suomessa*, Licentiate thesis, Dept. of Sociology, University of Helsinki.

<sup>130</sup> Piirainen, Veikko 1958, *Kylänkierrolta kunnalliskotiin: Savon ja Pohjois-Karjalan maalaiskuntien vaivashoitotoiminta maan yleisen vaivashoitopolitiikan murroksessa 1880- ja 1890-luvuilla*, Helsinki.

<sup>131</sup> Häkkinen et. al. 1991; Pihkala, Erkki 1982, *Kehitysmaasta hyvinvointivaltioksi*, in *Suomen taloushistoria* 2, Ahvenainen, J., E. Pihkala and V. Rasila (eds.), Tammi, Helsinki, 528.

defying the statutes concerning migration. During the famine nearly 100,000 individuals left their village communities looking for food.<sup>132</sup>

The differentiated social position of the underclass was legitimated by religion. The Lutheran Church had a central position in teaching and controlling the life and ideology of people.<sup>133</sup> Its position of authority was challenged only in a few individual cases, or covertly. However, this apparent harmony was increasingly challenged towards the end of the 19<sup>th</sup> century.<sup>134</sup> This phenomenon of secularization was followed by the disintegration of the social units, experiences and new ways of thinking and action.

The vast population migration had an impact on local systems of social relationships. In the poor regions entire villages lost their inhabitants, farms went uncultivated, and the consequences of the crisis were felt long into the future. However, the migration from the poor regions created new life patterns and opportunities for survivors. The migration hastened the process of urbanization and facilitated emigration in the decades following the famine years. As a social movement of the poor, mass beggary and migration shattered the basic ideas based on legal protection and the close community modes of operation, and the crisis questioned the ideological foundation of the system. Typical features of the wandering and migration later on as a social movement included spontaneity, aimlessness and lack of organization. As a social movement it highlighted the problems of agrarian mass poverty, and at the same time it was an instantaneous and temporary solution to the growing question of the relative surplus population.

The landless population in the countryside was considered to constitute a socially dangerous lower class. Administrative institutions and control practices were developed, instead of creating social policy programmes.<sup>135</sup> In order to control the new class, legislation on poor relief and vagrancy was reformed and the number of official institutions increased. While collective activity during the famine years of the 1860s amounted to no more than fumbling forms of activity, the event itself and its aftermath played their part in the formation of new political-structural activity. The underclass was created in reality and as a political concept. The Great Famine Years were the main manifestation and the

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<sup>132</sup> Häkkinen et.al. 1991.

<sup>133</sup> Diaries of the Church Councils 1814-1892, archives of the parishes, KA.

<sup>134</sup> Nenonen, Marko 1992, Noituus, taikuus ja noitavainot Ala-Satakunnan, Pohjois-Pohjanmaan ja Viipurin Karjalan maaseudulla 1620-1700, SHS, Helsinki; Bök, A. Th. 1912, Vanhankansan tapoja ja taikoja y.m. sivistyshistoriallisia pikkutietoja Keski-Hämeestä 1800-luvulta Karisto, Hämeenlinna; Episcopal Visitations in parishes 1860-1902, archives of parishes, KA.

<sup>135</sup> Häkkinen et. al. 1991, 250-272; Jaakkola, Jouko 1994, in Jaakkola, Jouko et.al. *Armeliaisuus, yhteisöapu, sosiaaliturva ...*, 91-93.

control system was a reaction against perceived dangers and 'hard' social policy was in use.

## 12.2 The period of crises and change at the turn of the 19<sup>th</sup> and 20<sup>th</sup> centuries

The period from the last quarter of the 19<sup>th</sup> century till the beginning of the 1920s included a phase of industrialization and urbanization of fast economic growth, the transformation of the class society and the creation of a parliamentary democracy with political parties, the construction of a civil society and the gaining of national independence in 1917. The growth and the change did not take place without severe backlashes and contradictory processes: numerous economic depressions, the frequent years of dearth connected with the long-lasting agrarian crisis. The creation of the new forms of political-structural organizations and practices included harsh political conflicts especially in the shadow of the First World War. The civil war in 1918 was a key point of this period because of its special origins, violence, and long-lasting consequences.<sup>136</sup>

The urban poor suffered hardest during the famine of the 1860s, but till the end of the 19<sup>th</sup> century the problem of the landless population remained and worsened. When the source of a permanent and sufficient livelihood in the countryside was farming, the rural underclass consisted of those without their own farms and on permanent wage work. The number of this section of the population surviving on random work is estimated to have grown from 400,000 persons in 1880 to 700,000 persons in 1910<sup>137</sup>, which meant an increase from 21 percent to 26 percent of the total rural population, although over 300,000 persons emigrated to the United States between 1867 and 1914. In this period the urban population increased 163 percent and migration to the towns was the main explanatory factor to this rapid growth.<sup>138</sup> When the rural proletariat expanded into towns the result was a new urban underclass.<sup>139</sup>

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<sup>136</sup> Ylikangas, Heikki 1992, *The Government and the Nation*, in Rahikainen, Marjatta (ed.), *Austerity and Prosperity: Perspectives on Finnish Society*, Univ. of Helsinki, Lahti Research and Training Centre, 38-39.

<sup>137</sup> Rasila, Viljo 1982, *Väestönkehitys ja sosiaaliset ongelmat*, in Ahvenainen, Jorma, Erkki Pihkala and Viljo Rasila (eds.) *Suomen taloushistoria 2, teollistuva Suomi*, Tammi, Helsinki, 136.

<sup>138</sup> Kero, Reino 1974, *Migration from Finland to North America in the years between the United States Civil War and the First World War*, Turun yliopiston julkaisuja B/130, Turku, 13 and table 9; *Suomen taloushistoria 3*, 1983, Tammi, Helsinki, tables 1.5 and 1.15.

<sup>139</sup> Waris, Heikki 1932-34, *Työläisyhteiskunnan syntyminen Helsingin Pitkäsillan pohjoispuolelle*, SHS, Helsinki.

In addition to the increase in the rural surplus population, the Finnish farming system was affected by two processes: the commercialization and competition inside the agricultural sector, and the farming system becoming more and more involved with raw material production and labour power of the forest economy. The social relations of the barter economy were gradually forced aside by the relations of the market economy and employment became more often a mediatory factor between the individual and poverty. In the commercialized economy, the labour force was seen as a cost factor without any moral connotations. Poverty was understood as a question of the relative surplus population, the problem of the landless population, and the small average size of the farms. The transformation became more emphasized in the economic crisis, when stagnation also reached the rural labour markets.<sup>140</sup>

The growing wood and paper industry employed the rural labour force directly in the factories, but felling and transportation created a new type of rural proletariat - small farmers and landless workers who periodically worked in varying locations during the winter in forestry, and during the summer on farms. Ownership or renting a small piece of land was a source of cheap labour for both the primary and secondary industrial sectors. This wandering labour had strong ties to a barter economy. For the creation and growth of the Finnish wood industry, its existence was essential and for the development of large-scale farming, its contribution was necessary.<sup>141</sup>

The last part of the 19<sup>th</sup> century and the beginning of the 20<sup>th</sup> century was a time of economic growth, new opportunities, prosperity and, despite the large rural surplus population, the average standard of living of the working class rose constantly. This improvement was sensitive to variations in harvests and economic fluctuations, and the large social class of tenants did not benefit from this progress.<sup>142</sup> In the countryside the increase in property lifted the prevailing 'hunger line' from being between the gentry and others, to between the medium-size farmers and others.<sup>143</sup> This progress was unequal and it widened the gap in the standard of living between different social classes, creating new contradictions. Compared with earlier poverty the changes were minor. The risk factors of poverty - remaining without support when young or old, becoming ill,

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<sup>140</sup> Peltonen, Matti 1992, *Talolliset ja torpparit: Vuosisadan vaihteen maatalouskysymys Suomessa*, *Historiallisia tutkimuksia* 164, SHS, Helsinki, 68-75; Soininen, Arvo 1982, *Maa- ja metsätalous*, in *Suomen taloushistoria* 2, Ahvenainen, J., E. Pihkala and V. Rasila (eds.), Tammi, Helsinki, 27-28.

<sup>141</sup> Haatanen, Pekka 1968, *Suomen maalaisköyhälistö tutkimusten ja kaunokirjallisuuden valossa*, WSOY, Helsinki, 143, 303.

<sup>142</sup> Heikkinen, Sakari, Timo Kortteinen, Hannu Soikkanen and Arvo M. Soininen 1983, *Palkat, toimeentulo ja sosiaalinen rakenne Suomessa 1850-1913*, Helsingin yliopiston talous- ja sosiaalhistorian laitoksen tiedonantoja N:o 13, Helsinki, 99-101.

<sup>143</sup> Jaakkola 1994, 88.

having an accident, losing one's home - were still evident, with unemployment becoming a new one. The rural underclass suffered from poor housing, poor health, scarce food, ragged clothing, few opportunities for education etc.<sup>144</sup> Progress did not open the way to social mobility equally for everyone. Numerous poor families lived the same way as their grandparents, and their children had no better hope for the future.

The new fast-growing urban underclass had similar features to the rural one, but with some differences. If a stable, underprivileged social position marked the latter's way of life with some exceptions, the former's life was characterized by the flexibility, mobility and irregularity of work. The rapid increase of the urban population and industrialization were followed by massive building construction and new places of work in the traffic, trade and services sectors. Because of the large migration, a chronic oversupply of labour existed and because of the seasonal nature of many jobs, unemployment was common. The new urban poverty was characterized by low income, poor housing standards and problems of health and employment. The urban wage level was better compared with the wage level of the rural areas, but the cost of living was higher and the risks were greater.<sup>145</sup> Where the rural poor had some chance to secure their livelihood in the barter economy, this way of surviving was lacking for the urban poor. The strong ties to the market economy made the urban poor more vulnerable to market fluctuations and the weakness of the social security system created risks: becoming ill, having accidents etc. These deficiencies were compensated by social networks and the potential of the working class culture.

After the Great Famine Years, and in line with international trends the growing Finnish labour class movement adopted the issues of poverty and inequality as some of the main themes in its programmes. The social-reform movement, represented mostly by various sections of the bourgeoisie, also considered poverty a key social problem, and the emphasis in the nation-building process was on the ideological and institutional structures that were built in this fight against poverty.<sup>146</sup> Poverty was manifested by massive cultural campaigns: literature, songs, theatre and symbols etc. The creation of a new type of working-class culture was based on the old traditions and experiences of everyday life and popular culture. It can be characterized by a kind of idealization of poverty, a strong juxtaposition between the rich and the poor and a legitimation of the class struggle. The poor masses participated in this conflict

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<sup>144</sup> Haatanen 1968, 154-155.

<sup>145</sup> Siipi, Jouko 1967, *Ryysyrannasta hyvinvointivaltioon*, Tammi, Helsinki, 18-32; *Vähäväkisten Helsinkiä*. Artikkeleita köyhien elinolosuhteista vuosisadanvaihteen Helsingissä, Häkkinen, Antti (ed.), *Helsingin yliopiston talous- ja sosiaalhistorian laitoksen tiedonantoja No 22*, Helsinki.

<sup>146</sup> Jaakkola 1994, 91-93.

with strong confidence in their own leadership, the goals of the struggle and the chances of achieving them.<sup>147</sup>

The democratic changes in the administration systems both on the local level and especially on the national level at the beginning of the 20<sup>th</sup> century gradually seemed to make the realization of the demands of the labour movement possible. The work of the local councils and boards shaped and organized the collective action of the working class into a more political-structural type. In the first parliamentary elections in 1907 the Social Democrat Party received the majority of the vote. The issues of poverty were all the time in the political arena, although for many reasons changes came about at a very limited and slow pace.<sup>148</sup>

The contradictions and problems became critical in the years of the First World War. At the beginning of the war, working conditions changed for the worse in nearly every sector of production except agriculture, where the problems appeared later and were less important. The labour force was reduced and working time was shortened. In the metal, weaving and spinning industries the change was temporary, but in the wood, stone, building, food and printing industries the recession was extensive and long-lasting, creating large-scale unemployment. The unskilled workers and dock-workers were in trouble as well. Unemployment reached a critical level in the towns and, later on, also in many municipalities.<sup>149</sup> According to contemporary research nearly half of the industrial workers were unemployed in September 1914.<sup>150</sup> In the major cities 13,290 unemployed were registered and in the rural areas "... without doubt it (the number) was great as well...".<sup>151</sup>

The war created an enormous demand for labour. Huge numbers of workers were needed on construction sites financed by the Russian government. In the beginning of December 1914, most unemployed persons throughout the whole country could get work there. The wages were also clearly better in this work than in relief work.<sup>152</sup> In these works about 100,000 men were employed, while in the metal and textile industries the demand for war materials increased,

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<sup>147</sup> Soikkanen, Hannu 1961, *Sosialismin tulo Suomeen. Ensimmäisiin yksikamarisen eduskunnan vaaleihin asti*, WSOY, Helsinki, 1-27, 161-182; Parikka, Raimo 1997, 'Varo veli, topora yksin matkustaa' - *Rahvas, vastarinta, politiikka*, in Parikka, Raimo (ed.) *Työväestö ja kansakunta, Työväen historian ja perinteen tutkimuksen seura, Väki Voimakas* 10, Helsinki, 99-171.

<sup>148</sup> Soikkanen 1961, 257-270.

<sup>149</sup> Julkinen työnvälitys Suomessa vuonna 1914, *Työtilastollinen aikakauslehti (TA)*, 3/1915, 9.

<sup>150</sup> Hoppu K.V. *Taloudellinen tila Suomessa, Yhteiskuntataloudellinen vuosikirja 1914*, 218-237.

<sup>151</sup> A. H. K, *Julkinen työnvälitys Suomessa 1914*, *TA*, 3/1915.

<sup>152</sup> *Ibid.*; Jussila, Osmo 1977, *Pusulan historia vv. 1859-*, Vammala, 325.

providing work for women as well.<sup>153</sup> Employment varied greatly in the country depending on the type of industry and the location compared with the fortification works. This created a large migration of persons seeking work.<sup>154</sup> In 1916, the employment and livelihood situation was fairly good, but the situation changed suddenly in the summer of 1917. The fortification works ended resulting in massive unemployment. The war materiel industry collapsed as well. The harvest of 1917 was poor and the war-time difficulties of exporting and distributing grain created an acute danger of starvation in 1917 and 1918.<sup>155</sup> In the civil war the emotional distrust, stemming from bitter memories of the past in connection with the acute need for food culminated and was one of its main contributory factors.<sup>156</sup> The conflict was not simply a revolution by the poor against the rich, but many of the points in the programmes of the red side welled up from poverty.<sup>157</sup>

The social problems layed the ground for revolution, but the question of power ultimately sparked it off. The Russian Revolution left Finland as a nation without coercive means of control, leaving the arena free for an open struggle for power. The Social Democrats had a key position in the organs of government and its defeat in the parliamentary election in the autumn of 1917 aroused a fear of losing its achievements and its grip on the levers of power. Risto Alapuro writes, "(the Social Democrats)... attempted to retain the power it had gained ..." and "... proceed and push through reforms within the existing system ...".<sup>158</sup> The revolution was an instrument by which the great achievements of the recent decades were defended and the threat of a counter-revolution was prevented.<sup>159</sup> The radical sections of the left started to disregard the governing body of the party and assumed a more active role in the process. Both the reds and the

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<sup>153</sup> Apunen, Osmo 1987, *Rajamaasta tasavallaksi*, in *Suomen Historia*, Vol. 6, W&G, Helsinki, 270; A. H. K, *Julkinen työnvälitys Suomessa 1914*, TA 3/1915.

<sup>154</sup> A.H.K, *Julkinen työnvälitys vuoden 1915 ensimmäisellä vuosineljänneksellä*, TA 3/1915; A.H.K 1916.

<sup>155</sup> Rantatupa, Heikki 1979, *Elintarvikehuolto ja -säännöstely Suomessa vuosina 1914-1921*, *Studia Historica Jyväskyläänsia* 17, Jyväskylä, 24-25; Häkkinen et.al. 1991, 28.

<sup>156</sup> Salkola, Marja-Leena (1985) *Työväenkaartien synty ja kehitys punakaartiksi 1917-18 ennen kansalaissotaa 2*, *Punaisen Suomen historia 1918*, VP, Helsinki, 21-27; Häkkinen 1990, 427-440.

<sup>157</sup> Alapuro, Risto 1985, *Yhteiskuntaluokat ja sosiaaliset kerrostumat 1870-luvulta toiseen maailmansotaan*, in Valkonen, Tapani, Risto Alapuro, Matti Alestalo, Riitta Jallinoja and Tom Sandlund, *Suomalaiset: Yhteiskunnan rakenne teollistumisen aikana*, WSOY, Helsinki, 73-77.

<sup>158</sup> Alapuro, Risto 1988, *State and Revolution in Finland*, University of California Press, Berkeley, 163, 272-273.

<sup>159</sup> Kettunen, Pauli 1986, *Poliittinen liike ja sosiaalinen kollektiivisuus tutkimus sosialidemokratiasta ja ammattiyhdistysliikkeestä Suomessa 1918-1930*, SHS, Helsinki; Kalela, Jorma 1989, *Työttömyys 1900-luvun suomalaisessa yhteiskuntapolitiikassa*, Työvoimaministeriö, Helsinki.

whites organized armed civil guards and the revolution began in January 1918, when the reds conquered Helsinki, and ended on May 5th, when the last remnants of the revolutionary army surrendered.

The unsuccessful attempt at revolution confirmed the early mistrust of the labouring classes felt by the bourgeoisie and it seemed to entitle them to take harsh punitive measures against the working class. The working class was divided into two groups of the 'decent' and the 'worthless'.<sup>160</sup> In addition to the loss of life in the conflict, the working class experienced the cruel punitive measures taken by the victors as extremely unfair and unnecessary, and felt a long-standing bitterness and anger toward the victors. The distinction remained a long-standing factor in the mental heritage and in political practices.

The new poverty law was approved in 1922. Two main principles of the law were dignity in the treatment of poor, and the idea of avoiding institutional care and favouring direct types of aid. The municipalities were obligated to take care of all their members, not only those earlier cared for, but also the unemployed and their families. Those who failed to diligently earn their own or their dependants' living, were treated most rigidly. The law allowed officials new means of control over the everyday life of the poor, whose personal rights could be rejected. It also included features of a more centrally planned system with rejections for the municipalities.<sup>161</sup> The new law, like many reforms of the period, despite their progressive nature, remained minor in their actual effects. Jorma Kalela has written, that the social reforms of the 1920s reflect a lack of coordination between economic and political developments that is characteristic of Finland. The reforms were more theoretical than practical in nature. They emulated foreign models rather than attempting to solve social problems, so the laws fell short of expectations. Consequently, mass poverty still existed.<sup>162</sup>

### 12.3 Depression in the 1930s – a crisis between the wars

In the national writing of history and in the collective and individual memory, the great depression of the 1930s has remained overshadowed by the two World Wars. Nevertheless, there are perceptible links between all three crises that connect them economically, politically and in people's mind. The international economic uncertainty created by the First World War constituted one of the main reasons for the 1930s depression, though in Finland there was

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<sup>160</sup> Kettunen, Pauli 1997, *Työjärjestys tutkielmia työn ja tiedon poliittisesta historiasta*, Tutkijaliitto, Helsinki.

<sup>161</sup> Urponen, Kyösti 1994, *Huoltoyhteiskunnasta hyvinvointivaltioon*, in Jaakkola, Jouko et. al. *Armeliaisuus, yhteisöapu, sosiaaliturva ...*, 177-182.

<sup>162</sup> Kalela 1989, 22-52.

exceptionally positive economic growth in the 1920s.<sup>163</sup> The Russian Revolution, Finland's independence and the birth of nationalist movements in Europe in the 1920s and 1930s, created new tensions in the political relationships between nations.<sup>164</sup> The events of 1918 cast a shadow well into post Second World War society in both national politics and on the internal relationships within local communities. The trauma left by the civil war in Finland is visible on the level of national policy in the form of growing difficulties in left-wing and trade-union activities. Sympathy for the poor and romantic notions about them at the end of the previous century had changed into 'great disappointment'; aspirations to elevate the masses to join the other classes had changed to fear and hatred. One of the objects of this aversion was the working class culture, the culture of poverty, which became a phenomenon against which all kind of assaults, legal and illegal, were directed.

The depression of the 1930s resulted in large-scale unemployment and poverty, made worse by deep recession in both the wood-processing industry and in agriculture. The effects were worst in the rural areas of northern and eastern Finland, where economic life concentrated almost exclusively on the agriculture and forestry sector. In addition to unemployment, the decreasing wage level threatened survival. Real earnings fell to a level lower than that of the middle of the 1920s and did not regain their earlier level until 1936 - 1937. The depression also resulted in a widespread livelihood problem. In the agricultural sector of eastern and northern Finland, the depression continued for a long time after it had disappeared from other sector, making the social consequences more sustained. The depression caused structural changes in both agriculture and the forest industry and diminished the demand for labour in the regions suffering most from the depression.<sup>165</sup>

In urban communities the depression spelled problems particularly for workers in construction, dock and loading work, as well as in seasonal or temporary jobs in general. The stagnation of the economy also affected other fields, where white-collar workers also had to face it. During the depression, masses of people were left without jobs. Lower wages, shorter working weeks, and long-

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<sup>163</sup> Mitchell, Broadus 1989, *Depression Decade: From New Era through New Deal 1929-1941*, M.E.Sharpe inc, New York, 5-10.

<sup>164</sup> Kalela, Jorma 1994, "Unemployment as a Dimension of Politics in Finland between the Wars", *Scandinavian Economic History Review* vol. 42 (2/1994); Peltola, Jarmo 1998, *Why did the Unemployment Rate Vary? Finnish Interwar Unemployment in a Comparative International Context*, in Myllyntaus, Timo (ed.) *Economic Crises and Restructuring in History, Experiences of Small Countries*, St Katharinen 1998.

<sup>165</sup> Kananen, Ilkka 1986, *MTK ja Suomen maatalouspolitiikka: Elintarvikepulasta omavaraistalouteen 1917-1949*, Kirjayhtymä, Helsinki, 130; Ahvenainen, Jorma, *Suomen sahateollisuuden historia*, WSOY, Helsinki 1984, 376-77, 383; Hjerpe, Riitta, *Long waves of industrial concentration. The Case of Finland*, Helsingin yliopiston talous- ja sosiaalhistorian laitoksen tiedonantoja N:o 12, 1982, 31.

term production cutbacks made the situation worse. The most visible signs of poverty caused by the depression were the numbers of the unemployed which had multiplied; the number of people receiving poor relief approximately tripled; personal savings diminished and the incidence of pawning increased; consumption decreased, particularly among the working population; certain diseases grew in relation to poverty and the migration of the population; a large-scale increase occurred in the number of people seeking jobs and begging. Poor relief, relief work, free food distribution, and charity were used to ease poverty and unemployment. The depression resulted in a clear lowering of the working population's standard of living and hunger was not uncommon.<sup>166</sup>

Employment and poverty were measured with the help of statistics. Statistics have also been used in research after the depression.<sup>167</sup> Already in 1934, these statistics showed a clear improvement in the unemployment situation (see figure 12.2). The slow return to pre-depression levels of the number of poor relief recipients was considered surprising, although the economic signs took a positive direction quite early and the numbers of officially unemployed returned the pre-depression level. The slow recovery was typical of the rural municipalities, the positive and rapid growth of the economy improving the poverty situation and employment especially in Helsinki.<sup>168</sup> The connection between poverty and the labour market situation is not merely a zero-sum game. The social logic of poverty does not adhere to the economic market logic. The rates of unemployment and poverty respond slowly at the beginning of a depression, and an expected economic boom correspondingly diminishes these numbers slowly. Changes in the standard of living respond more profoundly and more lastingly, involve more people and have more complex effects than unemployment or poor relief data indicates.

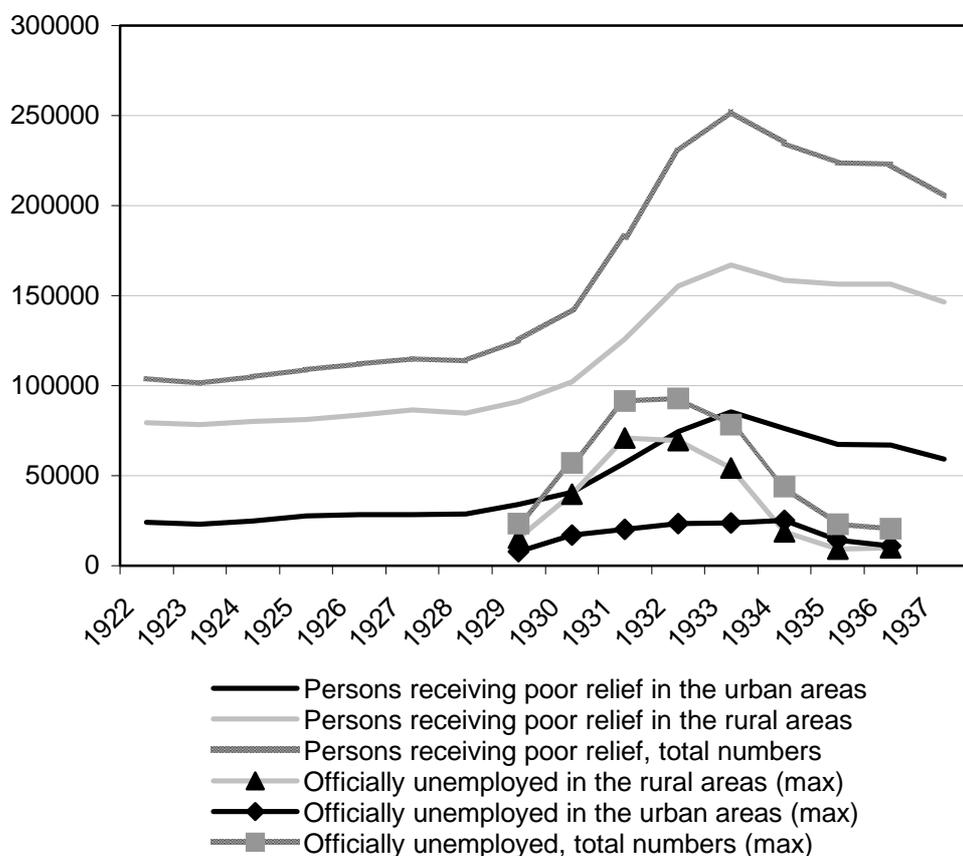
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<sup>166</sup> Parikka 1994; Peltola, Jarmo and Raimo Parikka 1998, Working class suburb in the years of crisis: Family, work and unemployment. Paper presented in the European Social Science History Conference; Peltola, Jarmo, 2001, Lama ja modernistuva kaupunki, Rakennustyöläiset Tampereella 1927-1939, 1930-luvun talouskriisi Suomessa, SKS Helsinki 2001; Hannikainen, Matti 2000, Kaupungin rakentajat, in Mattsson, O. and M. Sunell (eds.) Pääkaupungin kuva, luentoja Helsingin historiasta, Memoria 14, Helsingin kaupunginmuseo, Helsinki, 79-92.

<sup>167</sup> Kahra 1938; Lindberg, Valter 1943, Suomen kansantulo vuosina 1926-1938, Suomen Pankin suhdanneosaston julkaisuja sarja B:1, Helsinki; Waris, Heikki 1945, Kuluttajain tulot, kulutus ja säästäminen suhdannekehityksen valossa Suomessa vuosina 1926-1938, Helsinki; Haatanen 1968.

<sup>168</sup> Helsingin kaupungin kunnalliskertomukset 1933-38, Köyhäinhoito ja Huoltotoimi.

Figure 12.2. *Persons Receiving Poor Relief (1922-37) and the Number of Officially Unemployed in Finland 1929 - 1936*



Sources: SVT XXI, Köyhäinhuoltotilasto 1922-1938; Kahra, Eljas 1938, Työttömyys vuosina 1928-36, Työttömyysneuvoston julkaisuja, Helsinki, table 1.

The effects of the depression on the everyday life and life phases of the poor occurred in two different ways, neither of which can be understood solely from the perspective of lost income or lack of work in the official labour market. In the unofficial economy the poor had been able to compensate for their low income level, for the seasonal nature of work or lack of work, without being officially registered or taxed. The unofficial economy also offered products and services that were cheaper than those of the official market. The poor could lean on the forms and social networks of the unofficial economy particularly during times of crisis, and indeed did this extensively during the 1930s depression in the towns, in the countryside and between them.<sup>169</sup> However, the unofficial economy was

<sup>169</sup> Saaritsa, Sakari 2001, Selviytyminen ja muistitieto. Riskeiltä suojaavan vaihtoverkoston malli ja kellokoskelaisten epäviralliset taloudelliset suoritteet 1900-1950, pro gradu -työ, Helsingin yliopisto, yhteiskuntahistorian laitos, talous- ja sosiaalhistoria, Huhtikuu; Parikka, Raimo 1994, 1930-luvun pula ja selviytyminen, in Työ ja työttömyys, Väki voimakas 7, Parikka, Raimo (ed.), Työväen historian ja perinteen tutkimuksen seura, Helsinki, 258-61; Häkkinen, Antti 1998,

also bound to the official economy, and the depression affected the way it worked, although the demand factors targeting it could increase during depression. The depression of the 1930s, which involved almost all sectors and regions of the country, did not necessarily provide earning and livelihood opportunities outside the official economy.<sup>170</sup>

From the point of view of the poor, loss of employment, sickness etc. could launch a marginalization leading to long-term poverty in spite of improving economic opportunities. Most of those who had been unemployed returned to the labour market, but the depression also increased marginalization. From the point of view of individuals' and families' material and mental resources, the increasing destitution was a combination of several different factors. In urban communities long absence from the labour market resulted in a loss of material resources that could not be offset by poor relief or wages from relief work. Marginalization also involved weakening work qualification and more difficulties in earning a sufficient amount of money, especially if there were other related problems: family break-up, alcoholism, prison sentences, mental problems, diseases and general ageing.<sup>171</sup> Some of these effects can clearly be linked to efforts to survive the depression by turning to the unofficial economy. The break-up of families was related to migration, when people moved away to beg, peddle, or seek jobs. Punishment for breaking the law, followed by illegal means of survival, made return to the labour market difficult.

In the countryside, the mechanisms of impoverishment and marginalization were largely similar to those in towns. The vicious circle of unemployment, disease, crime, family break-up and alcohol problems was a factor maintaining the continuity of poverty. However, problems related to health were clearly greater in the countryside. The lower consumption level during the depression resulted in problems of malnutrition, and the increased mass migration of the population appears to have had a clear connection with the spreading of certain epidemics in the countryside. Public health was a factor increasing the differences between regions and social classes, as the level of health in remote

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“Samhällets bottenkikt”: Om den helsingforsiska subkulturens historia, *Historisk Tidskrift för Finland*, vol. 83, 1998:2, 308-335.

<sup>170</sup> The poor relief records of Helsinki 1927-1935, The Archive of Poor Relief, The City Archives of Helsinki; The Diaries of poor relief in Alavus 1927-37, The City Archives of Alavus, The Diaries of poor relief in Iisalmi Municipality 1927-37, The City Archives of Iisalmi; ”Kauniit kesät vai puute ja kurjuus'- 1930-luvun pula-ajan muistot”, a collection of memories of the Great Depression, collected in 1999, Folklore Archives of the Finnish Literature Society.

<sup>171</sup> Parikka 1994, 272-273; Peltola, Jarmo and Raimo Parikka 1998.

regions and in the urban working population was significantly lower than in the urban upper classes.<sup>172</sup>

From the point of view of social activity, the pressures directed towards the working population as a consequence of the civil war of 1918 hindered the creation of large-scale organized political-structural activity. In the late 1920s there were widespread strikes and at the start of the 1930s committees of the unemployed organised themselves on a local basis and also attempted to create nationwide networks and forms of activity. Results were achieved at a local level, but there was strong counter-pressure from the right-wing movement and strict control by the police. The movement was relatively active through the whole of the depression, but it had no success in mobilizing large masses of unemployed persons. In spite of hundreds of meetings, numerous appeals and demands, and more or less visible demonstrations, the strength of the movement was not great. Although the economic situation then had similarities with the period before the civil war, the movement was faced with much stronger coercive power. The internal political disagreements between the social democrats and communists, even the forces of the right wing parties, which all participated in this movement, weakened the achievements of the movement, when the Social Democrats tried to create political pressure through legal means and the radical left of the party aimed to take extra-parliamentary forms of action, with the Patriotic Popular Movement (IKL) seeking its own goals.<sup>173</sup> The widespread depression of the 1930s was not directly linked to nationalist right-wing movements, but those movements had their foundations in the agrarian population, mainly among owners of medium-size farms, who were suspicious of the organized labour movement and concentrated first and foremost on the numerous local protests.

Among the working-class population, collective action remained relatively local and isolated. For them, the class struggle seemed useless, even dangerous. Instead of becoming organized, young unemployed men participated in the so-called 'vagrant movement', whose participants were numbered in thousands. They wandered the countryside in search of work and food. More than ten thousand people moved illegally to Russia. The dispersed nature of the movement reflected the heritage of 1918, as well as the actions taken to pressurise and disperse it. The failed rebellion did not encourage the

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<sup>172</sup> Peltola and Parikka 1998; Häkkinen, Antti 2000, *The Finnish Rural Community, Poverty and the Short-Term and Long-Term Effects of the Great Depression: Case Studies of Two Local Communities*. Paper presented at the European Social Science History Conference.

<sup>173</sup> The reports, announcements and collections of clippings by the security police, The meetings of the unemployed 1928-34 and Relief work places and relief work 1933-36, The archive of EK-Valpo I XIV B 2-B4, KA.

development of mass movements.<sup>174</sup> The minor participation of the masses of both the urban and the rural underclass in the movements of the unemployed and the agrarian protest is striking. The measures taken to alleviate the social consequences of the depression were the same ones that had been used in earlier agrarian society. Various forms of poor relief were applied to secure the livelihood of only those citizens who had the largest difficulties; families that had drifted into difficulties due to unemployment were mostly helped by being employed in relief work. The ideology underlying this policy had strong roots in the old agrarian society based on the system of legal protection, where crises, caused mainly by crop fluctuations, were common, albeit short-lived and limited in extent. Within the social-political ideology there was a strong faith in the capacity and willingness of local communities to look after the destitute through the barter economy or charity. However, social relations were no longer based on the old system; the commercialization of agriculture and market forces had crumbled its foundation.

The depth and duration of the depression were in a sense a surprise, and in 1932 at the latest it became obvious that large scale poverty and unemployment problems had to be addressed. Even with the liberation of the crofters in 1918 and the settlement activities of the landless, the land-ownership problem still remained and this was "... quite indisposed ...", and only "... in England and Ireland the situation was even worse ...", according to F.A. Kotkanpää in 1933.<sup>175</sup> However, the continuation of this settlement and small farming policy was seen as the only way to solve the problem of the lack of work in the countryside. The employment services had already been discussed before national independence, but had met harsh resistance from the urban municipalities. The reality of the unemployment of farm workers and small farmers was neither admitted nor understood even in the worst years of the depression. Even small-scale ownership of land could hinder admittance the card-index of the communal employment services and relief work.<sup>176</sup> The system of relief work became stabilized as a permanent arrangement, that was also in use in better times later on.

The nutritional state of the population was found to be poor among working-class families in both the cities and rural areas in a large research project carried out in 1936. These questions of the way of life of the extended family

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<sup>174</sup> Peltola, Jarmo and Lehtonen, Heikki 2001, *Teollisuuskaupungin sosiaalipoliittinen järjestelmä 1930-luvun laman aikana, 1930-luvun talouskriisi Suomessa*, SKS Helsinki 2001; Kalela 1994; Lackman, Matti, *Taistelu talonpojasta, Suomen Kommunistisen Puolueen suhde talonpoikaiskysymykseen ja talonpoikaisliikkeisiin 1918-1939*, Oulu 1985; Kostiainen Auvo, *Loikkaarit, Suuren lamakauden laitton siirtolaisuus Neuvostoliittoon*, Otava 1988.

<sup>175</sup> Kotkanpää, F.A. 1933, *Työttömyys ja köyhyys nykajan yhteiskunnassa: Mietteitä etenkin Henry Georgen esittämistä väitteistä*, *Kansantaloudellinen aikakauskirja* 1933, Helsinki, 95.

<sup>176</sup> Kalela 1989, 110-111, Haatanen 1968, 187.

aroused interest partly for population policy and partly for military policy reasons.<sup>177</sup> The costs of the depression raised the question of the need for a social insurance system, which until then had been rejected.<sup>178</sup> The low standard of wages of farm workers, lumberjacks and floating workers aroused attention and, although there was great reluctance to interfere with the free processes of the formation of terms of employment, between 1935 and 1938 employers were forced to raise salaries in numerous cases.<sup>179</sup> Finally, when comparing general employment policy and economic trends between countries, the existing policy was found so effective, that the role of central government became even more active later on.<sup>180</sup> These observations were a backdrop to changes in practical social policy and facilitated the implementation of major social-political reforms before and after the Second World War.<sup>181</sup>

## 12.4 Unemployment and poverty as problems of the countryside 1945 - 1970

As in all warfare countries the Second World War created many kinds of human difficulties and problems in Finland.<sup>182</sup> Almost without exception, in the reminiscences of the elderly the war is described an enormous individual and national tragedy and the first post-war period is characterized as a time of austerity and tight rationing of goods, as the years with money but nothing to spend it on. This special collective memory wells from the experience of immense common sacrifice, in which the needs of the individual were placed below national goals.<sup>183</sup>

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<sup>177</sup> Kansanravitsemuskomitean mietintö 1940, 73, 87, 187 and 280.

<sup>178</sup> Mannio, Niilo A. 1936, Sosiaalivakuutus huoltomuotona ja lähinnä silmälläpitäen vanhuus- ja työkyvyttömyysvakuutusta, Esitelmä Kansantaloudellisen Yhdistyksen kokouksessa joulukuun 13 p:nä 1935, Kansantaloudellinen aikakauskirja 1936, 1-19.

<sup>179</sup> Kalela 1989, 110.

<sup>180</sup> Montgomery, Arthur 1936, Työttömyyspolitiikka ja suhdannekehitys Suomessa ja Ruotsissa, Kansantaloudellinen aikakauskirja 1936, 20-35.

<sup>181</sup> Peltola and Parikka 1998.

<sup>182</sup> Ranta-Knuutila, Jaakko J. 1967, Sotavammaisten huolto Suomessa, WSOY, Helsinki, 16-30; Hietanen, Silvo 1982, Siirtoväen pika-asutuslaki 1940: Asutuspoliittinen tausta ja sisältä sekä toimeenpano, Historiallisia tutkimuksia 117, SHS, Helsinki, 105; Urponen, Kyösti 1994, 206. In the Second World War 86 000 Finnish men were killed and about 200 000 men were disabled. The number of war orphans was 50 000 and war widows 24 000. About 440 000 persons were evacuated from the areas behind the new border and resettled in 1940, and about 400 000 persons again after the war.

<sup>183</sup> See note 170.

Immediately after the war, Finland's GDP went down to its 1936 level. Post-war economic growth was fast but not uninterrupted, nor did welfare spread evenly in all trades and all quarters. During and after the war, a pay policy with similar increase in income was followed, which had positive effects on the real earnings of those with low incomes compared with the well-to-do, wage earners compared with officials and civil servants, and females compared with males.<sup>184</sup> Later on, income disparities grew between labourers and officials to the benefit of the latter, and between labourers and rural wage earners to the benefit of the former, although great differences existed amongst rural income earners, with small farmers and farm workers being in the weakest position.<sup>185</sup> The old dichotomy between the standard of living of industrialized Finland and the backwoods continued in the 1960s and 1970s. The levels of wages, health and health services, mortality, education, and housing fell below the national average in the countryside, and the differences were clear in comparison with industrial Finland.<sup>186</sup>

In this period agricultural production became more efficient, but progress had its reverse side. At first, during the period starting in the 1950s, the farms had to reduce their outside labour force. From the 1960s onwards the smallholder-dominated system could no longer meet the demands of the new production methods, and the number of farms also started to decline. The demand for farm labour diminished by two-thirds between 1950 and 1980, and during the second half of the period one-third of the farms ceased to exist.<sup>187</sup> As a mirror of development, the transition from an agricultural society to a modern service and industrial society took place during the late 1950s and early 1960s, when the employment-share curves of agriculture, industry, and services crossed each other. At that point the share of all the major trades together made up about one-third of the working population. The proportion of working-age people actively working continued to grow, with the growth being a large extent due to women's entry into the labour market (see figure 12.1).<sup>188</sup>

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<sup>184</sup> Pihkala, Erkki 1982, *Teollisuus Suomi 1945-1980*, in Ahvenainen, Jorma, Erkki Pihkala and Viljo Rasila (eds.) *Suomen taloushistoria 2: Teollistuva Suomi*, Tammi, Helsinki, 358.

<sup>185</sup> Urponen 1994, 223; Viita, Pentti 1967, *Maatalous*, in Viita, Pentti (ed.) *Suomi 1975*, 43-45.

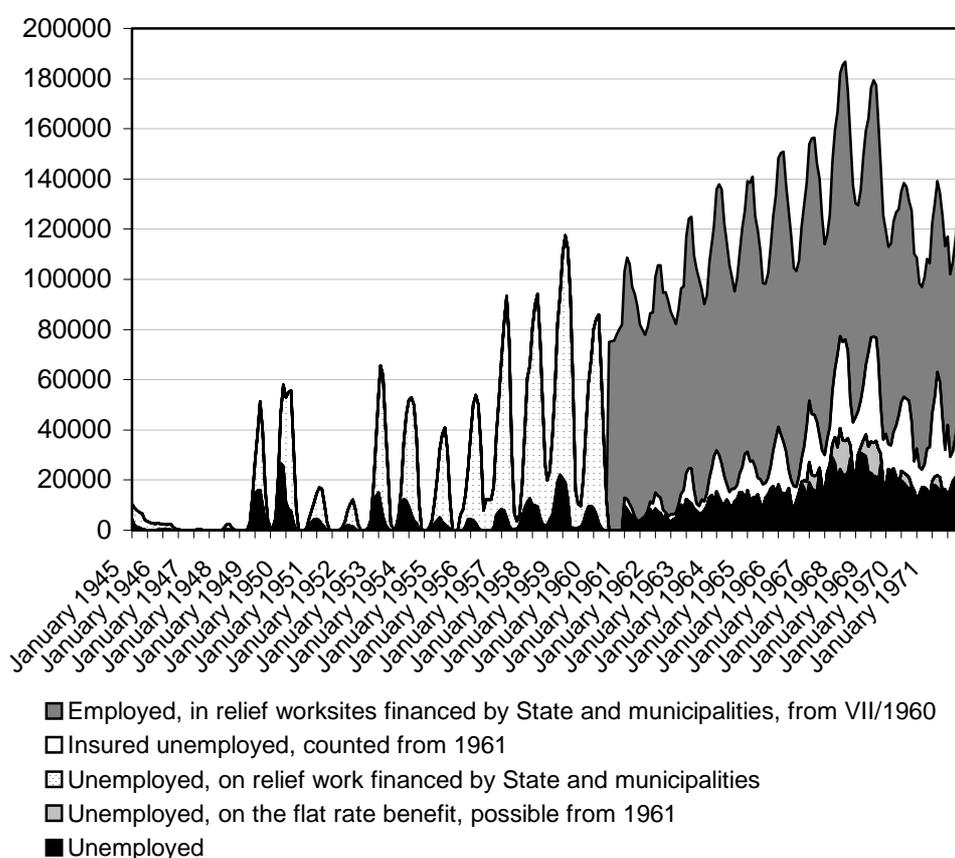
<sup>186</sup> Hjerpe 1989, Chart 5; *Tilastollisia tiedonantoja* 58, tables 3.6, 4.11, 5.4, 5.14, 6.4 and 8.10; Peltola, Jarmo 1994, *Metsätyömiehet ja hanslankarit, Kausityö ja -työttömyys II maailmansodan jälkeen*, in Parikka, Raimo (ed.) *Työväen historian ja perinteen tutkimuksen seura, Väki voimakas 7*, Helsinki.

<sup>187</sup> Granberg, Leo 1989, *Valtio maataloustulojen tasaajana ja takaajana, Bidrag till kännedom av Finlands natur och folk* 138, *Societas Scientiarum Fennica*, Helsinki, 50-51.

<sup>188</sup> Mjöset, Lars (ed.) 1986, *Norden dagen Derpå, De nordiske økonomisk-politiske modellene og deres problemer på 70- og 80-talet*, Oslo, 336-38; Alestalo, Matti 1985, *Yhteiskuntaluokat ja sosiaaliset kerrostumat toisen maailmansodan jälkeen*, in Valkonen et. al. 102-6; Ristimäki

The post-war resettlement reduced the average size of farms in Finland, but this does not explain why unemployment rose so high in the countryside in the late 1940s and the 1950s. Instead, it is likely that the one-sided nature of Finland's trade structure (the sensitivity of forestry to economic fluctuations) and the small average farm size together caused a situation where unemployment became common in the form of seasonal unemployment. On farms where agricultural and livestock work provided too little employment throughout the year, the men depended on forestry.<sup>189</sup>

Figure 12.3. *Average Number of Officially Unemployed and in Relief Work Employed Persons 1945 – 1971 (Monthly)*



Sources: Pulkkinen, tables 1 and 2; SVT, Tilastokatsaukset vuosilta 1957-1959; SVT, Tilastollisia tiedonantoja, n:o 61, Työvoimatiedustelun tuloksia vuosilta 1959-1975.

1955a, 8-9; Wiman, Ronald 1982, Maalta kaupunkiin, in Suomen taloushistoria 2, Teollistuva Suomi, Tammi, Helsinki, 494-495.

<sup>189</sup> Katajamäki, Hannu 1998, Alueellisen työnjaon muotoutuminen Suomessa, Turku, 35-8; Peltola 1994.

Unemployment stayed low for the first few years after the war.<sup>190</sup> Behind the phenomenon was the reconstruction work and rapid economic growth up to the end of the 1940s.<sup>191</sup> During the winter of 1948 - 1949 unemployment rose as a result of export difficulties in the forest industry. The quantitative impact of the phenomenon (1948 - 1959) can be compared with the depression years of the 1930s. As earlier, the unemployment periods were seasonal by nature (see figure 12.3) and took place mainly during the winter months, following tree-felling. Towards the summer, the unemployment figures dropped equally quickly and then the unemployment registers were closed, because there was hardly any official unemployment at all.<sup>192</sup>

Unemployment between 1949 and 1960 occurred mainly in the countryside, and regionally it accumulated in the areas of northern and eastern Finland. The situation was most difficult in the rural areas dominated by seasonal jobs, where forestry work could under no circumstances operate as a factor levelling out the seasonal fluctuations and where the demand for timber was restricted during economically bad years. Unskilled labourers, smallholders, and agricultural and forestry workers suffered most from unemployment. It hardly touched industrial workers, and even in the densely populated areas unemployment mostly involved construction workers. The relationship between the countryside and seasonal unemployment is also witnessed by the fact that when unemployment was high, it was concentrated on rural municipalities and that the level of unemployment did not fluctuate as much in densely populated areas as in the countryside.<sup>193</sup> The seasonal unemployment typical of the 1949 - 1960 period mostly involved men, not women, and this was mainly due to the fact that women worked mostly in the industrial and service trades.<sup>194</sup>

The major areas of change were agrarian eastern and northern Finland, regions that lost a major part of their population to the towns and to the Swedish labour market. While the problems of western Finland's independent population were partly solved by migration to America at the turn of the century, the agricultural workers left in the countryside immediately after the Second World War, the

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<sup>190</sup> Kalela 1989, 138-139; Pulkkinen, Terho, Työttömyyden levinneisyys, Sosiaalipoliittinen tutkimus työttömyyden levinneisyydestä Suomessa vuosina 1948-1953, Sosiaalipoliittisen yhdistyksen julkaisuja 3, WSOY 1956, 74-75.

<sup>191</sup> Hjerppe 1989, 49.

<sup>192</sup> Pulkkinen, 75-76; Kalela 1989, 161; Peltola 1994.

<sup>193</sup> Pulkkinen, 82-86; Kalela 1989, 169; Peltola 1994.

<sup>194</sup> Pulkkinen, 78-9, 86; Kalela 1989, 146-147. After the war there had been concerns about female unemployment, as the defenders of the country had the right to return to their former jobs. Since there was lack of labour soon after the war, however, there was no widespread female unemployment. The number of actively working women increased faster than that of men from 1940 to 1950.

maids and the farm hands, found themselves industrial jobs. The great migration of the 1960s and 1970s emptied Eastern and Northern Finland of the sons and daughters of small farmers. Population growth in these regions turned negative in the 1960s.<sup>195</sup>

At the end of the 1960s, Pekka Haatanen defined the portrait of a representative of this new rural poor:

*"... he is a smallholder in a remote region, most often the owner of a minuscule farm, who is constantly confronted by both open and hidden unemployment and the consequent lack of money due to the location of his farm. His prime years of manhood are past, and hitherto are his wages diminishing from one year to the next; nor has he the preconditions or willingness to increase the productivity of his farm through mechanisation or specialisation."*<sup>196</sup>

It should be kept in mind that various unemployment and relief work sites employed quite a large proportion of people who were registered as unemployed. Even the unemployed smallholders of the countryside 'applied' for compensation from the relief work sites for loss of income caused by the weak economic trends. Poverty had been defined, more distinctively than before, as a modern phenomenon dependent on earned income, where the importance of the natural economy had shrunk to a marginal level. When the research department of the Ministry of Social Affairs and Health analysed the characteristics of the fifth of the households with the lowest per-capita earned income, the following results were typical: they were smallholder families with a relatively high number of family members. The breadwinners of the families were of active working age, but the active working of the household was relatively limited, the environment was a rural district, and the share of those not working in a profession was relatively large. Correspondingly, if earned income was calculated household by household, poor families were typified by female breadwinners, not working in a profession, a high proportion of old-age benefits as the source of income, small size of the households and a relatively large share of smallholder households. Both methods of calculation associated poverty in smallholder families with either a father with a large family or a widow living alone. According to the research, the countryside in 1971 had hundreds of thousands of households where earnings barely sufficed to cover the basic necessities of life.<sup>197</sup>

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<sup>195</sup> Tilastollisia tiedonantoja N:58, Elinolosuhteet 1950-1975, Tilastokeskus, Helsinki 1977, tables 2.2, 2.6.-2.10.

<sup>196</sup> Haatanen 1968, 285; Peltola 1994.

<sup>197</sup> Halla, Klaus 1976, Pienituloiset kotitaloudet Suomessa vuonna 1971, Sosiaali- ja terveystieteiden tutkimuskeskus, Tutkimusosasto julkaisu 3/1976, 83-84.

With the problem of the rural proletariat becoming more and more acute every year, and with its first political manifestation, the Democratic League of the People of Finland, formed after the World War by communists and left-wing socialists, was successful in the 1958 parliamentary elections. Another manifestation in politics occurred during 1968 - 1975, when the small populist Finnish Rural Party succeeded in the parliamentary elections of 1970 and 1972 with the slogan "On behalf of the forgotten people of Finland".<sup>198</sup>

## 12.5 Beyond the Welfare State (1960 - 1991)

As to the question of poverty in the period between 1960 and 1991, a new feature consisted of measures aimed at preventing the problems and diminishing the risks. The most important of these measures were various social insurance systems to alleviate the impact of unemployment, illness, death, homelessness and other unpredictable risks. Support measures for large families and income transfer systems based on levelling out regional differences were being developed in order to deal with the structural factors of poverty. The ideals of the welfare state also included various reforms of the education system, health care, and childcare.<sup>199</sup>

The faces of poverty clearly changed compared with earlier periods. The systems of social policy (together with economic growth) succeeded in diminishing poverty. The calculated percentage of poor people decreased from 11.4 % to 2.5 % during the period 1966 - 1990.<sup>200</sup> Traditional forms of poverty, especially those linked with the life-curve risks of childhood, breadwinning and ageing almost disappeared. The decline in poverty was mostly based on the sharp decrease in certain special groups, such as large families, small farmers and elderly persons. A corresponding phenomenon cannot be found in single-person urban households, where the risks of poverty actually increased. These processes were linked with changes in the structures of population and industry, but over a period of twenty-five years the picture of poverty changed

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<sup>198</sup> Nenonen, Marko, Lapiolinjalla: Työttömyystyöt ja poliittinen järjestelmä Suomessa 1948-1971, in Parikka, Raimo (ed.) Työväen historian ja perinteen tutkimuksen seura, Väki voimakas 7, Helsinki 1994. The Democratic League won 50 seats of 200 in 1958, which was seven seats more than before. In 1970, Finnish Rural Party won 18 seats and 240 000 more votes than four years earlier. At the same time the Agrarian party lost 70 000 and the Democratic League 80 000 votes.

<sup>199</sup> Suominen, Risto and Matti Kallio 1975, Eräiden sosiaaliturvaetuksien kehitys Suomessa: Työttömyysturvan, huoltoavun, sotilasavustuksen ja opintotuen kehitys Suomessa: Hallinnollinen katsaus, etuuskien saantiperusteet, etuuskien saajien lukumäärät ja tuen suuruus, Sosiaali- ja terveysministeriön, sosiaalipoliittinen tutkimusosasto tutkimuksia 1/1975, Helsinki.

<sup>200</sup> Ritakallio, Veli-Matti, Köyhyyden muuttunut kuva Suomessa 1966-1990, in Heikkilä, Matti and Kari Vähätalo (eds.) Huono-osaisuus ja hyvinvointivaltion muutos, Tampere 1994, 176-177.

dramatically, social-political income transfers having a key role in the process.<sup>201</sup> The decline of traditional types of poverty emphasized the significance of unemployment as the main cause of poverty in the modern era, though it was a contributory factor in previous ones.

The social reforms did not take place simultaneously, nor were they realized without major contradictions. They were considered expensive and their moral effects were seen as undesirable. On the other hand, there were misgivings about the and possibilities of controlling them and the forms such control would take.<sup>202</sup> The social-insurance reform increased the share of social expenditure in the GNP. The share of social insurance grew rapidly from 8 % on 1950 to 25 % in 1988.<sup>203</sup> Postwar economic growth made it possible to realize the reforms, but without the strong contribution made by the Agrarian Party and the parties of the working class, the reforms would probably have been delayed significantly. There was also a strong urbanization process, which spelled structural changes in all trades.

The rapid economic growth of the early 1970s was halted by the first oil crisis. Unemployment increased and the situation became extremely difficult from 1975 to 1978, when the total number of jobs started to fall. At the same time migration within Finland dwindled and people were again forced to search for jobs in Sweden. The unemployment rate, which had stood at annual 2 % for the first half of the decade, rose to 7.3 % in 1978, after which it steadied to 6 % in the 1980s. Economic growth stagnated until 1979 - 1980, when there was an increase again. However the average growth of GNP was only 2.7 % between 1974 and 1985.<sup>204</sup>

While the problem of the 'surplus' population in the western parts of the country had been partially resolved by massive emigration to the United States at the beginning of the 20<sup>th</sup> century, in the 1960s and 1970s many grown-up sons and daughters from small farms in eastern Finland moved to Sweden. Between 1955 and 1977 about 350,000 people moved to Sweden.<sup>205</sup> However, unemployment diminished slowly. The same thing that had happened at the end of the unemployment period in the late 1960s happened again: the 'minimum' level of unemployment did not return to the previous level. Instead, it rose after

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<sup>201</sup> Ibid. 180-181.

<sup>202</sup> Urponen 1994, 228-246.

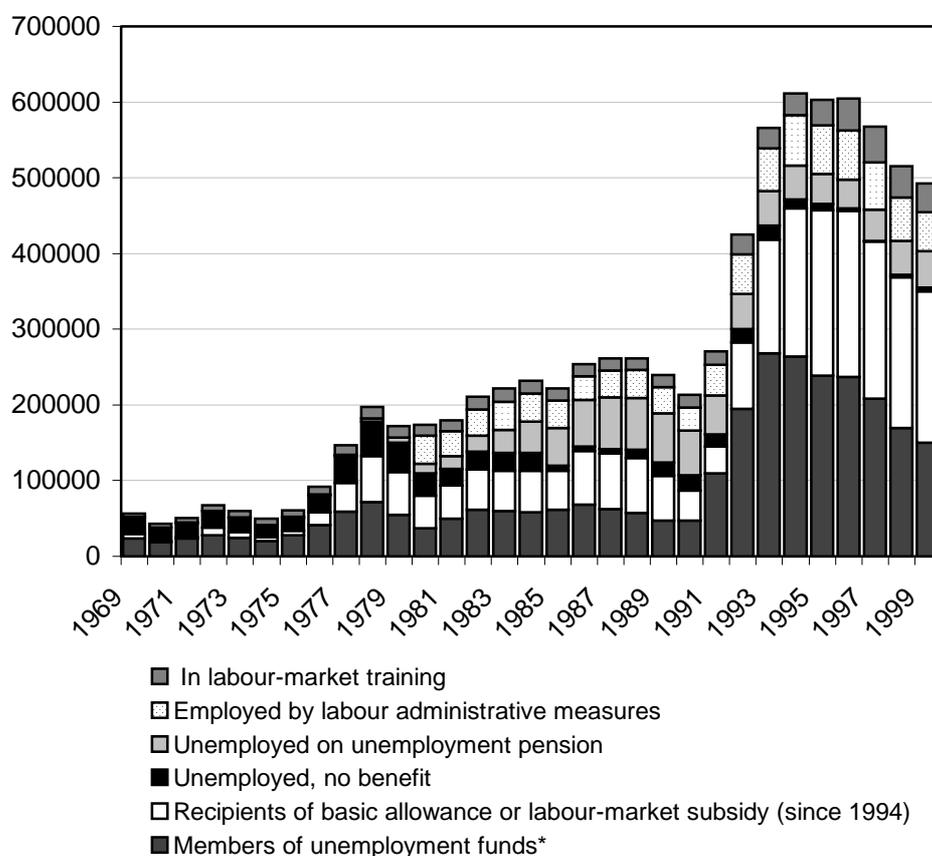
<sup>203</sup> Raunio, Kyösti 1983, Hyvinvointi ja taloudelliset muutokset. Tutkimus suomalaisen yhteiskunnan hyvinvoinnista ja taloudellisten muutosten hyvinvointivaikutuksista vuosina 1950-1977, Sosiaalipoliittisen yhdistyksen tutkimuksia 41, Turku, 226; STVK 1997, table 413.

<sup>204</sup> Kalela 1989, 198; Hjerppe 1989, 50.

<sup>205</sup> Suomen taloushistoria 3, table 1.19. Re-migration was common, too.

each unemployment peak. The official annual unemployment figures between 1980 and 1990 fluctuated around the 100,000 mark.

Figure 12.4. Average number of unemployed by benefits and labour administrative measures, 1969 - 1999



Sources: Statistical yearbook 1970-1994, unemployment figures based on Statistics Finland's employment surveys, which vary from Ministry of Labour statistics. Koskimäki Timo 1993, Työllisyys, työttömyys ja työn tekijät tilastoissa, in Tietoja työllisyydestä, työttömyydestä ja työvoimasta vuosilta 1960-1991, Labour Market 1993:7, Statistics Finland, Helsinki.

A new feature of unemployment was that significantly more people were confronted with it than could be deduced from the average figures. The increase of unemployment during the 1970s was, in fact, not only related to an increase

in the number of unemployed people; it also meant that the duration of unemployment lengthened.<sup>206</sup> The risk of becoming unemployed did not increase essentially in comparison with the early 1970s, but the chances of finding a new job quickly became significantly smaller. It is likely that competition for jobs increased. In the 1980s there were more employment positions than ever before, but the group seeking work grew even more, because an increasing number of women were looking for jobs. In a European context Finnish women have been working fulltime at an unusually high rate.<sup>207</sup>

Another new aspect in developments in the 1980s was that an increasing number of uneducated workers had to leave their jobs, most of them 'too old' to be re-educated – the younger ones became unemployed and the older workers, close to retirement age, received unemployment pension. In other words, Finland's workforce could no longer meet the qualitative demands of the labour market. Especially in the leather, shoe and metal industries, the demand for labour diminished in the 1970s.<sup>208</sup> Level of education became a new factor explaining unemployment in the long run. If poor education was further linked to problems in lifestyle or inability to adjust to regional labour markets constructed largely in adherence with conditions spelled out market forces, such individuals were confronted by the risk of long-term unemployment.<sup>209</sup>

Another significant feature expressing the selective nature of unemployment is the fact that the likelihood of unemployment is higher in more northern regions. The accumulation of lack of work related to both age and living area also reflected the labour-force policy. The most difficult unemployment regions were located in the country's eastern and northern parts in the 1970s and 1980s.<sup>210</sup> The changes in the geography of unemployment reflected the changes in the trade structure, but the unemployment rate remained high in the same regions where poverty had already been a major problem in the Great Famine Years.

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<sup>206</sup> According to Ministry of Labour statistics. Kalela 1989, 198-199.

<sup>207</sup> Kalela 1989, 199.

<sup>208</sup> Ristimäki 1981; Poikkeus, Leena, Työttömyys- ja varhaiseläkkeelle siirtyminen, Ikääntyvät työntekijät työmarkkinoiden ja työelämän muutoksissa ja heidän siirtymisensä työttömyys ja varhaiseläkkeelle 1980-luvun alkupuolella, Sosiaalipolitiikan pro gradu-tutkielma, Tampere 1989, 1-31.

<sup>209</sup> Peltola, Jarmo, Yhteiskunta liikahtaa?, Sosiaalinen liikkuvuus neljässä näytöksessä 1800-luvun lopulta 1990-luvulle, in Peltola, Jarmo and Pirjo Markkola (eds.) Kuokkavieraiden pidot, Historian marginaalista marginaalihistoriaan, Vastapaino 1996, 174-177.

<sup>210</sup> Ristimäki, Toini 1981, Työttömyyden rakenne, Kansantaloudellinen aikakauskirja 1/1981; Katajamäki, Hannu 1984, Työttömyyden kohonneen minimitasen alueittaiset piirteet Suomessa vuodesta 1974 vuoteen 1980. Työvoimaministeriön suunnitteluosaston työvoimapolitiittisia tutkimuksia n:ro 40/1984, 58, 89; Kalela 1989, 199; Peltola 1991, 146-155.

Attempts were made to employ people in regions of high unemployment with the help of the Rinne model.<sup>211</sup> Unemployment benefits and job-training programmes were other measures used to alleviate the problems throughout the 1970s and 1980s. This obligatory employment was organized both in the public and the private sectors. As in the 1950s, the public sector had to employ people who were left outside the open labour market. Roadwork had changed to office work. These long-term unemployed were also the poor of the welfare state.

In the new form of unemployment, poverty manifested itself as lack of work, and thus lack of money, which was indispensable in circumstances where even the remnants of the barter economy had disappeared. Poverty grew into a particularly severe problem. As unemployment dragged on, the birth of long-term unemployment was one reflection of structural changes that were taking place, partly unseen. The old, Fordian-type of production model focusing on mass production and mass consumption had been complemented in Finland – as elsewhere in Europe – by construction of the welfare state. The system was based on a high investment rate, relatively expensive consumption and high income tax. Public consumption was financed by abstaining from private consumption. The right to consume was also being distributed to the inactive population in the form of income transfers and services, whereby it became possible to speed up the pace of economic growth. In Finland this phase went on for a relatively long time, as the neo-mercantilist basic principle of state-controlled economic policy was thought to maintain the competitive capacity and efficiency of the economy. The government, political parties and unions were all tied to this incomes policy system. It was possible to pursue this policy right up to the end of the 1980s because Finland's economy was relatively closed.<sup>212</sup>

In connection with the structural changes, the 'time-bomb theory' emerged on the destructive influence of unemployment on the individual. As late as the mid-1970s there was discussion about how increasing unemployment would result in social crisis, disturbance of the social peace.<sup>213</sup> Underlying these fears were probably views about the long-term negative effects of unemployment and poverty linked to former social crises and disturbances of the social peace,

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<sup>211</sup> The late 1970s saw the establishment of the so-called Rinne model of obligatory employment, through which more than 20 000 long-term unemployed and youngsters were employed annually.

<sup>212</sup> Vähätalo, Kari 1998, *Työttömyys ja suomalainen yhteiskunta*, Gaudeamus, Helsinki, 11-12; Pohjola, Matti 1996, *Tehoton pääoma: uusi näkökulma taloutemme ongelmiin*, WSOY, Helsinki, 33-49.

<sup>213</sup> Katajamäki, Hannu 1985, *Työttömyys: katsaus teorioihin, tutkimustuloksiin ja ratkaisuvaihtoehtoihin*, Työvoimaministeriön suunnitteluosaston työvoimapolitiittisia selvityksiä 64/1985, 114-115; Helne 1994, 42.

perhaps even the memories of 1918. An expression of political instability was the great success won by the right-wing populist Finland's Agrarian Party (SMP) in the general election of 1970. Fuelling this movement was the massive unemployment problem, which the party promised to resolve in three months.<sup>214</sup>

It is likely that during the construction of the welfare state, unemployment changed from being a political problem in to a labour-market issue.<sup>215</sup> This must certainly have been the case in the experience of the unemployed at least to some degree. The 'political' of the officials was probably based on the lower labour-market position of those who became unemployed, because only workers could become unemployed. Workers, on the other hand, were identified with left-wing parties, so the officials considered the comments of workers and the unemployed calling for alleviation of unemployment to be 'political' comments. The situation was difficult in the sense that the unemployment was real enough, but measures were also often introduced from a political viewpoint. The same process had been seen in the 1930s in the activities of the committees of the unemployed.

The working population as a whole, not just its most militant section, seldom considered unemployment to be their own fault. Unemployment was experienced as a malfunction of capitalist society. The most radical individuals also thought that such malfunctions could be directed politically when necessary. This was actually the case in the 1930s as regards the Lapua movement, the employers' black lists and the Secret Police (Valpo). Black lists were still used in certain fields of industry as late as the 1950s and early 1960s.

Although no feeling of shame was involved in unemployment as such, it was strongly present in the control of unemployment. Going to work at relief worksites in the 1930s and 1950s had been somewhat shameful. The men picked up the spades only when there was no other choice: even a skilled worker who had been unemployed for a long time had to register himself as unemployed, having glimpsed his family sitting around the dinner table in the family's single room.<sup>216</sup>

Against this background, the welfare state was experienced as a shelter constructed through political struggle against malfunctions of the capitalist market and possible political pressure. There was no reason to feel ashamed while receiving unemployment benefits, especially benefit tied to former income. It was an advantage reached through collective efforts to protect one's interests:

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<sup>214</sup> Alestalo 1985, table 3.24; Haataja, Lauri 1992, Kekkosen aika, in *Itsenäisen Suomen historia* 4, Suomi 75-vuotta, W&G, Helsinki, 75-77.

<sup>215</sup> Kalela 1989.

<sup>216</sup> Peltola 2000; Häkkinen 2000.

a remedy for malfunctions in the system. By the 1980s, unemployment had gradually lost some of its political nature and become a labour-market issue. As urban poverty in particular had detached itself from its old class foundation, the opportunities for common political-structural action were weak. As the postwar political system leaned strongly on extremely powerful party and union machinery, an organized movement bypassing them was not created. Strikes were restricted to pay policy conflicts. The parties enjoyed the strong support of the people, and therefore there was little willingness to change the directions of social policy either.

## **12.6 The 1990s depression: A crisis of the welfare state, money market, or paid labour?**

During the construction of the welfare state, poverty diminished in Finland up to the late 1980s.<sup>217</sup> In addition to increasing unemployment the depression of the 1990s spelled a closer connection between unemployment and poverty. The longer the depression lasted for an unemployed individual, the more certain it was that the individual became poor. He/she also became more vulnerable to disease and it was more likely that his/her attitude towards society became less acceptable. The next step in a process like this is social exclusion.<sup>218</sup> The political activity of the unemployed disappeared from the public eye when the media was no longer interested in unemployment and the depression was over for the national economy.<sup>219</sup> It would also appear that politicians were not very concerned about the situation, as the lower classes created through impoverishment were not united and did not make up a significant political power. As the social order was not threatened, we are dealing with a moral question.

The development that has taken place can be considered a result of conscious value choices. At the same time, however, there was no discussion about restoring the welfare state's resources to the pre-depression level; instead, the attitudes imply a transition to a new kind of social thought. Throughout the depression, the most important consideration had been the abstract economy with its abstract variables, not the economy of private citizens.

The economic situation worsened during 1990. The depression contained both international and domestic, endogenous factors. The collapse of trade with the

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<sup>217</sup> Ritakallio 1994, 176-177; Kortteinen, Matti and Hannu Tuomikoski, *Työtön, Tutkimus pitkäaikaistyöttömien selviytymisestä*, Hanki ja jää, 1998, 171.

<sup>218</sup> Kortteinen and Tuomikoski 1998, 171-182.

<sup>219</sup> Cf. the three phases of the depression: Lehtonen, Heikki, *Talouden työmarkkinoiden ja sosiaalipolitiikan lamat*, in Kiander, Jaakko (ed.) *1990-luvun talouskriisi*, Suomen akatemian tutkimusohjelma: Laman pitkä varjo seminaari 13.4.2000, VATT-publications 27:4, 15-26.

Soviet Union was considered the greatest danger in some circles, but ultimately it appears only to have hastened the fall and made the pit deeper. The primary causes of the depression were probably domestic and particularly the fact that the money market was less controlled caused businesses and households to get more indebted than was acceptable. When households and businesses noticed that they had lived beyond their means at the peak of the economic boom, they started saving. When demand dropped, prices began to drop as well; the consequence was that the balances and results that had grown rapidly in the late 1980s now stood on feet of clay, which crumbled in the new situation. This, in turn, created a vicious circle leading to bankruptcies and severe loss of jobs in the private sector.<sup>220</sup>

When the future of the banks was at stake, the government decided in the spring of 1992 to support them. This led to financial problems for the Ministry of Finance, and the government had to take foreign loans. A savings campaign was begun to help finance the banks and to maintain the policy of the strong Finnish mark. In the first phase of the campaign efforts were made not to increase expenditure in the public sector. The economic difficulties of the country were increased by the strong mark policy, which caused difficulties in the national economy that was dependent on foreign trade: the balance of current transactions turned negative. Export companies in the forest and metal industry, both dependent on foreign trade, pressured the government to change the policy it had pursued and to devalue the Finnish mark. Toward the end of 1992 there were signs indicating that the wheels of the export industry were turning again and, as a result, the balance of current transactions turned positive towards the end of 1993.

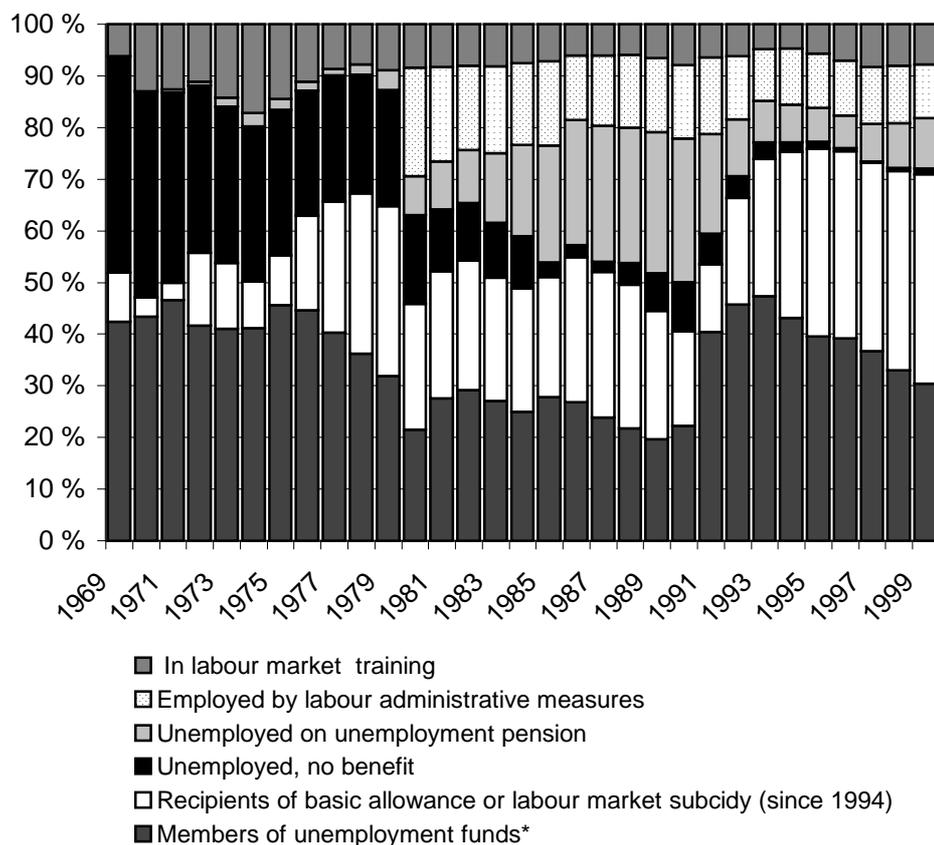
Initially the government's 'artificial respiration' for the economy only helped the banks and major industry and, in consequence, the domestic market still suffered from depression at the turn of 1993/1994. There was discussion about public sector shutdown in a country with more than half a million unemployed citizens. A total of 650 000 people suffered from actual lack of work. In terms of unemployment figures the peak of the depression was reached in 1994, after which unemployment started slowly to decline. During the unemployment peak, on average more than every fifth member of the labour force was unemployed at the same time. In the late 1990s, the national economy found its balance and debts were being amortized. The improvement of the economic outlook for the national economy did not mean rapid improvement in employment and disappearance of unemployment. On the contrary, unemployment changed into a relatively permanent phenomenon (figure 12.5), which also spelled an increase in expenditures caused by social policy measures. The amount of social aid granted due to unemployment did not start to fall until 1996 - 1997,

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<sup>220</sup> Pekkarinen and Vartiainen 1993, 422-424.

but the absolute amount of social expenditure continued to rise in the late 1990s, although the relative share of social expenditure in the GNP had begun to diminish earlier.<sup>221</sup>

Figure 12.5. *Unemployment benefits and employed by labour administrative measures, 1969 – 1999, %*



Sources: Ministry of Labour: Employment Service Statistics; Social Insurance Institution, \* From 1991 excluding joint redundancy notices.

At the same time as unemployment increased there were neither the resources nor the will to organize support measures. When unemployment began to rise in the last quarter of 1990, the labour administration hardly responded at all. As the figure indicates, the share of untreated, or open unemployment grew in comparison with unemployment that was alleviated through support measures. The depression was being managed with neo-liberal economic policy actions, which neglected to give much thought to poorly educated citizens past 40 years of age living in regions with a stagnant economy.

<sup>221</sup> Lehtonen 2000; STV 2000, tables 432 and 442.

The people with average income who had managed to keep their jobs somehow made ends meet, but those people who had already been on the fringes of the labour market before the depression, fell into a pit where hardly any light could be seen even a decade after the depression. Particularly at the beginning of the depression the idea of entrepreneurship was being marketed: those who had lost their jobs could establish their own business and be self-employed. As domestic demand had collapsed, such recovery measures largely lost their meaning.

What was the situation of the unemployed during the depression? In 1990 unemployment directly involved 14 % of the labour force.<sup>222</sup> In the worst unemployment year, 1994, the share was no less than 33 %. In 1998, the share had dropped to 27 %, i.e. the level of the early depression period. At the same time, the duration of unemployment changed significantly. In 1990 almost 60 % of the unemployed visited the unemployment office. When unemployment increased in 1991, the stream of the unemployed through the register accelerated as a relative measurement to begin with, but the absolute number of long-term unemployed also began to grow. But the longer the depression dragged on, the more long-term the unemployment became. Even though the unemployment situation had improved on the national level, the problems of long-term unemployment had significantly increased in comparison with the pre-depression level. In 1998 more than 62 % of the unemployed could be considered long-term unemployed.<sup>223</sup> This was not a question only of a process lasting as long as the 1990s depression. The accumulative and long-term nature of the phenomenon is revealed by the fact that particularly people who had been unemployed before the depression lost their jobs again.<sup>224</sup> The growth of the unemployment problem did not show only in the figures measuring open unemployment –unemployment also increased.<sup>225</sup>

Mass unemployment together with the ageing of the population created a situation where a minor part of the population earned a living from the labour market. Without the existence of social policy systems the depression of the 1990s could have meant severe mass poverty. In this regard the activities of the welfare state succeeded relatively well in Finland. Young adults remained

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<sup>222</sup> The added share of unemployed, participants in labour policy measures and persons receiving unemployment pension during the year.

<sup>223</sup> Lehtonen, Heikki et. al. 2001; Kiiski, Salme, Työn puute koskettaa yli miljoonaa ihmistä, hyvinvointikatsaus 3/1992 (Kiiski 1992a); Salme Kiiski, Työttömyyden profiili ei ole muuttunut, Hyvinvointikatsaus 3/92, (Kiiski 1992b).

<sup>224</sup> Kortteinen and Tuomikoski, 1998, 173.

<sup>225</sup> Kiiski 1992a; Kiiski 1992b.

outside the labour market because of unemployment or studying more than before and formed a major group in the new type of poverty.<sup>226</sup>

Long-term unemployment also meant poverty, since it removed on from the system of income-bound unemployment benefits. The depression meant an increasing number of poor people. It is likely that the lengthening of unemployment in a situation where the depression still continues although the economy of the country has grown very rapidly is apt to cause more difficulties to that part of the population still suffering from the problems caused by the depression. At this point poverty is no longer a passing phenomenon: instead, it threatens to become a permanent condition for many people.<sup>227</sup>

When entrance to the labour market requires better and better education, it is evident that those people with no education or relatively poor education who have been absent from the labour market for a decade will have a hard time finding a job. The situation is a difficult one also for those with a good education, as there is a significant excess supply of labour in many trades and the jobs offered are often short-term ones. Furthermore, the 1990s increased regional differentiation, where the country's only new jobs were created in growth centres with previously high unemployment rates. Living in the growth centres is much more expensive than living in the countryside or in smaller towns. For these reasons, finding a permanent job matching an individual's personal education has been difficult and will continue to be difficult in the future. The new social underclass can often be found among poorly educated, young single persons living in peripheral districts, who suffer from long-lasting unemployment and the social consequences related to it, isolated from the benefits of the welfare state and excluded from new prospects.

## 12.7 Conclusions

Changes in the standard of living have altered the manifestation of poverty. During the famine years, poverty manifested itself as mass hunger, disease and death. The poor died directly of hunger or from diseases that spread during the catastrophe. Exceptionally unfavourable weather conditions were the cause of the crisis, but the catastrophe could not have occurred without the masses of the poor, which under that particular mode of social organization, a class society, could simply be left without care and help. The society that was based on legal protection proved itself incapable and unwilling to care for its members, both on the local and national level. The existence of a large social underclass

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<sup>226</sup> Ritakallio, Veli-Matti 2000, Tuloerot ja köyhyys kansainvälisessä vertailussa 1980-1995, in Heikkilä, Matti and Jouko Karjalainen (eds.) *Köyhyys ja hyvinvointivaltion murros*, Gaudeamus, Helsinki 38-9.

<sup>227</sup> See also Lehtonen et. al. 2001 in this book; Kortteinen and Tuomikoski 1998, 166-182.

was determined by its permanent position in the judicial-natural based system of an agrarian society. Massive emigration diminished the size of the rural landless population and as a social action it started to break down the system of legal protection.

In the late 19<sup>th</sup> and early 20<sup>th</sup> century the faces of poverty were fairly similar to the preceding period. However, the risk of starvation had diminished. Wage work relations started to replace judicial-natural relations as the basis for human life and work, and unemployment became more often the source of poverty, and the criterion for becoming part of the underclass. In the urbanization process a new type of underclass was created in the cities. This process made poverty a social phenomenon in a new way and the issues of poverty and unemployment became objects of political mobilization and part of the nation-building process. The social underclass could take part in the working class movement and with a novel enthusiasm organized itself into a new type of political-structural movement, which in Finland escalated into an unsuccessful revolution. The revolt turned the poor into a dangerous class to the governing class and 'entitled' them to use a strong humiliating social policy and to divide the poor into 'good' and 'bad'. The legislative changes made in the first decade of independence remained ineffective and the social problems of the landless remained.

In the 1930s, poverty manifested itself as malnutrition, slower physical development in children, soup and bread queues, and increased susceptibility to pulmonary tuberculosis etc. The depression itself created massive, long-lasting problems of unemployment and livelihood. Once again the underclass were the ones who suffered most from the depression under strong pressure from and control by the governing class. In this period large-scale unemployment was recognized as one of the main causes of poverty and one of the most difficult problems of society as a whole, including the rural areas, where the old considerations of poverty had to be changed. In spite of their active attempts the failing radical working class movement failed to mobilize political resistance. Trust for the movement was lacking, its potential in the prevailing circumstances was minimal and individual modes of survival were in use. However, the bad position of the poor gained attention from the forces of social reform and initiatives were made to create and develop reforms. The positive economic growth at the end of the 1930s diminished the size of the underclass in urban areas.

After the Second World War a special type of social underclass was visible: a rural social group of small farmers, that was connected to the forest industry. This labour was occasionally used when the forest industry required it. In the meantime, this underclass could somehow manage by small farming and migrant work, in many cases with the help of permanent relief works. This cyclical system of small farming lumberjacking delayed technological

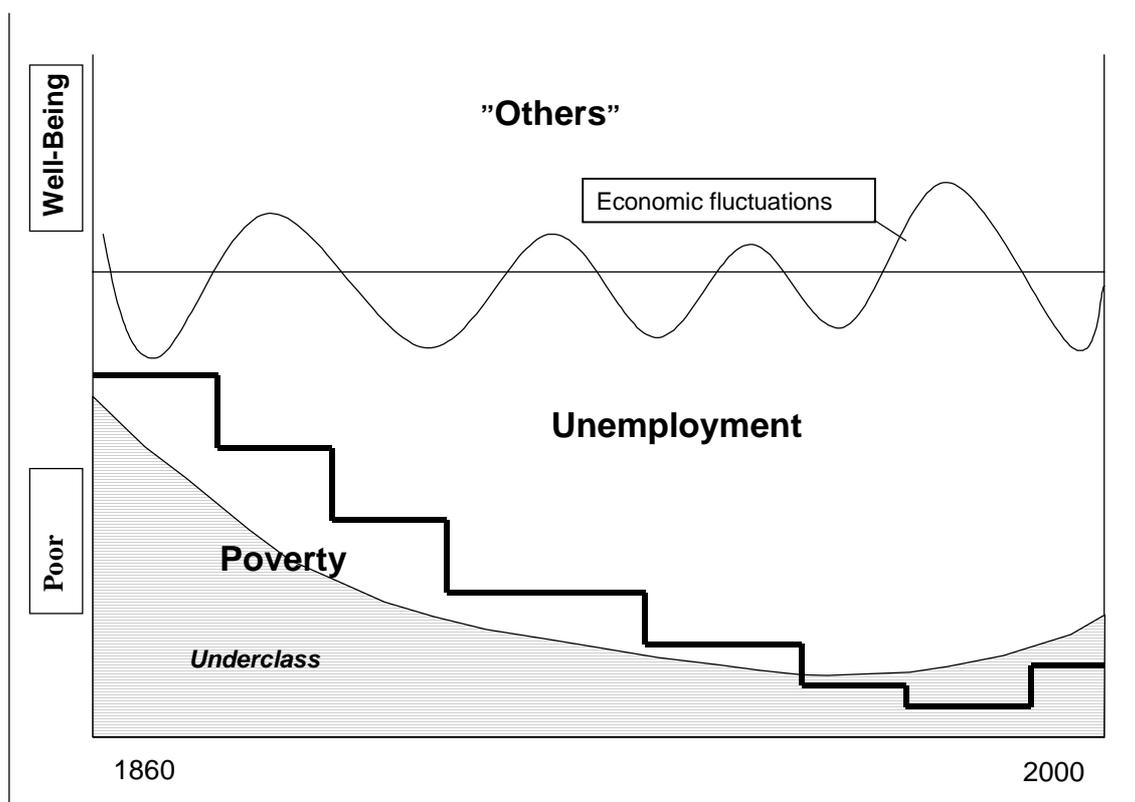
improvement in the Finnish forest industry and when the system was gradually demolished in the 1950s and 1960s, this population was forced to emigrate to Sweden or to southern Finland, where they were employed as unskilled labour in factories or in the service sector. The others, remaining in their home localities, suffered from permanent unemployment and chronic poverty.

In the period of construction of the welfare state, poverty first and foremost meant low income and unemployment. In this process special attention was given to preventing impoverishment and marginalization and to minimizing the negative consequences of poverty. This project succeeded in reducing the amount of the traditional types of poverty and the size of the underclass. It also succeeded in minimizing the risks of exclusion and in adjusting the standard of living of the poor. The most positive result, however, was the positive achievements made by placing those in danger of exclusion into society as independent citizens. For the first time the poor were seen as a potential resource of society, no longer as a burden or danger to common progress. This view arose from a strong political force in the left-wing and agrarian parties and the change was possible only through the active participation of the poor themselves. The ideology of a welfare state led to relatively stable but slow economic growth and political consensus.

In the period of depression of the 1990s mass unemployment was born. Without the existence of a social policy system the depression of the 1990s could have meant severe mass poverty. In this regard the activities of the welfare state succeeded relatively well in Finland. In spite of rapid economic growth after the depression large-scale unemployment remains and has created a new type of poverty, an underclass with long-lasting lack of work, a process of exclusion and several other related problems.

In the long run poverty changed into unemployment. The process was affected by changes in the areas of economy, policy and culture, which were reflected in the structures and practices of social policy. Economic fluctuations had their own impact on the situation. The phenomenon of a social underclass is mainly linked to the traditional type of poverty at the beginning of the and later on to unemployment.

Figure 12.7. Thematic model of unemployment, poverty and 'underclass'



It is notable, that the depression in the 1990s seems to have broken down the long-term trend of progress, in which poverty was seen more and more as a negative factor on both the individual and community level, in which opportunities for social mobilization were arranged and support systems had been created against marginalization, and in which a greater part of the population of working age had been connected to members of society with regular and sufficient means of living. In other words, the phenomenon of a social underclass had been recognized as a major social problem and more and more active preventive means had been adopted. These social policy aims were employed until the recession of the 1990s. The social policy adopted in the recession and afterwards seems to accept the existence of large-scale poverty and unemployment, even the return of the social underclass.

## 13 Economic Crisis of the 1990s: What happened to regional convergence and inequality, and housing market phenomena in boom and bust?

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### Abstract

Our analysis covers regional convergence and inequality, and housing market developments in Finland. Our first project studies convergence and divergence of per capita GDP among the 85 Finnish sub-regions during 1988 - 1997. It also decomposes the change in regional per capita GDP into the components of productivity, jobs and population and considers the role of changing regional production structure as a determinant of regional disparities. Our second project uses micro data (Household Budget Survey data 1971 - 1990 and Income Distribution Statistics 1990 - 1998) to study both regional convergence and inequality dividing Finland to four major regions and applying three income concepts: factor, gross and disposable income. We also study how changes in demography, sources of income including taxation and transfers have affected inequality at national and regional level. Our third project considers housing markets developments. We describe what happened to housing consumption, construction, housing prices and rents since 1980s. Then, we summarise results of an econometric regional housing market model based on panel data of 85 sub-regions from the years 1981 - 1997. Here, the main interest is in the relationship between housing consumption (housing demand), housing construction (flow supply), housing prices and various national and local economic and demographic factors during the boom of 1980s and the depression in early 1990s.

## 13.1 Introduction

The purpose of this paper is to summarize the results of our project “*Economic crisis of the 1990s, regional development and the welfare state*”<sup>228</sup> which is one of the studies financed by the Academy of Finland under the research program “*The Economic Crisis of the 1990s*”. We consider some trends of regional development over a longer period of time, and then take a closer look of what happened during the boom of late 1980s, the bust of early 1990s, and the years of fast growth since 1994. In this connection, we take the macroeconomic developments and related policies as given (see Chapter 3 of this book, Kiander and Vartia 1998, Koskela and Honkapohja 1999) and concentrate on regional aspects. The topics of our analysis cover regional convergence and inequality, and housing market developments in different areas of Finland.

During recent years there has been great interest in income differences between nations and regions. In this literature, one most often studies whether there has been convergence in GDP per capita across nations or regions over time. One of our projects studies whether Finnish regions have converged over a longer period of time, and especially what happened during the economic crisis of early 1990s. The latter is related to the regional effects of short-run fluctuations in the aggregate economy, a topic which has been addressed much less than convergence in the long run. In addition to documentation of regional developments we also provide an analysis of the determinants of changes that occurred during and around the recession of early 1990 by studying the pattern of convergence and divergence of per capita GDP among the 85 Finnish sub-regions during 1988 - 1997. For this purpose the change in regional per capita GDP is disaggregated into the components of productivity, jobs and population. Also, the role of changing regional production structure as a determinant of regional disparities, is considered.

In economics’ literature analyses of convergence and inequality are mainly separate topics. The former typically use national or regional macro aggregates (per capita GDP or the like) whereas the latter are based on utilization of micro data (household income, consumption or the like). These topics are related in studies, which explain economic growth, among other things, by measures of income inequality. In our second project we utilize micro data to study both regional convergence and inequality. We use Household Survey data to give a long run view of income differences between and within regions in Finland during 1971 - 1990. Here, we present results based on four major regions and apply three income concepts: factor income, gross income and disposable income. Annual income distribution statistics data is used to get a more detailed picture of the years 1990 - 1998. With these data we consider how per capita

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<sup>228</sup> Heikki A. Loikkanen has been in charge of this research consortium consisting of the three projects, which are summarized in this paper.

incomes have evolved regionally relative to the respective national averages during the economic crisis years of early 1990s and the subsequent growth phase. Then, regional Gini-coefficients etc. are used to study income inequality within regions. To find out what factors have affected changes in inequality, we decompose aggregate national and regional changes into components in order to find out the role of changes in demography and different forms of market income, and the mechanisms of the welfare state (taxation and transfers).

Our third project considers housing markets developments in boom and bust both from a national and regional perspective. There are good reasons for this topic. Housing markets were dramatically influenced by the overheating period in late 1980s and the depression of early 1990s. The sky rocketing rise of housing prices in 1987 - 1989 and their dramatic collapse in 1989 - 1993 belong to the best-known events of the whole period. As a matter of fact, the housing sector was an essential part of both the overheating and the depression. This becomes clear when we describe what happened to housing consumption, construction, housing prices and rents, vacancy rates, and how liberalization of financial markets, tax reforms and changes in international economy were involved in the dramatic changes shaking the Finnish economy. This descriptive part is followed by a summary on estimation results of an econometric regional housing market model. The analysis is based on panel data of 85 sub-regions from the years 1981 - 1997. Here, the main interest is in the relationship between the quantity of housing consumption (housing demand), housing construction (flow supply), housing prices and various national and local economic and demographic factors. The aim is to explain the dramatic developments of housing prices and housing construction - as well as the less dramatic development of housing consumption - during the boom of 1980s and the depression in early 1990s.

Our paper is organized as follows. Section 13.2 considers regional economic disparities from an aggregate and sectoral point of view. Section 13.3 utilizes micro data to study both regional income differences (convergence) and inequality. Regional housing market analysis in boom and bust follows in section 13.4. A short summary of regional developments (section 13.5) concludes the paper.

## 13.2 Regional economic disparities during an economic crisis: a sectoral analysis<sup>229</sup>

### 13.2.1 Introduction

The long-run evolution of regional production structures and economic disparities have always been a central focus of study in regional economics. The question of the regional effects of short-run fluctuations in the aggregate economy has been addressed to much lesser extent, however. Yet economic fluctuations are likely to affect regions differently, because regional production structures differ from each other (Temple, 1994). For this reason, the business cycle should also have an impact on regional disparities. Indeed, previous empirical studies indicate that there is a tendency for regional disparities to grow during recessions, and diminish when the economy is expanding (Evans and McCormic, 1994; Hess and Shin, 1997)<sup>230</sup>. Moreover, regional labour market disparities show exactly the same tendency as production in the goods market (Audas and Mackay, 1997).

Finland experienced a rapid economic upswing and an overheating period in the late 1980s that abruptly turned into an economic crisis at the beginning of the 1990s. The recession in Finland was the deepest in Europe, and it treated regions very differently: some regions were in recession only for 4 years whereas others felt its effects for up to 8 or 9 years (Kuntaliitto, 1999). Moreover, the slump radically changed the relative positions of subregions in the GDP per capita ranking, indicating noticeable repercussions on regional structure.

The economic crisis marked the end of a long period of regional economic convergence in Finland. Previous studies show that regional per capita incomes and GDP had been converging since the 1930s, and that convergence was particularly rapid in the 1960s and 1970s (Kangasharju, 1999; Loikkanen et al., 1998). The rate at which per capita disparities were narrowing had already begun to fall in the 1980s, and by the early 1990s, when the downturn began, no trace of a convergence process remained. In fact, Pekkala (2000) shows that regional convergence occurred before the slump, but that divergence dominated in the downturn and early recovery.

Despite a wide documentation of convergence and divergence, there are surprisingly few attempts in the literature to provide a detailed analysis of the

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<sup>229</sup> This is based on Kangasharju and Pekkala (2001).

<sup>230</sup> When differences are measured using incomes subject to public transfers, the result tends to be the opposite, however (Loikkanen et al. 1998 and section 13.3 of this article).

determinants of divergence that tends to occur during economic downturns. This is exactly what we are aiming at in the present paper.

We analyse the observed pattern of convergence and divergence of per capita GDP among the 85 Finnish subregions that are close approximations to commuting areas. The period of investigation 1988 - 1997 includes exceptionally large aggregate fluctuations. We aim at providing a coherent picture of the mechanism behind evolving regional differences.

Apart from regional difference in sectoral compositions, the literature suggests that labour productivity has crucial role to play, as the periods of slumps contribute to improvement in labour productivity (Aghion and Howit, 1998). Another obvious candidate for regional effect is the regionally differing number of bankruptcies and job reallocation (Davis and Haltiwanger, 1992). Finally, it is widely documented that inter-regional migration tends to fluctuate together with economic activity (Dewhurst, 1998). Since migration has strongly affected the regional numbers of population in Finland, migration has immense effects on the patterns of convergence and divergence.

On the basis of discussion above, we start by disaggregating the change in regional per capita GDP into the components of productivity, jobs and population. Secondly, we analyse the changing regional production structure and evaluate the extent to which differences in industrial composition affect the evolution of regional disparities.

### 13.2.2 Data and Method

The regional level of analysis is the NUTS4 of the European Union. In Finland this classification comprises 85 subregional units, the borders of which follow those of commuting districts. The source of the data is Statistics Finland Regional Accounts and Employment Statistics. GDP is expressed in constant prices deflated by sectoral indices.

As opposed to most previous studies, we do not merely analyse per capita GDP, but decompose it into GDP per employee (labour productivity), jobs and population as follows:<sup>231</sup>

$$(1) \quad \text{GDP}_i/N_i = \text{GDP}_i/E_i \times E_i \times 1/N_i,$$

where  $N$  is the population;  $E$  is the number of persons employed in region  $i$ , irrespective of the place of residence, i.e. the number of jobs in region  $i$ . This

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<sup>231</sup> We did not follow the total-factor-productivity approach either, due to the lack of data on regional capital stocks.

can further be manipulated into the following "change"-decomposition where time change refers to a log difference between two points in time:

$$(2) \quad \left( \frac{\dot{GDP}_i}{N_i} \right) = \left( \frac{\dot{GDP}_i}{E_i} \right) + \left( \frac{\dot{E}_i}{N_i} \right) = \left( \frac{\dot{GDP}_i}{E_i} \right) + \dot{E}_i - \dot{N}_i = \dot{GDP}_i - \dot{N}_i$$

Using this expression, we can analyse the change in per capita GDP in terms of various decompositions. We prefer here the decomposition where time change in per capita GDP consists of labour productivity (GDP/E), jobs (E) and population (N). We also use briefly other decompositions, such as labour productivity and employment component (E/N).

### 13.2.3 The Finnish regional economy and the economic crisis

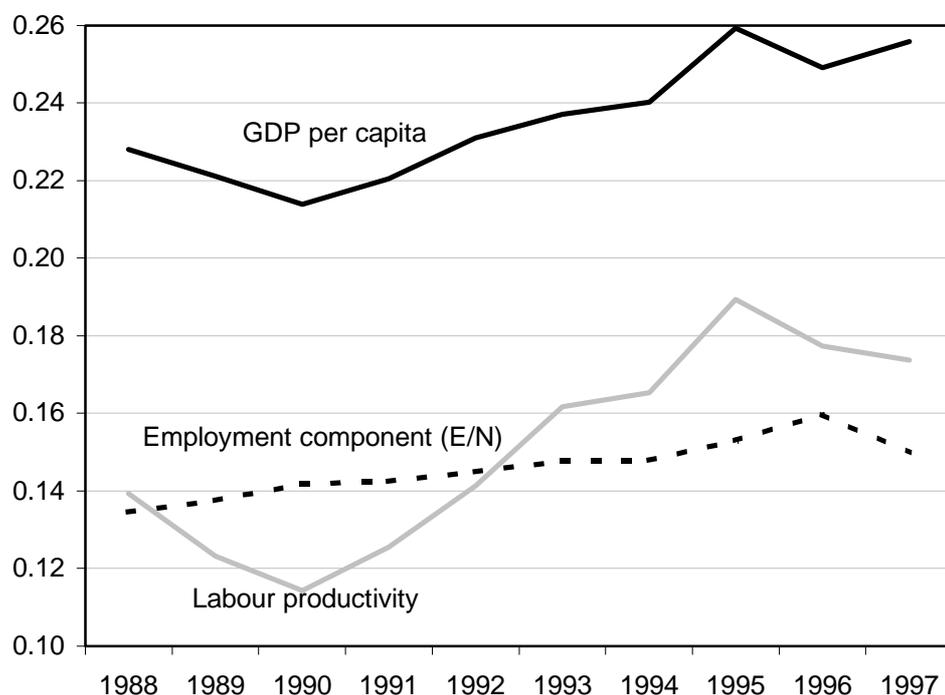
#### The evolution of regional disparities

When using relative measures, the coefficient of variation confirms that per capita GDP exhibited a degree of convergence in the pre-recession period, whereas divergence dominated during the slump years and early recovery (Figure 13.1). After 1995 the divergent trend levelled off, indicating the end of the recession in most parts of Finland. Rather than the employment component (E/N), labour productivity seems to dominate the changes in regional disparities of per capita GDP. The productivity component shows a pattern similar to that of per capita GDP: productivity disparities fall before the slump and then grow until 1995. The employment component behaves differently, displaying growing disparities all the way until 1996, and then falling in 1997. The fall in the "employment rate"<sup>232</sup> disparities implies that the "employment rate" started to improve in the lagging subregions relative to the leading subregions as late as 1997. The fall in the "employment rate" disparities also partially explains why the disparities in per capita GDP grew somewhat in 1997.

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<sup>232</sup> The real employment rate, of course, relates the number of employees to the working age population.

Figure 13.1. Subregional GDP per capita, productivity and employment components during 1988 - 1997: Coefficient of variation



### Differences in Growth

In order to find out what accounts for the observed divergence between the rich and poor subregions, we divide the subregions into two classes according to their per capita GDP relative to the national average at the beginning of the recession, in 1990. Clearly, the divergence observed during the slump must be a result of either poor regions growing more slowly (or declining more quickly) than the average, or rich regions growing more quickly (or declining less) than the average, or both. Indeed, it appears that between 1990 - 1995 per capita GDP fell on average by 2.93 percentage points less in the rich than in the poor regions (Table 13.1).

As expected, labour productivity and the number of jobs exert a divergent effect: the efficiency effect of slump has been greater in the rich subregions and the job destruction was milder. Results also seem to indicate that migration and/or fertility have been convergent forces, since the population of the rich subregions has increased at the expense of the poor subregions. However, the convergent effect is not strong enough to offset the divergent effect of GDP (the net effect of labour productivity and jobs, that is), as the difference in population growth rates is only 2.71 percentage points.

Table 13.1. Average changes in per capita GDP and its subcomponents, 1990 – 1995

	$\Delta\text{GDP/N}$	=	$\Delta\text{GDP/E}$	+	$\Delta\text{E}$	-	$\Delta\text{N}$
Rich regions, %	-4.07	=	16.52	+	-19.14	-	1.45
Poor regions, %	-7.00	=	14.31	+	-22.56	-	-1.26
Difference, %-points	2.93	=	2.21	+	3.43	-	2.71

Note: Growth rates are the averages over the regional units.

The lesson here is that even though inter-regional migration and regional differences in the net fertility (fertility-mortality) tend to have convergent effects on regional incomes, these effects have not been strong enough during the recession. This is in concord with a common observation that migration decreases in recessions. Another reason may be that the migrants from the poor to rich regions have been employed persons, who bring gains in GDP to their destination region. In sum, the effects from labour productivity and job destruction have been the cause of regional divergence during the recession.

### The effect of regional industry composition

As the analysis above showed, both the productivity and job components cause regional divergence of per capita GDP. It is obvious, however, that analysing these components at the aggregate level hides important information. Not all sectors grow or diminish at the average rate, but experience recessions very differently. Thus, the sectoral structures of regions can affect disparities as they determine how badly they suffer from a recession. In this section, regional productivity and the number of jobs are decomposed into five sectors: primary sector, manufacturing<sup>233</sup>, construction, private services and public services. Furthermore, manufacturing and private services are also divided into sub-sectors.

The evolution of regional productivity disparities has differed widely across sectors. Some differences are also found in the evolution of job numbers. However, regional divergence of productivity or jobs in a sector does not necessarily contribute to regional divergence of per capita GDP. A different result may occur, either due to the fact that the evolution within sectors in the rich group differs from that in the poor one, or due to differences in sectoral composition between rich and poor subregions.

Let us first focus on growth differences in productivity within sectors. Using the same division of rich and poor regions as above, we analyse whether the sectors contribute to divergence or convergence of the productivity component of per capita GDP during 1990 - 1995. On average overall productivity grew

<sup>233</sup> Manufacturing includes here mining and the supply of electricity, heating and water.

faster by 2.21 percentage points in the rich than in the poor regions. This difference in favour of the rich regions was the greatest in construction and manufacturing. This result implies that on average the rich subregions also have a higher level of labour productivity. Results also indicate that within manufacturing, the metal sub-sector contributed the most to the divergence, whereas forest related manufacturing was a convergent sub-sector.

Second, let us consider the effect of sectoral composition on the productivity results. After weighting the sectors by their job shares, manufacturing still shows up as the most divergent sector.<sup>234</sup> Primary sector turns to a highly convergent sector mainly because of large regional discrepancy in the proportion of jobs.

As far as the number of jobs is concerned, results are more or less opposite to those obtained for productivity, a result, which is mainly explained by the fact that productivity is typically enhanced by layoffs during recessions. After weighting the sectors by their job shares, most of the sectors are convergent, manufacturing being the most convergent. In contrast, primary sector is a highly divergent sector.

*Table 13.2. Difference in the growth rate of value added between rich and poor subregions during 1988 – 1997*

	Rich minus poor group of subregions		
	Change in productivity, %	Change in the number of jobs, %	Sum, %
All	2.21	3.43	5.64
Agriculture and forestry	-4.83	5.57	0.74
Manufacturing	3.36	-1.01	2.35
Forest	0.39	-0.55	-0.16
Metal	1.44	-0.42	1.02
Other manufacturing	0.15	-0.10	0.05
Construction	0.66	-0.83	-0.17
Private services	0.38	-0.93	-0.56
Wholesale and retail trade, hotels and restaurants	-0.12	-0.87	-0.99
Transportation	-0.12	0.44	0.32
Other private services	0.30	-0.49	-0.19
Public services	-0.10	0.10	0.00

Note: Sectoral growth rates in the bottom panel do not sum to that of all sectors, since growth rates are the averages over the regional units.

<sup>234</sup> The reason why job shares are used is the following:

$$\text{GDP}/E = (\text{GDP}_1 + \text{GDP}_2) / (E_1 + E_2) = (\text{GDP}_1/E_1) * (E_1/E) + (\text{GDP}_2/E_2) * (E_2/E)$$
, where subscripts refer to industries in an area and E without a subscript to the total of industries.

In order to find out the net effect of sectors on convergence and divergence, we combined the weighted changes in productivity and the number of jobs (Table 13.2). Note that this combination of productivity and jobs equals to the change in the value added. It appears that the net effect for primary sector and manufacturing is divergent, whereas it is convergent for private services and construction. Manufacturing shows up as the most divergent sector, caused mainly by metal industries. Within the most convergent sector, private services, wholesale and retail trade as well as hotels and restaurants were the most convergent sub-sector. The public sector appears to be neutral in this respect.

### **13.2.4 Concluding comments**

Our results imply that divergent forces will gain strength in the future. It follows from the current trend in migration towards largest cities and Southern Finland that the need for private services may decline outside the areas of positive net migration. If this is the case in the future, it contributes to a decrease in convergent forces, since private services was found to be the most convergent sector.

It also is reasonable to expect that the regional effects of the recession will be rather permanent in nature. We found that the job component caused a great deal of regional divergence of GDP. Moreover, divergence in the job component refers to more permanent effects than that in the productivity component, due to possible temporary changes in production volumes in capital intensive production. Apart from these possible temporary changes in production, the differences in the evolution of productivity are otherwise rather permanent in nature, since there is no theoretical reason to expect that the productivity gap emerging during a recession would be caught up during subsequent upturns. Instead, abundance of evidence suggests that convergence is a slow and long-lasting process.

## **13.3 Regional income differences and inequality during 1971 - 1998 and especially in the 1990s: an analysis based on micro data<sup>235</sup>**

### **13.3.1 Introduction**

In economics' literature analyses of convergence and inequality are mainly separate topics. The former, as exemplified by section 13.2 of this article,

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<sup>235</sup> This section has been written by Heikki A. Loikkanen, Marja Riihelä and Risto Sullström who worked together in joint project on income differences between and within regions, a subproject of the consortium (c.f. introduction). In this section we mainly utilise results from Riihelä and Sullström (2001).

typically use national or regional aggregates (per capita GDP or the like), whereas the latter are based on utilization of micro data. This section reports results based on the use of micro data in studying of both regional convergence and inequality. Thus our analysis is related to two somewhat separate, but related research areas.<sup>236</sup>

Research interest in income differences between nations and regions has brought about contributions based on the use of international data in "convergence analysis" (e.g. Barro and Sala-i-Martin 1992 and Sala-i-Martin 1996a, 1996b). Regional convergence studies in Nordic countries include Dilling-Hansen, Petersen and Smith (1994), Dilling-Hansen and Smith (1997) and Groes (1998) in which Danish aggregate county and municipality data is analysed. Persson (1997) studied convergence in per capita incomes across the Swedish counties from 1911 to 1993. Convergence and mobility in Sweden are both considered by Aronsson, Lundberg and Wikström (2001) at county level and by Lundberg (2001) at municipal level. In Finland Okko (1995) and Pekkala (1999) have studied post-war regional convergence of per capita value added at county, province and sub-region levels, whereas Kangasharju (1997) use information on taxable income from 88 areas during 1934 - 1993. This analysis differs from all these studies in that we use the Household Survey and Income Distribution Statistics data, which give richer possibilities to study regional income differences than more aggregate data.

As another and related research topic, we use our micro data also to study income differences within regions. There is a vast literature on the distribution of income – thousands of entries in the EconLit database (Atkinson, 1997). The latest empirical studies relevant to us can be mentioned Mookherjee and Shorrocks (1982), Atkinson, Rainwater and Smeeding (1995), Jenkins (1995) and Aaberge, Björklund, Jäntti, Pedersen, Smith and Wennemo (2000). Finnish studies in this area we can mention Uusitalo (1988), Aura (1996), Sullström and Riihelä (1996), Jäntti (1997), Jäntti and Ritakallio (1997), Suoniemi (1998, 1999) and Lehtinen (1998). Their main interest is mostly in analysis of inequality at national level.<sup>237</sup>

In this study, we shall present results on income differences both between and within regions in Finland during 1971 - 1998. The latter is related to the question of regional income convergence vs. divergence (section 13.3.3) and the latter to inequality within regions (section 13.3.4). To find out what factors have affected changes in inequality, in section 13.3.5 we decompose aggregate national and

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<sup>236</sup> This relatedness becomes most obvious when we decompose income differences at national level into between regions and within regions components.

<sup>237</sup> In addition to separate analyses of convergence and inequality, these two topics are present in studies, which explain economic growth among other things by measures of income inequality (e.g. Persson and Tabellini 1994, Partridge 1997, Forbes 2000).

regional changes into components in order to find out the role of changes in demography, income types and the mechanisms of the welfare state (taxation and transfers). Section 13.3.6 offers concluding remarks.

### 13.3.2 Data description and definitions

Our long-run view of income differences between and within main regions in Finland during 1971 - 1990 is based on the time series data of the Household Surveys from the years 1971, 1976, 1981, 1985 and 1990. A corresponding, but more detailed analysis of 1990s is done with annual Income Distribution Statistics data for the period 1990 - 1998. In both data information on different types of income makes it possible to calculate factor incomes for each household, then add transfers and get gross income, and subtract direct taxes to get disposable income. Thus we can study regional convergence and inequality with all three income concepts.<sup>238</sup>

Our data are samples, which do not allow very detailed regional classifications. Here, we divide Finland into four main regions: the Helsinki (Capital City) region, Southern Finland, Middle Finland and Northern Finland. The sample size (households) in the time series data of the Household Survey is about 3000 in 1971 and 1976 and about 8000 in 1981, 1985 and 1990. The samples of annual Income Distribution Statistics are bigger ranging from about 9 000 to 12 000. Both have enough observations for our regional analyses.

In studying regional income differences and inequality we apply the income per consumption unit form by using the OECD equivalence scale. Despite of this choice, we shall speak of per capita incomes in the sequel. Note that we have not deflated incomes by regional price indices, which deviate mainly because of housing price and rent differences (c.f. section 4 of this article).

### 13.3.3 On income differences between regions

When household survey data is used to consider real per capita income over time, irrespective of income concept used, real income level increased substantially until the year 1990. Thereafter, the depth of the depression of early 1990s is very clear. For the first time during the Post World War II period in Finland real incomes per capita decreased.

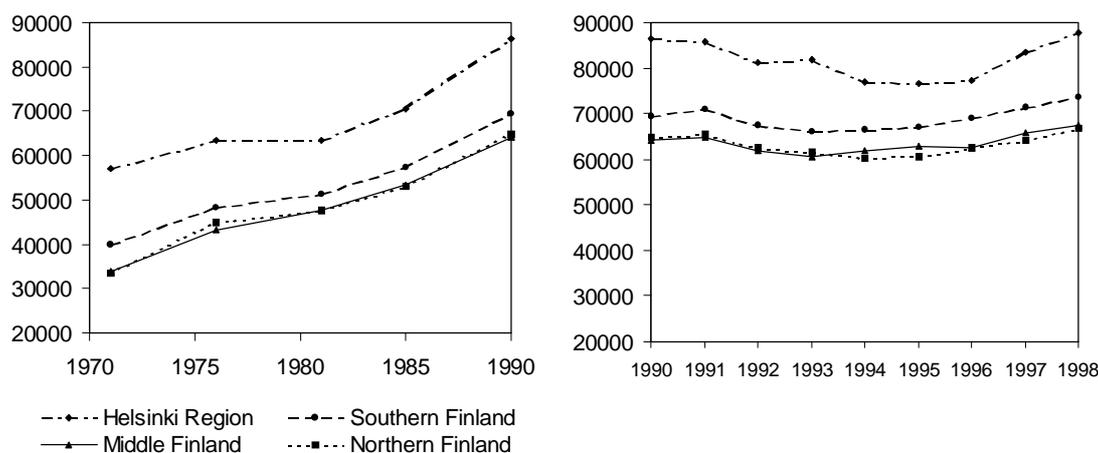
Figure 13.2 (left side) illustrates that real disposable income per capita increased steadily during 1971 - 1990 in all major regions. When the economic crisis led to declining GDP beginning in 1991-93 (right side of Figure 13.2), real

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<sup>238</sup> A discussion on the merits and demerits of different measures (alternative income concepts, expenditure, consumption etc) in welfare analysis can be found from Atkinson (1998).

incomes did not decrease immediately, but only in 1992, except for the Helsinki Region where a drop took place already in 1991. Also the decline in income level lasted longer in the Capital City Region than elsewhere, but when the turn up finally took place in 1997, growth in the Helsinki Region was faster than elsewhere.

Figure 13.2. *Real per capita disposable income in major regions during 1971 - 1990 (left) and 1990 - 1998 (right)*



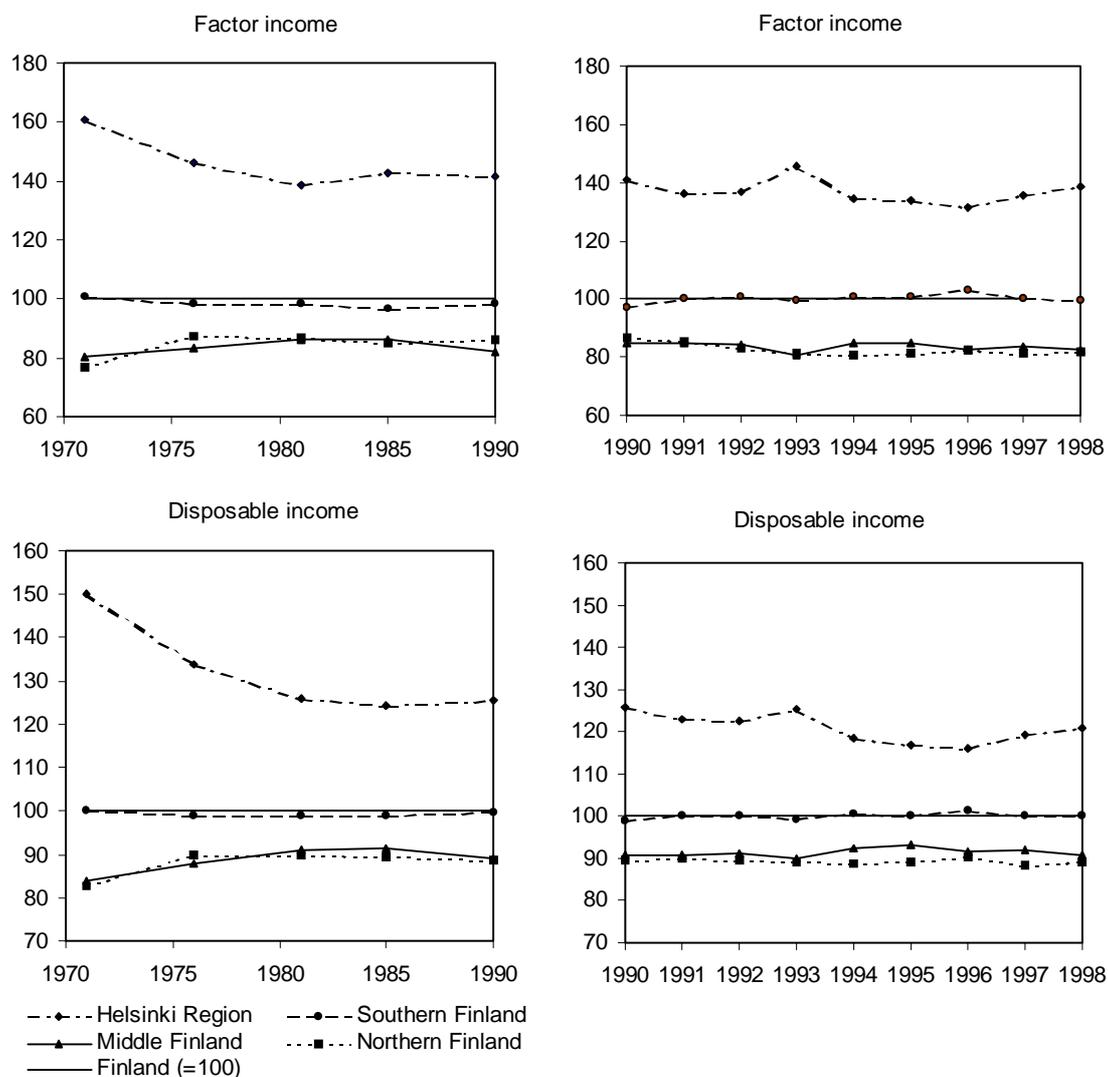
Next, we shall consider the evolution of regional per capita incomes relative to the national average (= 100) applying two income concepts: factor income and disposable income.

The left side of Figure 13.3 indicates that for both income concepts, there has been substantial regional convergence of relative income levels over time. Convergence was especially clear from 1971 to 1980. In the Helsinki region relative income level declined, whereas the opposite tendency was prevalent in Middle and Northern Finland. The relative position of Southern Finland has remained much the same. We also note that the relative income differences based on disposable income are somewhat smaller than those based on factor income. Thus, the mechanisms of the welfare state decrease regional disparities by taxation and transfers.

During 1990 - 1998 (Figure 13.3, right) relative income differences between main regions remained relatively stable. During the three years period of falling GDP, only in the final year 1993 regional disparities in terms of relative factor and disposable incomes increased temporarily. After slight convergence in 1994 - 1996, the last two years indicate some divergence, mainly because of

improved position of the Helsinki Region. Despite this phase, relative regional disparities in 1998 were not greater than they were in 1990.

Figure 13.3. Per capita factor income and disposable income in major region (Finland = 100) during 1971 - 1998



### 13.3.4 Distribution of income and poverty within regions

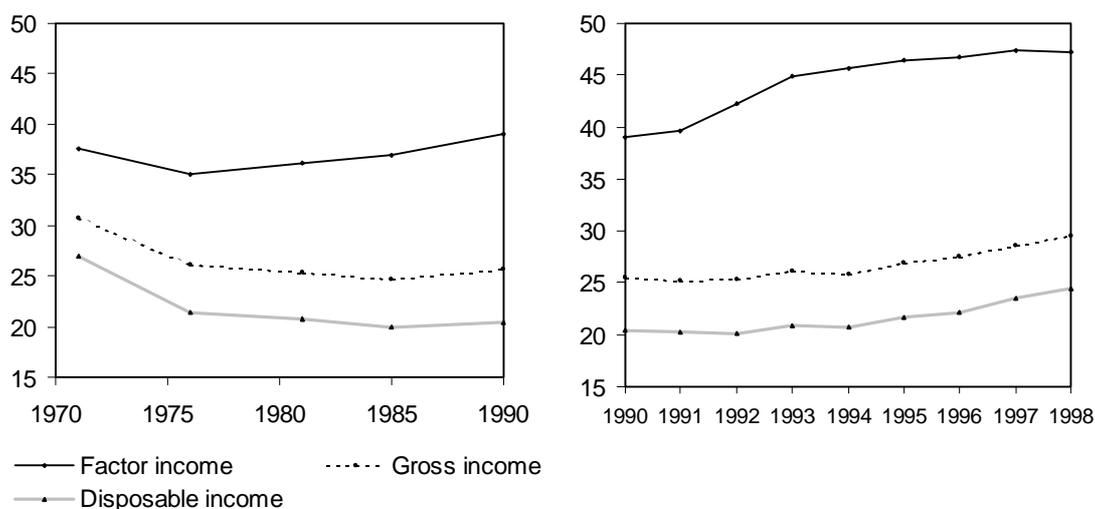
International comparisons of income inequality before 1990s indicate that Finland did not differ very much from other countries when the distribution of factor income is considered. However, together with Sweden, Finland had the most even distribution of disposable income (see e.g. Atkinson et al. 1995). Here, in addition to describing national developments, we also have results on

inequality for major regions in Finland. We measure inequality by Gini-coefficients based on per capita incomes (OECD equivalence scale). We consider in terms of three income concepts: factor income, gross income and disposable income.

Figure 13.4 describes national developments of Gini-coefficients for 1971 - 1990 (left), based on Household Survey data, and for 1990 - 1998 (right) based on Income Distribution Statistics. Our first observation is that direct taxes and transfers decrease inequality as Gini-coefficients decline when we move from factor income to gross income, and to disposable income.

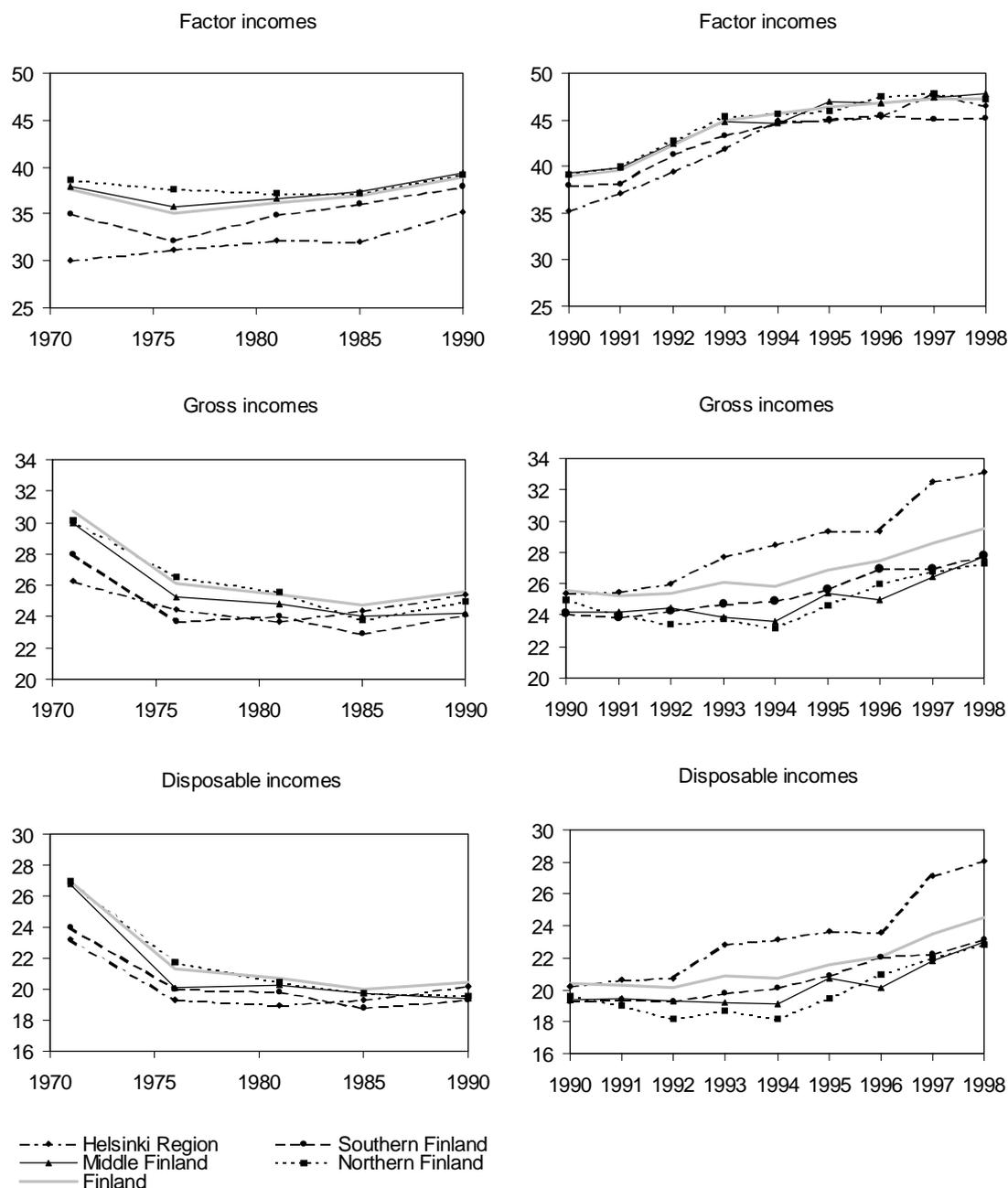
As for developments over time, after a slight decline, inequality based on factor income increased since mid-1970s. During 1990s the sharpest increase took place during the deepest recession in 1992 - 1993, after which the growth of this Gini-coefficient has continued at a lower rate.

*Figure 13.4. Gini-coefficients based on three income concepts during 1971 - 1998*



Gini-coefficients based on gross income and disposable income both decreased from 1971 to 1976, and thereafter there was no major change in their level. This is surprisingly also true for the deepest recession years 1990 - 1994 suggesting that the economic crisis left income distribution relatively unaffected. However, as the economy began to grow fast after 1994, also inequality began to increase.

Figure 13.5. Gini coefficients by income variables and main regions in 1971 - 1998

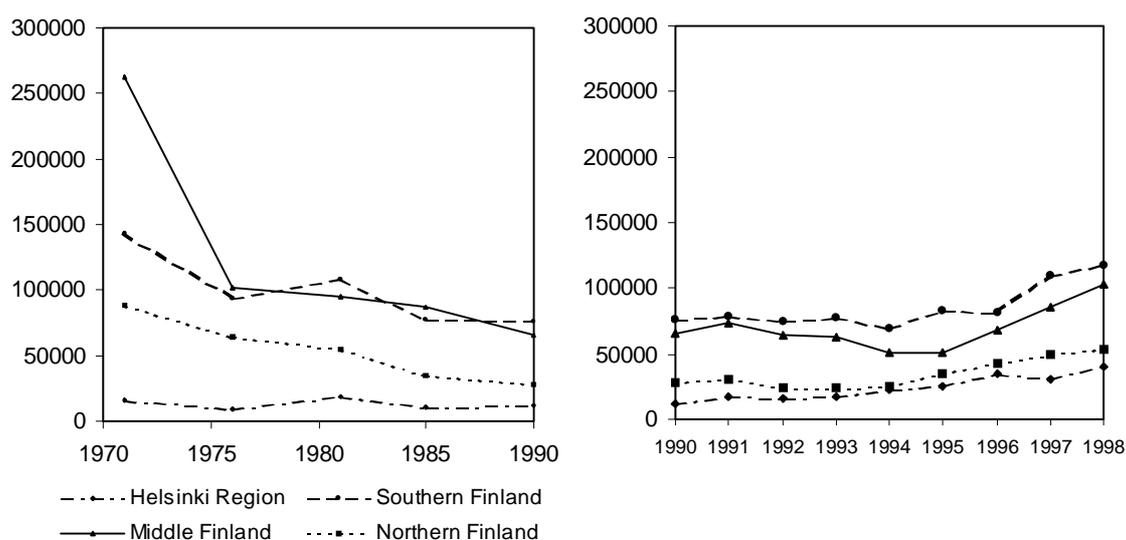


The general level and development of regional Gini-coefficients is remarkably similar to the national Gini-coefficients during 1971 - 1990 (Figure 13.5, left). The most noticeable regional differences are related to factor income Gini-coefficients, whereas e.g. in 1985 and 1990 Gini's for disposable income are almost the same in all regions. During the 1990s (Figure 13.5, right) these trends change. Disparities in regional inequality based on disposable and gross

income per capita increase since 1992. Especially, respective Gini-coefficients in Helsinki Region began to grow faster than those of the other regions. Somewhat surprisingly, regional disparities in factor income based inequality have slightly decreased during 1990s and are smaller in the boom than in the bust.

Consideration of poverty supplements our analysis of inequality. The number of poor people (disposable income per capita below half of respective mean income) in the Helsinki Region was low during 1971 - 1990 (Figure 13.6, left) whereas in all other regions it was initially much higher and decreased over time.<sup>239</sup> During the crisis years of early 1990s only in Helsinki Region the number of poor increased and this trend continued until 1998. In other regions, the number of poor began to increase only in 1994 when the economy began to grow fast.<sup>240</sup>

Figure 13.6. The number of poor by region 1971 – 1998, persons



When we studied similarly the number of rich (disposable income per capita twice the mean income), also their number grew during 1994 - 1998, especially in Helsinki Region and in Southern Finland.

<sup>239</sup> Note that we have not taken into account regional price differences, especially high housing costs in the Helsinki Region which partly explains why the number of poor is low in this area.

<sup>240</sup> We have also calculated the number of poor by using the 1990 real income level of the poverty line in considering later years. Then the number of poor increases more than in Figure 13.6 during 1992-96, whereas in 1997-98 the number of poor using this criterion decreases, but still in 1998 there are more poor than in 1990.

### 13.3.5 Decomposition of inequality

In the previous section, we presented Gini-coefficients for each region and the whole country. To find out which factors have caused changes in total inequality of disposable income, we decompose them into the contributions of demographic changes and changes in types of income.

Methodologically our analysis is related to studies by Jenkins (1995), Aaberge et al. (2000) and Suoniemi (1998, 1999) who decompose either changes in Gini-coefficients or generalized entropy measures. From the entropy family measures we use mean logarithmic deviation ( $I_0$ ) and squared coefficient of variation ( $I_2$ ) to decompose inequality to between and within region components, and  $I_0$  to decompose changes of inequality over time to contributions of regional populations and relative incomes. To conclude this section, we summarize results based on decomposing changes in regional Gini-coefficient by type of income. We use seven income sources and direct taxes, which add up to disposable income.

First, in Table 13.3 we consider the contributions of inequality within and between regions to aggregate inequality with our measures  $I_0$  and  $I_2$ . Both measures indicate that total inequality was high in 1971, clearly lower in 1981 and 1990, grew slightly between 1990 and 1993, and increased considerably between 1993 and 1998. Most variation of disposable income is within major regions. The share of between regions variation was 12-13 % in 1971, decreased to 5-8 % in 1981, 1990 and 1993, and still more in 1998. Since 1981 all the changes of aggregate inequality are due to the within regions components.

Table 13.3. *Within group and between group inequality, 1971 - 1998*

Year	Mean log deviation ( $I_0$ )			Squared coefficient of variation ( $I_2$ )				Gini coefficient	
	Within group inequality	Between group inequality	Aggregate inequality	Between/Aggregate (%)	Within group inequality	Between group inequality	Aggregate inequality		Between/Aggregate (%)
1971	0.111	0.016	0.127	12.5	0.122	0.018	0.141	13.0	0.270
1981	0.071	0.005	0.076	6.3	0.069	0.005	0.075	7.0	0.207
1990	0.064	0.005	0.069	7.6	0.074	0.006	0.080	7.3	0.204
1993	0.069	0.005	0.075	7.3	0.104	0.006	0.110	5.4	0.209
1998	0.099	0.005	0.104	4.4	0.237	0.005	0.241	2.0	0.245

The above decomposition does not tell to what extent changes in inequality are due to changes in regional population shares, income levels and internal inequality. Following Mookherjee and Shorrocks (1982) change in inequality measured by  $\Delta I_0$  can be approximately decomposed to four additive elements where A is a measure of changes in inequality within each group (pure change in inequality), whereas terms B and C indicate the impact on the within groups

and between groups components of inequality which result from changes in regional populations, and D gives the effect of changes in relative incomes of regions.

*Table 13.4. Sub-group decompositions of the changes in disposable income inequality*

Period	% $\Delta I_0$	% change in $\Delta I_0$ accounted for by changes in			Sub-group mean incomes (term D)
		Within- group inequalities (term A)	Population shares Within gr. (term B)	Between gr. (term C)	
1971-1981	-39.9	-31.0	-0.2	0.6	-9.2
1981-1990	-8.8	-9.5	0	0.1	0.5
1990-1993	7.7	7.5	0.1	0.2	0.1
1993-1998	38.8	39.6	0.4	0.2	-1.4

In Table 13.4 results of this decomposition of change in inequality (in %) is reported for four periods: (a) 1971 - 1981 (clear decrease in inequality), (b) 1981 - 1990 (slight decrease in inequality), (c) 1990 - 1993 (slight increase), (d) 1993 - 1998 (clear increase in inequality). They show that the pure effect A dominates and all other effects are small except term D during 1971 - 1981 when regional (relative) income changes decreased inequality.

Changes in total and regional population are slow and did not help much in understanding changes in inequality especially in the 1990s. Changes in sources of income and taxation have changed much more following booms and busts of the economy, changes in unemployment, and reforms in tax and transfer systems. To study their role we first note that disposable income can be defined as a sum of seven income sources minus direct taxes. The income items consist of wages, entrepreneurial income, capital income, national pensions (including survivors' pensions and excluding front veterans' pensions), earnings related pensions, unemployment compensations (basic and earnings related benefits) and other transfers. During 1971 - 1998 the share of wage and entrepreneurial income has had decreasing trend. Capital income's share surprisingly almost doubled from 1990 (6.6 %) to 1993 (12.3 %) and increased also thereafter. The share of national pensions has gone down and the share of work related pensions has gone up over time. The share of other transfers has increased and in early 1990s unemployment drove it to a still higher level.

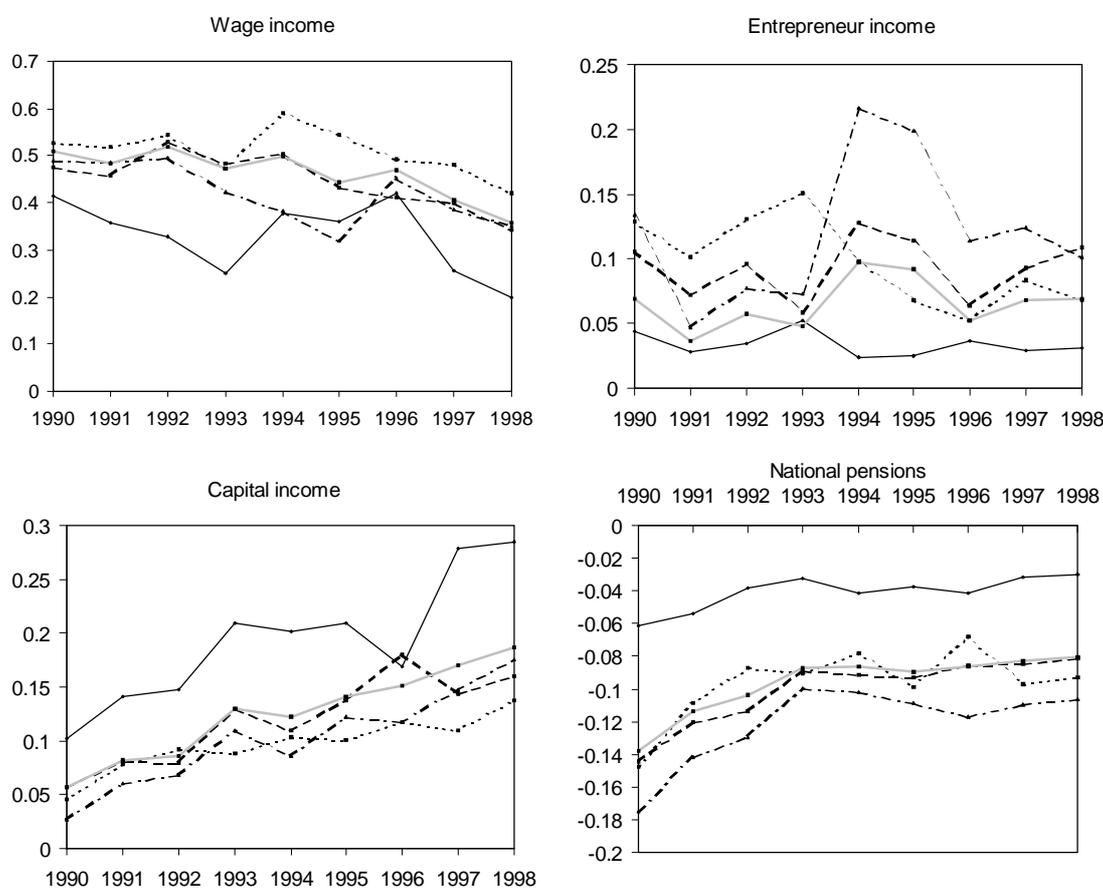
In Table 13.5 we present results of a decomposition of squared coefficient of variation by main regions and income sources, which indicates that the roles of income sources for inequality have changed over time. The positive contribution of wage income to aggregate (disposable) income variation has decreased

since 1981. The contribution of entrepreneurial income increased until 1990 but has since that decreased. The most noticeable change concerns capital income. Its contribution has increased very much since 1990, and most of the change comes from the Helsinki Region. Direct taxes have decreased variation of disposable income and this effect was at its greatest in 1990. Thereafter, the negative contribution has decreased to some extent.

*Table 13.5. Decomposition of the squared coefficient of variation by the Main Region and income sources*

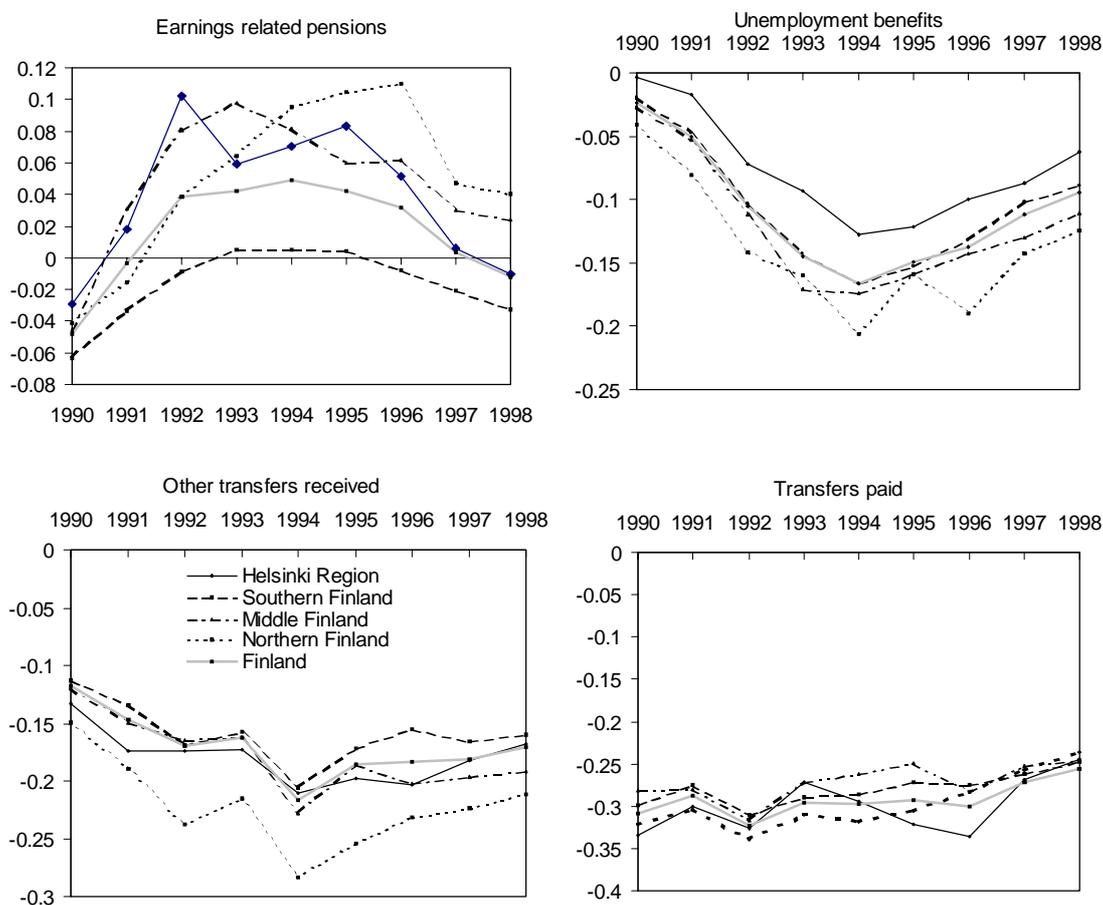
Year	Region	Wage income	Entrepreneurial income	Capital income	National pension	Earning pensions	Unemployment benefits	Other transfers	Direct taxes	Regional contribution
1971	Helsinki Region	56,8	2,4	5,1	0,2	5,8	0,0	3,5	-18,9	54,9
	Southern Finland	36,5	7,1	2,5	-1,8	3,1	-0,1	0,6	-14,6	33,4
	Middle Finland	11,3	1,2	1,6	-1,8	0,7	-0,1	-0,6	-4,3	8,0
	Northern Finland	6,8	-0,4	0,1	-0,8	0,2	-0,0	-0,1	-2,1	3,7
	Income source contribution	111,4	10,3	9,3	-4,2	9,9	-0,1	3,4	-39,9	100,0
1981	Helsinki Region	61,3	3,2	2,1	-0,0	5,6	0,0	1,3	-24,5	49,0
	Southern Finland	49,0	7,5	2,4	-3,6	2,7	-0,3	-1,1	-19,7	36,8
	Middle Finland	15,4	6,5	1,2	-2,5	0,9	-0,3	-1,3	-10,2	9,7
	Northern Finland	8,7	1,7	1,1	-1,0	0,2	-0,2	-0,8	-5,1	4,4
	Income source contribution	134,4	18,9	6,8	-7,1	9,4	-0,9	-1,8	-59,6	100,0
1990	Helsinki Region	64,3	5,5	9,5	-0,0	6,5	0,1	1,6	-32,9	54,5
	Southern Finland	40,9	11,8	7,7	-2,7	1,6	-0,3	0,3	-24,1	35,1
	Middle Finland	10,9	6,1	1,1	-2,4	-0,3	-0,4	-1,5	-7,3	6,2
	Northern Finland	7,3	2,6	0,9	-1,0	0,0	-0,3	-0,7	-4,7	4,2
	Income source contribution	123,5	26,0	19,1	-6,2	7,8	-0,9	-0,2	-69,1	100,0
1993	Helsinki Region	40,8	3,7	19,9	0,4	10,6	0,0	2,3	-26,9	50,8
	Southern Finland	37,2	4,7	22,5	-0,9	3,4	-1,6	-0,9	-24,5	39,9
	Middle Finland	6,8	2,8	3,2	-1,0	1,3	-1,8	-1,2	-5,5	4,6
	Northern Finland	3,7	5,1	0,8	-0,5	0,4	-0,8	-0,8	-3,2	4,6
	Income source contribution	88,5	16,3	46,4	-2,0	15,8	-4,3	-0,7	-60,1	100,0
1998	Helsinki Region	22,6	1,9	52,8	0,1	4,6	-0,1	0,7	-28,7	53,8
	Southern Finland	17,9	8,4	26,2	-0,6	1,8	-0,6	-0,7	-18,3	34,0
	Middle Finland	5,0	2,4	9,7	-0,6	0,7	-0,6	-0,9	-5,8	9,9
	Northern Finland	2,8	0,8	1,5	-0,3	0,2	-0,3	-0,5	-1,9	2,3
	Income source contribution	48,3	13,6	90,1	-1,3	7,3	-1,7	-1,6	-54,7	100,0

Figure 13.7. *Gini elasticities of income components by Main Regions in 1990s*



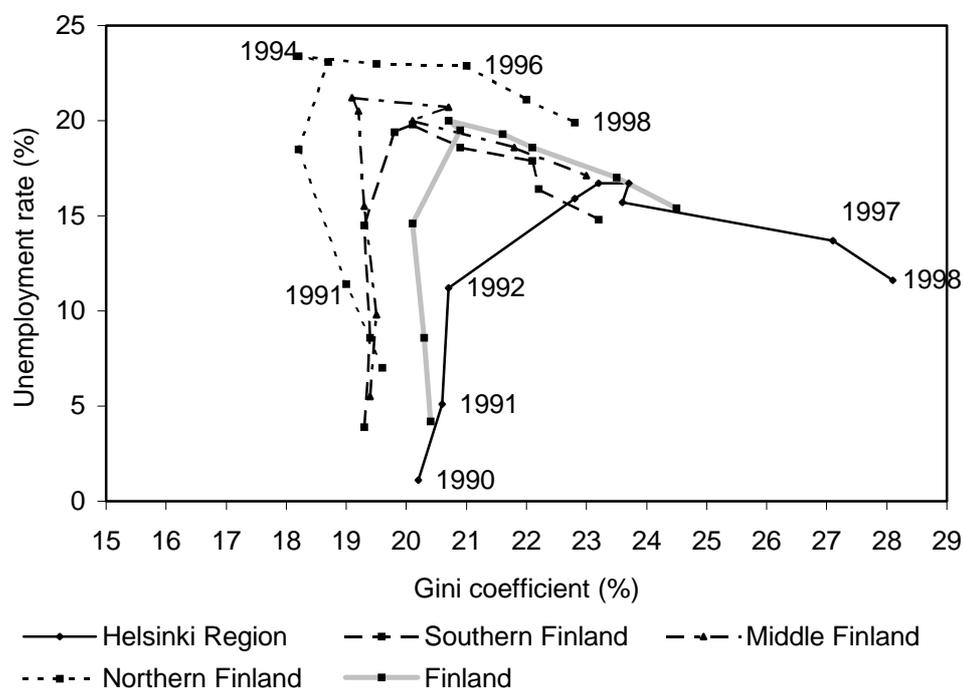
As another way to find out the role of different sources of income for inequality, we have decomposed regional Gini-coefficients by income type and calculated elasticities, which indicate how much a percentage change in each type of income affects total inequality during 1990 - 1998 (c.f. Lerman and Yitzhaki, 1985). The results in Figure 13.7 indicate that marginal wage increases (evaluated at mean value) increase total inequality, but this effect has decreased over time. The opposite is true for capital income: the contribution of its change has increased, and is clearly highest in Helsinki Region. Changes national pensions decrease inequality whereas the effect of earnings related pensions is predominantly the opposite. An increase in unemployment benefits and other transfers decrease inequality and these effects were greatest in 1994 at the end of the bust. An increase in taxes (transfers paid) decrease inequality and this effect is very similar across regions and years during 1990s.

Figure 13.7. *Gini elasticities of income components by Main Regions in 1990s (continued)*



The most visible indicator of economic crisis in 1990s was the increase in unemployment, which took place during 1990 - 1994 in all regions. Surprisingly, during this phase inequality did not almost increase at all, except in Helsinki Region where the subsequent increase in Gini-coefficient began in 1993 (Figure 13.8). Other regions followed with a lag.

Figure 13.8. Trade off between unemployment rate and Gini coefficient by Main Region



### 13.3.6 Concluding comments

In this study, we have used micro data to study both income differences both between and within major regions in Finland during 1971 - 1998. The latter is related to the question of regional income convergence vs. divergence and the latter to inequality within regions. Disposable income differences between regions as well as decrease in inequality were clear from 1971 to mid 1980s. Thereafter, there convergence continued, but at a slower rate, whereas inequality remained much at the same level. Somewhat surprisingly, these features also characterized the boom period of late 1980s and the bust of early 1990s. Only at the end of deepest recession did inequality start to increase, first in the Helsinki Regions, and then during the recovery in all regions. Our decomposition of inequality by income sources indicated the important role of capital incomes for inequality growth in late 1990s especially in this region. Also slight divergence of regional incomes can also be noticed due to the fast growth of the Helsinki Region.

One reason why this analysis gives a somewhat different picture than section 13.3 on regional disparities is first that here we only have 4 major regions instead of 85 sub-regions. Second, here we use (factor, gross and disposable)

income instead of GDP per capita which means that income can come from other regions where the household lives, too. Third, especially disposable income includes the mechanisms of the Welfare State, namely transfers and taxation, which decrease regional disparities and inequality.

To conclude, we note that elsewhere, instead of four major regions, we have also used NUTS 2 classification (five regions), “old provinces” (twelve), and a classification which divides Finland according to urbanization (cities, densely populated areas and country-side). Furthermore, we have also considered convergence and inequality on the basis of per capita consumption in addition to per capita income. Although the time periods of these studies have varied somewhat, the main long run tendencies and the basic picture of early 1990s concerning convergence and inequality is much the same as here.<sup>241</sup>

## **13.4 Regional housing markets in boom and bust: the experience of Finland<sup>242</sup>**

### **13.4.1 The economic crisis and housing markets**

The economic crisis of 1990s had a major impact on all sectors of the economy and the whole society. Housing markets were one of the sectors dramatically influenced by the depression as well as the preceding overheating period in the second half of 1980s. The sky rocketing rise of housing prices in 1987 - 1989 and their dramatic collapse in 1989 - 1993 belong to the best-known events of the whole period. As a matter of fact, housing sector was an essential part of both the overheating and the depression.

The dramatic changes in Finnish housing markets during the boom and depression reflect several special features of property markets, which make the branch especially volatile and sensitive to economic fluctuations. The basic reason behind the instability and volatility of property markets is that the supply is very inelastic in the short run. For this reason the changes in demand cause sharp changes in property prices. As a consequence of strong price fluctuations also the construction of residential and office buildings as well as the demand and prices of materials and other construction inputs tend to fluctuate sharply. Expectations and asymmetric information are important characteristics of property markets. In addition, dwellings, buildings and lots have a central role as securities of loans. As far as policy variables are concerned, the availability of finance, public subsidy systems and the taxation of the housing sector affect

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<sup>241</sup> See Loikkanen, Laakso, Sullström (1997a, 1997b), Loikkanen, Rantala, Sullström (1998), and Loikkanen, Riihelä, Sullström (1999).

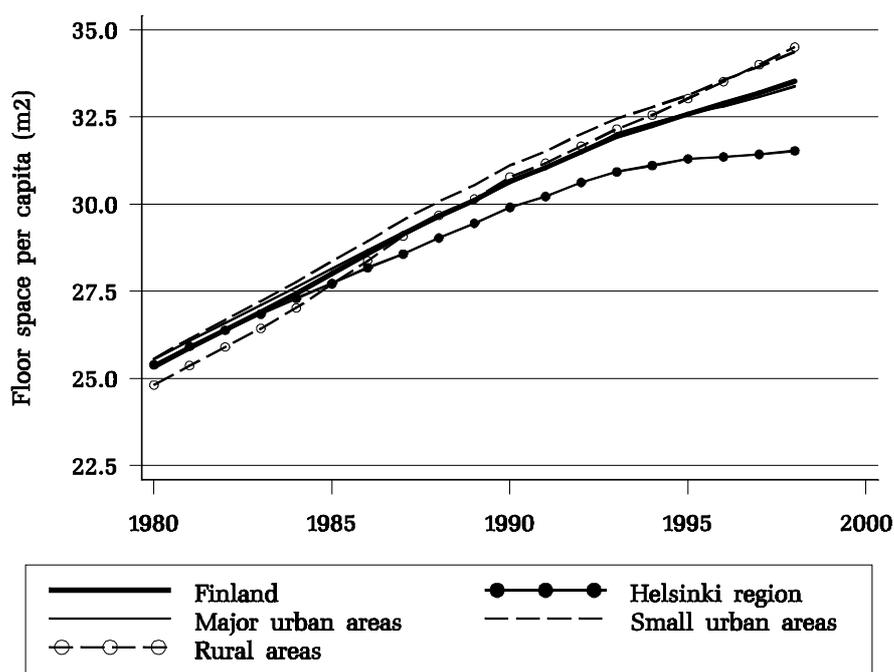
<sup>242</sup> This section is based on Laakso (2000).

prices (both asset values and user costs) and the functioning of housing markets. Demographic factors including the age and household structure of the population and regional mobility affects housing markets, too.

### 13.4.2 Housing markets developments in Finland

The trend in housing consumption growth in Finland, when measured by floor space per capita, did not change significantly either during the overheating period or during the recession. Regional development with respect to floor space per capita is quite interesting. In the Helsinki region this indicator was at the same level as in the whole country in the beginning of 1980s. Still, the growth rate in the Helsinki region has been lower than in elsewhere – especially in 1990s – and consequently the Helsinki region now lags behind the rest of the country with respect to per capita housing consumption.

Figure 13.9. Occupied floor space ( $m^2$ ) per capita by region type in 1980 - 1998



The supply of housing services is based on housing stock. Construction of new dwellings cause addition to the stock and demolition of old houses cause deduction. Housing construction relative to housing stock was around 3 percent in Finland in the beginning of 1980s. The trend was downwards until the boom

years of housing markets in the second half of 1980s. Following rising housing prices a lot of new housing construction was started in 1988 - 1989 causing overheating in the construction industry. Respectively, there was a peak in the volume of completed dwellings in 1989 - 1990. After this boom the volume of housing construction declined sharply until the year 1996. New growth started in all region groups as late as in 1997. The time profile of housing construction during the boom and bust years is quite similar in all region groups.

The vacancy rate of housing stock reflects the tightness of housing markets. In 1987 – at the beginning of the housing market boom – vacancy rates were relatively low in Finland, especially in the Helsinki Region. There was a sharp increase during the years 1988 - 1991, due to increased housing production. After the production peak, vacancy rates started gradually to decline. These trends were quite similar in all region groups until the year 1991, but thereafter they diverged. In the Helsinki region the share of vacant dwellings has declined sharply while in the rural areas vacancy rates have continued to increase to a historically high level.

Figure 13.10. Total floor space of completed dwellings relative to housing stock (%) by region type in 1980 - 1998

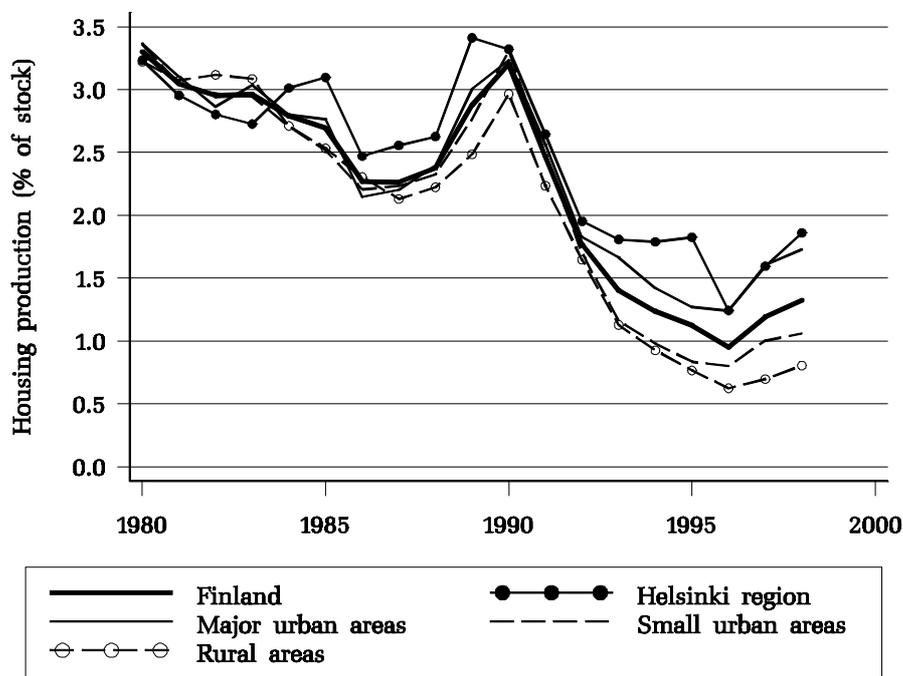
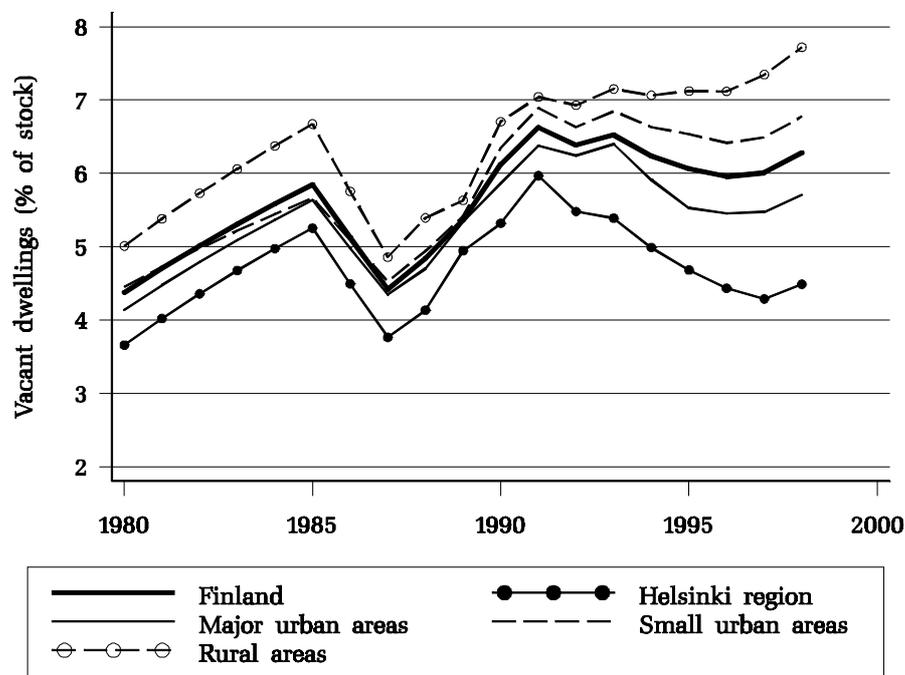


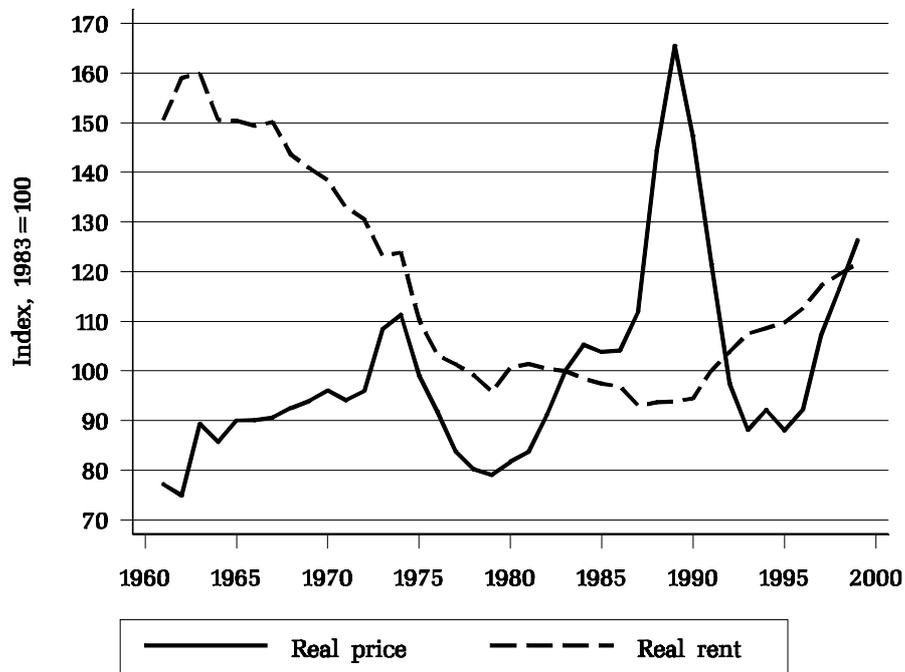
Figure 13.11. Total floor space of vacant and temporarily occupied dwellings relative to housing stock (%) by region types in 1980 - 1998



Housing prices have been extremely volatile during the last decades. Two big cycles can be noticed since 1960. The first significant peak was in the years 1973 - 1974 and the second in the second half of 1980s. After a quiet period in 1985 - 1986 real prices started to sky rocket during the second quarter of 1987. The growth continued for about two years. Real housing prices rose by 60 % and nominal prices by 74 % from the first quarter of 1987 to the first quarter of 1989. Real prices reached their peak during the first quarter of 1989 and started to fall thereafter. They declined almost to a half of their peak value, reaching their bottom in the first quarter of 1993. The new growth of real housing prices started in the beginning of year 1996.

The long run development of real rents is totally different from that of real housing prices. Real rents declined in Finland continuously from the first half of 1960s to the end of 1980s. Even during the overheating periods of housing prices in 1973 - 1974 and 1987 - 1989 real rents did not increase. The main reason for this development was rent control being in effect in various forms most of the time during this period until it was released in several stages during 1992 - 1995. Real rents started to increase during the recession in 1991. At the same time, the supply of privately owned rental dwellings started to grow as well, after the decline of several decades.

Figure 13.12. Real housing prices and rents in Finland 1960 - 1999, index 1983=100



Real housing price developments are very similar in all region types (major urban, smaller urban and rural areas) in spite of the fact that they differ with respect to population and economic structure. The price peak in 1987 - 1989 like the collapse in 1990 - 1994 was experienced in all regions in Finland. Even the timing of major changes is similar. However, the relative price peak 1987 - 1989 was higher and the drop after the peak was deeper in the Helsinki Region than in other regions. The relative gap between the Helsinki region and other areas, especially smaller urban and rural areas widened during 1986 - 1988 when prices grew faster in Helsinki than elsewhere. The gap narrowed significantly in 1989 - 1992. One consequence of the recession was that the regional differences in housing price levels shrank. From 1993 on regional price gaps has widened again.

Figure 13.3. Real housing prices by region type in 1983 - 1999, index 1983=100

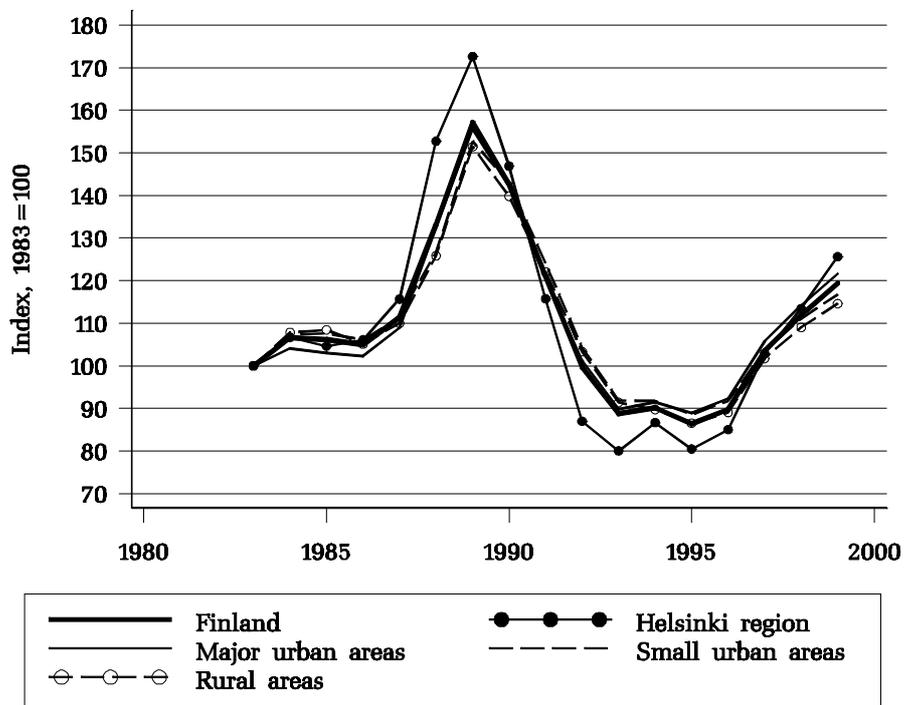
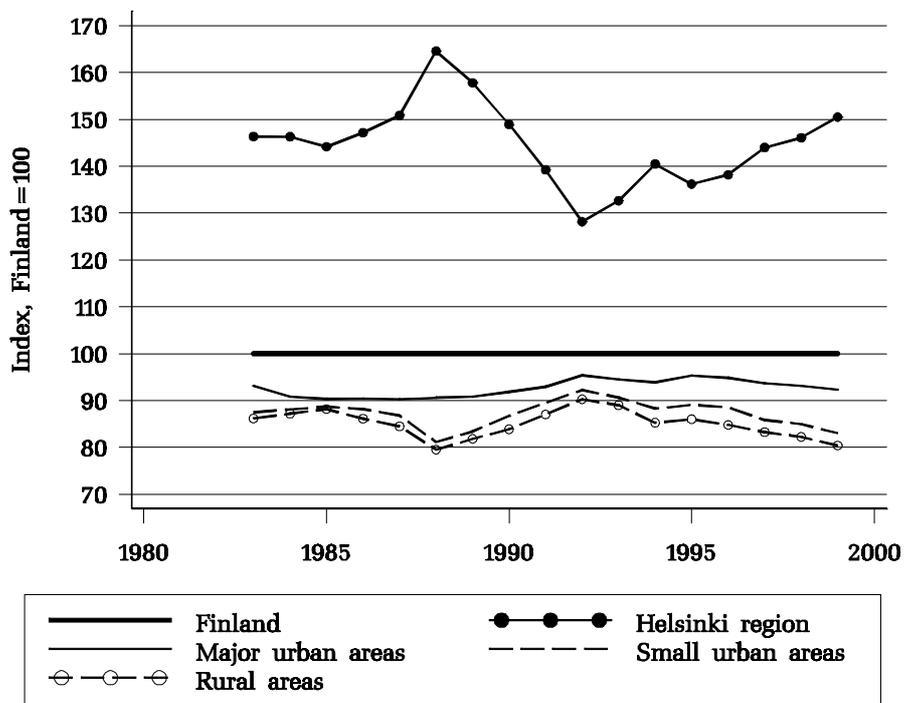


Figure 13.4. Relative housing prices by region type in 1983 - 1999, Finland=100

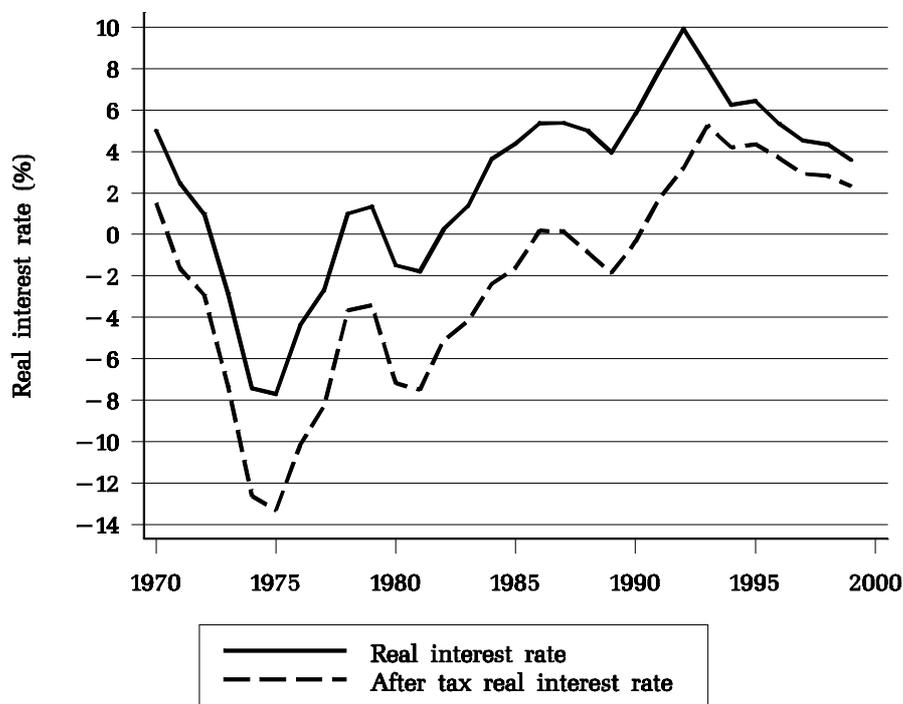


### **13.4.3 Financial markets and taxation**

Financial markets were liberalised in several stages in Finland like in many other Western countries during the second half of 1980s. The liberalisation of financial markets had a major impact on Finnish housing markets (see Koskela, Loikkanen and Virén (1992) and Kosonen (1995)). The previous credit rationing with strict bank saving requirements as a condition to get loans were released and consequently the availability of bank loans for ordinary households' housing investments became significantly easier than earlier. Competition between banks became harder and new forms of housing finance emerged. The significance of market based interest rates increased instead of previous administratively regulated interest rates and they became more and more dependent on international financial markets. Under these circumstances and lowering inflation rates real interest rates became permanently positive, unlike in the 1970s and in the beginning of 1980s. The liberalisation of Finnish financial markets was followed by extremely rapid growth of housing loans. The real value of housing loan stock increased by half during three years from 1986 to 1989.

Interest payments of bank loans – including housing loans - were deductible in income taxation until the year 1992. The tax reform starting in 1993 changed essentially the deductibility of interest payments of housing loans. The reform made the gap between real interest rate and after tax interest rate significantly narrower than it used to be.

Figure 13.5. *Real interest rate and real after tax interest rate (%) in Finland 1970 - 1999*



#### 13.4.4 Econometric analysis of Finnish regional housing markets

A brief summary on estimation results of regional housing demand, supply and price models is presented in this section. Results are based on the panel data of 85 sub-regions from the years 1981 - 1997. The detailed presentation of models, methods and estimation results is in Laakso (2000).

The main interest in the econometric analysis is the relationship between the quantity of housing consumption (housing demand), housing construction (flow supply), housing prices and various national and local economic and demographic factors. The aim is to explain the dramatic developments of housing prices and housing construction - as well as the less dramatic development of housing consumption - during the boom of 1980s and the depression in early 1990s.

According to the results the variation of local housing consumption - measured by occupied floor space - depends on demographic factors, income factors and housing cost factors. Population growth as well as the change of household

structure (measured by household/population ratio) have significant positive effects on local housing consumption. Rise of permanent income increases housing consumption while rise of user cost of housing has a negative effect, respectively.

Local housing construction - measured by completed floor space relative to housing stock - depends basically on two factors: real housing price and real interest rate in previous periods. These factors reflect the effects of expected selling price and financing costs of construction from the point of view of construction firms. Lags are essential because the time from the decision making to the completion of new housing is quite long, one year at the minimum. Construction costs - measured by real construction cost index - do not have a negative effect on housing construction according to estimations. Instead, they seem to follow construction activity. In addition to housing prices and interest rates, there are local demand and cost factors and supply restrictions affecting housing construction activity. In estimations these are taken into account using sub-regional dummy variables.

The main variables used to explain local housing price development - measured by real housing price index - are local demand factors, after tax interest rates and vacancy rates. Local demand factors - the change in the number of jobs and income level - have a significant positive effect on housing prices. Real after tax interest rate - reflecting the joint effect of interest rate level, inflation and tax deduction rules - has a strong negative effect on real housing prices. Vacancy rate (the proportion of empty and temporarily occupied floor space in housing stock) has also a significant negative effect on real prices: the lower the vacancy rate the faster real prices increase and vice versa. Vacant dwellings work as a buffer in housing markets and the vacancy rate acts as an indicator of the tightness of local housing markets.

In addition to these fundamental factors, price change from the previous period has some effect on the price change in the next period. This indicates a tendency to have price bubbles, in other words, price growth (decline) creates expectations of the continuation of growth (decline). Still, according to the estimation results this effect is not especially strong and explains only a minor part of the dramatic real price changes in 1980s and 1990s. Consequently, results of this study do not give evidence on growths and bursts of significant price bubbles in Finnish housing markets when the development is considered at annual level.

There is variation with respect to both housing demand, supply and price developments between sub-regions. The reason for this is mainly in different local demand factors, especially demographic and employment developments. Results of this study indicate that there are also some differences in the coefficients of independent variables between regions when models are

estimated separately for region groups. Still, it must be pointed out, the basic trends of housing markets were very similar in all regions in Finland during 1980s and 1990s. All regions experienced a price boom in 1987 - 1989 and a sharp collapse after that. Construction boom followed the price boom and construction depression came after the price collapse in all regions, too. Finally, the development of housing consumption was reasonably stable all over the country. The reason for this regional similarity is that the most crucial external effects on housing markets – changes in interest rates, taxation rules, and income, employment and inflation development - took place at national level and were transmitted to all local housing markets approximately at the same time. Only several years after the depression, from 1997 on, clear deviations between regions with respect to housing market developments have appeared: This is a consequence of recently increasing polarisation of regional employment and population development.

#### **13.4.5 The economic crisis and housing markets - concluding remarks**

During most of the post war period the Finnish housing markets operated under conditions characterised by regulated financial and rental markets. In an economy export sector cycles were reflected to most activities including housing, which was also very volatile in international comparison. In booms new jobs were created in cities, and they also increased their population by mobility from the countryside. This increased demand for unregulated owner-occupied housing whereas rental housing supply depended on public housing as private renting was under rent control or regulation. Booms of the economy led to housing price increases and often to an overheated situation in construction. In busts everything reversed. Average housing consumption (square meters per capita) remained internationally rather low i.e. because of internationally extremely unfavourable terms of housing finance in general and lack of specialised housing finance institutions.

With this background it is not surprising that when financial markets were deregulated in the latter half of 1980s during an unrecognised and unexpected boom, there was exceptionally great demand for new housing loans, which now were granted with small or no collateral and minimal requirements of self finance. Given inelastic supply of housing, these developments led first to a sky rocketing of housing prices, and a subsequent construction boom. Bad luck (recession in Western export markets and in East trade as Soviet Union collapsed), bad banking and bad policies (expansionary in boom and restrictive in subsequent bust) turned the Finnish economy, all asset prices including housing prices, and with a lag also the construction sector into an unprecedented depression with bankruptcies and mass unemployment. Although similar cyclical behaviour was related to many other economies which

deregulated their financial markets in 1980s, in no other case was the boom so great and the bust so deep as in Finland, both generally and especially in the housing markets.

From 1980s until mid 1990s the basic trends in the housing markets were quite similar nationally and regionally. The strong variations in prices and production were experienced approximately at the same time in all regions, although the development was more volatile in the Helsinki region than in other parts of the country. The trends in housing markets started to deviate regionally around the beginning of the recovery. Being now driven by the newly emerged ICT sector, employment growth and migration occurred only in six cities instead of almost all urban centres like in earlier booms. Regional differences in housing prices, housing production, vacancy rates and housing consumption have started to increase substantially: Since mid 1990s housing demand and prices, and construction activity have increased strongly in the growing urban areas, while an increasing fraction of housing stock has become vacant especially in the rural areas.

The economic costs of instability of the economy and housing markets are high for households, construction industry and the public sector. However, the means of housing policy to control housing market fluctuations seem limited. Production, employment, income, population, interest rates and inflation are the fundamental factors influencing the housing markets, but their development is mainly determined by factors which are outside the reach of housing policy during normal cycles not to speak of exceptional circumstances associated with institutional changes, like those involved in late 1980s and early 1990s. The microeconomic costs of a macroeconomic disaster and related policies are great and they have had far reaching consequences for housing markets during the whole end of 1990s.

### **13.5 Conclusions**

The consortium on "*Economic crisis of the 1990s, regional development and the welfare state*" had three projects which studied regional disparities and inequality, and housing market developments both from a national and regional point of view over time and especially since latter half of 1980s. This period included an exceptional boom and subsequent bust of extraordinary magnitude, and the subsequent recovery in late 1990s. As for regional disparities, regional GDP as well as micro data based (factor, gross and disposable) income indicators indicate that there has been convergence among Finnish regions over time, more earlier and less when we come closer to the end of 1980s. The analysis based on 85 sub-regions found that the economic crisis of early 1990s led to regional divergence when GDP per capita was considered. The analysis based on Household Survey data and Income Statistics data studied both

income differences between and within regions. It ended up with somewhat different results when four major regions were considered. At this level of regional aggregation, regional disparities remained more or less the same in early 1990s, and increased slightly thereafter.

As for inequality, we first note that the greatest decline in (disposable) income differences since 1971 took place before mid-1980s, thereafter they remained pretty much the same. Somewhat surprisingly, this was also the case in early 1990s, when output dropped and unemployment increased dramatically. When the recovery began in mid-1990s inequality began to increase rapidly. These developments were surprisingly similar both at national level and at the level of major regions thinking of both time profiles and levels of most typical inequality indicators (Gini-coefficients, generalised entropy measures). Only in the recovery period we could detect clear regional divergences as inequality in the Helsinki Region began to increase earlier and to greater extent than elsewhere. This was very much due to capital income which increased both as a source of income and contributor to inequality especially in the Helsinki Regions, a fact which is related to the rise of ICT-industry since mid-1990s.

We also studied housing market developments, since mid-1980s. Financial liberalisation and macroeconomic developments and economic policies were at the background of the boom and bust of the Finnish economy, and affected all regions very similarly until mid-1990s. Thus, there was a tremendous housing price hike and construction boom following financial liberalisation, and when the depression came as a result of bad luck, bad banking and bad policies, the bust in Finnish housing markets was also deeper than in other countries. When the housing markets began to recover in late 1990s, regional divergence could also be detected in this connection. Unlike in earlier booms, job growth and migration benefited only a half a dozen urban areas. As a result, housing prices have increased fast again and construction activity has increased to its capacity facing supply of land etc. constraints especially in the Capital City Region, the fastest growing metropolitan area in EU. In many other Finnish cities the situation is more stagnant and in the countryside vacancy rates are increasing as they face emigration of population.

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## 14 Income Inequality in Finland during the 1990s<sup>243</sup>

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### Abstract

This study uses a decomposition analysis of income inequality by income groups and income sources to understand and explain the inequality increase in Finland during the 1990's. Several conclusions can be drawn from our results. Total inequality rose significantly during the latter part of the 1990's. The results suggest that capital income is the most significant contributor to overall inequality in Finland. As a general pattern inequality rose proportionately more within those socio-economic groups with growing capital income share. The 1993 tax reform, a so-called dual income tax system, is undoubtedly one of key factors responsible for this trend. Rising unemployment in the early 1990's, perhaps surprisingly, did not just increase income inequality. More importantly, the numbers of the unemployed below the poverty line (50 percent of national average income) have risen from 1994. One of the most striking findings of our study is that since 1991 there has been a declining trend in the average real disposable income of unemployed households. The paper also shows that the redistributive impact of taxes and transfers has declined during the 1990's.

Key words: Inequality, unemployment, income decomposition

### 14.1 Introduction

For a long time in the post war period income differences were gradually declining in many industrialised countries. This was just as Kuznets (1955) hypothesised that, following an initial widening of the income distribution,

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<sup>243</sup> We have benefited from the comments, discussion, and advice of Tony Atkinson, Reino Hjerpe, Ravi Kanbur, Heikki Loikkanen and Jussi Simpura.

income differences in advanced countries would move towards greater equality. The recent experience from the beginning of the 1980s shows that the process described by Kuznets has gone into sharp reverse in many advanced countries. Nevertheless income inequality did not increase in all countries in the 1980s, among others in Finland. Moreover, according to Atkinson et al. (1995) income inequality in Finland was lowest in OECD countries in the 1980s.

Figure 14.1 shows what has happened to the Gini coefficient (of different income concepts) in Finland between 1966 and 1998. Three periods can be distinguished in the case of disposable income.<sup>244</sup> The first period, between 1966 and 1976, saw a very remarkable fall in inequality. The inequality remained almost constant until the turning point in the beginning of the 1990s. Since then, from the beginning of the 1990s, there is little doubt that income distribution has become more unequal. In the first five years (1990-1994) considered in Figure 1 inequality rose only modestly, coinciding with a period of rapidly increasing unemployment. During the following period as the Finnish economy recovered, inequality rose very quickly. Average real incomes have grown significantly since 1994, but at the bottom of the scale there has been little or no rise in real income, whereas top incomes have risen a much faster than the average. This rise of income inequality is departure from the pattern of previous decades in Finland. Figure 14.1 also shows how the indicators of redistribution have varied in Finland over the period since 1966. The Gini coefficient for factor income declined from around 38 percent in 1966 to 35 percent in 1976, since then it increased slightly up to the beginning of the 1990s. Then it rose rapidly due to unemployment, but from 1993 the Gini coefficient for factor income has risen much less than the Gini coefficient for disposable income. The Gini coefficient for gross income (including transfers) has very much the same pattern as for disposable income. The redistributive impact of transfers and taxes appears to have fallen since 1994. So we know what happened during the 1990s but the question to be asked is why?<sup>245</sup>

What can explain this rise in inequality? Why has the previous trend been reversed? There are strong grounds for believing that the rise in income inequality in Finland in the 1990s was associated with a fall in the proportion of households with income from work. Between 1966 and 1998 there was a declining trend in the importance of work. Most importantly between 1990 and 1994 there was a significant reduction in the proportion of household income

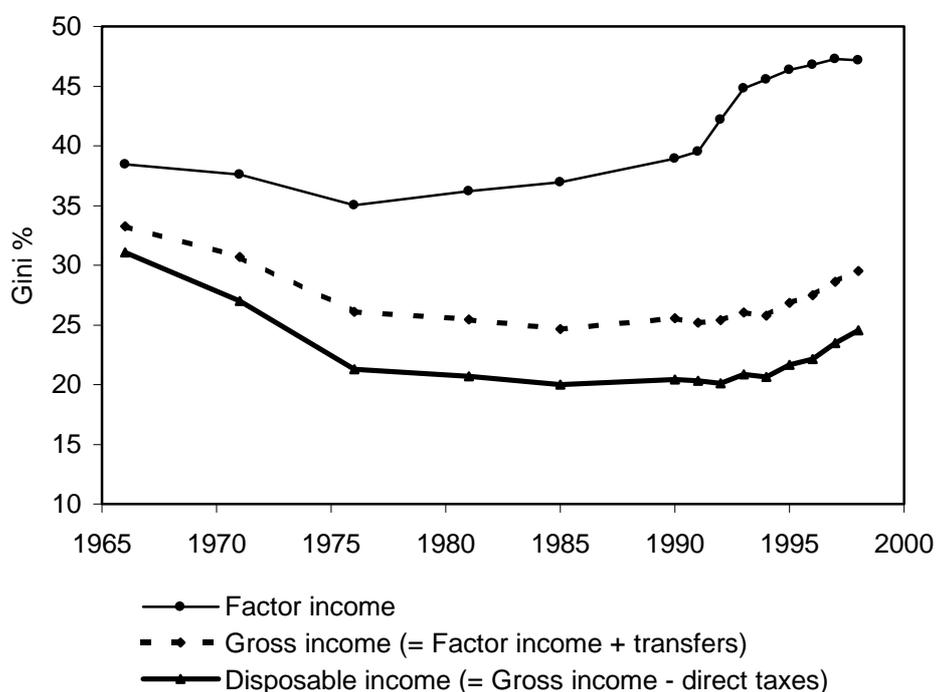
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<sup>244</sup> Like most inequality measures, the Gini coefficient measures inequality relative to two limits. It takes a minimum value of zero if income is equally distributed across the population, with all individuals receiving the same income. It takes a maximum value of one in a situation where all income would be given to a single individual in the society.

<sup>245</sup> For further discussion of recent evolution in Finnish income distribution, see Uusitalo (1988, 1989, 2000), Suoniemi (1997, 1998), Riihelä, Sullström and Tuomala (2001), Riihelä and Sullström (2001).

from work, resulting mostly from unemployment. Although the biggest income component of household income is still earnings (= labour income plus entrepreneurial income), 85.8 percent of disposable income in 1998, the share of capital income has risen from 6.6 percent in 1990 to 15.1 percent in 1998. There has been no single cause of the distributional changes in Finland during the 1990s. It seems to us safe to conclude that the important part of explanation for the inequality increase must be sought in the divergence of experiences with particular groups, in changes of different source of income, and especially in the redistributive role of the government budget.

Figure 14.1. *Gini coefficients of incomes in Finland 1966 - 1998*



In this paper we are concerned in particular with the economic circumstances of people who do not work versus those that do. If we look at the distribution of earnings, we observe great inequality. There is considerable inequality not only amongst those who belong to the labour force, but there is large number of people without any labour income. People without labour income may still have a reasonable standard of living. The reason is not only that we have welfare state programs, but consumption is not only determined by current income, but also by past and future income. The distribution of lifetime income would almost by definition show less inequality than that of annual income. These are important considerations in assessing consequences of the deep recession we experienced in Finland in the 1990s.

It is clear that if we are concerned with inequality, what really matters is not the distribution of income per se, but the distribution of the standard of living between individuals and households. At a more general level we can raise an important question: What is precisely the difference between income inequality and economic inequality? As has been argued most notably by Amartya Sen (1997) the distinction is of considerable importance for economic practice as well as economic theory. "Income is, of course, a crucially important means, but its importance lies in the fact that it helps the person to do things that she values doing and to achieve states of being that she has reasons to desire". There may be substantial differences between the income-based view and non-income indicators of quality of life. In particular inequality comparisons will yield very different results depending on whether we concentrate only on incomes or also on the impact of other economic and social influences on the quality of life. For example, it may be so that an over-concentration on income inequality alone has permitted greater social and political tolerance of unemployment in Finland than in other European countries that cannot be justified if we have a broader view of economic inequality.

Standard of living is not an easy concept to make empirically operational. It clearly depends on the level of consumption of private goods, on the supply of public goods and publicly provided private goods such as education, health care and social services. There is no single, correct way of measuring the standard of living. Therefore, both income and expenditure inequality need to be considered in forming a comprehensive view of inequality. The majority of empirical studies concentrate on income as the primary measure. In most cases this reflects the availability and reliability of data. Nevertheless, there are a number of important insights that can be gained by looking at expenditure as well. In this paper we focus on income inequality whereas Riihelä and Sullström (2000) focuses on expenditure inequality.

We employ a decomposition analysis of inequality by income source and by population groups to understand and explain particular aspects of economic inequality in Finland. Making use of decomposition allows answers to questions as: How much is contributed to inequality by different population groups? And how much is contributed by different income sources? There are numerous ways of decomposing the population to reveal its constituent parts and their contribution to the overall picture of economic inequality. Because one of our aims is to explain how the shift from work has affected economic inequality it turned out to be very useful to consider two categories, those in work and those not in work.

The structure of the paper is as follows. Section 14.2 describes the data used in our study. We focus on two groups, those households where either husband or wife is in work and those where neither in work. Section 14.3 uses decomposition analysis to study the impacts of the shift from work on inequality.

It also examines changes in the tax and benefit system and the effects that these have had on inequality. The following section breaks income down into its constituent parts. It considers from where households receive money and how the importance of different sources has altered during the 1990s. Section 14.5 concludes the paper.

## 14.2 The Data

We describe briefly the data used in this study. We use the income distribution statistics (IDS) published by the Statistics Finland. The IDS is a sample survey of around 9000-11000 households drawn from the private households in Finland. The IDS contains information on incomes, taxes and benefits together with various socio-economic characteristics of the Finnish households. Most of the information contained in the IDS has been collected from various administrative registers. Auxiliary information is collected through interviews. The following components of disposable income are used in this study,

- labour income
- + entrepreneurial income
- = earned income
- + capital income
- = factor income (market income)
- + current transfers received (taken separately national pensions, earnings-related pensions, unemployment benefits and other current transfers received)
- = gross income
- direct taxes, social security contributions and other current transfers paid.
- = disposable income

Sometimes we call disposable income net income because it is factor income (market income) plus net transfers (difference between received and paid transfers of households). Indirect taxes, such as VAT and specific commodity taxes and the provision of public services are not included on our data. This may have important consequences, because indirect taxes and public services tend to be regressive (see for example Sullström and Riihelä, 1996 and Suoniemi, 1993).

All types of income used in this study are calculated on annual basis. The OECD equivalence scale is used in order to make comparable households with different size and composition. The OECD-scale is calculated as follows. The first adult in each household has a weight of 1 and each additional adult a weight of 0.7. Each child under 18 years old gets a weight of 0.5.

### 14.3 Decomposition by income groups; Impact of the shift from employment on the distribution of income in the 1990s

Overall, the most important component of income is earned income, earnings, (labour income plus entrepreneurial income) which makes up 85.8 percent of disposable income in 1998. Table A1 in Appendix shows how the shares of disposable income have altered. The share of earned income has fallen from 99.7 in 1990 to 85.8 in 1998 and as a percent of factor income from 93.9 to 86.0. This reflects the trend towards lower levels of employment. The greatest fall occurred between 1990 and 1994, when the share of earned income fell from 99.7 percent to 80.2 percent, just as the rate of unemployment reached unprecedented levels. In fact the gradual trend downward had occurred throughout the last three decades. The second biggest source of income throughout the period has been transfers or social security. Its share has risen sharply from 27.1 percent in 1990 to 41.9 percent in 1994 and then it has fallen to 35.7 in 1998. According to Household Survey the share of capital income actually declined from the mid 1960s to the mid 1980s, but since then it has gradually risen to form 15.1 percent of households' disposable income in 1998.

*Table 14.1. The ratio of mean incomes ( $m_1 / m_2$ ) and the population share of group 1*

Year	Factor income	Gross income	Disposable income	Population share
1990	5.91	1.51	1.29	78.9
1991	5.00	1.41	1.23	77.5
1992	4.86	1.38	1.21	72.4
1993	4.67	1.36	1.21	68.5
1994	5.01	1.41	1.24	67.0
1995	5.54	1.42	1.24	68.5
1996	5.79	1.44	1.24	68.7
1997	5.65	1.46	1.27	69.5
1998	5.05	1.45	1.26	70.2

Incomes is adjusted by the OECD equivalence scale.

The consequences of the shift in the importance of earned income depend on how it has been shared. Has the fall in earned income spread proportionately across the population, especially during the first part of the 1990s? There is no evidence for this case in Finland in the 1990s. On the contrary the proportion of households where the head was employed or self-employed fell dramatically by 10.4 percentage points between 1990 and 1994 (see Table 14.1).

Using the inequality decomposition technique and the data from IDS in 1990 - 1998 we explore how has this decline in the importance of work affected the distribution of income during the 1990s in Finland. There are, of course, a

number of different ways of splitting the population for the purposes of decomposition analysis. In the first stage we have chosen to split it into two groups; those households where household head is in work, denoted by group 1 and those where household head is not in work denoted by group 2 including mainly unemployed and pensioners.<sup>246</sup>

The basic idea of decomposition is that some forces affect the income inequality by changing the size of different groups, others affect income sources, and some do all of these. We consider in this section decomposition by population subgroup. Total inequality depends on inequality within each of the subgroups, the size of subgroup relative to the total population and the average income of each subgroup. For additively decomposable inequality measures, total inequality is equal to the weighted sum the inequalities within each subgroup (within-group inequality), plus between group inequality which is equal to the total inequality there would be if each person would receive the mean income of the subgroup to which he or she belongs. More formally we can write any additively decomposable inequality measure  $I = I_w + I_b$ , where  $I_w$  is inequality within group and  $I_b$  is between-group inequality.

How to interpret the empirical evidence? The shift from work produces simultaneous shifts in both population shares and relative incomes (see Table 14.1). The effect of this shift from group 1 to group 2 also depends on the distribution within the two groups. Is income inequality greater among group 1 than among group 2?

All six measures used, the generalised entropy measures (including Theil's measures, the mean log deviation ( $c = 0$ ) and the Theil index ( $c = 1$ ) and the squared coefficient of variation ( $c = 2$ ) (Shorrocks, 1980), the variance of logarithms<sup>247</sup>, the Atkinson index ( $e = 0.5, 1$  and  $2$ ) and the Gini coefficient<sup>248</sup>, reflect higher inequality among those not in work, i.e group 2<sup>249</sup>. On the basis of IDS data, the inequality in both groups continued to increase throughout the 1990s. Furthermore, the Lorenz curves for groups 1 and 2 do not cross during the 1990s.

In order to make meaningful comparisons between estimates of inequality measures we need to examine the statistical significance of the results. We

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<sup>246</sup> See Kanbur (1982) on the pioneering work in using the analytical framework of inequality decomposition.

<sup>247</sup> The variance of logarithms does not belong to the generalised entropy class. The variance of logarithms uses the geometric mean an alternative representative income that places more weight on low incomes (see Anand, 1983).

<sup>248</sup> See Cowell (1995) for a good exposition of these measures.

<sup>249</sup>  $e$  is the relative inequality aversion parameter.

employ technique developed by Cowell (1989). Table 14.2 attaches standard errors to the calculated inequality measures.

The rise in the proportion of households without earned income is important because this group not only has a lower average income but also exhibits much greater inequality than group 1. It may be some surprise that inequality is greater among the household without earned income. Because earned income makes up the largest single source of household income we might reasonable expect the most important trends in inequality are driven by changes in the distribution of earned income. This does not seem to be the case in Finland in the 1990s. This also makes it of particular interest to examine more closely income distribution in both groups.

The clear conclusion of the decomposition analysis was that variation within groups was far more important in accounting on total inequality than variation between groups. In the two-group case, between-groups component contributed less than 3 percent to total inequality in 1998. When the population is grouped into eight socio-economic groups according to the squared coefficient of variation, disparities between groups account for 15.5 percent of total inequality in 1990, 12.1 percent in 1993 and 8 percent in 1998.

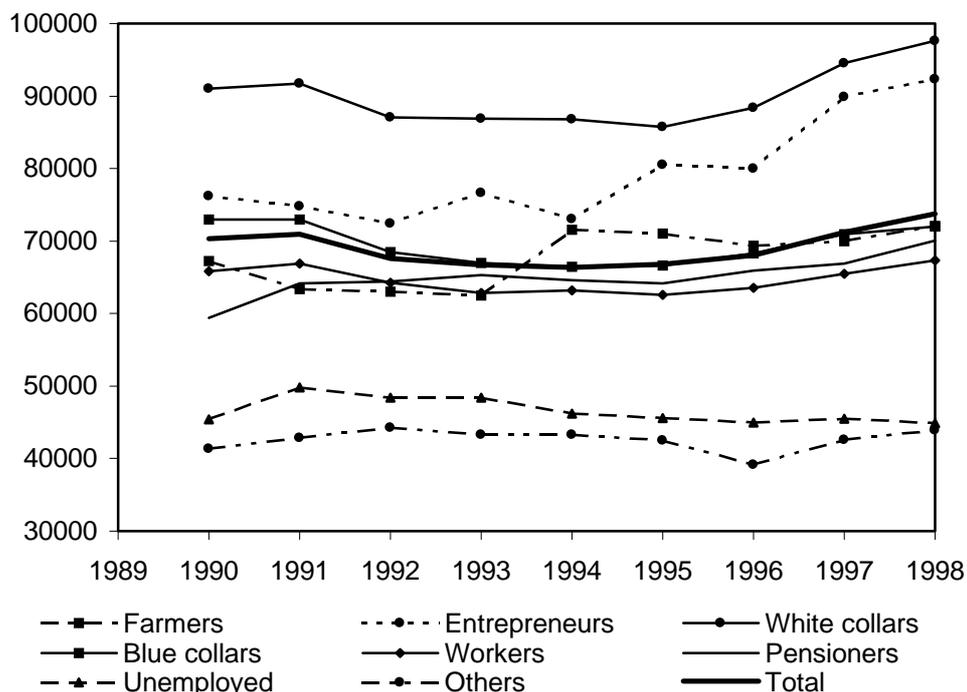
The inequality in both groups continued to increase during the latter part of the 1990s. Interestingly, the divergence in inequality between two groups remained almost the same until 1997. Since then the growth of inequality has been more rapid among those not in work than in group 1. An important part of the explanation for the overall increase in inequality must be sought in the divergence of experiences within different groups. There are divergences in the average income of different groups (see Figure 14.2) and the relative sizes of groups changed over the 1990s (see Table A3 in Appendix). So it is not just the increased numbers of unemployed and the increased gap between the incomes of group 1 and group 2 which is responsible for increased inequality, but also the gap between well-paid people in group 1 and poorly paid people in group 1; between richer pensioners and poorer pensioners in group 2.

Table 14.2. *Income Inequality in Finland in 1990, 1993 and 1998*

Inequality measure	Group	Year 1990			Year 1993			Year 1998			
		FI	GI	DI	FI	GI	DI	FI	GI	DI	
Generalised Entropy class of measures (c = 0)	1	14.0 (0.29)	9.3 (0.20)	6.2 (0.13)	17.1 (0.45)	10.1 (0.30)	6.9 (0.24)	19.2 (0.67)	12.3 (0.51)	9.1 (0.46)	
	2	56.7 (2.24)	10.6 (0.43)	7.1 (0.31)	55.1 (2.66)	11.3 (0.58)	7.7 (0.47)	78.0 (6.37)	16.0 (1.50)	11.6 (1.25)	
	Total	37.3 (0.71)	10.9 (0.19)	7.0 (0.12)	44.0 (0.99)	11.4 (0.28)	7.5 (0.22)	49.4 (1.27)	14.8 (0.53)	10.4 (0.47)	
	(c = 1)	1	13.5 (0.32)	9.8 (0.27)	6.4 (0.15)	16.8 (0.70)	10.8 (0.55)	7.5 (0.45)	19.9 (1.16)	14.1 (0.97)	10.7 (0.92)
		2	45.3 (2.14)	11.4 (0.54)	7.5 (0.37)	45.7 (3.38)	12.4 (0.94)	8.3 (0.77)	92.0 (17.0)	21.5 (9.95)	15.6 (3.24)
		Total	24.7 (0.42)	11.2 (0.25)	7.1 (0.14)	31.2 (0.77)	12.2 (0.48)	8.1 (0.39)	36.3 (1.56)	17.1 (1.13)	12.5 (1.05)
	(c = 2)	1	16.1 (0.72)	12.1 (0.62)	7.2 (0.24)	22.9 (3.46)	15.3 (2.49)	10.4 (1.77)	30.9 (4.30)	22.6 (3.34)	17.5 (3.16)
		2	72.7 (8.09)	14.3 (0.96)	8.9 (0.64)	83.4 (15.5)	17.4 (2.53)	11.2 (1.89)	666.2 (292.0)	66.6 (28.9)	45.6 (21.0)
		Total	26.2 (0.86)	13.7 (0.58)	8.0 (0.23)	38.5 (4.08)	16.9 (2.10)	11.0 (1.43)	59.5 (9.09)	31.9 (5.74)	24.1 (5.16)
Variance of logarithms	1	29.9 (0.76)	18.0 (0.38)	12.5 (0.31)	36.7 (1.08)	19.5 (0.71)	13.3 (0.65)	39.8 (1.41)	22.5 (0.59)	16.4 (0.55)	
	2	174.2 (8.87)	20.1 (0.77)	14.1 (0.67)	164.3 (11.2)	21.1 (0.87)	14.7 (0.73)	200.0 (14.6)	27.1 (1.69)	19.9 (1.68)	
	Total	125.5 (3.91)	21.4 (0.38)	14.0 (0.28)	138.6 (4.66)	22.2 (0.59)	14.6 (0.43)	158.8 (6.39)	27.4 (0.72)	18.8 (0.50)	
Atkinson Index (e = 0.5)	1	6.6 (0.62)	4.6 (0.63)	3.1 (0.63)	8.0 (0.81)	5.0 (0.83)	3.5 (0.84)	9.1 (0.90)	6.3 (0.92)	4.7 (0.93)	
	2	21.3 (1.03)	5.3 (0.82)	3.6 (0.82)	21.0 (1.38)	5.7 (1.12)	3.9 (1.12)	32.0 (3.42)	8.5 (1.62)	6.2 (1.55)	
	Total	13.4 (0.56)	5.3 (0.54)	3.4 (0.54)	16.3 (0.66)	5.7 (0.67)	3.8 (0.67)	18.1 (0.79)	7.5 (0.78)	5.4 (0.79)	
	(e = 1.0)	1	13.1 (5.78)	8.9 (6.16)	6.1 (6.17)	15.7 (7.30)	9.6 (8.03)	6.6 (8.06)	17.5 (7.92)	11.6 (8.67)	8.7 (8.69)
		2	43.3 (4.33)	10.1 (7.44)	6.9 (7.60)	42.4 (5.89)	10.7 (10.1)	7.4 (10.3)	54.2 (6.20)	14.8 (11.6)	11.0 (11.9)
		Total	31.1 (3.92)	10.3 (5.09)	6.7 (5.15)	35.6 (4.39)	10.8 (6.29)	7.2 (6.38)	39.0 (4.74)	13.8 (6.89)	9.9 (7.02)
	(e = 2.0)	1	27.3 (1.20)	16.7 (1.09)	12.1 (1.16)	37.2 (3.67)	21.0 (3.22)	15.1 (2.85)	38.0 (2.33)	21.9 (1.70)	16.7 (1.74)
		2	93.4 (1.13)	18.9 (1.55)	13.8 (1.58)	90.4 (1.80)	19.9 (1.87)	14.3 (1.97)	96.1 (0.85)	28.4 (4.08)	22.2 (4.02)
		Total	92.8 (1.16)	19.7 (0.89)	13.5 (0.96)	90.4 (1.64)	22.1 (2.08)	15.5 (1.95)	95.6 (0.87)	26.7 (1.92)	19.6 (1.85)
Gini coefficient	1	28.2 (0.32)	23.7 (0.29)	19.4 (0.22)	31.2 (0.48)	24.5 (0.44)	20.0 (0.39)	32.7 (0.60)	27.0 (0.57)	23.1 (0.54)	
	2	55.5 (0.90)	25.4 (0.50)	20.5 (0.43)	55.5 (1.11)	25.7 (0.67)	20.8 (0.59)	66.6 (3.03)	30.4 (1.70)	25.3 (1.52)	
	Total	39.0 (0.35)	25.6 (0.26)	20.4 (0.20)	44.8 (0.45)	26.1 (0.36)	20.9 (0.32)	47.2 (0.63)	29.5 (0.57)	24.5 (0.55)	

Household income is adjusted by OECD equivalence scale, FI = Factor income, GI = Gross income, DI = Disposable income, Asymptotic standard errors in the parentheses.

Figure 14.2. Real average disposable income by socio-economic groups

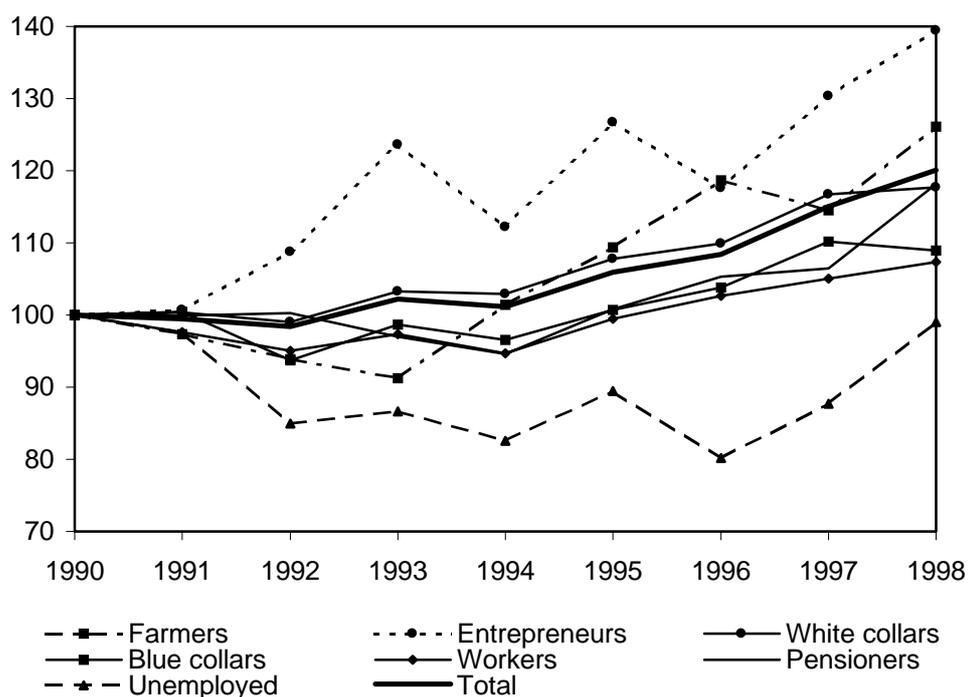


It is also apparent that the differences between the mean income of various subgroups within those not in work and those in work have diverged during the latter part of the 1990s. Therefore, we also perform further decompositions in both groups. The purpose of this is to try to isolate where the growth in inequality is occurring. Figure 14.2 indicates that whilst the economy has grown significantly during recent years the fruits of that growth are not shared equally. There was a declining trend in the average disposable income of unemployed population (household head more than six months unemployed) while other groups have, on average, enjoyed more and less significant real income gains over the last 4-5 years. In particular, real disposable income has grown significantly in the case of entrepreneurs during the latter part of the 1990s. As for the differences between the mean incomes of various groups they have diverged. In particular, the mean income of the white collars group in 1990 was around twice that of the second poorest group (unemployed). This gap declined in 1993, but increased in 1998 clearly over the gap of the 1990.

The multifaceted nature of the inequality increase is well illustrated in Figure 14.3. It shows how the Gini coefficient indexed at 100 in 1990 rose for most of the groups in the period 1990 - 1998. Over the first six years under examination (1990 - 1995), the contribution of the unemployed population to overall inequality based on the Gini declined. It rose between 1996-1998. As we showed in the previous section the contribution of a particular group to overall

income inequality, however, depends on the combination of two things – the extent of income inequality within the group and the size of the group. In the earlier period (1990-1993) these two factors were working in opposite directions. Between 1994 and 1998 the most significant increases occurred among households headed by pensioners, farmers, entrepreneurs and white collars.

Figure 14.3. *Gini coefficients for different socio-economic groups (1990=100)*



To gain further understanding of changes in income inequality between 1990 and 1998 we used a shift share analysis (Atkinson, 1992).<sup>250</sup> This method is based on decomposition of inequality measures by household employment status. Table 14.3 shows, for generalised entropy measures and variance of log income, what would have happened to total inequality if subgroup population shares had changed from their 1990 levels to their 1998 levels, but other things

<sup>250</sup> Although the process Kuznets (1955) hypothesised has gone into sharp reverse in Finland and other advanced countries, it does not mean that the analytical framework used by Kuznets (1955) could not be still useful. "Changes in the distribution of income are outcome of several forces operating in different directions. As the balance of these forces varies, we may expect the resulting trend in inequality to change direction ... The balancing of conflicting forces is evident from what is perhaps the most important legacy of Kuznets' approach: the analytical framework for examining the contribution to overall inequality of different sectors of the economy." Atkinson (1992, p. 26).

had remained the same. If we take, for example, the variance of log income and replace the 1990 values for the share of those in work by that for 1998, then the calculated change is 10 % of actual rise. The actual total rise in income inequality from 1990 to 1998 was 4.8 percentage points. Then we repeat the same procedure showing impact of changes in group mean incomes, other things held constant. Finally Table 14.3 shows the impact of ceteris paribus changes in group inequalities. The quantification of the different effects depends on the choice of inequality measure. The most striking feature of the results in Table 14.3 is that in most cases the inequality changes between 1990 and 1998 are accounted for by changes in inequality within the work status subgroups, rather than by changes in relative subgroup sizes or average incomes. It appears that in the case of variance of log income 82.5 percent of the inequality growth arose from inequality within the work status subgroups. The shift from employment only accounts for up 10 percent of the increase. In sum, the results of decomposition analysis are confirmed by shift-share analysis.

*Table 14.3. Shift-share analysis of inequality changes, 1990 - 1998, based on employment status*

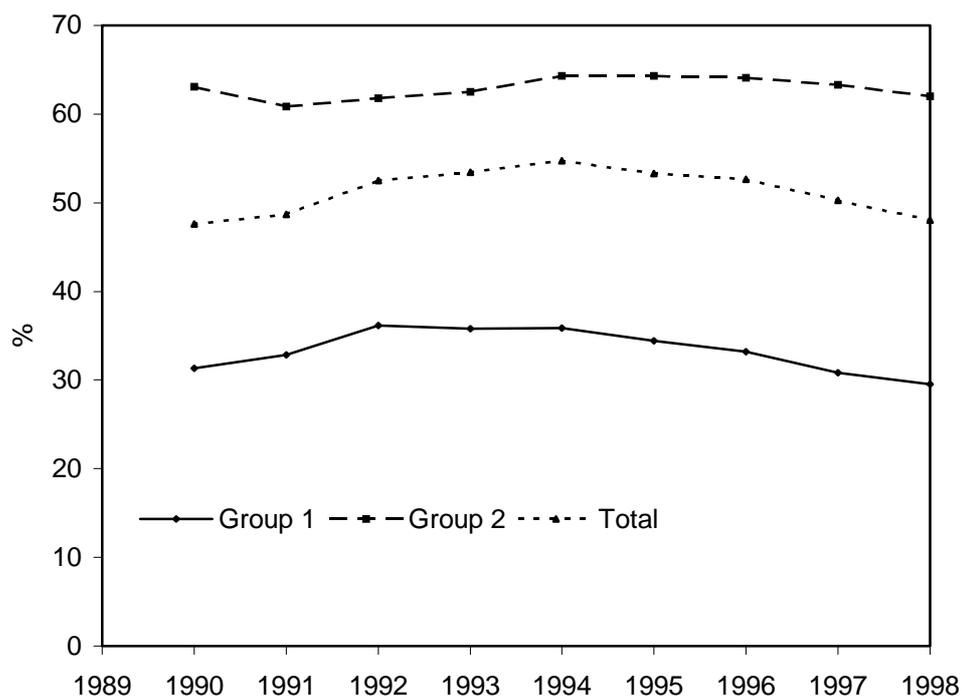
$I(c)$	Year	Actual $100 \cdot I(c)$	Pop. share		Means		Inequalities	
			Pred.	% <sup>*)</sup> change	Pred.	% change	Pred.	% change
$c = 0$								
	1990	6.95						
	1993	7.49	9.69	510.2	4.84	-392.6	7.12	32.0
	1998	10.39	9.24	66.5	4.96	-57.7	8.37	41.2
$c = 1$								
	1990	7.06						
	1993	8.07	4.72	-231.3	8.92	183.4	8.40	132.3
	1998	12.45	5.10	-36.2	9.07	37.2	13.50	119.5
$c = 2$								
	1990	7.99						
	1993	11.01	4.29	-122.8	4.21	-125.5	5.72	-75.2
	1998	24.13	4.28	-23.0	4.34	-22.7	11.60	22.3
$Lnvar$								
	1990	13.96						
	1993	14.61	14.55	90.2	13.50	-70.8	14.65	106.5
	1998	18.84	14.45	10.0	13.96	0.1	17.98	82.5

\*) % of actual change:  $100[\hat{I}(t+1) - I(t)]/[I(t+1) - I(t)]$ , where  $\hat{I}(t+1)$  is the predicted value for the period (t+1)

### Redistributive impact of taxes and transfers

We are especially interested in households' net income, that is, their income after they have received social security benefits and paid taxes on their income. Understanding the impact of taxes and benefits is a crucial part in understanding trends in inequality. The most obvious way to proceed is to examine the actual amounts of taxes paid and benefits received by households in groups 1 and 2 in our data and then look at how those have changed over time. Of course this approach is not without problems. Namely this approach is not able to distinguish between changes in the tax structure and changes in the distribution of the pre-tax income.<sup>251</sup> Using the actual amounts of taxes paid and benefits received by households we may ask whether the redistributive role of government has fallen or not during the 1990s. Is it so that policy has contributed to the rise in inequality?

Figure 14.4. *The extent of redistribution; for groups 1 and 2 and the whole population*



<sup>251</sup> The alternative would have been to apply the 1990 tax and benefit system to the 1998 distribution of household income. The difficulty with this approach would be that it is not easy to trace all behavioural changes if the old tax and benefit system were reintroduced. Moreover it is not easy to reconstruct the old tax and benefit system. For these reasons we didn't adopt this approach.

In considering the impact of taxes and transfers, we can distinguish between the automatic responses of budget to changing gross incomes and policy changes in the tax and benefit system. There are a number of automatic mechanisms in taxes and benefits. For instance, the unemployment benefit system provides protection against loss of labour incomes, hence moderating the rise in inequality in gross incomes. This is just what happened in Finland in the beginning of the 1990s. Figure 14.1 in the Introduction shows how indicators of redistribution have varied over the 1990s. The Gini coefficient for factor income increased from 39 percent in 1990 to 44.8 percent in 1993, mainly due to rise in unemployment, but thereafter, it did not rise so rapidly. The rise in the Gini coefficient for gross income (including transfers) was less rapid up to the mid 1990s: the rise from 1990 to 1993 was 0.5 percentage point compared with a rise of 5.8 percentage points for factor income. After 1993 the situation reverses: the Gini coefficient for factor incomes rose by 2.4 percentage point from 1993 to 1998 but for gross income the respective increase was 3.4 percentage points. The rise for disposable income was even larger, 3.6 percentage points. In Figure 14.4 the average redistribution of income measured in terms of the relative difference between the Gini coefficient of factor income and disposable income are given from 1990 to 1998. More formally

$$100 * (G_F - G_D) / G_F$$

where  $G_F$  and  $G_D$  are the Gini coefficients of factor income and disposable income respectively. We see that the redistributive contribution of direct taxes and transfers fell in all cases during the latter part of the 1990s. In other words over that period while factor income inequality rose, post-tax inequality rose faster still.

#### 14.4 Decomposition by income sources

So far we have looked at the income inequality treating income as a single lump. Of course people have incomes from different sources such as labour, capital and social security. These different income sources are distributed differently within the population. Next we examine some of major trends in the different sources of income. We use a measure that is decomposable in order to assess how changes in different income sources have affected overall income inequality. We break down total income into following components: labour income, entrepreneurial income, capital income, pensions and other transfers.

To see how the composition of income varies in different parts of the income distribution we show in Figure 14.5 composition of disposable income by decile. Throughout the last decade, labour income has made up the most important

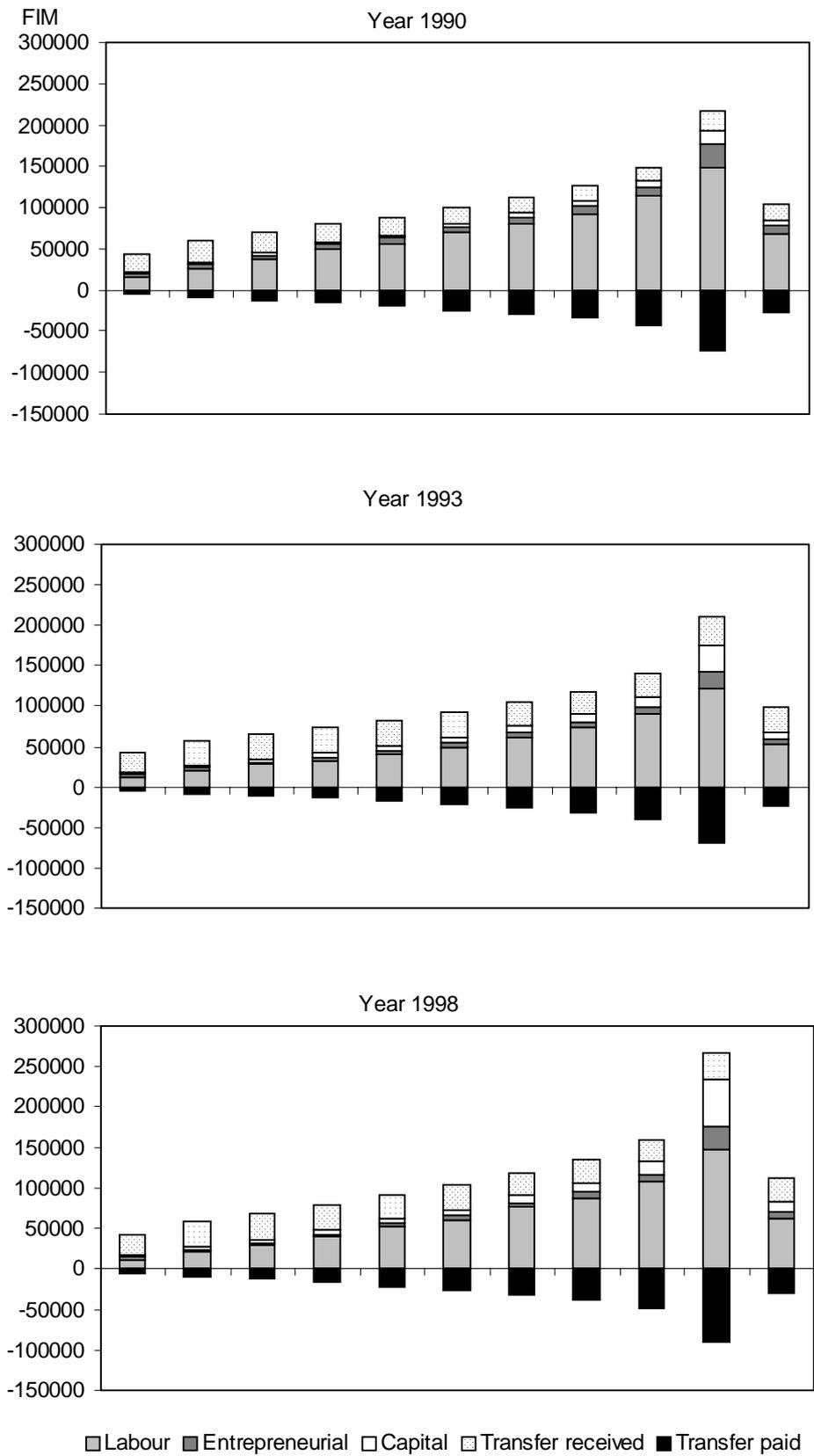
source of total household income, but its role is less important for poorer deciles in 1998 than in 1990. Figure 14.5 shows that the shares of labour income below the median have declined during the 1990s. For the poorest decile, labour income plays a rather minor role, making up about 40 percent of the income of the poorest decile in 1990 and just over 30 percent in 1998. Labour income provides over a half of income from the second decile, reaching a maximum in the ninth decile. It falls back in the decile of richest tenth reflecting large receipts of capital income and entrepreneurial incomes in the top decile. The high level of capital income also reflects the considerable concentration of wealth and therefore income from wealth. The tenth decile gets 33 percent of its income deriving from capital, other deciles 14 percent and less. Transfers provide the major part of income for the poorest deciles. They play an important role for some households even in the fifth and sixth deciles.

One way to looking at changes in the contribution of different income sources is to consider the share of each income component going to group 1 and group 2. Such figures are given in Table 14.4. They show among other things that the share of capital income in group 1 has grown during the 1990s. In fact we shall see that the reason for this is that capital income has risen significantly among entrepreneurs and white collars. The inequality in question is that of disposable household income. This is the household income after taxes and social security contributions. Disposable income could be expressed as the sum of incomes of all sources of gross income minus taxes and social security contributions. Here taxes and social security contributions are treated as a negative income.

*Table 14.4. The shares of incomes by two groups 1990, 1993 and 1998*

Income source	Year 1990			Year 1993			Year 1998		
	1	2	Total	1	2	Total	1	2	Total
Earnings	97.7	2.3	100	95.3	4.7	100	96.5	3.5	100
Capital income	64.5	35.5	100	63.2	36.8	100	68.0	32.0	100
Transfers received	42.9	57.1	100	37.0	63.0	100	35.5	64.5	100
Transfers paid	91.2	8.8	100	81.6	18.4	100	84.5	15.5	100
Disposable income	82.8	17.2	100	72.4	27.6	100	74.8	25.2	100

Figure 14.5. Income composition by deciles



Another way of thinking about the same issue is to look at changes in the contribution of different income components to the squared coefficient of variation. By contrast to the decomposition analysis by population subgroups there are relatively few measures that will allow a convenient breakdown by component of income. Following the methodology of Shorrocks (1982) we use the squared coefficient of variation<sup>252</sup>. This measure can be readily broken down into its constituent parts. This measure is well defined even in the presence of income components with negative values. We define total inequality,  $I$ , as the sum of the contributions of each source of income.

$$I = \sum_k S_k$$

where  $S_k$  is the absolute contribution of source  $k$  to total inequality. Now define

$$s_k = S_k / I$$

so  $\sum s_k = I$ , where  $S_k$  is the proportional contribution of source  $k$  to total inequality. When the squared coefficient of variation is used, the absolute contribution of a given income source is

$$S_k = \text{cov}(y_k, y) / m^2$$

where  $m$  is mean income and  $y$  is total households income and  $\text{cov}(\cdot)$  is the covariance between the household incomes from source  $k$  and total income. The proportional contribution of each source to total inequality can be written as

$$s_k = \text{cov}(y_k, y) / \sigma^2 = \rho_k \sigma_k / \sigma$$

where  $\rho_k$  is the correlation coefficient of between  $y_k$  and  $y$ ,  $\sigma_k$  is the standard deviation of incomes from source  $k$  and  $\sigma$  is the standard deviation for total incomes.

The role of each income source in contributing to overall inequality is shown by Figure 14.6 and Tables 14.5-9. It is determined by three factors, the correlation between income from source  $k$  and total disposable household income, the share of income from source  $k$  in total disposable income, and within source inequality.

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<sup>252</sup> See also Suoniemi (2000).

Figure 14.6. Decomposition of the squared coefficient of variation

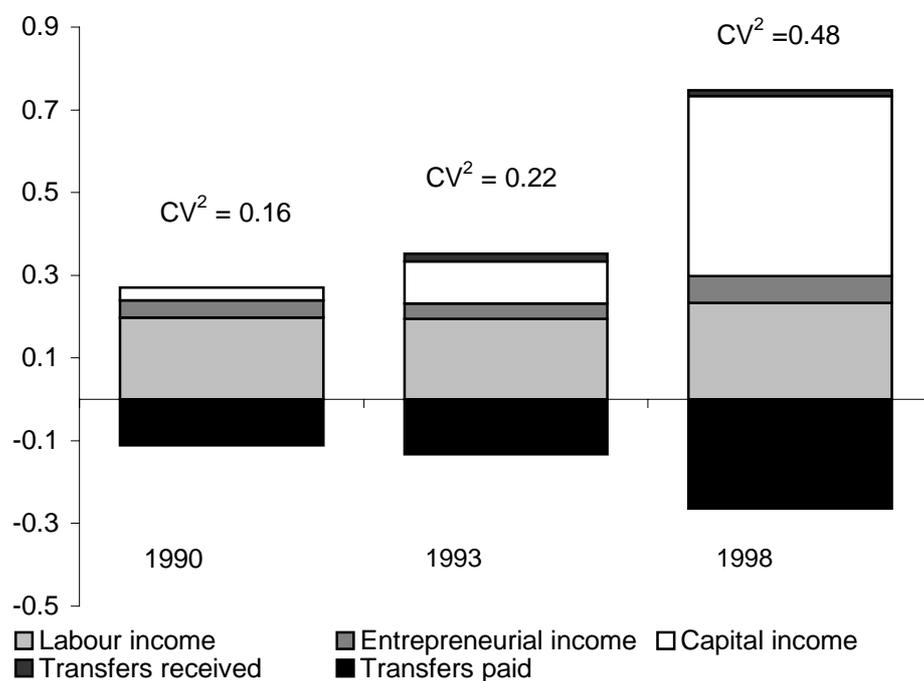


Figure 14.6 shows how the evolving level of total income inequality since 1990 has been generated by different disequalising contributions from these different sources of total household income. This figure has two especially striking features. First overall inequality has increased substantially, as we already have seen in the previous section. The sources of income inequality are in 1998 more diverse than in 1990, when the great majority of income inequality reflected inequality of earnings. By the late 1990s, the combined effects of other income (mainly capital income) sources has grown to be more important. Table 14.5 provides a detailed decomposition of inequality ( $CV^2$  index) by income source for different group.

Table 14.5. *Decomposition of different group inequality by income sources in year 1990, 1993 and 1998*

	CV <sup>2</sup>	100*s				$m_k / m$				$\rho_{y_k, y}$			
		EI	CI	TR	TP	EI	CI	TR	TP	EI	CI	TR	TP
Year 1990													
CV2		0.584	8.856	1.584	0.943								
Farmers	0.184	126	18	2	-46	97.6	12.3	19.1	-29.0	0.89	0.43	0.06	-0.74
Entreprn.	0.311	138	41	5	-85	121.4	10.1	13.2	-44.8	0.89	0.50	0.17	-0.87
Wcollars	0.123	165	17	1	-83	132.5	5.1	9.7	-47.2	0.91	0.42	0.03	-0.89
Bcollars	0.094	125	16	10	-51	114.9	4.4	14.1	-33.3	0.81	0.42	0.16	-0.82
Workers	0.081	147	10	-6	-52	111.5	2.9	16.6	-30.9	0.87	0.32	-0.09	-0.83
Pension.	0.159	31	28	90	-49	10.0	14.2	93.4	-17.5	0.48	0.58	0.79	-0.82
Unempl.	0.118	36	13	73	-22	38.8	6.8	70.2	-15.9	0.43	0.38	0.70	-0.67
Others	0.320	34	45	32	-11	45.3	8.7	56.8	-10.7	0.48	0.68	0.45	-0.49
Total	0.159	150	19	1	-69	99.7	6.6	27.1	-33.4	0.78	0.39	0.01	-0.85
Year 1993													
CV2		0.872	6.935	1.001	1.034								
Farmers	0.156	99	24	15	-38	79.2	18.5	24.9	-22.6	0.82	0.55	0.30	-0.78
Entreprn.	0.784	82	72	1	-55	94.7	23.8	17.1	-35.5	0.78	0.81	0.03	-0.88
Wcollars	0.145	140	31	5	-76	122.5	10.5	15.0	-48.0	0.85	0.59	0.11	-0.88
Bcollars	0.086	138	21	-1	-58	104.6	7.9	21.5	-33.9	0.82	0.51	-0.01	-0.85
Workers	0.081	135	23	-6	-51	100.2	7.3	24.9	-32.3	0.79	0.48	-0.09	-0.81
Pension.	0.202	16	61	76	-53	8.3	19.3	96.3	-23.8	0.33	0.80	0.74	-0.82
Unempl.	0.115	60	31	46	-37	27.9	8.9	81.9	-18.7	0.55	0.53	0.52	-0.75
Others	0.335	9	61	51	-21	23.2	10.8	78.6	-12.6	0.17	0.79	0.68	-0.72
Total	0.220	105	46	9	-60	80.2	12.3	40.1	-32.6	0.66	0.67	0.10	-0.85
Year 1998													
CV2		0.893	24.97	1.145	1.349								
Farmers	0.371	102	23	1	-26	87.6	17.8	19.7	-25.2	0.91	0.48	0.05	-0.72
Entreprn.	1.092	49	103	0	-53	89.3	38.1	13.6	-41.0	0.60	0.90	0.01	-0.93
Wcollars	0.281	95	71	-1	-66	126.4	13.4	11.9	-51.7	0.73	0.78	-0.02	-0.88
Bcollars	0.104	132	21	3	-56	108.9	9.0	19.8	-37.6	0.82	0.55	0.05	-0.86
Workers	0.095	150	15	-10	-55	108.9	7.1	20.7	-36.7	0.88	0.49	-0.17	-0.87
Pension.	0.810	8	116	21	-44	8.5	21.4	94.4	-24.3	0.26	0.93	0.43	-0.93
Unempl.	0.162	38	52	43	-32	20.4	8.9	87.9	-17.1	0.45	0.70	0.52	-0.84
Others	2.388	3	154	6	-63	29.3	14.6	71.1	-15.0	0.14	0.97	0.30	-0.97
Total	0.482	62	90	3	-55	85.8	15.1	35.7	-36.6	0.53	0.83	0.05	-0.89

EI = Earned income, CI = Capital income, TR = Transfers received, TP = transfers paid.

### Earnings and inequality

Earnings are the biggest single source of income (85.8 percent in 1998, see Appendix, Table A1), but their contribution to total inequality has declined over the 1990s. Earnings made the biggest contribution to total income inequality in 1990 and 1997, but not anymore in 1998. Within source inequality for earnings has actually fallen over the period and it is in fact relatively low compared with within-source inequality for the other income sources. There are two reasons why earned income is still an important contributor to total income inequality. The biggest component of disposable income is earnings and furthermore, earned income has high correlation with total disposable income.

As it can be seen in Table 14.5 in 1998 62 percent and in 1993 105 percent of the total income inequality is attributed to earnings.<sup>253</sup> Table 14.6 shows decomposition according to labour income. The picture is very much the same as it was in the case of earnings. This is simply so because the major part of earnings comes from labour income.

Table 14.6. *Labour income and inequality*

	Year 1990			Year 1993			Year 1998		
	1	2	Total	1	2	Total	1	2	Total
$100^* s_k$	122.9	12.5	123.4	97.2	9.7	88.5	65.3	2.6	48.3
$CV_k^2$	0.389	5.359	0.706	0.493	4.354	1.021	0.472	6.339	1.000
$m_k / m$	1.040	0.095	0.877	0.946	0.119	0.718	1.002	0.086	0.771
$\rho_k$	0.721	0.242	0.670	0.666	0.184	0.573	0.561	0.114	0.435

### Capital income and inequality

Capital income has always been highly concentrated and so changes that increase the importance of capital income in household income have a disequalising influence. Capital income is a source of income whose contribution to overall income inequality has risen dramatically over the 1990s. This is because the number of households receiving large amounts of capital income from property, share income and capital gains has risen. A notable example is the increased personal ownership of equities, especially during the latter part of the 1990s. During the 1990s there has been the substantial shift of wealth for the stock market. The share of capital income in total income has risen from 6.6 percent in 1990 to 15.1 percent in 1998. For those not in work (group 2) the share has risen from 13.6 percent in 1990 to 19.2 percent in 1998. The reason can be found from the corresponding figures for pensioners; 14 percent in 1990 and 21 percent in 1998 see Table 14.5. This has meant that capital income has become increasingly positively correlated with total disposable household income; it is high income households in which the receipt of large amounts of capital is concentrated. Hence, as can be seen in Tables 14.5 and 14.7 the impact of capital income as contributor to overall inequality has been increased. In 1990 only 19 percent of the income inequality of the total net income is attributed to incomes from this source while in 1998 that figure is 90 percent. The dominant contributor to overall inequality in Finland during 1990 - 1997 was earnings. In 1998 capital income was the number one.

<sup>253</sup> Individual contributions can exceed 100 percent, since some of the components are negative (see Figure 14.5).

Table 14.7. *Capital income and inequality*

	Year 1990			Year 1993			Year 1998		
	1	2	Total	1	2	Total	1	2	Total
$100^* s_k$	20.1	29.4	19.0	45.9	56.2	46.4	74.4	117.8	90.1
$CV_k^2$	13.88	2.352	8.85	8.671	4.337	6.937	16.89	40.28	24.98
$m_k / m$	0.051	0.136	0.066	0.107	0.163	0.123	0.137	0.192	0.151
$\rho_k$	0.401	0.597	0.389	0.663	0.782	0.674	0.782	0.924	0.831

The contribution of entrepreneurs to income inequality rose markedly during the 1990s (see Table 14.5). This is simply because capital income has become a more important income source for this group. The factor share of capital income for this group has risen from 10.1 percent in 1990 to 38.1 percent in 1998. At the same time capital income of entrepreneurs has become more unequally distributed amongst this group and has also steadily become more positively correlated with total income over the period. These three factors together explain the disequalising effect of capital income for this group. The 1993 tax reform, so-called dual income tax system, is undoubtedly one of the key factors responsible for this trend. This view is supported by the fact that the share of entrepreneurial income indicates a declining trend over the period. The dual income tax system requires a splitting of the income of the self-employed and the income of active owners of firms into a labour income component and a capital income component. Since the two components cannot be observed directly, this splitting gives rise to a number of practical problems. On the other hand, the dual income tax system creates new room for tax avoidance through the transformation of labour income subject to high marginal rates into capital income subject to low marginal rates. In fact critics of the dual income tax system warned of this kind of distributional consequences.

### **Social security and taxes and inequality:**

The main source of income for those not in work is in fact social security. Therefore, it is important to know the redistributive impact of transfers during the 1990s. Table 14.8 shows that the proportional contribution of social security income to the squared coefficient of variation first rose and then came down. It is hardly surprising, as Table 14.8 shows, that the majority of social security income is paid to those not in work.

Table 14.8. Social security

	Year 1990			Year 1993			Year 1998		
	1	2	Total	1	2	Total	1	2	Total
$100^* s_k$	1.2	89.3	0.5	0.5	77.0	8.8	-1.1	22.6	2.8
$CV_k^2$	1.498	0.295	1.584	0.918	0.284	1.001	1.002	0.279	1.145
$m_k / m$	0.141	0.903	0.271	0.205	0.917	0.401	0.169	0.915	0.357
$\rho_k$	0.026	0.772	0.006	0.011	0.747	0.103	-0.039	0.446	0.050

The proportional contribution of income taxes and social security to overall inequality was -69 percent in 1990 and -55 percent in 1998 (see Table 14.9). Hence the contribution of taxes and transfers in alleviating income inequality declined during the 1990s in Finland.

Table 14.9. Income taxes and social security contributions

	Year 1990			Year 1993			Year 1998		
	1	2	Total	1	2	Total	1	2	Total
$100^* s_k$	-71.2	-43.8	-68.9	-62.2	-47.2	-60.0	-57.8	-47.0	-54.7
$CV_k^2$	0.742	1.941	0.945	0.8	1.642	1.034	0.869	4.559	1.35
$m_k / m$	-0.369	-0.171	-0.335	-0.367	-0.218	-0.326	-0.415	-0.225	-0.366
$\rho_k$	-0.853	-0.779	-0.847	-0.864	-0.803	-0.851	-0.889	-0.933	-0.894

## 14.5 Conclusions

In this study income inequality in Finland was investigated using a decomposition analysis by income group and income source. We have offered some explanations for the recent trends or episodes in income inequality, focusing on changes in employment status, different sources of incomes and the redistributive role of the government budget. Several conclusions can be drawn from the results. Total inequality rose significantly during the latter part of the 1990s. The clear conclusion of decompositions is that variations within groups were far more important in accounting for total inequality than variations between groups. As a general pattern inequality rose proportionately more within those socio-economic groups with growing capital income shares. In particular among entrepreneurs this share grew most significantly during the 1990s. The results show that capital income although it appears to represent only 15 percent of the total equivalent household income makes by far the most significant proportional contribution to overall inequality. The 1993 tax reform, a so-called dual income tax system, is undoubtedly one of key factors responsible for this trend. Rising unemployment in the early 1990s, perhaps surprisingly, did

not increase income inequality. More importantly, the number of the unemployed below the poverty line (50 percent of national average income) has risen from 1994. Since 1991 there was a declining trend in the average real disposable income of unemployed households. This is without due to those policy measures cutting the redistributive impact of transfers, which have led inequality of disposable income to increase more than that of factor income.

The interpretation of our results raises several issues such as the incidence of taxation, life-cycle considerations, the valuation of public spending of goods and services etc. But, taken at face value, our results suggest that the government budget has ceased to offset the rising inequality of factor income and that the increase in inequality during the latter part of the 1990s was attributable to reduced redistributive efforts of the government.

What might be an explanation of this evolution of redistribution policy in Finland during the 1990s? An analytical framework for thinking through redistribution policy is put forward by James Mirrlees in his Nobel Prize winning paper (Mirrlees, 1971). Three elements of the Mirrlees model are useful for our purposes. First is the concept of inherent inequality (factor income inequality) reflecting among others skilled/unskilled wage differentials, asset inequality and social norms. Second is the egalitarian objectives of the government. Third is the level of incentive and disincentive effects. In other words the redistribution policy is the product of circumstances and objectives. Kanbur-Tuomala (1994) shows that when inherent inequality increases the optimum income tax system becomes more progressive, taxing the better off at higher rates to support the less well off. Thus, one of the policy responses in rise of inherent inequality should be a greater willingness to redistribute through the tax and transfer system. Or is it so that the redistributive objectives of our politicians have become less egalitarian during the 1990s?

## Appendix

*Table A1. The share (in percentages) of income from different sources in total disposable household income 1990 - 1998 (OECD-units)*

Year	1990	1991	1992	1993	1994	1995	1996	1997	1998
Earned income	99.7	93.0	89.1	80.2	81.5	84.6	85.1	84.7	85.8
Labour income	87.7	82.6	79.0	71.8	71.8	74.7	76.5	75.7	77.1
Entrepreneurial income	12.0	10.4	10.1	8.4	9.7	9.9	8.6	9.0	8.7
Capital income	6.6	8.3	8.8	12.3	12.1	11.3	12.3	13.8	15.1
Factor income	106.3	101.4	97.9	92.4	93.7	95.9	97.4	98.5	100.8
Transfer received	27.1	30.0	36.6	40.1	41.9	41.4	40.3	37.7	35.7
National pensions	5.0	4.6	4.9	5.1	5.0	5.0	4.9	4.4	4.1
Earnings-related pensions	12.0	12.6	14.1	15.0	15.7	16.5	16.8	16.1	15.6
Unemployment benefits	1.3	2.8	5.8	8.0	8.1	7.3	6.9	6.1	5.0
Other transfers received	8.8	10.0	11.9	12.1	13.1	12.6	11.7	11.1	11.0
Gross income	133.5	131.4	134.5	132.6	135.5	137.2	137.7	136.2	136.5
Transfers paid	-33.5	-31.4	-34.5	-32.6	-35.5	-37.3	-37.8	-36.2	-36.5
Direct taxes	-32.4	-30.3	-33.4	-30.0	-31.9	-32.5	-32.6	-30.9	-31.3
Other transfers paid	-1.1	-1.1	-1.1	-2.6	-3.7	-4.7	-5.2	-5.3	-5.3
Disposable income	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

We have divided the population into two groups: those households where household head is in work and those households where household head is not in work. From Table A3 we can find that the non-working has increased its share from 21.1 in 1990 to 29.8 in 1998. The reason for this is the rise of the unemployed households as we can see in the lower part of the Table A3. We also perform further splitting by socio-economic status in both groups.

*Table A3. Population shares of different groups*

Population group	1990	1991	1992	1993	1994	1995	1996	1997	1998
Working activity									
Group 1	78.9	77.0	72.4	68.5	67.0	68.5	68.7	69.4	70.2
Group 2	21.1	23.0	27.6	31.5	33.0	31.5	31.3	30.6	29.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Socio-economic status									
Farmers	5.7	5.5	4.9	4.8	4.9	4.6	4.5	4.1	3.7
Entrepreneurs	7.4	7.4	6.8	6.6	6.3	6.4	6.3	7.0	7.3
White collars	16.2	16.1	15.4	15.0	15.1	15.3	15.8	15.5	16.6
Blue collars	19.5	20.3	20.1	19.9	18.5	18.8	19.1	19.1	18.3
Workers	30.1	27.8	25.1	22.3	22.2	23.3	23.1	23.7	24.3
Pensioners	18.4	17.9	18.7	19.8	20.2	20.6	20.9	21.0	20.7
Unemployed	0.6	2.3	5.0	8.0	8.7	7.5	6.8	5.9	5.4
Others	2.1	2.9	3.9	3.7	4.1	3.4	3.5	3.8	3.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

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## 15 Multidimensional Poverty in the Aftermath of the Recession: Finland in 1995 and 2000

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The Finnish recession of the 1990s was exceptional both by national and international standards. The economic crisis that Finland went through was the most severe one in the country's independent history and deeper than in any of the advanced OECD countries. As a consequence of dramatic changes at the macro level, problems at the micro level increased rapidly as well. The recession was particularly rough for three groups of people: people living in households that met unemployment, those who had recently bought a new dwelling and private entrepreneurs (small firms).

Research and statistics have painted a somewhat inconsistent picture of changes in poverty that took place as a consequence of the recession in Finland. This article examines poverty from many different points of view, and pays particular attention to the multidimensionality of poverty and to the length of the period of observation. The main emphasis is on comparing the picture of poverty provided by two surveys on the economic situation of the population in 1995 and 2000. This means that we are focusing on the changes in poverty during the five years after the end of the deepest recession. The immediate impact of the recession on poverty is at first examined on the basis of statistics and other research. We will examine the concept of poverty because inconsistencies in conclusions about poverty during the recession may be due to differences in definitions of poverty. For instance, it is often the case that no distinction is made between big drops in income that are characteristic of recession years (impoverishment), and being below the poverty line (poverty).

### 15.1 Multidimensionality of Poverty

Recent studies have shown that the picture of poverty is highly dependent on the way in which poverty is defined, and in particular on the way in which poverty is measured (Andress 1998). Different measures of poverty can provide us with very different assessments of poverty (Gordon, Pantazis & Townsend 2000). In some cases this has led to frustration among re-searchers and to abandonment of research. Other researchers have interpreted the new observations in a more positive manner. Different measures simply provide different results. None of the results are in themselves wrong, but merely limited. The phenomenon under observation is multidimensional, and different approaches

capture different dimensions of this phenomenon (Kangas & Ritakallio 1998). In this view, getting a comprehensive picture of poverty involves making use of many different approaches simultaneously (see for instance Muffels, Berghman & Dirven 1992; Kangas & Ritakallio 1998). Alternatively, one can use a single measure that in one way or another covers different dimensions of the phenomenon (see for instance Mack & Lansley 1985; Ringen 1987; Nolan & Whelan 1996; Halleröd 1998). The latter studies use the concept of accumulated deprivation as a synonym for poverty which may be a concept that better reflects the multidimensionality of the phenomenon under study.

It is commonly accepted that in wealthy countries poverty should be defined on the basis of ability to function in society: poverty is understood as limited ability to function socially as a result of lacking or limited economic resources (Mack & Lansley 1985; Ringen 1987; Gordon et al. 2000). In this definition, poverty is constituted by the simultaneous existence of economic need and inability to function in society. In other words, poverty is a matter of accumulated deprivation. Paucity of economic resources is not enough in itself, but we need to make sure that it co-exists with inability to function socially. Conversely, it is not enough that a person is unable to function and participate in society, but he or she must suffer from economic deprivation as well. If this is not the case, it is matter of something else than poverty. A considerable share of research that goes under the name of poverty research does not meet this condition (Ringen 1988; Gordon et al. 2000). Most research has simplified the question of poverty into a question of small income. A multidimensional phenomenon has been reduced into a unidimensional one. Income is a central component of poverty, but even as a measure of economic resources it is fairly problematic. The resources of an individual and a household are dependent not only on income but also on many other factors such as wealth and the availability and ability of a social network to offer support. Ability to participate and function in society is also a multidimensional concept. All in all it is evident that the bulk of poverty research has reduced a multidimensional phenomenon into a unidimensional one.

This research takes the multidimensionality of poverty as its starting point. The aim is not to construct a comprehensive measure but to examine in parallel the trends in different dimensions of poverty. In addition to being unidimensional, most poverty research has kept to the tradition of objective measurement of poverty. In addition to using an objective definition of poverty, this study will use a more 'subjective' definition based on the experience of economic problems. This more subjective definition is here argued to be a relevant complementary element of the measurement of poverty when constructing an overview of poverty.

## 15.2 Immediate Impact of the Recession

This article focuses on the impact of recession on poverty. A crucial determinant of our conclusions is the length of the period under observation and the points of view from which the impact is examined. Assessing the immediate impact is fairly straightforward and it is easy to reach agreement on how to do this.

The increase of economic difficulties at the level of individuals and households is evident from the increase in the proportion of the population receiving social assistance (a means-tested benefit of last resort): whereas this was only six percent in 1989, it had increased to 11.3 percent by 1993. Changes in the number of social assistance recipients were mainly dependent on the unemployment rate that increased from three percent in 1989 to over 16 percent in 1993. (Statistical Yearbook 1990-1995.)

The proportion of the population in receipt of social assistance increased in the beginning of the 1990s mainly as a result of dramatic increase in unemployment. Another important factor that weakened the economic situation of households was the indebtedness of households at the start of the recession. The financial markets were deregulated swiftly in the mid-1980s. Combined with the free movement of capital and the general economic upswing, deregulation led to rapid growth in lending to private individuals as well as to companies (The Finnish Bankers Association 1997). The deregulation of the financial markets also caused a boom in the housing prices, with the real prices almost doubling. Families hastened the purchase of a dwelling due to the rapidly rising prices. Economic confidence was high among private households as well as among businesses. Those who changed their dwelling first bought a new one and then sold the old one. This made sense in the context of rising prices. The Finnish custom has been to pay small deposits and to pay the balance over a short repayment period of around ten years. In the 1980s it was common to take even the entire trade sum as a loan. Close relatives often acted as guarantors. Short repayment periods together with small deposits and high prices of the dwellings generated a model where young families had a very limited household economy and scarce livelihoods even under normal economic conditions. (Ritakallio 1998.)

In the spring of 1990, together with the turn in the Finnish economy, the housing market collapsed. Prices of dwellings turned into steep decrease, which lasted 36 consecutive months during which the sales of properties almost ground to a halt. Between 1990 and 1993, the prices of houses and apartments fell by 48 percent on average in the greater Helsinki area (Bulletin of Statistics 1991-1994). Those who had bought a new house or apartment, but had not yet sold the old one were forced into "the trap of two dwellings". They had two dwellings at a time when prices were steeply decreasing. In addition to the decreasing prices they were hit by the rising interest rates. One month's interest rates

varied in the first years of the 1990s between ten and eighteen percent. Taking also into consideration the marginal to the banks and the halved price of property, this meant that during one year the people with mortgages in some cases had to pay in interest alone a sum of money equivalent to one third of the value of the dwelling. For those in the trap of two dwellings the situation was impossible to manage. For many others the value of their dwelling was much less than the mortgage. So one didn't have to have two dwellings to be trapped. For many families the sale of the dwelling generated a situation where one hadn't a flat/house, but one still had to pay back big loans.

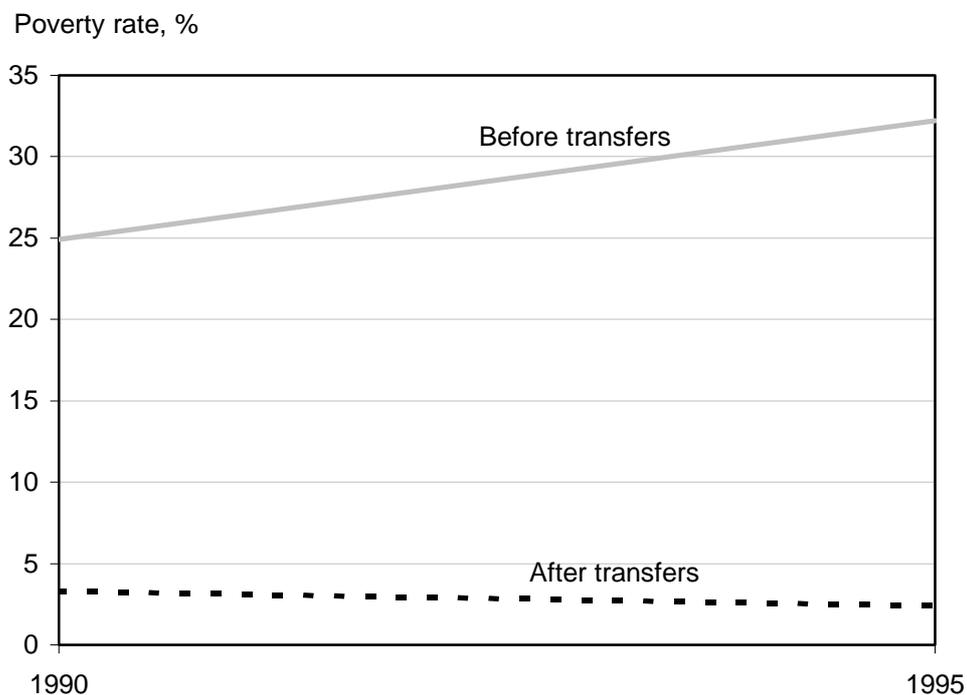
There are few estimates of the number of over-indebted households (Numminen 1994). However, Ritakallio (1998) estimated on the basis of the 1994 Household Expenditure Survey that 10 percent (N= 200 000) of the households in Finland had debt management costs of over 30 percent of their disposable income. Most frequently this was the case with households headed by young adults (25-34 years of age in 1990).

The deep economic depression also hit firms, particularly small ones. There were 30,500 bankruptcies during the first half of the 1990s, whereas this figure had been 12 700 during the later half of the 1980s. This resulted in a large number of over-indebted small entrepreneurs and their guarantors (Numminen 1994).

### **15.3 Poverty during the Recession**

The above, rather dramatic, figures on developments in the 1990s are complemented by income distribution statistics from Statistics Finland. According to these statistics income ine-quality and poverty (as measured by low incomes) did not start to increase as the recession went on but rather remained low, even in international comparison. A common interpretation is that the income distribution system functioned as expected in the hardest possible test to which it could be put. This interpretation is supported by comparison of poverty rates before and af-ter income transfers (poverty rate based on disposable incomes) (Figure 15.1). The share of the population reliant on income transfers increased dramatically in 1990 - 1995 but thanks to the poverty-preventing impact of the income transfer system (Figure 15.1 – the vertical diference between the curves) there was hardly any change in the curve indicating the extent of 'real' poverty.

Figure 15.1. Poverty rate in Finland before and after income transfers, 1990 - 1995, %



Poverty line is 50 % of median OECD-equivalent disposable income in each year).

In the mid-1990s, the picture painted by poverty statistics and people's experiences came increasingly into conflict. Poverty and even experiences of hunger became favourite topics in the media. A large number of centres distributing free food were also opened. The number of clients at these centres was so great that queues measuring several hundred meters formed outside them.

The Department of Social Policy at the University of Turku decided at the turn of 1994/1995 to collect more varied poverty-related material than that provided by income and social assistance statistics. A representative group of the population (random sample of 3,000 18-70-year-olds) were asked to complete a postal survey which sought to estimate on the basis of several parallel indicators the extent and depth of economic deprivation as well as the characteristics of the people suffering from deprivation. The 2000 replies received produced a re-markably detailed picture of poverty at what was perhaps the worst point of the recession in 1995.

This study (Kangas & Ritakallio 1998) made use of five different ways of approaching poverty: low incomes, involuntary and accumulated lack of necessities, experienced paucity of resources, experience of over-indebtedness

and recourse to social assistance. All five measures of poverty indicated poverty rates in the region of 10 percent. The results were rather surprising. Perhaps the most surprising finding was that the income measure that is in principle the same as that used in the official statistics produced a figure that was three times higher than that in the official statistics (nine percent as compared to three percent). This is due to the fact that official statistics are based on information in registers and on annual incomes. The material used in our study was based on incomes as declared at the moment of completing the survey. Basic research by statisticians has shown that variance of incomes is greater the shorter the period on which information of incomes is collected. It is also the case that material based on a survey indicates greater income inequalities (and poverty) than material based on registers (see Hovi, Nordberg & Penttilä 2001).

Another central finding of the 1995 study is that the different dimensions of poverty didn't tend to overlap in practice. We could generalise from the findings that most people who are deemed poor in the light of one measure are not poor in the light of the alternative measures. Of the persons included in our study 28 percent were classified as poor in the light of at least one of the five measures. Thirteen percent were classified as poor by two measures. Only 2 percent of the survey respondents were poor in the light of four measures, but there wasn't anybody who was poor in the light of all five indicators. The more than one fourth of the people included in the study who are in a weak economic position in the light of at least one indicator form the group that the concept of poverty refers to. (Kangas & Ritakallio 1998.)

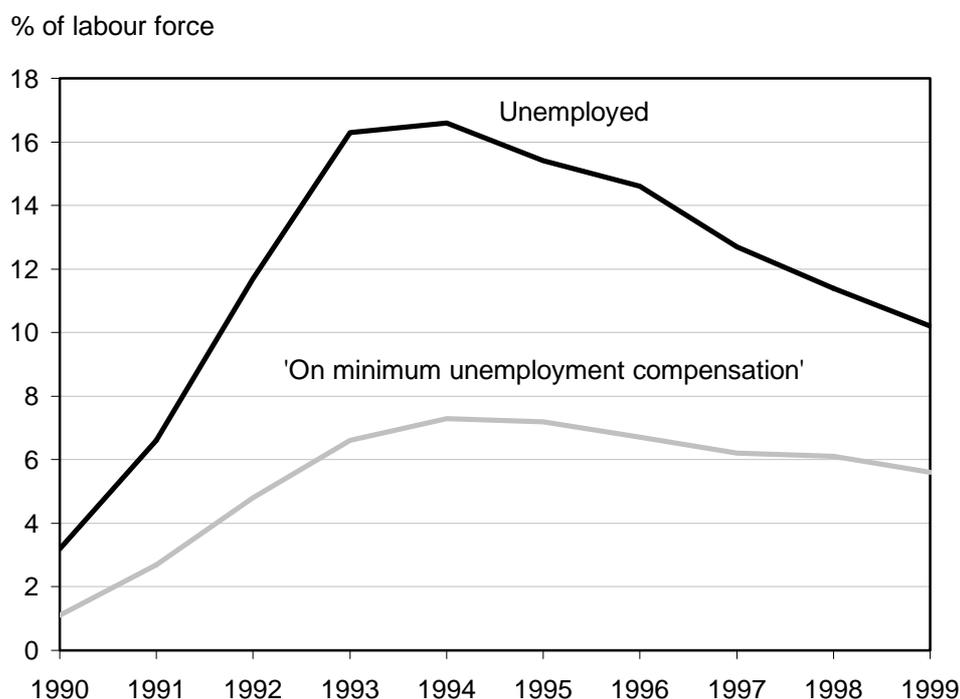
The second important finding of the study was that different indicators identified different risk groups in the population. A good example of this is the poverty risk of different age groups. Different indicators produced conflicting information with regard to the poverty risk associated with different age groups. The young and the old age groups were characterised by low incomes. Old people experienced clearly more economic hardship and indebtedness than other age groups. Old people also avoided using the social welfare office and suffered considerably less from accumulated deprivation than the younger age groups. Young people were frequently clients at the social welfare office and suffered from accumulated lack of essential items. On the other hand young people did not experience hardship more frequently than the rest of the population on average. Middle aged people have the largest incomes and suffered only rarely from accumulated lack of essential items. On the other hand the experience of economic hardship and over-indebtedness was most common among middle aged people. From the point of view of social policy making these observations were problematic. How should we target assistance? The only group at poverty risk that was not dependent on the measurement used were the unemployed. They had a high risk of poverty as measured by all the indicators. Yet there are great differences even among the unemployed. The risk is particularly high in

the case of those families affected by poverty where the unemployed person is reliant on the mini-mum assistance (i.e. is not entitled to earnings-related benefits). The households worst affected by the recession were those where more than one person was unemployed (Aalto 1996).

## 15.4 The Longer-Term Consequences of the Recession

Measured by national economic indicators, the recession ended when the economy started to grow again in 1994. From the point of view of social problems, however, the matter may not be so straightforward. The most unfortunate consequences of great economic and social upheavals are often of long duration at the level of individuals. (Jahoda, Lazarsfeld & Zeisel 1933; Sinfield 1981; Gallie, Marsh & Vogler 1994). It has been established that that one long unemployment period can have negative social consequences for the rest of the person's life. Equally it can take a household decades to emerge from over-indebtedness. Unemployment and other economic problems often cause domestic problems that may have a negative influence on the children. As a consequence, the effects of a recession can be multi-generational.

Figure 15.2. Structure of unemployment, 1990 - 1999



From the point of view of poverty there was a significant change in unemployment during the late 1990s. Unemployment rate had been nearly halved but the number of long-term unemployed had hardly decreased. At the beginning of the recession the loss of incomes from work was to a large extent compensated by entitlement to earnings-related unemployment benefit that offers considerably higher income replacement rates than the basic payments.

In the longer run the problem was that the unemployed continued to experience difficulties in finding work even when the economy was growing and unemployment was gradually structurally transformed into long-term unemployment. The long-term unemployed are entitled only to minimum security which in most cases is no greater than the level of social assistance (Ukkola-Kettula 2000). Social assistance was originally designed to cover only temporary need of minimum income. Social assistance was not designed as a source adequate income in the longer term. However, in practice a large share of the long-term unemployed have been living for years at this level of income. Empirical evidence of increasingly persistent poverty emerging from this study is incomplete in the absence of proper panel data. However, the conclusions we can draw from unemployment statistics allow us to assume that a qualitative change has taken place in poverty that makes the matter more serious than before. Permanent poverty is always worse than temporary poverty, like permanent unemployment is always worse than temporary unemployment.

## **15.5 What are the Effects of the Recession?**

It is more difficult to estimate the longer-term consequences of the recession than it is to estimate the short-term impact. In many cases it is not obvious what is caused by the recession and what is not. This is particularly true in the case of social policy decisions.

An important influence on the day-to-day lives of people suffering from economic deprivation has been the change in (social) policy (Hvinden, Heikkilä & Kautto 2001; Julkunen 2001). At the level of public and political social policy discourse this change is illustrated most strongly by the dominance of the 'disincentives' view on social policy. This was the leading theme in the programme of Paavo Lipponen's first government (1994 to 1999). Social policy discourse was dominated by system-blaming terms such as "poverty traps", "incentive traps" and "unemployment traps". Lipponen's second government (1999-) has keenly followed the example of the first by focusing the bulk of its efforts on increasing work incentives by cutting heavily the income taxes of those who are employed.

At the same time the purchasing power of minimum benefits has been moderately weakened and in particular the entitlement rules of earnings-related

unemployment benefit have been considerably tightened (Ruotsalainen 1998). The minimum daily sickness allowance was abolished in 1996. Before the reform, in the mid-1990s it was paid annually to an average of 14 000 persons without any earnings at all (Maljanen & Niemelä 2000). In principle the sickness insurance reform of 1996 was a major step away from universalism in Finnish social policy. (Kangas 2001).

In practice the cuts in last resort social assistance hit a much larger number of disadvantaged people. The value of the extended basic amount of social assistance (designed to cover costs other than housing and children's day care costs) decreased in real terms by three percent between 1990 and 1999 (Stakes 2000). During the same period the median value of the disposable incomes of all households decreased by approximately the same amount. Indicative of the increase in income inequality especially at the upper end of income distribution is the fact that the average incomes of households (measured in terms of the average income) increased by 7 percent in real terms in the 1990s (Income Distribution Statistics 1999).

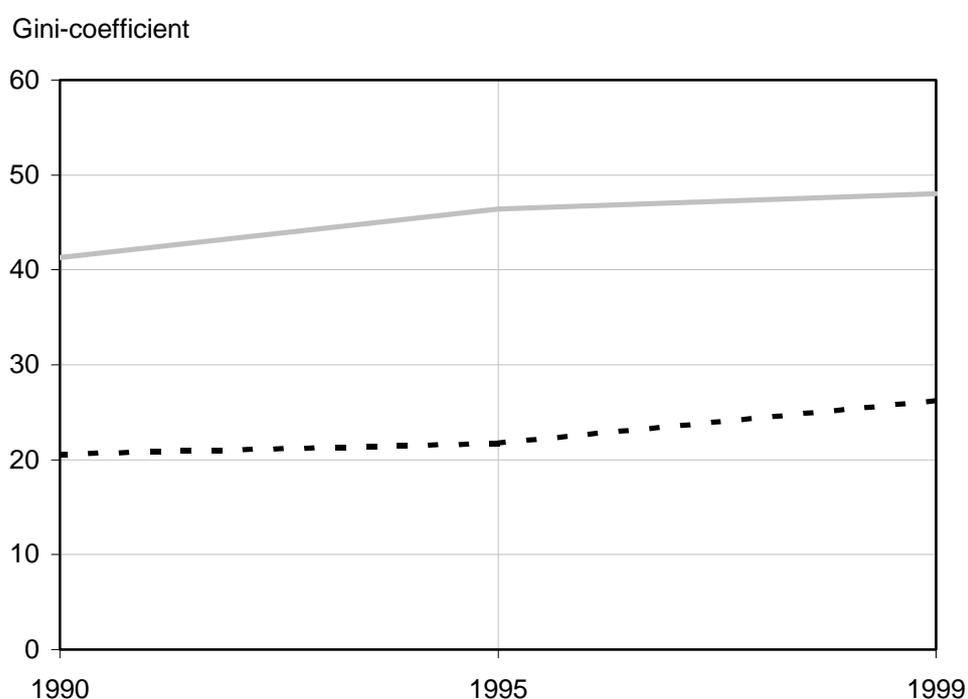
During the first half of 1998 there were two important changes in social assistance, the impact of which is not evident from the figures cited above. The first change concerned payment of housing costs and the second the child care costs. Before the reform housing costs were in most cases covered in their entirety, but since 1998 social assistance recipients have been responsible for covering 7 percent of their housing costs. The payment of child care costs was simultaneously made more stringent. According to Aino Ukkola-Kettula (2000, 135-138), these changes caused a 6 percent cut in the social assistance payments of recipients living alone. In the case of families with children the impact of the reforms was greater, approximately 10 percent. The impact of these reforms, contained in a single piece of legislation, was greatest in the case of the long-term unemployed and their families because they form the largest single recipient group (annually circa 500 000 persons in the mid 90s).

From the point of view of incentives the system works better now than it did at the beginning of the recession (Kurjenoja 2000). The policies aimed at "straightening out" the system of incentives have been justified on the grounds of addressing the problem of unemployment. However, it is possible to make a counter-argument on the cause of the change in the direction of policy (see also Julkunen 2001). Finland is more closely integrated into the world economy that indirectly influences national policy making. Social factors do not carry great weight in the world economy. The dominance of economic over social considerations may therefore not be the consequence of the recession but rather the result of globalisation (cf. Bonoli & Palier 1998).

Once the economy started to grow again income inequality also started to increase dramatically. A significant cause of the increased income inequality is

due to considerable increase in the capital incomes of the richest population groups. The impact of the politics of incentives on the income inequalities of the late 1990s has not been the subject of any detailed studies. In international comparison the income inequalities in Finland were extremely small at the start and during the recession but the increase in income inequality at the end of the 1990s is almost without comparison. The indicator of income inequality (gini-coefficient) used in the graph below is very stable. The Gini-coefficients of different countries are tend to be very stable even in long-term studies. The five-unit growth of after-transfer-poverty over the last five years has taken Finland to a typical European level and away from the Nordic group of small income inequalities (cf. Ritakallio 2001).

Figure 15.3. *Income inequality in Finland, 1990 - 1999*



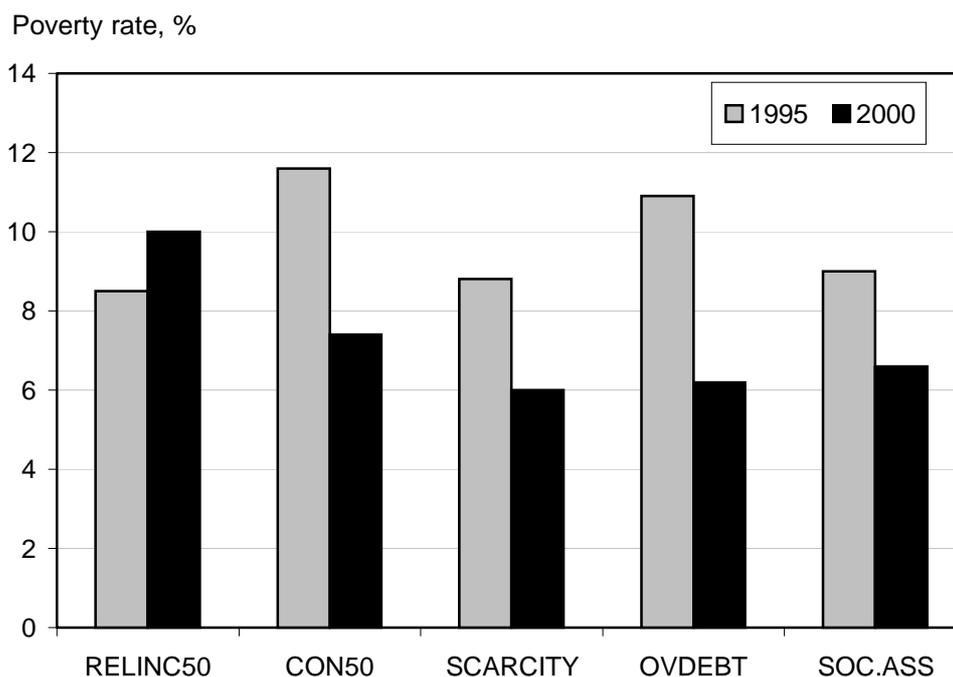
## 15.6 Poverty Trends 1995 - 2000

In the following analyses we study trends of multidimensional poverty of Finns in the aftermath of the recession (1995 - 2000). The five measures used are: 1) relative income method (the poor are those whose equivalent income is less than 50 % of median income) (RELINC50), 2) consensual deprivation (those who are involuntarily lacking items that are by the majority of the population classified as necessities) (CON50), 3) subjective feeling of hardship in the form of subsistence problems (severe difficulties in paying bills etc.) (SCARCITY), 4)

subjective feeling of over-indebtedness (excessive debts in relation to income) (OVDEBT), and 5) reciprocity of social assistance (SOC.ASS). We will investigate the degree to which these different approaches lead to the same conclusions of the extent and location of poverty. And in particular: To what extent has the picture of poverty changed from 1995 to 2000? What is the trend of poverty risk as indicated by different poverty measures?

Data used in this study was the earlier mentioned 1995 survey and a new mail survey conducted by the Department of Social Policy at the University of Turku in the beginning of 2000. Effective sample sizes were 2000 and 2400 yielding effective response rates of 65 % and 62 %, respectively. The survey broadly mapped the level of welfare and subsistence among Finns, and their views on social policies. The sample was collected from the data of the Population Register Center using random sampling and it represents the total Finnish population between the ages of 18 and 70.

*Figure 15.4. Poverty rate (%) as measured by different indicators in Finland, 1995 ja 2000*



The main finding is that there are some inconsistencies in poverty trends. The income poverty rate has increased somewhat, while the other four measures (the involuntary lack of necessities, the subjectively experienced poverty and overindebtedness, as well as reciprocity of social assistance) yield significantly

lower (one third) poverty rates in 2000 than in 1995. The share of those who are poor in the light of at least one indicator dropped from 28 to 21 percent in 2000. The overlapping of the different measures of poverty is still weak in 2000. The share of the population that is poor in the light of at least two different measures dropped from approximately 13 percent in 1995 to 8 percent in 2000. On the basis of these figures we can draw the cautious conclusion that the number of the poor decreased in the aftermath of the recession in the late 1990s and that their share in the population decreased by about a fourth. However, it would be wrong to draw the conclusion that poverty has disappeared. Every fifth person in Finland is still poor in the light of at least one poverty measure in the beginning of 2000.

The 1995 - 2000 trends are also studied against such background factors as labour market position, age, type of household, social background, gender, geographical area etc. How has the pictures of poverty in the late 1990's Finland changed along these factors?

Table 15.1 illustrates that the general trend is evident in nearly all population groups. Poverty measured on the basis of income has grown and poverty measured by other indicators has diminished. The table has a total of 195 cells, of which only 28 (14 percent) show change that goes contrary to the general trend. The poverty risk of the unemployed shows the most systematic change in contrast to the general trend. It has grown according to all measures used. Already in 1995 the unemployed were the only group that stood out as the worst-off group in society in the light of all the indicators. By 2000, the gap between the unemployed and other groups had grown. This was due to structural change in unemployment. Most unemployed people now rely on the minimum unemployment payments, in contrast to the situation five years ago when earnings-related benefits were predominant. Appendixfigure 1 shows that the poverty risk of those unemployed relying on earnings-related benefits has evolved in accordance with the general trend, and has not diverged dramatically from the average for the whole population. In contrast, the situation of the unemployed relying on minimum assistance is poor and clearly worsened during the growth period of 1995 - 2000 (Appendix figure 2). The situation of part-time employees seems to have improved significantly in the late 1990s. Poverty rate among students has, with the exception of low-income poverty, decreased during the five-year period of observation. At the same time, however, students are more clearly than before the group with the second highest poverty risk after the unemployed. According to the low-income poverty measure their risk is in fact the highest if the unemployed are treated as a single group. People working full-time and pensioners are best protected against poverty. The relative position of both of these groups improved even further during the late 1990s.

Because the samples collected at the two different points in time are almost the same size comparison of statistical significance revealing p-values can be used to draw conclusions about changes in the differences between population groups. Have the differences in the poverty risks of different population groups increased or diminished? If p-value has decreased, the differences of poverty risks between population groups have increased and on the contrary, if p-value has increased, the differences of poverty risks between population groups have decreased.

Generally speaking it seems that, in the light of all the poverty measures, the explanatory power of social characteristics (labour market position, education and social position) has grown during the five years. Labour market position, education and social position were to a statistically significant extent related to poverty risk in 2000 in the light of all poverty measures. This was not the case in 1995. Over-indebtedness and social assistance reciprocity in particular are now more concentrated among the poorly educated and blue-collar workers. Five years ago this picture was muddled by the equally high risk of the entrepreneurs. The increasingly clearer picture of the social profile of poverty goes against the post-modern theories according to which risks have become more opaque, diffused and random (cf. Beck 1982).

Hereditary nature of poverty was studied with the help of two questions seeking information on the social starting points of the respondents. One of the questions concerned the occupation of the principal breadwinner which served to indicate the social status of the home. The second question sought to establish whether the respondent's family home ever took recourse to poor relief or social assistance. The relationship between social background and poverty was considerably more obvious in 1995 than in 2000. In 2000 statistically significant differences in poverty were linked only to use of social welfare offices' services, which is most common among those from entrepreneur background (other than farmers). In as sense these two groups are located at the polar opposites of poverty risk. Those who grow up in farmer families are least likely to end up visiting social welfare offices. The second question measuring the economic circumstances in the childhood home has greater explanatory power and the change during the period under observation was not as great as above. Regardless of the measure used social welfare office visits from the childhood home are statistically significantly related to poverty. In 1995 the same was true with the exception of low-income poverty. According to different measures it is the case that those whose childhood homes took recourse to social assistance have double the poverty risk. In other words there are some signs of the hereditary nature of poverty.

Alongside social position the differences between the poverty risks of household types are great and have increased somewhat. Over-indebtedness in particular is now more closely associated with type of household than five years ago. At

that time the differences were not statistically significant. The most poverty-prone households are now one-person households and single parent households. The relative position of single parents in particular seems to have worsened in the aftermath of the recession.

The above discussion has focused on poverty on the basis of table one mainly in the case of those background factors whose explanatory power increased in the late 1990s. The number of children, age, sex and place of residence in particular have lost some of their explanatory power. There are no differences between towns and villages of different sizes with regard to experience of poverty and risk of over-indebtedness in particular. Five years ago there were at least some indications of higher poverty among countryside dwellers in these respects. With regard to social assistance reciprocity, it is known that city dwellers make more use of this assistance (Heikkilä 1990; Ritakallio 1994). The risks of accumulated deprivation and low incomes do not vary significantly between different areas.

*Table 15.1. Poverty rate (the percentage share of the poor) by different measures in different population groups in 1995 / 2000 (p-values in brackets)*

	RELINC50 95/00	CON50 95/00	SCARCITY 95/00	OVDEBT 95/00	SOC.ASS 95/00
Whole population	9/ 10	12/ 7	9/ 6	11/ 6	9/ 7
Labour market position	(.000/ .000)	(.000/ .000)	(.000/ .000)	(.003/ .000)	(.000/ .000)
Full-time work	2/ 4	7/ 3	5/ 3	10/ 4	3/ 2
Part-time work	11/ 13	15/ 7	13/ 4	12/ 5	16/ 7
Unemployed	16/ 28	27/ 29	24/ 25	19/ 23	29/ 32
Student	26/ 41	22/ 14	12/ 9	10/ 5	19/ 11
Pensioner	10/ 3	7/ 5	4/ 5	8/ 5	4/ 2
Education	(.002/ .000)	(.008/ .000)	(.018/ .000)	(.047/ .004)	(.043/ .001)
University	3/ 1	5/ 2	6/ 2	8/ 4	4/ 2
Higher tertiary	8/ 11	12/ 7	8/ 4	10/ 5	10/ 6
Less	11/ 11	13/ 9	11/ 9	13/ 8	9/ 8
Social position	(.000/.000)	(.000/ .000)	(.001/.000)	(.271/ .005)	(.000/ .000)
Farmer	22/ 12	6/ 2	5/ 3	13/ 4	2/ 1
Other entrepreneur	7/ 9	6/ 2	6/ 4	14/ 6	10/ 3
Blue-collar	8/ 11	16/ 12	12/ 10	13/ 9	10/ 8
Lower white-collar	5/ 5	10/ 5	8/ 4	10/ 5	8/ 5
Upper white-collar	1/ 2	4/ 2	4/ 2	8/ 3	3/ 2
Social background	(.095/.369)	(.000/ .704)	(.000/ .767)	(.030/ .554)	(.001/ .022)
Farmer	10/ 10	6/ 7	6/ 5	9/ 6	5/ 3
Other entrepreneur	1/ 6	16/ 4	15/ 6	15/ 5	13/ 9

Blue-collar	8/ 10	16/ 7	12/ 6	14/ 6	11/ 6
Lower white-collar	8/ 7	12/ 7	11/ 4	13/ 5	15/ 8
Upper white-collar	6/ 7	9/ 5	5/ 5	7/ 4	8/ 4
Recourse to social assistance in childhood home					
	(.472/ .030)	(.000/ .049)	(.000/ .000)	(.000/ .000)	(.000/ .001)
No	9/ 8	11/ 6	8/ 5	10/ 5	9/ 5
Yes	7/ 13	22/ 10	20/ 12	22/ 13	19/ 11
Household type					
	(.001/ .000)	(.000/ .000)	(.000/ .000)	(.051/ .000)	(.000/ .000)
Living alone	10/ 14	27/ 17	12/ 10	13/ 11	18/ 15
Childless couple	7/ 5	7/ 4	6/ 3	9/ 5	6/ 4
Couple and children	8/ 11	7/ 4	10/ 5	13/ 5	6/ 4
Single parent	4/ 21	32/ 26	19/ 22	16/ 10	36/ 19
Number of children					
	(.005/ .002)	(.018/ .171)	(.118/ .015)	(.058/ .489)	(.155/ .527)
None	9/ 9	14/ 8	8/ 6	10/ 6	10/ 7
One	5/ 11	9/ 5	10/ 7	10/ 5	7/ 7
Two	6/ 10	9/ 6	12/ 5	16/ 5	7/ 6
Three or more	14/ 20	8/ 7	9/ 12	12/ 9	12/ 4
Residence					
	(.000/ .167)	(.117/ .287)	(.642/ .909)	(.040/ .463)	(.005/ .017)
Small town/village	14/ 12	10/ 9	10/ 6	14/ 7	6/ 4
Average town	8/ 10	11/ 7	8/ 6	9/ 5	9/ 8
Large town	5/ 9	14/ 7	8/ 6	10/ 6	12/ 7
Age					
	(.000/ .000)	(.000/ .000)	(.000/ .057)	(.002/ .051)	(.000/ .000)
-24	22/ 30	28/ 15	9/ 5	6/ 6	25/ 15
25-34	7/ 9	14/ 8	8/ 6	12/ 4	11/ 11
35-44	5/ 11	10/ 7	14/ 9	16/ 8	7/ 7
45-54	7/ 9	9/ 7	11/ 6	11/ 8	6/ 5
55-64	4/ 5	5/ 5	4/ 5	8/ 4	4/ 2
65-70	17/ 3	4/ 3	2/ 3	7/ 5	1/ 1
Gender <sup>254</sup>					
	(.162/ .284)	(.224/ .149)	(.014/ .424)	(.058/ .083)	(.266/ .021)
Female	7/ 13	25/ 16	10/ 11	10/ 9	18/ 12
Male	12/ 17	31/ 21	18/ 13	17/ 13	23/ 20

In the 1995 study the relationship between age and poverty varied widely between the different measures of poverty. The same pattern is evident in the results of the new survey. Accumulated deprivation and social assistance reciprocity decrease in a linear fashion as we move from the youngest to the oldest cohorts. Low-income poverty displays the same pattern, although in the 35-44 age group there is a slight deviation (upwards). In the case of low-income poverty the position of 65-69-year-olds appears considerably better than five

<sup>254</sup> Singles and lone parents.

years earlier. The risk of experienced poverty and over-indebtedness displays the same pattern as five years earlier. The risk is highest among the middle aged.

The relationship between the number of children and poverty is statistically significant in the newer survey only as measured by the low-income and experienced poverty indicators. In the light of these indicators the group at highest risk are families with at least three children. In 1995 the number of children bears a statistically significant relation to poverty only in the case of low-income poverty.

Gender was in the 1995 research statistically significantly related to poverty only in the case of experienced poverty. It was clearly more common among men. In the 2000 survey the only statistically significant difference between men and women's poverty risk is evident in the measure of social assistance reciprocity. This is considerably more common among men than women. As regards the gendered nature of poverty we can conclude that it is different from the Anglo-Saxon countries where women are clearly at higher risk of poverty than men (see for instance Glendinning & Millar 1992.)

## **15.7 Summary and Conclusions**

The deep and long recession of the 1990s was preceded by a period of economic growth that lasted almost a decade. For this reason the Finnish economy was in good shape at the start of the recession. Unemployment was negligible; rather, there were labour shortages. Public debt was at a very low level and the welfare state had expanded to meet the demanding criteria of the Nordic welfare model. Poverty was not a topical theme (Jäntti & Ritakallio 2000) The single significant factor that formed a departure from this positive economic picture was the very high levels of indebtedness among households and businesses.

The most immediate impacts of the recession concerned the indebted members of society. Due to the interest rate policy during the recession, interest rates remained well over 10 percent for several years. At the same time inflation remained negligible while house prices were halved in real terms. Previously disguised over-indebtedness became a familiar issue when the extent of the indebtedness of businesses and households with large mortgages came into light. In the case of households, over-indebtedness hit particularly hard young families that had acquired their first home at a high price just before the onset of the recession. Another immediate result of the recession was the skyrocketing unemployment. In October 1990 there were 90 000 unemployed people in Finland, whereas exactly three years later there were 460 000 of them (Bulletin of Statistics 1990-1995).

The economic impact of unemployment was considerably alleviated by the fact that a significant share of the unemployed were entitled to earnings-related unemployment benefit at start of the recession. Interestingly, low-income poverty did not start to increase during the recession but rather remained very low even by international comparisons. This can be interpreted so that despite the impoverishment (decrease in incomes) of a very large share of the population caused by unemployment, poverty did not increase because the unemployment benefit system compensated for the loss of earned incomes so that the unemployed did not fall under the poverty line.

However, poverty is not constituted merely by low incomes. The survey carried out by us in 1995 showed that the results produced by parallel measures of poverty can diverge widely. The over-indebted were not the ones with the lowest incomes; those on low income did not experience poverty; and overlap between overindebtedness and reciprocity of last resort social assistance was weak. As large a proportion of the population as 28 percent were classified as poor in the light of at least one indicator. Poverty was particularly widespread among the unemployed. Otherwise, the incidence of poverty could not be explained by the commonly used background factors.

By the end of 1990s the unemployment rate fell to about 10 percent of the labour force. However, from the point of view of economic hardship it is more significant that the reduction in unemployment has occurred for the most part among those unemployed who were receiving earnings-related benefits. The number and share of the labour force of those entitled only to minimum security (mostly long-term unemployed) has hardly decreased. Unemployment has acquired more and more a long-term character which is particularly problematic from the point of view of poverty. Poverty in Finland has tended to be temporary but now we have evidence to conclude that we have a large-scale problem of relatively persistent poverty.

On the basis of the survey carried out in 2000 it seems that the incidence of poverty has not increased in Finland in the aftermath of the recession. The main finding of comparisons between the 1995 and 2000 surveys is that there are some inconsistencies in poverty trends. The income poverty rate has increased somewhat, while the other four measures (the involuntary lack of necessities, the subjectively experienced poverty, overindebtedness and reciprocity of social assistance) yield significantly lower poverty rates in 2000 than in 1995. The share of those who were poor according to at least one measure fell from 28 percent to 21 percent in 2000.

In other words, there are fewer poor people in Finland but relatively speaking those who were poor in 2000 tended to be poorer than those who were poor in 1995. We do not have indicators for multidimensional poverty before the recession. However, because (long-term) unemployment, the major riskfactor of

poverty, was almost non-existent at that time, we have reasons to conclude that poverty problem in Finland in nowadays is much larger than it was before the recession.

There are good reasons also to conclude that before the recession poverty in Finland used to be temporary in nature, but has now become a increasingly persistent problem. Quantitatively speaking we have less poverty than during the peak of recession, but qualitatively, the persistency makes the problem more severe than in the past. If we take as a point of comparison the time just before the recession, the late 1980s, then we conclude that poverty in early 2000 has worsen both in quantitative and qualitative terms.

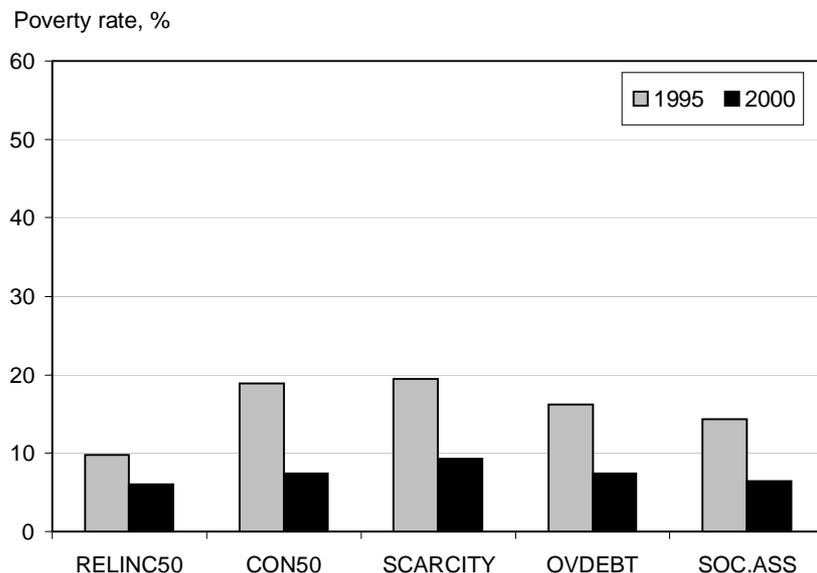
Devising and targeting an effective poverty alleviating program is easier now than five year ago. If policy makers would want to get orders of an effective poverty alleviating policy, the message of ours would be: at the moment the problem of poverty is predominantly a problem of long-term unemployment. Due to this, the socio-economic circumstances of the unemployed should be improved in one way or other if we want to cope effectively with today's poverty problem in Finland.

The observed decrease in poverty in the aftermath of the recession should not be interpreted as an achievement of social policy making during this period. Rather the contrary is true: the indebted have managed their debts mostly alone. The benefits for the long-term unemployed (particularly social assistance), who belong to the core group of poor in nowadays, were cut during the late 1990s. This has deepened the poverty problem. In addition, the tightening of the entitlement rules of earnings-related unemployment compensation worked for worsening poverty, because it affected to the structure of unemployment by decreasing the number of unemployed entitled to earnings-related compensation.

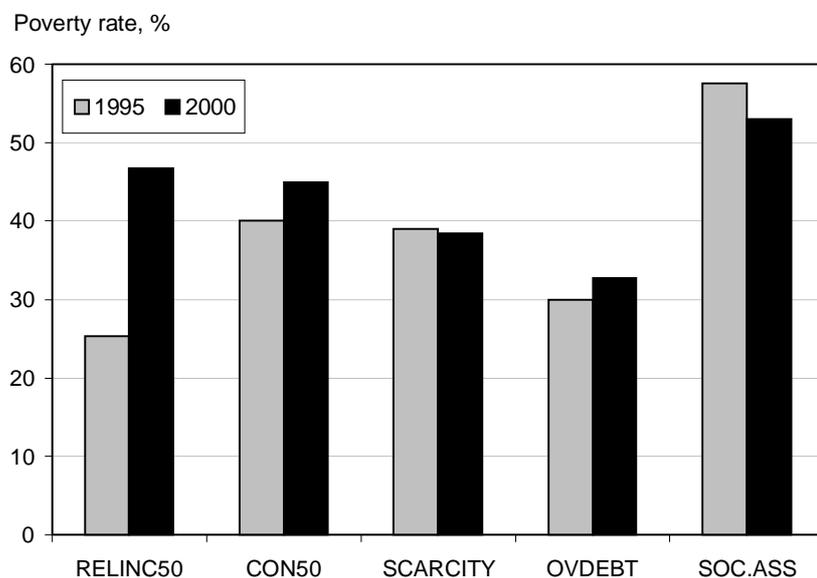
Finally, it is important to recognise that most poverty research has up to now ignored recent immigrants. During the 1990s the number of people born abroad who reside in Finland doubled from 65 000 to 131 000. The number of people from the former Soviet Union, Asia and Africa increased during this period from 18 000 to 70 000 (Statistical Yearbook 2000). During the recession foreign-born people were particularly vulnerable to unemployment (Forsander 2001). Also their other resources are weak compared even to the native unemployed. A consequence of this is that, the risk of poverty of foreign-born people is extremely high and in nowadays they form a considerably large sub-group inside the population in poverty. Ethnic segregation is increasingly connected to areal and economic segregation in the larger cities, making the poverty more visible. Future poverty research must accordingly pay attention to the situation of recent immigrants.

## Appendices

*Figure 1. The poverty rate of people in receipt of earnings-related unemployment benefits, different measures, 1995 and 2000, %*



*Figure 2. The poverty rate among recipients of minimum unemployment assistance, different measures, 1995 and 2000, %*



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## 16 Mediated Economic Reality or Aching Spots of Civic Society? Finnish Mainstream Media Publicity of Welfare Disparities 1988 – 1998

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### Abstract

The aim of this article is to analyse general trends in media coverage between 1988 - 1997, and look at how certain themes were covered in media (unemployment issues, regional disparities, gender equality). The article consists of four parts. The first part explores the general trends of mainstream media coverage of the time. The second part focuses on stories about unemployment. The third part studies writings on welfare and issues related to gender equality. The fourth part studies how regional media reveals differences compared to national mainstream media. The study builds on news coverage of Helsingin Sanomat, four big regional newspapers, Finnish Broadcasting Company and MTV3. Additional data has been sought from Statistics Finland. The data is supplemented by interviews of journalists.

In mid-October 1993, a big fuss was caused in Finland by one single piece of news, sent out by the Finnish Broadcasting Company radio newsroom; later the whole media chorus joined in the exercise. The news announced that an old cooperative with a strongly worker-based membership was approaching bankruptcy. Hundreds of concerned pensioners queued up at the cashier's to check out their money. In one day, some 10 million Fmk was cashed, making the situation worse. After ten days of big headlines and secret negotiations with various sponsors, the "crisis within the crisis" was over, but the company had to start a bitter reorganisation process. Though the company first threatened the Finnish Broadcasting Company with a court case, this never happened. The facts were valid. So were the figures, which the company brought into public during the process. In short, the media simply had a perspective totally differed from that of the business world. Nobody lied, but the two pictures given of the situation were

dramatically different, not to talk about the third one, formed by alarmed citizens who interpreted the two pictures in their way and ran after their savings.

Did the media give a biased picture of what was happening in Finland in the early 1990s and thus create crises within the economic crisis? Did the media “manufacture uncertainty” as Zygmunt Bauman (1999) has said? In the following, we elaborate on the issue by providing three case studies about the mainstream media coverage of the economic recession in Finland. All view the phenomenon longitudinally, through 1988-97. One focuses on the news menu offered by the public service broadcasting company Yleisradio (YLE) television news bulletins. Another two-phase study analyses, on the one hand, the reporting on work and unemployment and on the other, the coverage of gender-related issues under crisis offered by the biggest newspaper in the country, Helsingin Sanomat (HS). The third case study elaborates on how four regional number-one papers processed the economic recession. Further, we also offer an often-neglected perspective by outlining briefly the political economy of the media in the country during the difficult years of the recession.

Older studies in media coverage tended to focus on how accurately the media report on the issue or process under scrutiny, as if the media were a mirror of reality, standing outside social processes. Today, media studies quite generally accept as a point of departure the fact that the mediascape<sup>255</sup> is situated in the middle of the society, reflecting it but simultaneously moulding it. Various studies (e.g. Ekecrantz-Olsson, 1994, Kunelius 1996, Mörä 1999) have also indicated that the ideological power of the media has grown.

The media have always had selection power – today only 5-10 percent of the news collected is finally reported in media products, the rest goes wasted -- but today the media also exercise what could be called definition power. Earlier the media after selection tended to refer and report quite forwardly what actors of

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<sup>255</sup> The concept mediascape is here used roughly in the same meaning as the Indian-American researcher Arjun Appadurai (e.g. 1996) uses it. A mediascape stands for a totality of the media in society, structures, contents, and all mediated messages such as folklore narratives, rumours, and jokes. The mediascape offers a horizon that surrounds the receiver, and the receiver is able to direct his/her attention to either one particular element of the mediascape or the whole spectrum. We do not claim that all media operate in the same way, quite the opposite, but we do claim that the media affect each other both at the production as well as at the reception stage. That is why it is quite essential to study big prominent media, because they set the tone, but it is similarly important to focus on small or highly specialised media, because their credibility in the eyes of the receivers is strong. As Appadurai, we also assume that there is an ideoscape to be found in any society. This dominant but multifaceted ideology ranges from fundamental religious and political beliefs to insignificant details which still can mould people's minds concerning the past, present and future. Thus the ideoscape can be viewed as offering a “reading code” for the mediascape. Also the ideoscape allows considerable variation depending on citizens' age, gender, education, occupation, and location, and the ideoscape also has a time/space dimension; it changes slowly over time.

power said. Today, they far more often also package the issues reported according to their own timing, rules and regulations which partly reflect professional standards, partly business interests. A media research classic, Gaye Tuchman said already in the 1970s that the role of the media is to “mould the unusual into a routine” and thus make it as “natural” and unquestionable an element of life as possible (Tuchman, 1978). News are made into “olds” as soon as possible, and the basics of these processes often have a simple, or even banal (Billig, 1995) background: the media agenda is presented not only in the words and sources used but in the structure of presentation, page set-up, divisions of issues into local, national, and international, weather maps and similar technicalities, still deliberately chosen.

Thus the media have been able to develop a variety of symbiotic relationships with other social actors, naturally including receivers. This does not concern the receivers alone, as the “watchdog ideology of the press” assumes. It views the media being representatives of the public in decision-making circles, keenly reporting to the public about proceedings on the arenas of power. The present view gives a far more complex picture of the media/receiver relationship. The media definitely tend to set an agenda of social issues for the receivers, but it is up to the receivers, their social conditions and their ideoscape, whether they accept, resist, or ignore the agenda. This relationship also tends to be highly routinised. Hence ignoring media messages is on the public's side rarely a deliberate action but rather a coincidence. The message does not fit into the daily routines of the receiver who spends in Finland some 7-8 hours daily with the media, but most of that time is passive “tapestry reception” which means that the messages are available but do not get the receiver's total attention.

From this point of departure, it is not relevant to draft a “true” publicity picture of the economic crisis in Finland in the early 1990s via comparing the media coverage to economic realities. In the following, we draw a profile of the media's recession. It is a social construction, partly deliberately made, but to a large extent a product reflecting the time, space and competence limitations in newsrooms. Its biases and misinterpretations hardly represent a plot or a conspiracy, but these potential biases definitely reflect the operational basis of the mediascape. It did not remain unchanged during the economic crisis. Hence it is important to look at the mediascape of 1988-97 as a professional but also an economic and political body under transition. The media performance during the years of crisis carried responsibility equally to journalism as a profession, to the media business under pressure and to the ethnoscape<sup>256</sup>, the people at the reach of the media and relevant to them.

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<sup>256</sup> The concept ethnoscape also originates from Arjun Appadurai, but this concept we use in a somewhat different meaning than Appadurai. Appadurai refers with the concept only “people

In the following, we focus on the mainstream media coverage on the economic crisis 1988-97 in YLE television channels, in the biggest newspaper Helsingin Sanomat (HS), plus in four regional number-one papers. A more detailed report on a wider media screen is under preparation (Aslama et al., forthcoming); a more detailed description of the “crisis within the crisis” mentioned in the beginning is presented in the report. Here we focus on the mainstream only. The idea is to give a glance into the most common discourses offered to the Finnish public on matters related to the economic recession.

In a few occasions, comparisons are made to the coverage of the Finnish campaign for membership in the European Union, because these two big news items ran parallel in the mediascape. A citizen met the EU question in the mainstream media altogether more than 17,000 times in 1992-94. Reports focussing specifically on the economic crisis seem to have been considerably fewer, though references to the phenomenon were frequent in the early 1990s. However, studies made about the media performance on the case of EU membership confirm an issue which has been met also by the present researchers: the media adjusted the EU issue into a part fitting their own routines, they did not change their routines according to the EU matter under inspection (Heikkilä 1996, Mörä 1999). Another aspect also seems similar in the two cases. Besides the mainstream, there were alternative and opposite discourses on the EU issue as well as concerning the economic recession, but the mainstreams – national or regional – provided an updating machinery even for these discourses. The public had in any case to seek the majority of news-type material from the mainstream, while the alternative sources provided details, comments and debates to support or to oppose it. The alternative discourses were thus not cut off the mainstream, either.

But before the contents it is necessary to view the “launching base”, the media production machinery that underwent quite radical changes in the 1990s. This political economy aspect is necessary, because changes in the production apparatus influence -- directly and indirectly -- the content of reporting.

### **The production base**

The economic recession hit Finnish media industries quite badly, predominantly due to decreased advertising, which decreased by 24 percent. The media business had grown steadily in Finland from 1980 to 1990, but then a drastic change occurred. The total turnover of the media industries dropped in 1990-1993 by 12 percent, while the GNP dropped “only” by 6 percent. Thus it is justified to say that the mediascape in fact suffered more than many other Finnish businesses. Since the middle of the 1990s, the whole media field

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under move”, human mobility in society. We use the term as equivalent to the population as a whole. Still, we include in the concept the “mental existence” of people as Appadurai does.

started to recover, and the annual growth came soon up to 5-6 percent. In 2000, the total turnover reached 20 billion Fmk. Still, the proportion of the media field in the GNP dropped from 3.1 percent in 1990 to 2.8 percent 10 years later. It might be justified to say that the media no longer belong to the expansionist branches of the national economy. (Sauri, 2000, 2001.)

Power relations within the media also developed significant changes in the 1990s. Not all the media experienced the economic recession equally strongly. The newspaper branch went through the most radical changes, while the 1990s was a relatively successful decade for the magazine business. In 1990, Finnish newspapers got 70 percent of their income from advertising. During the recession years the figure dropped to 50 percent, and then grew slowly to 60 percent, which now seems to be a saturation point. Thus dependency on subscription fees and other forms of income grew due to the recession. Furthermore, the proportion of the print media in the total turnover decreased by 3 percent for the benefit of broadcasting during the 1990s, but still the print comprises 73 percent of the annual turnover, the Finnish mediascape thus being one of the most print-oriented in Europe. The newspaper business alone still accounts to one-third of the turnover. However, the total circulation of newspapers dropped in the 1990s quite considerably, from 4.1 million copies to 3.3 million copies. Instead, the total circulation of popular journals remained unchanged, and their advertising income grew considerably.

Concerning newspapers, another typicality weakened. Finland has traditionally had a strong regional press with 22 regional centres. During the early 1990s, practically all number-two regional papers disappeared in the country, and fairly many of the regional number-one papers also had serious economic problems. Several papers tried a life-saving effort tested throughout the past 20-30 years: party papers cut their party ties, thus trying to increase their credibility. Most of Finland party press was gone by the end of the 1990s. That cannot be listed as an effect of the economic crisis alone, because the trend started much earlier.

The share of broadcasting of the total media turnout grew in the 1990s, but it still is only roughly one-fifth (3.9 billion Fmk in 1998), and the growth has not been as fast as media economists have calculated. This concerns especially television advertising which, unlike newspaper advertising has not indicated growth even during the late 1990s. Finland (20% of the media advertising total) lags far behind the European average (32%) in television advertising. Another typicality is that so far, only national broadcasting exercises, television as well as radio, have turned out to be successful, while local commercial radio stations have never reached the status predicted for them in the early 1980s. Furthermore, though quite much discussion has been carried out of the "information society" axis in Finland, of the on-line services, only those offered to businesses have so far taken off. Pay-services for private customers are marginal. (Sauri, 2001.)

The coverage of newspapers is remained in Finland the third highest in the world, after Norway and Japan, though it dropped somewhat in the 1990s. An average Finn spent in 1998 42 minutes per day with newspapers, 49 minutes with periodicals, and 26 minutes with books. Newspaper readership has dropped considerably among the young people, but the figure – 26 minutes – is still internationally quite high. The proportion of the population reached by the print media on a daily basis is as high as 98 percent, and the broadcast media reach roughly a same number (96 %). These figures dropped temporarily slightly in the early 1990s. Only the radio reach (76 %) remained untouched during the recession.

The broad trends of the mainstream media coverage during the 1990s are here viewed through the television program output of the Finnish Broadcasting Company (YLE), as its organisational history and public service role have traditionally positioned it as a prominent, and even “official”, national medium. Structurally, while Finland went through economic depression, which greatly affected the press, and ended the commercial radio boom, the mainstream broadcasting seems to have survived well. The crisis may have influenced television companies at various less visible levels, but its traces cannot directly be detected either from their turnover or employment figures. During the 1990s, YLE’s turnover showed a moderate and steady increase and the number of employees fluctuated only slightly; the commercial competitor, MTV Group, more than doubled its turnover from 1985 to 1998. (Tilastokeskus 2000.)

In general, the role of television has continued to strengthen in the past decade. During the 1990s, television viewing in Finland has increased from the average 104 minutes per day in 1990 to 149 minutes in 1998. (Tilastokeskus 2000.) Increased programme output has influenced this trend. In 1993, the commercial company MTV3 started its own, third national TV channel and in 1997, a new commercial competitor, Channel Four, entered the market. Also, alone YLE’s yearly programming hours have doubled during the research period (YLE:n vuosikirjat 1987/88-1998). YLE and MTV3 have also competed for audiences by offering increasingly numerous programme types, yet with quite similar programming profiles (Hellman 1999).

In sum, the Finnish mediascape was shaken by the economic crisis, but recovered on the mainstream level quite well. Big media businesses grew bigger, and there seems to be space for very small companies also; the medium-sized media businesses have weakened. However, competition on the national level has become harder towards the end of the 1990s due to increased number of participants. Hence it is justified to say that the mediascape is today more market-oriented than it was before the economic crisis, and its lightest fringes indicate greatest growth in circulation figures: broadcast entertainment, afternoon papers, free-distribution papers, local papers, popular journals. After the recession, the media sphere has been

characterized by the emerge of new conglomerates which operate across the media, in print and broadcasting, on national and local levels as well. They acquire sources for the whole company, they often hire professionals to work for the whole company, no longer for individual media. Hence the idea of media turning into “packaging industries” arrived in Finland in the late 1990s, thus also strengthening the commodity character of media products.

### **The Television Sphere: Business as Usual**

Word searches of the television programme archives of YLE suggest some trends regarding the extent and the chronological progress of the crisis coverage. Key words economic crisis and its popular, every day language synonym lama (henceforth translated as depression) indicate that the televised depression begun with the concrete and detectable symptoms of the economic crisis. A sudden increase of this topic in all YLE’s programming occurred in 1991, and reached its peak in 1993. The ordinary term for the crisis, lama, has practically entered television’s mainstream vocabulary only in early 1990s: in the archives comprising of data since late 1950s, most of the programmes with this keyword are to be found during the timeframe of 1988-98. Word searches in MTV3’s news archives (1991-97) provide for some indicative comparisons, which imply that the extent of the crisis coverage was very similar in the public service and in the commercial television.

A crude quantitative analysis of YLE’s main newscast (20.30 news) depicts the mainstream medium’s most prominent and official product during the research period. Two weeks per year, altogether 2040 news stories, have been coded from the news abstracts for the years 1988-98, to provide an outlook on topics, actors, spatial foci (in the axis local – global), and specific topical foci (the economic crisis; the EU membership). As numerous international and national studies prove (see e.g., Kivikuru & Pietiläinen 1998), the news seems to be the journalistic format, which resists changes most persistently. The only drastic alteration in YLE’s main newscast during the research period pertains to its format. While the overall number of daily television newscasts in 1998 amounted to five times as many as two decades before (Lähteenmäki 1999), the number of news stories within the 20.30 newscast has decreased remarkably during the past decade.

Regarding to both actors and topics, the news of the 1990s seems to follow traditional journalistic criteria, and change only little in ten years. Politics comprise approximately one fifth of the stories, many of which are positioned as the number one news items. An even greater topic area is composed of issues relating to economy and business (26%). Here this grouping is defined to include the subcategories of the public sector, the private sector, the “general” economic issues, and lastly, the employment-related issues – the category which could be also classified under politics. Thus, this data does not

indisputably speak for the often-stated assumption that economic coverage has continuously increased during the 1990s, although the proportion of economic coverage grew notably for the years 1991-93. However, the acclaimed hierarchical agenda shift from traditional politics to economic issues is certainly not only numerical but also qualitative. Simultaneously, the birth of special economic current affairs and news programmes and the increase of business journalists both transmit a clear message of the escalating importance of economic issues in the media agenda. Of the other news topics of the 1990s, wars and related conflicts account for close to 13 percent. It is notable and perhaps symptomatic to the research period that at the opposite end of the list, one finds social issues (including education and health care) which account for only some 3 percent of the news items.

Accordingly, it is no news that the main actors consist predominantly of "states" or state representatives (one third); enterprises and their representatives comprise some 11 percent of the main actors; and government representatives and party politicians together form another 10 percent. "Ordinary people" account for close to 7 percent of the main actors, mostly in stories dealing with politics, with wars and conflicts, and with the few stories on social issues. However, very few representatives of a certain profession, of non-governmental interest groups, or defined as unemployed are given voice in the main newscast.

During the research period, some 5 percent of all coverage explicitly address to the economic crisis, and of all economy news items, 15 percent deal with the crisis. The coverage on the European integration processes -- which was presupposed to form one of the key news themes of the 1990s (see e.g. Kivikuru 1996) -- outnumbers depression news only slightly in the 20.30 news data. On the other hand, key word searches of all YLE's programming suggest that in general, the EU related topics have greatly exceeded the media publicity on the national economic crisis in the past decade.

### **Similar Whirls in the Mainstream**

One of the most central topics of the economic crisis, namely that of employment and unemployment, reveals the uniformity of the mainstream media. Regardless of the different methodologies and data sample, the unemployment coverage of the newspaper Helsingin Sanomat (HS) and that of YLE, the two most "official" media, look very much alike. The theme begins to appear in growing frequencies from 1991 on and reaches its first peak in 1993. Until that point, the television coverage seems to correspond to the development of the rate of unemployment; but whereas the rate still increased up until 1994, there is a slight decrease in the coverage of the issue in 1994. A similar break occurs also in HS. Explanations may range from the emergence of a certain saturation point of the topic, to a temporary shift in the news agenda,

due to the EU membership elections. At least the latter seems to hold in YLE television programmes: according to word searches, the coverage addressing EU-related themes doubled from 1993 to 1994.

Another similarity is the notable increase of the topic unemployment in 1996. A closer look at YLE's news and current affairs programming during 1996 suggests that two issues are at stake here. On the one hand, the negotiations for Finland to join the European Monetary Union (EMU) were at hand and it was debated if and under which rate of employment Finland could in fact join the union. Another explanation is the discussion, and finally the government's decision, to cut unemployment benefits. This particular subtopic reached its highest peak also in HS in 1996. In this article, an in-depth analysis of the stories on unemployment forms the first part of the examination of the mediated 'aching spots' of the economic crisis.

The television news data does not reveal any individual trend pertaining to the second topic of the specific analyses, namely that of the welfare issues relating to gender equality. The general observation is that these topics and foci are not overtly expressed in the mainstream media agenda. A key word search for TV programmes on equality matters indicates that the theme is explicitly covered only in some 240 programmes during the research period. It received increased publicity in 1995, most likely in relation to topics such as the nurses' strike and the 4th UN World Conference on Women. In addition, a gender and equality-focused study on YLE's 20.30 and MTV3's 10 o'clock news in 1995 (Halonen 1995) shows that women comprise only approximately one-fifth of the news actors, and they are mostly of undefined professional status or anonymous. Only four of the 167 researched stories bring up gender; three of them relate to women's participation and representation in traditional politics (EU; parliamentary elections).

Regional views – the third specific focus of this article – are another form of realities, which remains invisible in the mainstream media agenda. "States" as the main actors of the YLE's 20.30 news data already indicate that the location-related actuality of the mainstream news has in the 1990s still been in the level of nation states. Domestic and foreign news comprise almost an equal share of all news items; 14 percent of the stories deal with issues pertinent to Finland and another country (for example much of the EU coverage); only few items take a global outlook; and local issues make it to national newscasts in 6 percent (130) of the stories. Local matters on national news consist quite equally of topics regarding to private businesses, of accidents, of culture and of crime; only one story overtly addressed the crisis. The disparity between national picture and the local crisis landscapes is illustrated in the following comparative analysis of the regional media.

In sum, the outlook on this mainstream national medium shows that the official media agenda regarded the economic crisis of the 1990s as “business as usual”. In particular, the news, the most “official” and conventionally structured programme genre, gave voices to the traditional power elites and paid no particular attention to the “aching spots” of the civic society. For instance, a search for the key word depression combined with the key word citizen(ship) (kansalai\*) points towards the fact that the two concepts have not been linked in the media’s agenda. Only a handful of programmes or news stories seem to have explicitly brought up citizenry to the main focus when addressing the topic of depression.

However, a look at YLE’s programming dealing with the crisis and not classified as news or current affairs shows that the number of these programmes was the greatest during the “deepest” recession years in 1992/93. A closer examination suggests that during those years, the ordinary life and the everyday experiences sneaked into more popular genres. YLE broadcasted a diverse array of programs ranging from numerous discussion programmes to a series of unemployed people’s survival stories, to a “Depression Gala Show” (“to lift up the spirit of Finland”), and to a “youth program” *Mediakomppania* (with the subtitle: “the entertainment program of the depression era”)<sup>257</sup>.

The look at broad tendencies in the national media agenda is not too flattering regarding the mainstream media. They may provide the news coverage most close to both real time and highest authorities. However, based on this crude outlook, they grasp and address particular aching spots or broader socio-cultural value shifts slowly and conservatively. Not only the variety of themes but the variety of voices and viewpoints are lacking. The analyses below will shed light on how and to what extent this overall picture is realised in the media coverage of the specific aching spots.

Helsingin Sanomat (HS) is an interesting source of data for a number of reasons. Firstly, in spite of discourses stressing globalisation or localisation, there certainly was a “national” level in the crisis. No matter the stress and pressure recent developments might have put on the nation state system, modern societies are still built on nation state and its political organisation.

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<sup>257</sup> An example of how the ‘unofficial’ programme types addressed and analysed some aching spots after the acute crisis could be read in the vast popularity of domestic fiction such as Ilman kavaluutta (1996). It is a Kafkaesque yet not an untypical story of the depression era, portraying a young teacher who is unjustly responsible for a debt and seeks revenge against both her ex partner and the bank. Another recent example of traces of the economic crisis in popular media culture could be seen in Yle’s *Raid*, the most watched domestic fiction program of year 2000 (Finnpanel 2001). This detective series depicts Finland as a very cold and cruel version of the Wild West, where Espoo forms an autonomous economic area to provide a safe haven for the one and only real power actor of the society, namely the technology conglomerate Escon; where an isolated group of unemployed have become anarchists; and where the justice is created only by individual ‘lonely riders’ at the very margins of the society.

Accordingly, mass communication has been nationally organised (e.g., national broadcasting companies). In Finland, the newspapers have been regional, and only afternoon papers and HS have claimed being “national”, even though their “national” has been criticised for being more or less symbolic. HS is the biggest and probably the most influential print medium in Finland. It is claimed to be exceptional even internationally because of its large circulation within Finland: Suhonen (1994, 70) argues, that there might not be too many newspapers in any country that reach such a big national audience. In addition, HS has a special role in Finnish political culture and in formation of discussion of social issues. For journalists working in other media, HS is a source of information as well as a framework and measure stick for their own work (also e.g. Koistinen 1998).

In the following, we elaborate on two different substance areas in the HS reporting during the economic crisis, both related to work and social policy. First we focus on work life and unemployment reporting, then reporting on gender-related issues.

### **Reporting the Unthinkable -- Helsingin Sanomat and the Unemployment Crisis**

In the 90s, Finland has gone through a set of changes that endeavour traditional Finnish values. Seemingly, the most drastic changes were external (Finland became a member of the EU), but the internal changes, too, have been dramatic. The deep economic crisis had effects in all aspects of society. In three years (1990-1993) the unemployment rate grew from 3,5 % up to 20 %. Much of the national anxieties have been connected with the mass unemployment created during the crisis. Lack of jobs was one of the most painful problems in the Finnish society in the 90s: a society build on strong work ethics was not able to provide work for its members. In addition, it seems that the mass unemployment came to stay even though the crisis in purely economical terms has been over since 1995.

When circumstances in a society alter, the media have a central position as a mediator of stories about the on-going alterations. A longitudinal study of media content provides an interesting perspective to cultural transformations: stories written during the economic crisis both offer documents about political actions and tell about existing values, norms and ideas.

#### **Shifts in the agenda**

The first phase of the study work life reporting in Helsingin Sanomat was quantitative; providing a description on the themes, volume and characteristics

of writings about work and unemployment 1988 – 1997<sup>258</sup>. The method used in the first phase was quantitative content analysis, a method seeking to produce objective, quantitative and justifiable description of the explicit contents (e.g., Riffe & al., 1998). Stories were divided into generic categories crudely on grounds of “who speaks”. This categorisation is unorthodox and perhaps too rough, but it tried to illustrate an actor-based organisation of public discussion. A “theme”, in turn, is the total of stories that deal with the same issue, based on headlines. Themes can be looked as serials, which are in some contexts included in and in some others excluded from the public arena of journalistic discourse.

Overall, writing about work-related issues seems to have both increased and widened during the crisis - the recession forced to the agenda themes, which were unknown to the HS of the 1980s. It also seems that some discussions came to stay: even if work life is discussed only a little bit more often now than before the crisis, there are five times more stories about unemployment now than there were in the 1980s. It seems that after the end of 1993, there have been also qualitative changes in many discussions: unemployment turned into “low employment” (EU policy), the unemployed gained new social status, discussions about developing working life re-appeared but in slightly changed colours. The news threshold seems to have lowered for most of the work-related themes, for when work life was in the middle of transformation, most social actors considered it inevitable to discuss the changes. The formerly institutionalised agenda was suddenly accompanied with a selection of new agendas of recession-related topics and themes. The public sphere of work-related issues was thus necessarily fragmented, and it is hard to avoid interpretations that emphasise the reactivity of the media coverage. This reactivity, of course, reflected the diversity that was characteristic to understanding of the crisis and its impacts among politicians, economists and researchers.

In the beginning of the research period, there was simply some unemployment. The statistics were published twice a year, and once in a while there was a story about unemployment as a social problem. Even when the recession started, unemployment and the unemployed were handled in the same stories – all the aspects of the problem were combined or generalised. Later, in 1992, unemployment as a theme started to disperse into more specific categories. The stories started to report unemployment within a certain field, within

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<sup>258</sup> The quantitative data includes all stories about work, working life and unemployment published in HS and in its weekly and monthly appendixes (Kuukausiliite, NYT-liite) during 1988 - 1997; 31 401 stories. HS as a source of data is interesting for a number of reasons. It has a special role in Finnish political culture: it has an (internationally) exceptionally broad national circulation (Suhonen 1994, 70) and for journalists working in other media, HS is a source of information as well as a ‘measure stick’ for their own work (e.g., Pietilä & Sondermann 1994, Koistinen 1998).

particular groups such as young men, young people in general, ageing people and women. Long-term unemployment, social dropouts and marginalisation emerged on the agenda later. In 1992, public discussions about adequacy or inadequacy of unemployment benefits started and were continued until the end of the research period. At the end of the period, though, the focus was on possible misuse of these benefits. Also, writing about unemployment in general started to shift from describing its impacts on both the unemployed and the societal structure into speculating its costs and their equal division. These kinds of shifts and developments in the “agenda of unemployment” undeniably tell something about changing values and hierarchies in the society.

These results are of course very general. Particular issues would call for more specificity, but even this very general form of monitoring is able to produce some useful elaborations. Even if we might never find out the extent of influence from outside the media, we can know something about the face shown to the public.

### **Discursive Struggles Remain Absent**

The second, qualitative phase of this study consists of a series of qualitative case studies on the rhetoric of unemployment publicity (see e.g., Valtonen 2000, Renvall & Valtonen 2000), focusing on questions like: How was the public sphere of unemployment constructed during the research period? How did it change over time? How talk on unemployment in different institutional discourses (e.g., of politics and economy) is echoed in the media?

The daily flow of public information is overwhelming. Individual news stories are woven together as a fabric of continuing themes, and to make sense of the news, it is required to link together the pieces of news information to news issues and to the interpretative frames used. In order to make sense of the political world, both the media and the public employ simplified frames as hooks to capture pieces of the abundant flow of the “world outside” which the media research classic Walter Lippman (1922) has talked of. In general, there were three basic lines of writing about unemployment. First, there were either problem-centred, administrative or process-oriented stories, in which information about unemployment was given in a form, that easily dispels political or ethical dimensions. The second way of writing comprised of stories representing controversy of interests. These stories brought up competing views and stressed struggle. Third, there were moral, ethical and scandalous stories, in which the theme was dealt with in a way that easily provokes prejudice, etc. (e.g., Renvall & Reunanen 1999: 85). It seems that a notable number of arguments in discussions about work life and especially unemployment were located in the sphere of the moral (see e.g., Vähätalo 1998). In the media publicity of work related issues, questions dealing with the functionality of Finnish society, reasonability and rightfulness of policies and

economic decisions are central – that is, questions which have to do with common values and shared perceptions of right and wrong.

One of the themes constructed as moral or even scandalous was writing about unemployment benefits. Quantitatively, this kind of writing about unemployment benefits reached its peak as late as in 1996, when the unemployment rate already had slowly lowered for a year. Assumingly, unemployment as a social problem was experienced being so painful that critical discussion about its costs was possible only after the worst was over. Before the culmination point of the unemployment rates, the stories were neutral, and so was the reporting style, and even though some stories about e.g. misuse of unemployment benefits were published, critical stories remained as a side issue in the media discussion. In 1996 and 1997, as much as a fifth of all the stories about unemployment benefits and costs was about their misuse. The moral -- or the more traditional -- aspects of unemployment gained foothold, even though moral panic forecasted by some researchers (e.g. Julkunen 1993, see also Golding & Middleton 1980), never received space in the coverage of HS.

A change took place in the positioning of the unemployed. In 1992 – 1995 HS published a number of series about the “life as unemployed”. In 1994 the angle in these stories started to shift. Previously, the focus had been on survival strategies, on everyday practices and on potential for “recovery”. Around 1994 the emphasis started to stress more “regular” news material, events, decisions and changes in policies or regulations. It is significant that the unemployed, formerly represented as a “marginal” group, were turned into a group of social actors in the media discourse. Heikki Luostarinen describes the relationship between media discourse, elites and the people aptly by using metaphors like “doormen of public sphere” and “repairing coefficients” (1993: 244 - 246). He claims that journalists recognise their role as “doormen of the public sphere”, who are also able to evaluate social groups and their abilities to function in society and influence social debates in the media. “Repairing coefficients” are drawn from these evaluations, and with the coefficients, journalists try to distribute possibilities to take part in public debates more evenly. Luostarinen argues that there are groups in the society like the unemployed, who are outside all coefficients. This longitudinal data shows, however, that slow changes do happen. For example, the unemployed were transferred in the media discourse from the margins to the active public sphere, where it is at least possible to become heard (and not only asked questions) and to benefit from repairing coefficients.

It seems that contemporary understanding of unemployment is drawn from (myths about) efficiency of the labour market and economy and from morality of the work ethic and self-sufficiency. It also seems that the publicity on unemployment as well as on social policy in general is dominated by government announcements and by discourses of the officials and elites.

Maintaining the necessary distinction between the “proper”, deserving and “improper”, undeserving poor seems to remain as one of the functions of the media, even though there are shifts in the demographics of those two groups. Still, there was an attempt in HS to present citizens’ perceptions of the recession, but when actors in the data are studied, it is clear that “ordinary people” have a miniscule role in the discourse of HS journalism. Tuchman (1978) called the position of the ordinary people in the news symbolic; people were included in journalism to cheer at royalties or to cry in case of a severe accident. Their function was not to represent themselves, but the whole population. The growing number of stories, where the unemployed were presented more as actors than as objects at the end of the research period hints, however, of a possibility for another type of journalistic culture.

### **Helsingin Sanomat and the Gender Perspective**

The economic crisis, as the dividing parameter of the crossroads, was marking the shift from viable politicising of equality issues to a more subdued public sphere of equality questions. From a gender perspective, the deepest years of the crisis were the years of silence when the explicit preoccupation with gender was pushed aside by the publicity of different cuts and savings (Parikka 2000a). The decline in equality interest was thus replaced by presentation of economic interests in other subjects. In health care, for example, economising the issue (see Fraser 1997) started to take place 1991 and the health care topics were primarily addressed in economic terms, by the increasing coverage of cuts and savings, rather than in terms of employment or gender politics. The come back of equality issues took place in 1995 but the gender was no longer politicised in quite the same way as earlier. How were the preconditions for negotiating gender relations reconstructed during the “missing years” of equality publicity? What was the gender reality like into which the workingwomen awoke after the crisis?

In the following, an overall view of the spirit of the crisis is drawn to show how it got its shape in the media publicity offered by Helsingin Sanomat, not so much by the economic parameters but by the discussions that relate to gender and societal welfare. For these purposes, the publicity of health care at large, between 1988 - 1997, was chosen to provide a chronological outline of the twists and turns of the crisis in the scope of one theme. Because the variable of gender was such a hidden subject of the crisis, it is approached here by focusing more closely on one event only; the strike of the nursing personnel in 1995.<sup>259</sup> This event, embedded in the larger scale of the journalistic flow, brings forward a strip of the discursive reality of the economic crisis in which women’s

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<sup>259</sup> See Parikka 2000a/2000b for more comprehensive analyses concerning the publicities of equality and welfare.

economical interests and collective opportunities were negotiated in the midst of a larger economic decision-making. Roughly put, what was defined as an equality issue in 1990 was no longer defined as such in 1995.

### **From Wishful Thinking to Gender Realism**

In 1990 women's rights were purposefully pursued in different social sectors, in politics, religion, protection and in the work life. In health care, in which the changes were discussed more than in any other single theme under study during that year, women were concretely fighting over money. The health care crisis was defined by the vast shortage of nurses and the give and take play between the employers who need human resources and the employees who demand benefits in return.

Women's demands were supported by discussions of wage equality; these discussions were carried out at the same time. So-called equality shares for the underpaid made an issue, as well as the need to measure the demands of women's and men's jobs and to transfer the wage inequality into history. In 1990 the economic issues were, in the subjects in question, defined as gender specific questions. Hopes for a social change were created by, for instance, expressing the relevancy of money in women's lives (see Haug 1992) and the decade was optimistically foreseen to become both the women's decade and a decade of employee shortage.

The year 1991 suddenly detached gender issues into an arena of their own, away from economic elaborations. Equality discussions collapsed in quantity, and single stories expressed doubts about the necessity of equality and the effectiveness of equality laws. In health care the shift from 1990 to the first actual year of the economic crisis was reflected in the changing interpretations of the health care crisis. The crisis defined by the shortage of nurses, wage and benefit demands, career advancement requirements, was now unfolding itself as a structural crisis of health care defined first and foremost by economical terms. Within this frame the shortage of nursing personnel was beginning to be regarded more and more as an opportunity to save money rather than as a problem. In the publicity of health care the economising appeared not only by the rhetoric of economy in 1991 but also by the lack of defence of the human resources. Both the employees in health care and their representatives appeared paralysed. No one was eager to advocate for better working conditions.

A frame in which the equality discussions were scarce and the health care crisis was defined as a structural crisis was affirmed in 1992 but went on until 1995.<sup>260</sup>

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<sup>260</sup> The structural changes in health care seem not to be discussed in a versatile way as the closing down of the hospitals and wards are represented on a quite general level and as part of

Rhetorically, a shade of facelessness or nonpersonification, plus unconditional tones described the health care headlines. Aims to cut wages did not seem to meet with much opposition. In the air of money wasting and expensiveness, the nurses defended their interests in only two stories.

In sum, in the five-year life span of equality publicity, there were elements for the temporal dealings with equality in such a way that, right before the crisis the relationship between women and men was fairly visibly politicised, whereas during the silent years of the crisis the equality goals were hardly questioned. Discursively the shift in the publicity of equality could be described as a move from hopefulness to a certain type of gender realism. In the atmosphere of hopefulness old equality problems were pursued, but the economic crisis introduced an air of gender realism in which the political will to struggle with equality issues in public was diminishing. This was basically the frame in which the nurses began their strike in 1995.

### **Women's Strike and the Insurmountable Economic Obstacles – End of the Crisis**

As the economic crisis was facing its turn, the quantity of equality stories exploded. In 1995 it explicitly seemed as there would be a return to the topics introduced before the crisis. The nurse strike made an immense topic that year. The women came forward with their wage demands once again since 1990 but in 1995 there were unexpected counter-forces ahead which aimed to control women's economic struggles in public.

Before and in the beginning of the strike different parties' views were legitimised.<sup>261</sup> In employers' view the wages of the nurses could not be raised as much as they demanded. The employers were appealing to the solidarity of nurses in respect to other workers who already had negotiated their wages on commune level. In the nurses' view the strike was motivated by a will to get compensation for the wage cuts done during the economic crisis. Besides wage demands, the nurses were represented as responsible and worrying for their patients welfare and assuring the adequate amount of protective work during the strike.

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a larger health care system. The programs for cuts, actual cuts and savings, temporary lay-off etc. are reported in the informative manner of events that need to be told to have happened. Examples of headlines: "The expenses in the hospitals are not increasing this year" 2/91, "The Bureau for Health Care in Helsinki succeeded in cuts" (HS3/92), "Vantaa is going to save in intensive health care" (HS 5/92), "HYKS [The University hospital of Helsinki] is going to make it with less money this year than last year"(HS 9/92), "The Vaajasalo hospital is going to dismiss half of its personnel" (HS 10/92).

<sup>261</sup> The main phases in the publicity of the strike include reporting the threat of the strike, agreeing on the limits of the strike and covering the strike itself as well as the end of it.

The newspaper's editorial view was against the strike right from the beginning. The situation was said to be deadlocked unless the nurses compromised their "unreasonable" demands. The organisations of nurses, Tehy and Super, were blamed for the unbearable situation which unabled the conciliator and the employers to fulfil their duties and the employers to respond with their offer. There was simply not enough money in the municipalities and besides, the conciliator was tied up with the agreements already fixed with other organisations in the communes. It was also regarded illegal to refer to the strike as a women's strike. Not all the women were on strike and would not receive the bonus for the underpaid, either. The talk of solidarity was evolving to steer the attention to other people's agendas.

In the beginning of the strike HS advised citizens on how to act during emergencies and covered closely the situation in the hospitals, jamming, delays, lack of comfort, etc. As the strike was prolonged, the pressures started to add up on nurses. Distress and the detailed descriptions of the crowding hospitals accumulated. The talk emphasising the risky nature of the strike for the society, introduced in the beginning of the strike, expanded rapidly. Moreover, publicity on patients' rights, on health care professionals' duties and on the responsibilities of those who declined the protective work started to increase. Doctors were brought forward as agents who were concerned about the lives of their patients, and they started to present omens of possibly spreading epidemics and treacherous illnesses which perhaps were left undiagnosed. Meanwhile, the employer party seemed to disappear from the publicity almost completely as the risks of the strike started to expand.

Gradually, the risky nature of the strike began to act against the nurses, not in favour of them. Nurses had difficulties even in raising support from the Leftist parties. They were also discouraged as the Chairperson of the Union of the Nurses suggested a compromise, due to the concern expressed by the citizens in public (HS 5.3.95).<sup>262</sup> Between solidarity talks and discourses on the potential risks caused to society by the strike, the rhetoric on the nurses' demands to increase the value of their work did not advance much. As the strike continued, its risky nature was articulated more and more clearly, opposing the demands of the nurses.<sup>263</sup>

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<sup>262</sup> In this story as well as in the reactions of the citizens, references are made to other expressions stressing on anxiety and seriousness of the situation: "The news around the country have clearly pointed out that the lives and health of the patients can no longer be guaranteed..." (HS 22.3.95).

<sup>263</sup> For instance the Chairperson of Tehy Raija Hukkamäki is represented (HS 12.3.95) as a woman who is responsible for "over 80 000 women on strike but also for the health of Finnish people". Hukkamäki is personified as a woman who has channeled her own personal and selfish interests into the union life and who "does not see anything else but her own objectives. Flexibility by her is experienced as humility, oppressing and degrading women". Hukkamäki's

The talk of revenge, so visible at the end of the crisis, further emphasised the risks of the crisis, but now rather the risks to the nurses' finances than to the society as a whole. Besides that the strike was not represented as amounting to much (HS 3/95), the employers now returned to public to explain how costly the strike was to the nurses and how long they had to work to obtain the money lost during the strike (HS 3/95). The talk of revenge, that is the other side of the risk talk, included the implication that in the end, the health care system seemed to bare the pressures of the strike almost too well. Suddenly the question of possible over-capacity of the nursing personnel awakened, and the evaluation of the strike as a risk to society came to an end.

The strike was supposed to be more or less women's political proof of power.<sup>264</sup> The political nature of women's wages was overshadowed by the talks of solidarity and risks caused for the society. As said earlier, one of the central differences, compared to the wage struggles in health care in 1990 was the politicisation of women's economic interests. In 1990 women rather straightforwardly "demanded the money right here and now". In 1995 it was even questioned if it was right to present women's wage demands in public, both as an issue of equal wages and as a collective interest with political weight. In 1995 quite a few issues degenerated the politicising of women's demands. Presenting the strike as women's strike as being questioned, the issue of equal wages was said not to be actual, elite women in politics were said to remain silent about the issue, and so on. In the end, women received more sympathy than money: "the importance and the demanding nature of the nurses' work have received lots of attention and public understanding. But when there is no money, it is difficult to spread out" (3/95).

These kinds of power struggles may not be surprising per se, but rather as part of the moral and political world filled with power struggles and violence, backed up by ideologies and cultural hegemonies, as Benhabib points out (1990). What was more surprising was the women's isolation in this struggle and the fact that the egalitarian interpretations of the strike were no longer welcomed. Gender equality has traditionally formed a strong ideological base for women's pursuits of well-being in Finland.

In Laaksonen's view gender was not an explaining factor for the hardships experienced during the economic crisis (see Laaksonen 1999). The economic crisis let many people face disproportionate poverty and economic misery regardless of gender. In the light of this study on the publicity of economic crisis,

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capabilities of negotiation and stern strength will largely become one-sidedness, originating in her own private interests.

<sup>264</sup> For example in the story "Equality will be left for professionals" the strike is warm heartedly referred to as an example showing that not everyone gives up even under the pressures of economic crisis and that someone still has some eagerness to fight.

people were neither commonly specified as women and men, nor were the societal issues scrutinised much for their possible gender consequences. But regardless of the “fading out” of gender as a category in the publicity of the crisis, the preconditions for negotiating gender issues were nevertheless reconstructed during the crisis. The unsupportive reception of women’s economic demands right after the crisis, for example, suggests a rupture in the Finnish egalitarian ideology, in which the gender-based political struggles seemed to have withered and lost their force. The argument of equal wages for all women and men no longer made such a powerful or self-explanatory statement which forced especially women to reframe their agendas. In the end, gender issues were largely left to wait for the upheaval of even better economic times. As in the story “Equality issues left to professionals” it is deliberated: “The economic crisis hit on us immediately with such a force that even women were stiffened.”

### **The Sphere of the Regions: Meaning Marketing**

In the Finnish mediascape, the mainstream is not only composed of Helsinki-based “national” media such as YLE or Helsingin Sanomat. Strong regional newspapers have their say in the publicity, reflected not only in their respective regions but also bringing variation to the national agenda.

What can a regional perspective to a crisis reveal? Are regional mediascapes different from those created by national media? The focus of this part of the project has been on the regional character of the crisis and on its portrayal in regional newspapers. The media coverage of the crisis in regionally profiled newspapers was analysed, asking how the “stories of the crisis” were brought to the people in a regional setting and what kind of journalistic strategies were applied in handling the issues.<sup>265</sup>

Significant differences were found in how the economic crisis affected different regions in Finland. From economic studies we know that the centre-periphery polarisation increased. The consequences with respect to horizontal regional disparities have, however, so far been less clear. (see e.g. Okko et al. 1998: 38; Peltola 1996; Löytyniemi 1997). In this study of regional newspapers, it was

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<sup>265</sup> For this research project (Moring 2000a), four newspapers (Etelä-Suomen Sanomat from Southern Finland, Lapin Kansa from Northern, Ilkka from Western and Karjalainen from Eastern Finland) were selected. The regions are different both economically and culturally. Data for the content analysis (number of observations = 36,093) was collected from the newspapers between 1988-1997. The analysis focused on local and regional news, editorials, columns and letters-to-the-editor. Around 500 articles were selected for a supplementary qualitative analysis. Contextual data was sought from statistics collected by Statistics Finland and survey data portraying media use produced by MDC-Gallup Finland. The data was supplemented by interviews. The research methods were a comparative content analysis of the news agenda, a textual analysis and a close reading of interviews

found that the crisis was represented differently and there were striking variations in the timing, scale and nature of the strategies in handling and reporting of the crisis (Moring 1999; 2000a; 2000b). Subtle meaning-making and interpretation processes of the situation varied, forming specific regional media landscapes.

A socio-cultural point of view leads us to expect regional media to mediate everyday practices, to maintain the democratic discussion in society and to link events on global and national levels to the regional communities. Regional media often claim to act as agents carrying factual and truthful information, with a polity for common good as a criterion for their values. But mass-mediated communication is also a commodity, functioning in a market of media products. This brings mixed motives into the picture.

The role of the regional newspapers proved to be the role of resistance, skewing the representation of the crisis towards regionally distinct and overly positive discourses<sup>266</sup>. The characteristics of these discourses could be traced back to differences in how the crisis formed the economic and political conditions for the region and for the media themselves. As a consequence of this, the media actively took into consideration the effects of their own interventions, in some instances even in a way that may lead into a conflict with their journalistic ideals.

### **The Regional Picture of the Crisis**

As a rule, newspapers in Finland are profitable enterprises, making their revenue from subscriptions and from selling audiences to advertisers. The particular asset of the regional newspapers is in their capability of creating an “identification frame” of the local/regional/national community to their readers. Regional newspapers have to create and maintain their public to keep their attractiveness on the market. Presenting specific opinions and connotations favourable to the regional public and also to the firms and enterprises of the region usually serve this purpose. This set of active journalistic actions could be seen as an effort to govern the “regional public sphere”. The regional economic structure is clearly reflected in the ways that the economic crisis was

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<sup>266</sup> The results of the quantitative analysis of the content of the news agendas of the regional press were striking. A broad categorization of subject matters discussed did not reveal any greater differences in choice of themes reported. But as soon as the analysis went beyond abstract categorizations, quite specific ‘profiles’ of local content were detected, constructed by the journalistic representation of each of the four regions. Issues like regional politics, employment, the center-periphery dimension and regional identity were differently represented. The news agendas also did not mechanically follow the regional development of the economy (as measured by the regional statistics on GNP). Regional newspapers actively and sometimes consciously constructed their own agendas with a time-space that differed from the mainstream publicity of national media. The qualitative analysis gave support to the observation of differences detected in the quantitative analysis.

interpreted. Depending on the region, different balances were found in how the main poles (agriculture, wood industry, regional development and the centre-periphery -nexus) defined the regional mediascapes.

Some main features found in the empirical analysis were:

- 1) There were temporal differences in how the recession as a media event entered the regional newspapers. There were also differences in how long the textual recession/depression lasted as a part of the regional news agenda. For example in Northern and Eastern Finland (Lapin Kansa, Karjalainen) the economic recession made its way to the news earlier than elsewhere. In the East it also lasted longer than in the South (Etelä-Suomen Sanomat) and the West (Ilkka).
- 2) There was a regional variation in how subject matters were emphasised. The timing and extent of news on unemployment, economy and regional policy varied notably between the regions. In Western Finland regional policy (in particular related to EU) was critically emphasised. In Northern Finland the conflict axis between North and South was a key issue. In Eastern Finland a general criticism against regional policy outcomes rose as an issue. In the South the crisis was seen partly as an effect of the fall of the Soviet Union and a subsequent decrease in Finnish exports.
- 3) The relation to the state/national framework varied along the scale co-operative-neutral-conflict oriented. In the North and in the West the relation was perceived as conflicting, in the South this matter did not rise.
- 4) In certain substance issues (i.e., in issues related to EU), regional identity aspects were increasing and certain newspapers (in particular Ilkka in Western Finland) were taking more active critical or even aggressive standpoints towards the end of the decade.
- 5) A general transformation in orientation towards regional self-reflexivity, i.e., growing regionalism occurred. This notion of reflexive space of regional journalism was displayed in ways that revealed the growing interest towards regional characteristics as such.
- 6) A tendency towards "Europeanisation" occurred (i.e., in presenting the region as an active actor in politics transgressing the earlier borders of local/national).
- 7) An effort to control the regional publicity through defining "welfare issues" strategically, presenting the region in a more positive light, occurred almost simultaneously and in similar ways in all the four studied newspapers.

## Strategies of Hope and Consolation

Media coverage is often presented as recording of “hard facts”. But news, editorials, current affairs and columns are social practices that are constructed within the social and political world about which media report. Social, economic and political life is absorbed by media in a process of interpretation of values, beliefs, fears, propositions and even ideology typical of the time. In order to maintain hope regional newspapers created different strategies to survive the hardest years.

*We reacted so that we took a side, though we are on the side of commerce and other industry, we took the people' s side, who lost their jobs. So we got complaints because our news were always on negative effects, and the biggest news were that this firm has fired so and so many employees and we asked those people 'how are you feeling now'. We got severe criticism from the companies of the region. And this was clear, and I don't remember the year when we understood that it is no use in telling that there are again hundred and fifty new unemployed people, or this company went bankrupt. At that time we tried to turn to something positive if there was something positive from this regional business side, and even exaggerate a bit about these positive sides. Although at times it was almost impossible. But we had this decision that we make a big story of positive things and this negative side we just let go as its own. (Jaakko Koskela, ESS, 15.3.2000)*

*We tried to keep up the spirit, I myself at least was trying to avoid the term depression and used regression instead. Depression as a word has a bad echo. We were trying to gather some positive news. We ended up during 95-97 with those small firms and workshops consisting of ten people or so, that had developed one special product - business has gone well although the relation with subcontractors was a bit problematic. We were trying with our economy section to make some stories on them but this article series dried up. They were afraid, I believe, of some kind of jealousy and envy. (Pekka Sitari, Karjalainen, 22.4.2000)*

News on regional economics are thus not simple reflections of the regional GNP (see Moring 2000a, 2000b). Instead, newspapers have helped and actively manipulated the representation of the crisis in the regions. The representation of the economic crisis was affected through positive news production in order to boost positive mentality into the regional publicity. This was then believed to be helpful and profitable for the development of investments, consumer's trust and overall readiness to function as taxpayers and citizens. The function of news was also understood as consolation of the community. Stories on unemployment and negative development of the regional GNP had to be handled in a humane and comforting way.

*Firstly we approached unemployment as an economic problem. But when we realised how huge it was going to grow, at that point we started to handle it as a human tragedy and started to write these understanding and positive stories about the unemployed. We really discussed about this and there was also the point that a big part of our readers lost their jobs, and we were thinking that if we did this they would remain as subscribers. Some remained, some did not. (Kari Hokkanen, Ilkka, 17.3.2000.)*

*Of course, the amount of stories on unemployment grew. And all these survival stories, there has been plenty, although they sell badly... people do not want to read about these things, they don't care. We've anyway done a lot of that kind of stuff, because it is only one fifth of Lapland's population that is out of work. We haven't made this kind of a categorical decision (of making positive news) but of course I urged to find some positive approach to things and I myself have for example focused positively on 90 percent of things in my columns. As to say, a newspaper is also the one giving hope and consolation. (Heikki Tuomi-Nikula, Lapin Kansa, 16.3.2000)*

These comments reveal an effort by the regional newspapers to actively maintain a positive strategy of the image of the region. Although Finland has been perceived as both culturally and socially quite homogenous when it comes to norms, values, symbols, etc. the aberrance rising from the economic crisis of the 1990s disturbed this picture. Regional differences between different parts of Finland, with the main cleavage occurring between the wealthy centre(s) and the poor peripheries, increased markedly. In this situation, new voices of difference and otherness started to emerge into the otherwise flat and conservative Finnish political and media landscape.

#### **Four Finlands: Different Regions, Different Frameworks of Welfare Publicity**

The representation of the regions in regional newspapers is not limited to the construction of regional images. Also Finnishness as such is differently defined. Through the analysis of these papers, a picture of four different representations of Finland can be constructed.

Southern Finland. The discursive landscape of Etelä-Suomen Sanomat is characterised by a politically significant border between the traditional rural Finland and the southern part of the country, undergoing processes of urbanisation and concentration. The framework of signification focuses on (personal) security, order, traffic, environment and risks that may challenge the life style. The rhetoric and style of addressing to the readers builds on individualism, liberalism and city jargon. The countryside scarcely defines the newspaper's relation to its readers.

Western Finland. Ilkka's relation to its surrounding is farmer-oriented, independent and active (the last point can be observed also in the views presented in letters-to-the-editor, columns and editorials). In Ilkka's discursive landscape, an image of people as active entrepreneurs prevails, which has come to be considered as particularly West-Finnish. This image also intertwines with the (historical) profile of the wealthy farmer. The image is particularly evident in connection with political events, such as elections. The population of the province is the collective "we", as the Southern Ostrobothnian identity is a distinct category, which is all the time being actively developed with positive characteristics.

Eastern Finland. The border towards Russia and its nearness fundamentally moulds the discursive landscape of Karjalainen. The closeness of the border also brings the peripheral nature of the region to the fore. Because of the border and its past history, the pages of Karjalainen are still much influenced by history and a common past. This can be seen as memories from the war and the frequent appearance of soldiers and veterans in the writings. The Karelia behind the border and the territories lost to the Soviet Union are still strongly present in the geography of the newspaper. This can be seen in how the newspaper covers projects of co-operation and economic aid to assist the Karelia behind the border. From the point of view of the region and regional policy, the way of reflecting the province in relation to a national level is crystallized in the rhetoric of developing regions and how the region can be helped.

Northern Finland. In Lapin Kansa Finland is represented as divided into South and North. The Northern dimension is, however, not only a geographical positioning. Attached to it are understandings of life style, harsh conditions and the unique character of the region. As Lapland is one of the internationally best-known regions in Finland, tourism and traditional life enter into conflict. The idea of being the last desert in Europe does necessarily not stimulate such regional policies that would make the people stay in the region. On the other hand, many stereotypes concerning the Sámi, reindeers and other perceived features of arctic life find their way also into the newspaper as part of a tourism-rhetoric. This ambivalence produces a fear that the northern way of life cannot survive solely on the one, economically vulnerable, field of activities provided by tourism.

In the representations of the newspapers the relation to regionalism was relativistic. The region is always built and described from some point of view. In this sense, the regions and places do not have any independent existence, they are not "really somewhere out there" as well defined objects for description, waiting for the journalistic machinery. Thus they can be looked upon from several perspectives, leading to partly different pictures. Regionalism - as journalistic content and as an object of research - becomes a part of cultural

and social discourse rather than being based on quantifiable facts. Thus the region is both a process (also in the newspapers) and the product of this process.

### **Aching Spots, Healed with Time?**

The project Media Coverage versus Citizens' Experience focuses on the Finnish economic crisis of the 1990s from a double perspective, that of the citizen and that of the media, which form an essential part of an ordinary person's life in present-day Finland. The mediascape provides an arena for various social forces, but it also frames the issue for ordinary people. We do not assume that people accept everything that is put on the media agenda, but the framing no doubt has its influence in how people view upon the society and their own status in it. We consider the Finnish economic crisis as a test case for democratic activity. Did the media provide the citizens motivation to operate actively to form a public sphere, or were they "audienced", satisfied with receiving passively information or feeling totally marginalized from social activity? We discuss the citizen's and the decision-makers' perspectives more in detail in another article in this volume (Aslama et al.), while this article has analysed media texts and their production base.

The presentation of the case studies above suggests that the Finnish Broadcasting Company YLE news menu, while reporting on the economic crisis, offered a "standard" selection of substance proportions applied to any larger news issue, leaning strongly on experts talk and treatise on national level.

Further, it was interesting to note that the curves describing general news interest in economic issues by the two major national media, YLE news bulletins and Helsingin Sanomat, were so similar. The rise in reporting started in 1991 and reached its first peak in 1993 when the unemployment rate was highest. The final peak was in 1994. Typical to the standardized manner of reporting on anything, the saturation point was reached and the media reacted by reducing gradually the volume, disregarding the fact that even crucial elements could emerge later in the process. The saturation point was reached, and the news value of the item started to decrease.

In the analysis of the coverage of Helsingin Sanomat, two closely related issues were studied. The "work talk" seemed to find a way to discuss the sensitive topic by "normalising" gradually the theme, first raising problem-centred headlines but ending up with a fairly regular coverage including "standard" critical aspects such as misuse of unemployment benefits. On the other hand, an overdue attempt was made to meet the grassroots by discussing also moral aspects in relation to reporting on "proper" unemployed, who were trying hard to meet the standards of ordinary life disregarding limitations of resources.

Further, the biggest paper in the country changed its gender-related reporting quite considerably by economizing the issue. First, the national catastrophe did not allow to give any privileges to gender-based issues. Everybody was called to join the task force to subdue the ghost of permanent economic decay. Later on, a nurses' strike, demanding for special benefits to the cause of a profession dominated by women, was shown in the paper as being unjust and even unfavourable for the feminine gender as a whole, serving only selfish interests of one professional group.

In the meaning-marketing taking place in regional number-one papers, an interesting division into "four Finlands" was found, indicating that after the first chock of economic recession, all the four regional papers studied created "survival agendas" of their own. Some of the papers seemed to want more or less to be united with the national, urban-dominated agenda, while some others made a definite distinction between "middle-Finland" and the region concerned. Especially after some delay, efforts to control the regional agenda became more prevalent. Most of the studied regional papers developed a practice to strengthen positive developments taking place within their "realm".

Overall, the most relevant dimension of the mediascape of the crisis are the following:

First, this became most evident in the case of Yleisradio but also in the found similarities between YLE and Helsingin Sanomat, the crisis was moulded to fit the everyday routines of the media apparatus. However sore a wound the economic crisis was for the whole society, the media mainstream applied its conventional selection criteria and media formats to cover it; hence the coverage was quite homogenous. Further, especially at the first phase it was dominated by the news genre which allows only a few items to be selected for reporting. Gradually the crisis spread to other forms of reporting, in newspaper journalism to feature reporting and editorials, in the case of television also to entertainment and fiction formats. It was obviously assumed that the audience had grown step-by-step to tolerate a wider scope of media coverage.

In sum, the media apparatus seems to work on the premise that the news is the "normal" form of reporting on "big", dramatic and essential issues to the citizens. In the study of the news genre (e.g. Kunelius 1996), an element of distancing belongs to the manner a news is addressing its receivers. It could be claimed that at the first phase, the Finnish mediascape appeared as carrying a healing element or at least aiming at arbitrating between conflicting interests merely by distancing the reporting with the news genre. However – and that became obvious also in the interesting turn to "positive reporting" by the studied regional papers – this careful, protecting attitude changed with time. The media started to use a fuller arsenal of reporting techniques. Still, as especially the analysis of the regional papers depicts the change did not necessarily emerge from the

essence of the issue reported but, rather, from the context and the interpretation the media had done about the social significance of the issue under consideration. It was assumed that the public was able to meet a crisis with the genre of news, which is frequently applied by the media to cover a variety of catastrophes, ranging from floods to coups in various parts of the world. The genre was used predominantly due to professional routines, but partly also due to the fact that it was assumed that the public expected the use of such a “window to the reality”.

Second, the media coverage on chosen issues, all related to individual well-being, indicate clearly that the media apparatus in Finland avoided drastic turns and “played it safe” in such a way that items interpreted as especially bitter or sensitive were first discussed predominantly on a very general level, that is, on the level of the nation or the region, and references to nationally accepted experts were frequent. Only with a delay, the media started to take more analytical approaches, either by blurring their position, or in a few rare cases such as the nurses’ strike, by sharpening their positions, or by daring to be detailed and reach the level of individual experience as in the case of a series focussing on the life of the unemployed.

Perhaps the most interesting point was made in the comparison of the national and regional agendas. It appeared as if the regional publicity agendas were allowed greater liberties than the national mainstream. With some delay, the regional publicity was also politicised in a way that could be named as selfish or self-centred; the regional papers were behaving as it was found best for the regional interests. The media operating on the national level did not allow themselves similar liberties. The agendas dealing with social policy issues, offered by the broadcasting or the dominant newspaper, were extremely careful, and they stressed national security and/or personal safety, both highly respected values in the Finnish society and found endangered by the recession. Accordingly, discourses focusing on work life or gender-related issues in social welfare were never politicised in the same way as it was done in the coverage of the regional papers. Some sensitive aching spots were healed without problems when the time passed by, but “responsible” nation-level journalism had also to take into account certain potential dangers to the whole society and thus play things safe in a far more careful way than the regional media did. So it was obviously rationalised – or simply routinised in the course of the process without any deliberate editorial decisions – by the national mainstream media.

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## **IV Survival Strategies of Groups and Individuals**

17. Individual Survival

18. Perceived Job Insecurity Among Finnish Employees in 1990 – 2000:  
Prevalence and Antecedents

19. The Labour Market Participation of Immigrants in Finland  
during the 1990s Recession

20. Ethics and Changing Incentives, Social-ethical Model for Examining  
Changes in the Finnish Incentive System during the Economic  
Crisis of the 1990s



## 17 Individual Survival

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### Abstract

Three studies examining the after-effects of the economic crisis of the early 1990's show that individuals with a strong status seemed to be able to keep up their previous, relatively good life style, while those in a weaker position did not appear to be possessive of this ability. In danger of becoming social dropouts were in particular entrepreneurs of the male gender suffering from mental disturbances as well as those who through bankruptcy had been left unemployed and had consequently also lost their families. Another after effect of the recession appeared to be increased loneliness, which added to the danger of being left outside, since the social primary network would seem to serve as a buffer in stressful life situations. The economic crisis generated special areas in which individual problems would pile up, thus making it impossible for people to cope with their difficulties. The studies showed that women and enterprisers who were able to continue their entrepreneurship were the best survivors.

### 17.1 Survival

The deep economic crisis of the 1990s effected the lives of Finnish citizens on a variety of levels. The studies on the consequences of the recession, on which this article is based, show that individuals with a strong status seemed to possess the ability to keep up their comparatively fine basis of life, while those already in a weaker position before the recession did not appear to have this faculty. The development of their lives seemed to be inevitable. They did not survive the recession and became social dropouts. That is to say that, as a consequence of the recession, those already in a weaker standing consequently lost part of their social capital, while, correspondingly, individuals with a strong status were able to make it grow. Enterprisers who went bankrupt during the recession are an exception to this rule. Their previously strong status fell sharply during the recession and, compared to other groups of people, they became the biggest losers both economically and socially.

Surviving the recession can mean a great variety of things. On the whole, when can it be maintained that an individual has survived an economic crisis? For instance, while it is a well-acknowledged fact that a number of entrepreneurs killed themselves after going bankrupt, can it be said that those not choosing suicide have survived the recession? Or, is it conceivable to raise the level of survival to such a height that only those who have been able to maintain their previous standard of living are survivors? And if so, what does this standard of living signify? Does it mean only the material standard or does it also include their mental and spiritual status?

Generally, survival is conceived as a situation, in which a person has been able to either wholly remove, or even partly reduce, the problems caused by their negative life situations. An essential prerequisite for coping with problems is that a person possesses a sufficient amount of resources suitable for coping with the problems.<sup>267</sup> Thus, survival would be based on material and non-material resources and the ability to employ them.

The ability or inability of Finnish men in particular to cope with their problems can be studied through the ethos concept of survival. According to this concept, in the Finnish society his job is for the man "a field of glory", where he earns his own place without mercy. The ethos concept implies that coping with the tasks of working life is the only way the Finnish man can gain appreciation in his working community as well as in society in general.

## 17.2 Materials and methods

The three studies, on which this article is based, belong to the 1990s Economic Crisis in Finland Project sponsored by the Academy of Finland. In her qualitative study, Liisa Lampela-Kivistö examines the experiences and survival strategies of the owner-entrepreneurs and their spouses who went bankrupt during the 1990s economic crisis<sup>268</sup>, with particular focus on the extent to which religion has provided mental and spiritual resources amidst the difficulties brought forth by the recession. The research material consists of the life-story interviews of 44 bankrupt owner-entrepreneurs of small and medium-sized businesses. The interviewees represent 35 different enterprises. In order to find the special characteristics of the phenomenon, the interviewees were divided

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<sup>267</sup> As to these resources, Antonovsky employs the word generalized resistance resources. Antonovsky 1979.

<sup>268</sup> Before the recession and until 1990, the annual number of bankruptcies had stayed under 3,000. In 1991 6,253 businesses went bankrupt and in 1992 the figure was 7,355. In 1990-1996, the number of bankrupt enterprises exceeded 38,000. The number of businesses against which bankruptcy petitions were filed was markedly higher, but many petitions were dropped due to lack of money. Statistical Yearbook of Finland 1997.

into several groups according to the different stages of the life-spans of the businesses.

The study of Hannu Sorri concentrates on the mental and spiritual ill-being of the recession victims in the light of phone calls made to the Telephone Counseling Service of the Finnish Church. The material of Sorri's quantitative study provides a unique regional long-term profile of the extent to which the financial depression changed and increased the ill-being of the crisis hotline callers. The material is based on the statistics of 68,000 calls made to six service centers of the Telephone Counseling Service in 1991-1996. During this period, a total of 348,000 calls were answered in all the service centers of the Telephone Counseling Service. The centers selected for Sorri's study supply an extensive regional coverage of Finland.

Jouko Kiiski's qualitative study examines the experiences of the effects of the recession on partnership relations of the clients of the Centers For Family Issues run by the Church.<sup>269</sup> The study scrutinises how unemployment, bankruptcies, over-indebtedness, and other recession-related issues have been reflected in individuals, their partnership relations, and family lives. The research material consists of the interviews of 31 clients of the Centers for Family Issues and the drawings they made on their partnership relations. In the analysis of the material, the interviewees were divided into several different groups.

Albeit the materials and methods of these three studies differ, their results are inter-supportive. The personal experiences of individuals provided by the qualitative studies of Lampela-Kivistö and Kiiski are strengthened and supported by the general material of Sorri's quantitative study, and vice versa. The quantitative examination also helped to survey the extent and regional division of the problems.

### 17.3 Survival of different social groups

Social conditions may provide people with an important external resource, which helps them to cope with their personal problems.<sup>270</sup> However, during the recession social conditions did not prove to be a resource, instead, they rather produced the problems. The economic crisis affected society as a whole, creating gaps especially in social welfare services.<sup>271</sup> This caused material

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<sup>269</sup> The numbers of client consultations of the Centers For Family Issues: 1988 54,930, 1991 63,056, 1994 72,425, 1997 77,920, 2000 84,113. Annual Reports of CFI, 1988-2000.

<sup>270</sup> Antonovsky 1979.

<sup>271</sup> On the consequences of the recession, see Julkunen 2001; Niemelä 2000.

adversity and insecurity for people, who already before the recession had had to resort to social services provided by society.<sup>272</sup>

The economic crisis produced problems of a certain type common to huge groups of people. For example, it has been established that different social conditions are reflected in the calls made to the crisis hotlines of the Evangelical Lutheran Church. Accordingly, one of the present studies examined the social situation prevailing during the economic crisis by scrutinising the characteristics of the calls made to the telephone counselling services.

Since the recession had a weakening influence on the Finnish social security system and the welfare network provided by it<sup>273</sup>, an important factor for the survival of those who called the crisis hotlines appeared to be whether or not they had succeeded in keeping up their social networks during the recession. The economic crisis would seem to have hit worst the people suffering from problems of mental health. As to these people, the word for them is not survivor but social drop-out.<sup>274</sup>

Tightening of work pace and difficulties in getting any work, cuts in the psychiatric health care, and squeezes in social welfare services seem to have worst influenced the chances of survival of those suffering from mental problems.<sup>275</sup> For these people, the simultaneous tightening of assistance from three different directions brought about a grave problem of displacement. Also, their weak social networks and social imprinting have increasingly hindered them from building new human contacts. Also, their inability to seek help, means of help or to deal with their problems has impaired their situation. Neither do they possess any structural collected forces, such as the labour unions of employed people, to fight for them.<sup>276</sup> Also, enterprisers going bankrupt, whose social security system was feeble and whose social relationships broke as a result of their bankruptcies, were in danger of falling into this group.

Social networks, acting like buffers against difficulty, are an important mental resource for people living in problematic situations.<sup>277</sup> Many people, who had suffered big material losses and experienced grief, stress, and increasingly threatening mental problems, survived the recession in the first place because they were able to keep up their social networks.

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<sup>272</sup> Sorri 2001; Niemelä 2000.

<sup>273</sup> Gaps in the Finnish social system, see Niemelä 2000.

<sup>274</sup> Sorri 2001.

<sup>275</sup> On the influences of the recession, see Julkunen 2001.

<sup>276</sup> Sorri 2001.

<sup>277</sup> Antonovsky 1979.

Also, the economic crisis caused problems for middle-class people, although they would seem to have had the best chances of survival.<sup>278</sup> Generally, they were possessive of good social primary networks and were capable of discussing their lives also with their friends. As to them, the important part upbringing and education have in individual survival perhaps manifests itself best.<sup>279</sup> They were able to utilise the social services offered by the Church and society in a great variety of ways. They were also the first to go and look for conversational help when it was needed. This phenomenon could clearly be established among the clients of the Centers for Family Issues and callers to the crisis hotlines with problems with their personal relationships.<sup>280</sup>

Thus, surviving the recession primarily seems to depend on networks.<sup>281</sup> Additionally, although individual capabilities and possibilities of belonging to networks differed due to personal social talents, internal changes took place in the networks of different groups. The networks of the groups with initially weak networks became still weaker. This took place especially among persons suffering from mental disturbances and personal problems. For example, the proportion of single people among them grew, which clearly signified increasing loneliness. The number of employed citizens fell, while that of unemployed and retired people increased, which verifies the decrease in the networks related to working life.<sup>282</sup>

As regards the differences in the survival success of males and females, all three studies seem to verify that women were better survivors than men. This may be seen as a result of women's better social capabilities than those of men. Typically, women appear to cope with their problems by talking, while men seem to prefer to solve theirs by themselves, either by choosing to be alone, resorting to work or hobbies, or seeking help from alcohol.<sup>283</sup>

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<sup>278</sup> In Kiiski's study (2001), this was specially accentuated as far as teacher and nurse respondents were concerned.

<sup>279</sup> Individual generalized resistance resources also include upbringing, education, and wisdom acquired through experiences of life. Antonovsky 1979; Blom 1999; Oinonen 1999.

<sup>280</sup> Sorri 2001.

<sup>281</sup> Also, see Kortteinen & Tuomikoski 1998; Heiskanen 1996; Kuisma 1994.

<sup>282</sup> Sorri 2001.

<sup>283</sup> Kiiski 2001; Lamplala-Kivistö 2000. This observation is also supported by Heiskanen (1996), according to whom women typically look for solutions primarily from friends and close relations by discussing with them their difficulties, while men generally try to solve their problems through rationalisation; and Tolkki-Nikkonen (1990), who points out that in conflicts withdrawing from the problematic situation and waiting and seeing are especially typical of men.

When groups with strong networks are examined, the female representation is high. The weaker the social networks become, the higher the proportion of men rises.<sup>284</sup>

Also, women appear to be active as regards seeking professional help. When their family was threatened by a crisis situation, men very seldom wanted help from outside, while women came by themselves to the Centers for Family Issues to seek help for their families. Or, if the couples came together, the initiator was the wife.<sup>285</sup>

Also, among those who had gone bankrupt, survival seemed to be considerably easier amid women than men. An important part of the ethos of Finnish survival seems to be in that failure especially in work-related things gives men the mark of losers also in all other sectors of life.<sup>286</sup> Society does not impose on women similar claims for success in working life as it does on men. For this reason, failure in business was easier for female enterprisers. For women, failure did not seem to lead to as big identity problems or social shame of the same kind as for men.<sup>287</sup>

Family-centeredness is another explanation for the better survival capabilities of women. The role of mother rather than that of enterpriser would appear to define their identity more strongly.<sup>288</sup> Also, Lampela-Kivistö established that after failure as entrepreneur, the role of mother stood out even more strongly. When they experienced that they had succeeded as mothers, going bankrupt as entrepreneur did not feel to be as big a failure as for men. Family support was important to both female and male enterprisers, helping them to survive. Without family support, when it was needed and wanted, the situation became really difficult and easily led to isolation and displacement.<sup>289</sup>

The Finnish ethos of survival mentioned earlier is one explanation of the weaker work-related survival capabilities of men. Furthermore, unemployment would still seem to be more shameful for men than women. Professional failure produced social shame, making it more difficult to take care of their human relationships or creating new ones. For many of the men, their human relations seemed to be work-committed, when the loss of enterprise-related human

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<sup>284</sup> Sorri 2001.

<sup>285</sup> Kiiski 2001.

<sup>286</sup> Kortteinen 1992.

<sup>287</sup> Lampela-Kivistö (2000) examines entrepreneurship from the viewpoint of identity. In her study identity was seen to consist of several internalized roles.

<sup>288</sup> Also see Numminen 1994; Kortteinen 1992.

<sup>289</sup> Lampela-Kivistö 2000.

relations connected with the bankruptcy as well as unemployment added to their loneliness. Also, the break-up of friendship and family relations as a result of bankruptcy was a very hard experience for many men.<sup>290</sup> This, on the other hand, led to increasing abuse of alcohol. Consequently, men seemed to form the majority of the callers to the crisis hotlines, with personal problems and willingness to talk. They were the least successful groups of recession survivors. Also, these men included aging men, facing a more and more lonely old age.<sup>291</sup>

Consequently, especially for men the economic crisis signified that their social networks became less and less coherent. Also, divorce often brought along the cutting-off of their other human relationships. However, there is a good number of other factors that provide an explanation for the inability to survive. The studies showed that men were not as good as women in seeking outside help with their personal problems. While women sought emotion-based conversational help in their various problems, male enterprisers, for example, tended to look for active help from consultants, lawyers, and bank directors with their financial problems.<sup>292</sup> Consequently, many male enterprisers tended to base their survival strategies on the rational solving of problems.<sup>293</sup>

Kiiski's study showed that among the victims of the consequences of the economic crisis, bankrupt enterprisers survived less well than the unemployed.<sup>294</sup> In the worst position seemed to be those men who had gone both bankrupt and become unemployed without the means to take care of their often huge debts.<sup>295</sup> They experienced their status as far less secure than that of other recession victims, especially because of the deficiencies in the social welfare systems.<sup>296</sup> In those days, entrepreneurs were not entitled to any unemployment benefits and only received the basic unemployment compensation.<sup>297</sup> Furthermore, a bad listing in the credit information registry

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<sup>290</sup> Lampela-Kivistö 2000.

<sup>291</sup> Sorri 2001.

<sup>292</sup> On emotion-oriented and functional problem solving strategies see e.g. Niemelä 1991.

<sup>293</sup> Lampela-Kivistö 2000; see also Heiskanen 1996.

<sup>294</sup> Kiiski 2001.

<sup>295</sup> Before the recession, only 10% of the entrepreneurs, who had discontinued their businesses, had been left unemployed. In the recession years 1991-1994 the figure was approx. 30%. 1992, when the recession hit the bottom, the figure went up to approx. 40%. Parkkinen & Volk 2000.

<sup>296</sup> Lampela-Kivistö 2000; Turunen & Niemelä 1995.

<sup>297</sup> On the feelings of insecurity of enterprisers, see Turunen & Niemelä 1995; The Unemployment Benefit Society of Finnish Entrepreneurs was founded as late as January 1, 1995. Two years of membership and entrepreneur activities are required to be entitled to the benefits. [www.syt.fi](http://www.syt.fi).

made getting a job more difficult, as employers regarded it as a sign of unreliability.<sup>298</sup> Thus, being a bad credit risk meant "having a social stigma", which made bankrupt enterprisers' lives excessively more difficult in many areas of life.<sup>299</sup> Consequently, the immense changes in the lives of the men and women who had gone bankrupt tended to cause a great deal of anxiety and low spirits as well as suicidal tendencies and, as regards part of them, also abuse of alcohol. Naturally, a psychic reaction of this type also cast a negative reflection in marital relations, which in some cases led to divorce. When divorce was added to the problems mentioned above, the tolerance limit of bankrupt men was really put to the test.<sup>300</sup>

As to the unemployed, their situation was quite different. While bankruptcy meant sudden and fast changes, unemployment was a slow process. First, being left without a job seldom caused a great deal of changes and, not even in the long run, as many as did the bankruptcies. Typically, the material losses were rather small. However, with its lengthening, the consequences of unemployment began to be reflected in the unemployed and their partnership relations.<sup>301</sup>

The survival of the mutual relationships of people living in partnership clearly depended on the state of their pre-recession relationship. If they had had a strong relationship already before the recession, the upcoming difficulties seemed to have even made their relationship closer and thus impeded the generation of other partnership problems. According to Kiiski, the consequences of the recession - such as bankruptcy, increased indebtedness and unemployment - added to the difficulties and weakened a partnership, in which the husband was entrepreneur and the wife managerial personnel. No problems existed before the economic crisis, but then they came between the spouses. In partnerships, in which one had been long unemployed, difficulties had been typical already before the recession, and the problems brought about by the recession only added another feature to the relationship problems.<sup>302</sup>

Naturally, the consequences of the recession strained the relationship. The situation became particularly problematic if earlier unsolved problems existed. Then both the old unsolved problems and the recession-related difficulties became a strain on the relationship, forcing the partnership into a crucial crisis.

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<sup>298</sup> Lampela-Kivistö 2000.

<sup>299</sup> Also see Erola 1997.

<sup>300</sup> Kiiski 2001; Lampela-Kivistö 2000.

<sup>301</sup> Kiiski 2001.

<sup>302</sup> Kiiski 2001: also, Lampela-Kivistö's study supports this result as far as bankrupt enterpriser are concerned.

In most families economic difficulties raised disagreements, and in some families the blame was put on the partner who had gone bankrupt.<sup>303</sup>

Generally, the quarrelling and the cooling of the relationship were the result of the other spouse having stood surety for the entrepreneur-partner's loans. If the entrepreneur-spouse was regarded as the only guilty one for the economic distress of the family, this usually ended in divorce. The "guilty" partners suffered from strong depressions, suicidal tendencies and increased use of alcohol.<sup>304</sup>

Among the consequences of the recession, unemployment and bankruptcy in particular generated a variety of threatening elements, which were aimed at individual identity. A person's professional role and social relations associated with it are of importance to individual identity. For the entrepreneurs, their entrepreneurship was a part of their own identity and losing it produced numerous identity problems. The best survivors among those having gone bankrupt were those who, either through their own rational actions or resorting to outside professional help, were able to secure the continuance of their business activities. As they felt that, for them entrepreneurship was the only feasible career alternative, they did their utmost to be able to continue as entrepreneurs and succeeded in it. However, their new entrepreneurship was encumbered by excessive indebtedness.<sup>305</sup>

Among the latter, the poorest survivors also experienced entrepreneurship as their only possible career alternative, but they lacked both mental and economic resources to secure the continuation of their business activity after the bankruptcy. Instead, they had to give up their efforts and were left jobless. Adapting to unemployment proved to be an almost insuperably difficult effort because of the related negative stereotypes, which they found impossible to come to terms with.<sup>306</sup> In the most difficult situation were those enterprisers who had to face all imaginable deprivations: loss of family, work, social status, self-respect, and property. Their dropping outside society was worsened by the social problems caused by being listed as bad credit risks and big debts, the seizure of which made looking for work frustrating. Loneliness, depression,

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<sup>303</sup> Lampela-Kivistö 2000. Several other studies also show that economic worries cause additional arguments in partnership relations. E.g. Jarva 1996; Nukala-Korkala 1994; Kontula & al. 1992.

<sup>304</sup> Lampela-Kivistö 2000.

<sup>305</sup> Lampela-Kivistö 2000.

<sup>306</sup> Also see Breakwell 1986.

overuse of alcohol, and suicidal notions were characteristic of these individuals.<sup>307</sup>

Also, another danger related to the loss of a professional role threatened their identity and was connected with their self-esteem. Both bankruptcy and unemployment are generally regarded as an indication of failure. This jeopardy to the identity was closely related to social fears. An essential element of social fear was shame, which was not a result of any special action such as being guilty. Instead, it was related to one's own identity and the value of one's individuality. Enterprisers who had experienced social shame believed that their bankruptcy proved them to be altogether incompetent as businessmen, especially in the eyes of other people.<sup>308</sup>

The loss of credit rating in the Credit Information Registry due to the bankruptcy brought about social problems, because they felt that it marked them as unreliable and, more particularly so, as undesirable members of society. The enterprisers, who before bankruptcy had regarded themselves as honest and honourable citizens, felt really bad about the label of criminal offender against the Bankruptcy Act and of unreliable businessman. Another problem was in that bad credit risks were treated as if their insolvency were a chronic quality, and their earlier complete trustworthiness as individuals were disdained, although bankruptcy had not in the slightest changed them in that respect. Also, the bad credit rating took out of their control many things affecting their everyday life, and this increasingly added to the mental and spiritual burden.<sup>309</sup>

Also, bankruptcy brought other than economic burdens to the partnership. Commonly, wives feared that their entrepreneur spouses should lose their will to live and either become ill or commit suicide. These wifely worries about their husbands' ability to endure the situation are a clear impression of the rough burdens their husbands had to shoulder. The wives, seeing their husbands' pain and anxiety at close quarters, manifested in their fears that which their husbands may not have been able to say.<sup>310</sup> Another indication of these men's inability to talk about their problems or the enormosity of the shame they shouldered is in that only two bankrupt men participated in Kiiski's study, while seven spouses of men gone bankrupt took part in it. According to Kiiski, typical of the men gone bankrupt was the immensity of their disappointment, which made them unwilling or unable to talk about it.<sup>311</sup>

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<sup>307</sup> Lampela-Kivistö 2000.

<sup>308</sup> Lampela-Kivistö 2000.

<sup>309</sup> Lampela-Kivistö 2000; this result is also supported by Erola 1997.

<sup>310</sup> Lampela-Kivistö 2000.

<sup>311</sup> Kiiski 2001.

## 17.4 Individual survival strategies

Accordingly, the experiences of the recession of different groups and how they survived it differ a great deal. Also, there are differences in the reactions between the people belonging to these groups. The stressful situations of their lives had not always the same impact on all of them. Their influences varied in accordance with the specific situation and time in their lives. Even difficult crises could result in minor damage, if the persons, for example on the basis of their previous experiences, knew that they had a chance to get over the situation and did everything they could to find a positive solution of their problems. Instead, ignorance of their own possibilities or inability to utilise them to solve their problems could lead to serious consequences.<sup>312</sup>

For individuals to cope with a crisis situation, it is important that there exist sufficient resources of various kinds for the solution of the problems as well as the possibilities and the skills to utilise these resources. The inner resources include different coping strategies and, for example, cognitive readiness, intelligence, and idiosyncratic factors, which help to build an individual concept of oneself (ego identity), and can be counted as an emotional resource. Also, upbringing, education, and wisdom gained through life experiences belong to these individual inner resistance resources.<sup>313</sup>

The 1990s economic crisis caused individual people economic problems that came out of the blue and almost without any forewarning. The change from the prosperity of the boom-days to the deep whirlpools of the recession was an immense one. In personal experiences, the major element causing mental and spiritual encumbrances was the feeling of being powerless in the face of the social changes. During the recession, events just came tumbling down without people being able to do anything to help themselves. People felt that they had totally lost the external control of their own lives. However, for a person to feel good mentally and spiritually, a notion of being able to control one's own life is of great importance.

Situations in front of which individual people felt powerless included bankruptcy, unemployment, over-indebtedness, and cuts in the social welfare services provided by society.<sup>314</sup> In addition to economic and social problems, powerlessness before these phenomena caused by the recession brought along, mental and spiritual problems, which, at their worst, led to psychic crisis. Among the experiences of the respondents, bankruptcy was in every respect

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<sup>312</sup> Lampela-Kivistö 2000.

<sup>313</sup> Antonovsky 1979.

<sup>314</sup> Julkunen 2001.

the most burdensome experience.<sup>315</sup> In connection of bankruptcy, people usually lost their possessions, professions, part of their human relationships, and their self-esteem. Losses of this size, which were in most cases unexpected, produced anxiety, depression, and feelings of guilt and bitterness. Almost all men, who had gone bankrupt, increased their use of alcohol temporarily, and all of them told that, at some stage, they had contemplated committing suicide.<sup>316</sup>

When individuals found that they had lost control over many things influencing their own lives, the importance of family and close friends became more marked. In the middle of the changes, spouse, family, friends and relatives represented safety and permanence. For individual people, the absolutely most important condition for survival was their social primary networks. Another means of coping was adaptation to problematic situations they could not change themselves and far-sightedness, which helped them see "behind" the problematic situation and set the problem in the right framework.<sup>317</sup>

As their survival strategy, several persons utilised problem-oriented rational activity. However, the ability to use it called for the feeling and awareness that the continuity of close human relationships had been secured. Another important prerequisite for rational activity was that confidence in own capabilities and skills had remained unchanged. The aim of the rational solving of problems was to secure the pre-recession situation. If own resources for solving the problems were considered inadequate, professional helpers were resorted to. In partnership problems, help was sought from the Center for Family Issues and in bankruptcy cases from consultants, lawyers, and bank directors.<sup>318</sup> Actions like these were very effective, and, in spite of their financial losses, these people were able to maintain their ability to act efficiently in their human relationships, life roles, and were able to sustain a positive concept of their own ego.<sup>319</sup>

Some respondents dodged reflecting on their predicaments or acting pertinently. Their behaviour was passive and evasive. They escaped from directly facing their problems to wishful thinking, religious explanations of problematic situations, or abuse of alcohol. Behaviour of this kind was more typical of men than of women. For these persons surviving the recession was

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<sup>315</sup> This is illustrated by the studies of Lampela-Kivistö (2000) and Kiiski (2001), while Sorri's paper (2001) does not support it.

<sup>316</sup> Lampela-Kivistö 2000; Kiiski 2001.

<sup>317</sup> Lampela-Kivistö 2000. Also Niemelä (1991) considers these survival strategies effective.

<sup>318</sup> Lampela-Kivistö 2000; Kiiski 2001.

<sup>319</sup> On effective life control strategies, also see Miller 1987.

remarkably more difficult than for the ones who acted rationally. Also, their problems tended to accumulate. A difficult situation brought out feelings of shame, which made them incapable of seeking social help for their problems. For example, alcohol was an escape from a reality experienced as too tough and its occasional use was a relaxing experience. However, when it went on for longer periods, it caused problems in partnership relations and increased loneliness.<sup>320</sup>

It was more typical of women than of men to use subconscious control strategies. They had a tendency to refuse to acknowledge negative feelings and to harden their behaviour in order to endure the strong mental stress. However, in behaviour of this kind there is always the danger of embitterment, which could be seen in a few female enterprisers who had forced themselves to become hard-boiled.<sup>321</sup>

Also, this subconscious conduct included looking for scapegoats elsewhere. For example, in bankruptcy situations this scapegoat thinking or projection manifested itself in that the sole explanation of the bankruptcy was a direct consequence of socio-economic decisions made by politicians. However, what made the issue problematic was that in many recession-related bankruptcies this was a concrete fact - not only an effort to put the blame for others to shoulder. When the interest rate policy of the Government resulted in a collapse of demand or indebtedness suddenly increased as a consequence of devaluation, looking for the reasons behind it was not projection with the State as scapegoat, but an effort of truth-finding and conscious, not subconscious, thinking.<sup>322</sup>

As regards religion-oriented people, the significance of religion grew along with the increasing problems. For many people, belief in God gave life a purpose and made it meaningful. They believed that God directed their lives and helped them amidst their difficulties. For example, praying increased so much that even those enterprisers, who had gone bankrupt and never experienced themselves as religious at all, told that they had prayed. Also, some among them started to look for answers to existential questions and found in religion an orientation programme which suited them and within the framework of which they found a sound explanation model for their problems and their own way in life.<sup>323</sup>

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<sup>320</sup> Lampela-Kivistö 2000; Kiiski 2001; according to Breakwell (1986), even temporary use of alcohol can be regarded as an inefficient, even dangerous, means of controlling stress.

<sup>321</sup> Lampela-Kivistö 2000.

<sup>322</sup> Lampela-Kivistö 2000.

<sup>323</sup> Lampela-Kivistö 2000.

Lampela-Kivistö showed that the survival strategy religion has five different functions. The two most important functions were to develop and improve the achievement of a sense of coherence<sup>324</sup> and adaptation to the new life situation. The third function was to ease the process of living through the grief and sorrows caused by the losses of many different kinds. The aim of the fourth function was to bestow an experience of being accepted and aid on the way from guilt. Function number five was to give help in experiences of having been treated unjustly.<sup>325</sup>

Also, religious communities were increasingly resorted to in order seek help in the mental and spiritual distress the recession kept piling up. These communities seemed to have an important role in the examination of individual survival from the consequences of the recession. During the recession, the free family counselling services provided by the Church were increasingly utilised.<sup>326</sup> The Telephone Counseling Service was the mainstay of many lonely people. For example, the cuts in the non-institutional services could clearly be seen especially in the number of calls people suffering from mental disturbances made to the crisis hotlines. When loneliness grew and aid from administrative bodies was no longer available, people could at least make a telephone call and receive help and relief in moments of distress.<sup>327</sup>

A religious community, for example the revivalist movement, became to many people a sanctuary amidst the predicaments and changes of life. Tormented people found there support and understanding from friends in faith, God's merciful presence, familiar songs, sermons and other rituals, which made them feel they were safe. Also, friends belonging to the same revivalist group could also give a helping hand in economic matters.<sup>328</sup>

## 17.5 Regional differences in survival

The research material gathered by Sorri provided a possibility to examine how people living in different regions had coped with their problems. The economic crisis created regions, in which coping with the recession had been made

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<sup>324</sup> The sense of coherence consists of comprehensibility, manageability, and meaningfulness. Antonovsky 1979; religion helped to generate comprehensibility when the bankruptcy was experienced as fate-oriented or punishment or lesson of God. Belief in God as a trustworthy guide of life helped to create the sense of manageability. Awareness of a deeper meaning of life brought forth by belief in God gave life meaningfulness. Lampela-Kivistö 2000.

<sup>325</sup> Lampela-Kivistö 2000.

<sup>326</sup> Kiiski 2001.

<sup>327</sup> Sorri 2001.

<sup>328</sup> Lampela-Kivistö 2000.

impossible.<sup>329</sup> Surviving the recession was particularly difficult in the rural net emigration areas. In these areas loneliness and isolation had grown, more particularly so within the aging generation who had remained there. This group seemed to have special difficulties in coping with the rural structural changes.<sup>330</sup>

In the growth centres, such as Greater Helsinki and Oulu, there were only slight changes in the number of callers to the crisis hotlines. There the status of people with problems with their human relationships remained the whole time central. One explanation for this may be the migration of young people with related crises in their human relationships, while in the net emigrants' areas the rural depopulation of the younger generation and the growing loneliness of aging people were manifest.<sup>331</sup>

## 17.6 Conclusions

The studies show that the recession would seem to have treated different social groups in different ways. Because they were economically committed, the primary objects of the direct consequences of the recession were the entrepreneurs. In this sense, they have been "in the front lines". Also, some social groups living in especially vulnerable circumstances, such as people suffering from mental disturbances, have been in grave difficulties. Also, the aged part of the population of outlying areas has managed badly, because finding employment for them has been difficult.

The distress brought forth by the recession was often related to bankruptcy, unemployment or drifting in other ways outside the working life. In addition to economic difficulties and depending on the social group or individual person, this has meant social shame, identity crisis or the break-up of the working-life related human relationship networks. The best survivors were those people, whose networks of family and close friends were supportive. Were they already weak, the networks have not been capable of offering protection against the deprivations produced by the recession. In these cases, the networks have only increasingly weakened during the recession, which again has resulted in the piling-up of problems. Consequently, the recession would seem to have increased the differences between different social groups.

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<sup>329</sup> Also see Kainulainen & Rintala & Heikkilä 2001; Volk 2000; Suomen uusjako 1999.

<sup>330</sup> Sorri 2001.

<sup>331</sup> Sorri 2001.

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## 18 Perceived Job Insecurity among Finnish Employees in 1990 – 2000: Prevalence and Antecedents

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### Abstract

This article focuses on perceived job insecurity among Finnish employees during the 1990s from two points of view. Firstly, we examine the prevalence of perceived job insecurity with representative data on employees gathered in 1990, 1994 and 1997 (Study 1). Secondly, we investigate the antecedents of perceived job insecurity by using questionnaire-based follow-up data from the years 1999 and 2000 (Study 2). The main finding of the macrolevel analysis performed in Study 1 was that perceived job insecurity, i.e. the threat of losing one's job, became more common during the recession, and did not return to a lower level despite economic recovery. Furthermore, since 1994, feelings of job insecurity have been almost twice as common in the public sector when compared to the private sector. The microlevel analysis in Study 2 revealed that the threat of job loss, reflecting cognitive elements in evaluating one's work situation, was best predicted by organizational factors (e.g. poor organizational communication) during a one-year follow-up period. However, the worry over job loss, capturing emotional elements in the evaluation process, was best predicted by personality factors and particularly by a lack of optimism. The lack of optimism - or pessimism - also played a significant role in predicting an increase in perceived job insecurity, both the perceived threat and the worry of losing one's job, between the years 1999 and 2000. Thus, our results point out that there are mechanisms of structural job insecurity in Finnish working life that maintain perceived job insecurity, such as persistent large-scale unemployment, an increased use of temporary contracts, continuous changes in the workplaces, and industrial restructuring in the form of corporate mergers.

However, personality factors also determine the feelings of job insecurity, especially under fairly stable circumstances.

## **18.1 Introduction**

### **Societal context**

This article focuses on perceived job insecurity among Finnish employees during the 1990s from two points of view. Firstly, we examine the prevalence of perceived job insecurity with representative data on employees gathered in 1990, 1994 and 1997 (Study 1). Secondly, we investigate the antecedents of perceived job insecurity by using questionnaire-based follow-up data from the years 1999 and 2000 (Study 2).

The 1990s in Finland's economy can be divided into two different periods. The first period (1990-93) was characterized by the plunge into the recession, or depression, which was accompanied by the unforeseen growth of unemployment, as well as the bank and public finance crises. The deepness of the recession is best described by the growth of unemployment from 3 % in 1990 to 18 % in 1994. The depression policies had two main targets: maintaining the competitiveness of exports and halting the explosive growth of the public debt. The second period, economic recovery, began in 1994 when the gross national product began to grow. In the late 1990s, Finnish companies were ranked among the most competitive in the world. However, despite steady economic growth, mass unemployment has decreased quite slowly. A new feature is the unemployment rate of women that has been higher than that of men since 1996 (10.6 % vs. 9.1 % in 2000). This is partly explained by the public sector retrenchment since the early 1990s. Three decades of a continuous expansion of services and public (female-dominated) personnel ended and was replaced by a reduction of personnel and overall resources. Even after the recession, the employment rate has increased less in the public sector (only 2 % between 1994 and 1999) than in the private sector (15 %).

At the individual level, economic recession was experienced, on the one hand, in the form of changes in working conditions (e.g. increased temporary employment), and on the other hand, as unemployment. Temporary employment contracts and unemployment can be interpreted as forms of structural job insecurity, or as objective components of insecurity (see Pearce 1998; Schmidt & Svorny 1998; Voydanoff 1990). Furthermore, cutbacks and dismissals, as well as changes in job characteristics may give rise to perceived job insecurity concerning the nature and continuity of one's work, even if changes in one's position are not in sight (Bourdieu 1998).

This trend towards a more insecure labour market is not solely a Finnish phenomenon. It seems that perceived job insecurity has become more widespread in the 1990s in all the OECD countries (OECD 1997). However, perceived job insecurity in Finland seemed to exceed the European average. In more theoretical studies, the last two decades have also been described as a period of increased insecurity or as a transition to a risk society (Beck et al. 1994; cf. Noro 2000).

### **The concept of job insecurity**

Job insecurity can be defined by using the concept of economic distress. According to Voydanoff (1990), economic distress is a multidimensional concept that includes both objective and subjective factors linked to work and income. Unemployment is an objective (structural) indicator and job insecurity a subjective indicator of work-related economic distress. This means that job insecurity is based on an individual's subjective evaluation of his or her work situation (Jacobson 1991).

In the most general sense, job insecurity can be seen as a discrepancy between the level of security a person experiences and the preferred level (Jacobson & Hartley 1991). Studies on job insecurity have usually adopted a "global" view, in which job insecurity is regarded as an overall concern about the future of one's job in the context of an organizational crisis or change (Rosenblatt & Ruvio 1996). From this point of view, job insecurity has been studied as an anticipatory phase characterized by the threat of impending unemployment (Joelson & Wahlquist 1987), which does not, however, mean that unemployment necessarily follows. In fact, the proportion of the working population experiencing job insecurity is usually considerably larger than the number of workers who actually lose their jobs (Happonen & Nätti 2000).

The questions used in these types of studies that utilize a global view to job insecurity (e.g. Johnson et al. 1984; Kinnunen & Nätti 1994; Roskies & Louis-Guerin 1990) can be divided into two groups: on the one hand, questions implementing a cognitive appraisal of the likelihood of losing one's job, and on the other hand, questions reflecting an affective concern about job-related changes (Jacobson 1991). In this article, perceived job insecurity was approached from these global perspectives: firstly, it was operationalized through the probability of job loss (Studies 1 and 2), and secondly, through feelings of worry over job loss (Study 2). Both of these aspects - cognitive and emotional - have been argued to be important for perceived job insecurity (Borg & Elizur 1992).

There are also scholars who want to emphasize the more complicated nature of job insecurity. For example, Greenhalgh and Rosenblatt (1984) defined job insecurity as "perceived powerlessness to maintain desired continuity in a

threatened job situation.” The experience of job insecurity is relevant whether or not an objective threat (organizational crisis or change) exists, and it may be caused not only by the threat of unemployment but also by the loss of any of the conditions of employment (Ashford et al. 1989; Rosenblatt & Ruvio 1996).

### **Antecedents for and consequences of job insecurity**

According to earlier studies (Greenhalgh & Rosenblatt 1984; Klandermans et al. 1991), factors influencing perceived job insecurity exist on three different levels: the demographic and positional characteristics of the employee (e.g. age, gender, socioeconomic status, job contract); organizational conditions (e.g. organizational change and organizational communication); and the employee's personality characteristics (e.g. self-esteem). In addition, feelings of job insecurity might be connected to the estimated consequences of losing one's job, such as standard of living, the possibility of getting a new job and the quality of the jobs available. From this point of view, the surrounding society and labour markets, for example, job security, rate of unemployment and available jobs are relevant to perceived job insecurity (Gregg & Wadsworth 1995; OECD 1997).

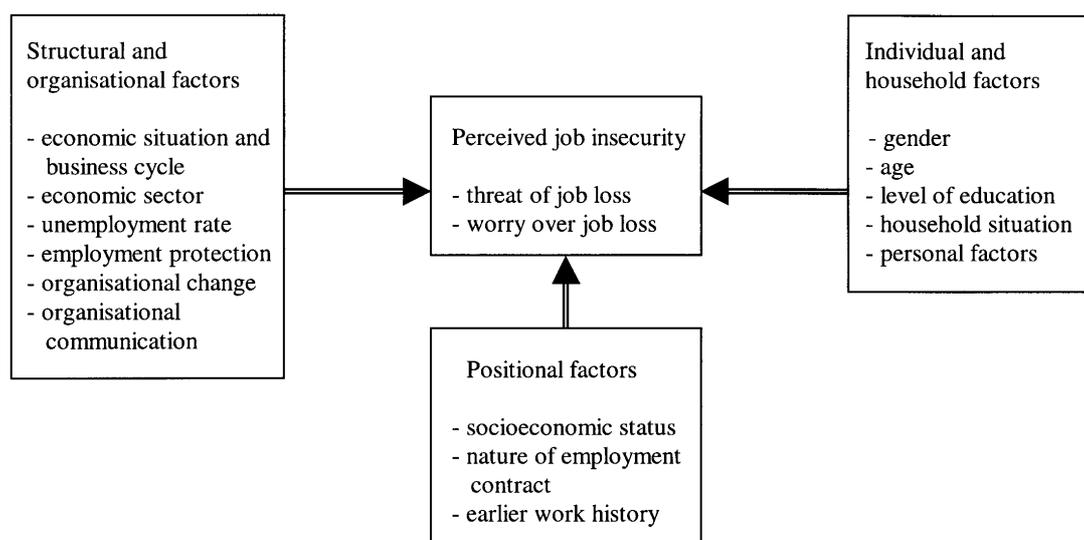
In previous studies, the best predictors have usually been positional factors such as earlier unemployment experiences and temporary job contracts (Happonen 1999; Kinnunen & Nätti 1994), personality factors (Kinnunen et al. 1999; Roskies & Louis-Guerin 1990), and signals of potential threats (e.g. rumours of reorganization or changes in management; Ashford et al. 1989; Kinnunen et al. 2000a). The best predictors may also depend on the indicator of job insecurity. Objective or positional circumstances may determine cognitive job insecurity, whereas emotional job insecurity may be linked more closely to personality factors.

Most existing research on job insecurity has focused on the negative consequences on individuals as well as on organizations. These negative consequences - psychological and psychosomatic symptoms and negative attitudinal reactions - are well documented in previous cross-sectional (e.g. Ashford et al. 1989; Hartley et al. 1991; Lim 1996; Rosenblatt & Ruvio 1996) as well as longitudinal studies (Dekker & Schaufeli 1995; Ferrie et al. 1998; Heaney et al. 1994; Kinnunen et al. 1999; Mauno & Kinnunen 1999). The above-mentioned dynamics also have consequences at the organizational level, primarily through their effects on efficiency and innovation (Borg & Elizur 1992; Greenhalgh & Sutton 1991; Kinnunen et al. 2000a; Rosenblatt & Ruvio 1996).

Due to these negative outcomes of job insecurity, it is especially important to examine the antecedents of job insecurity; this kind of information can help us in attempting to prevent job insecurity. A majority of the above-mentioned studies were cross-sectional and concentrated on the consequences of job insecurity.

Therefore, our study may shed new light on this phenomenon by looking at the long-term trends in the prevalence of job insecurity (Study 1), and by examining the predictive power of the antecedents of job insecurity during a one-year period (Study 2). The general framework for analysing the antecedent factors of perceived job insecurity is presented in Figure 18.1.

*Figure 18.1. Framework for analysing the antecedent factors of perceived job insecurity*



## 18.2 Prevalence of perceived job insecurity in the 1990s: Study 1

### Aims and methods of the study

The aim of Study 1 was to get a picture of the prevalence of perceived job insecurity in Finland during the 1990s, a time interval which covered both a slowdown and a recovery in economic growth. Studies on perceived job insecurity have often been carried out in single downsizing or merging enterprises. Although there are a few studies that have used more representative data (e.g. Burchell et al. 1999; OECD 1997), appraisals concerning the prevalence of perceived job insecurity have usually been based more or less on guesstimates.

We studied the prevalence of perceived job insecurity through representative data on Finnish employees (The Quality of Work Life Surveys and The Living Conditions Survey from Statistics Finland) in 1990 (response rate 85 %, n =

3503), 1994 (73 %, n = 3475) and 1997 (79 %, n = 2978). For each survey, employees were interviewed via telephone using a standard questionnaire. The questions concerning perceived job insecurity were the same every year. Thus, we were able to investigate not only the prevalence of perceived job insecurity each year, but also the changes which took place between the three points of time in the 1990s: before the plunge into the recession (1990), during the deepest recession (1994), and after a strong economic recovery period (1997).

The deep recession first affected (male-dominated) private manufacturing and construction, and only later the (female-dominated) public sector. Therefore, we studied perceived job insecurity by gender and by the economic sector. Furthermore, in order to study whether the experiences of job insecurity accumulated in the groups that have traditionally been the most vulnerable (i.e. the poorly educated, see Taylor-Gooby 1997), we also took the level of education into account.

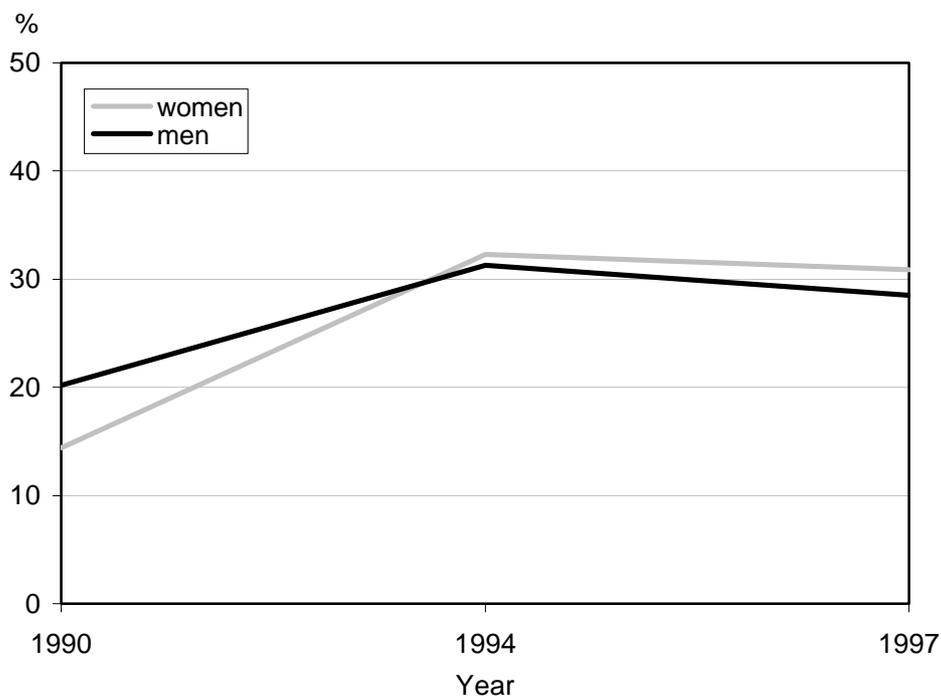
In the Finnish labour market, women form almost half of the labour force (48 % in 1990 and 1999). In our employee data, women were slightly over-represented due to their higher response rate when compared to men (Lehto & Järnefelt 2000). Women's share of the respondents increased from 51 % in 1990 to 53 % in 1997. Based on their employer, the respondents were divided into two groups: working in the private or the public sector (the state, a municipality, or a municipal or public association). The proportion of employees working in the private sector decreased from 59 % in 1990 to 52 % in 1994, but increased back to 61 % in 1997. The level of education among the respondents was classified into three groups: low (primary education), medium (secondary education) and high (tertiary education). In 1990, the proportion of the three educational levels was as follows: low 33 %, medium 53 % and high 14 %. By 1997, the proportion of the low educational level among the respondents had decreased to 24 %, whereas the proportion of the high educational level had increased to 20 %.

In this study, perceived job insecurity was defined as an overall concern about the future of the respondent's job, and it was measured by using a three-item question that emphasized the threat (probability) of losing one's job: "Does your work carry any of the following uncertainties: threat of temporary lay-off; threat of dismissal; threat of unemployment?" The items were rated on a dichotomic scale (0 = no, 1 = yes). A composite score for the perceived job insecurity was computed by summing up the ratings of the three threats. The Cronbach alpha of the scale was reasonable, varying between 0.77 and 0.82. We divided the respondents into two categories: either they perceived job insecurity (1 = perceived at least one threat) or they did not (0 = perceived none of the three threats).

## Results

As can be seen from Figure 18.2, before the recession in 1990, 15 % of female and 20 % of male employees perceived job insecurity. Besides gender, job insecurity varied with the economic sector and the educational level: feelings of insecurity were more common in the private sector and among the less educated when compared to the public sector and the highly educated (Figures 18.3 and 18.4). This was also the case in the 1970s and 1980s (Nätti et al. 1998; Happonen & Nätti 2000). Furthermore, within the public sector, job insecurity was more common among women than among men, while in the private sector job insecurity was more typical with men than with women (Figure 18.5). To sum up, in 1990, job insecurity was most common among men in the private sector: the first hints of the upcoming recession were seen in the male-dominated manufacturing industry and construction.

Figure 18.2. Job insecurity by gender, %



The proportion of employees feeling the threat of losing one's job increased quickly in the early 1990s. In 1994, during the deepest recession, almost one out of three employees perceived the threat of losing one's job. The increase in perceived job insecurity was especially obvious in the public sector: in 1994, feelings of insecurity were four times more common than in 1990. Furthermore, job insecurity also increased among the highly educated employees (Figure 18.4), especially if they were women (Figure 18.6) and working in the public sector (Figure 18.7). Thus, the year 1994 seems to be a turning point in

perceived job insecurity and the economic crisis: the manufacturing industry was already booming, while recession was still deepening in the public sector.

Figure 18.3. Job insecurity by economic sector, %

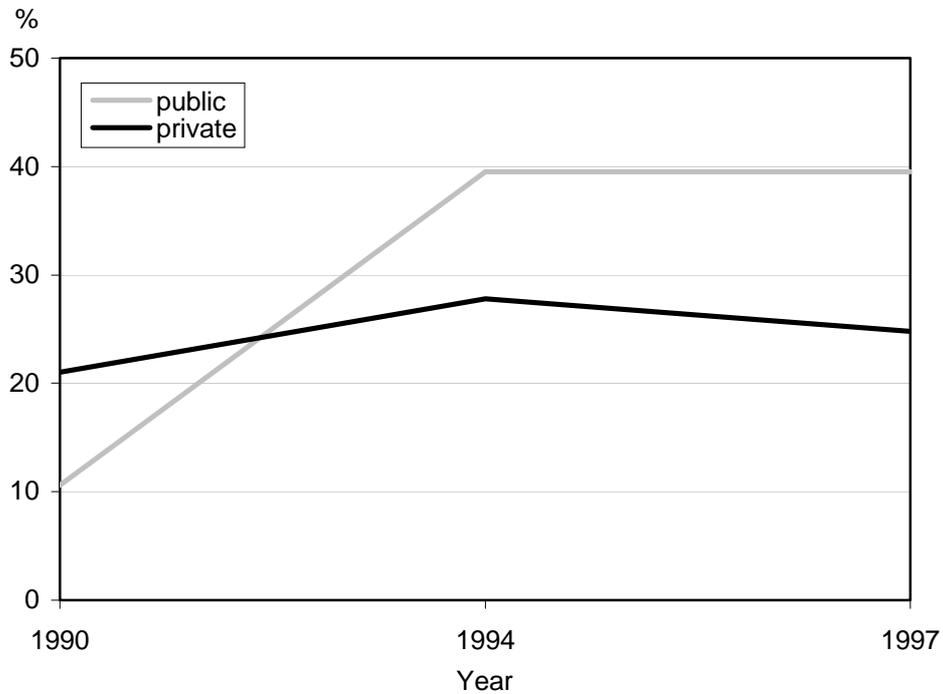


Figure 18.4. Job insecurity by educational level, %

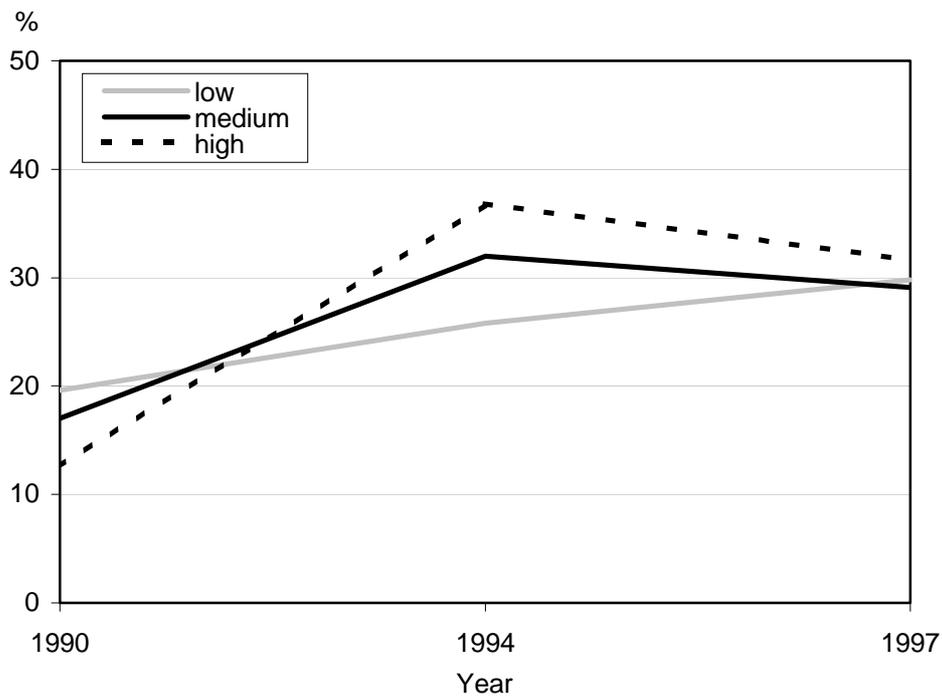


Figure 18.5. Job insecurity by sector and gender, %

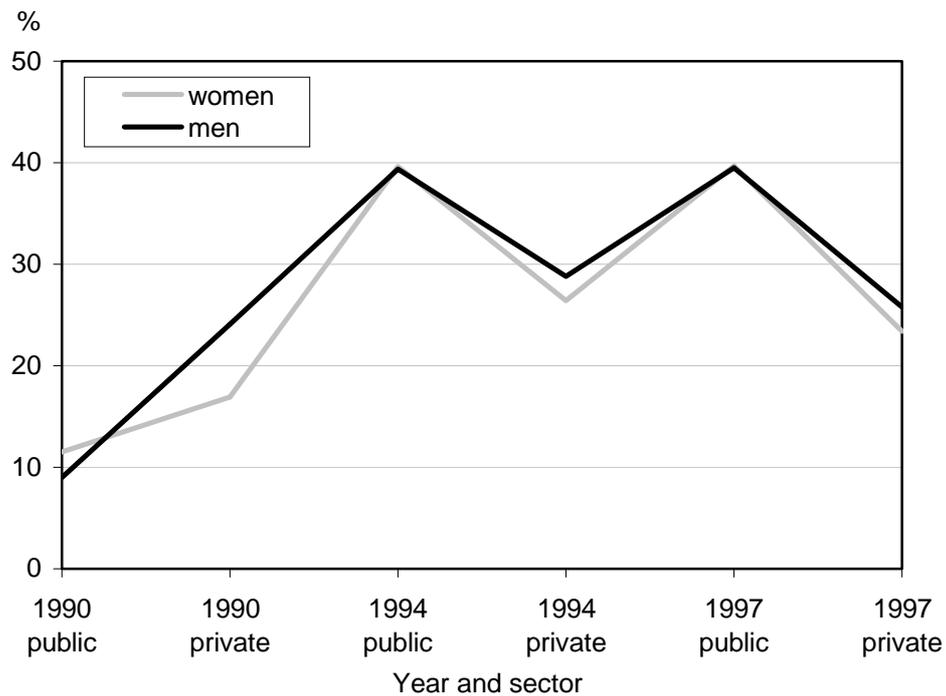


Figure 18.6. Job insecurity by gender and educational level, %

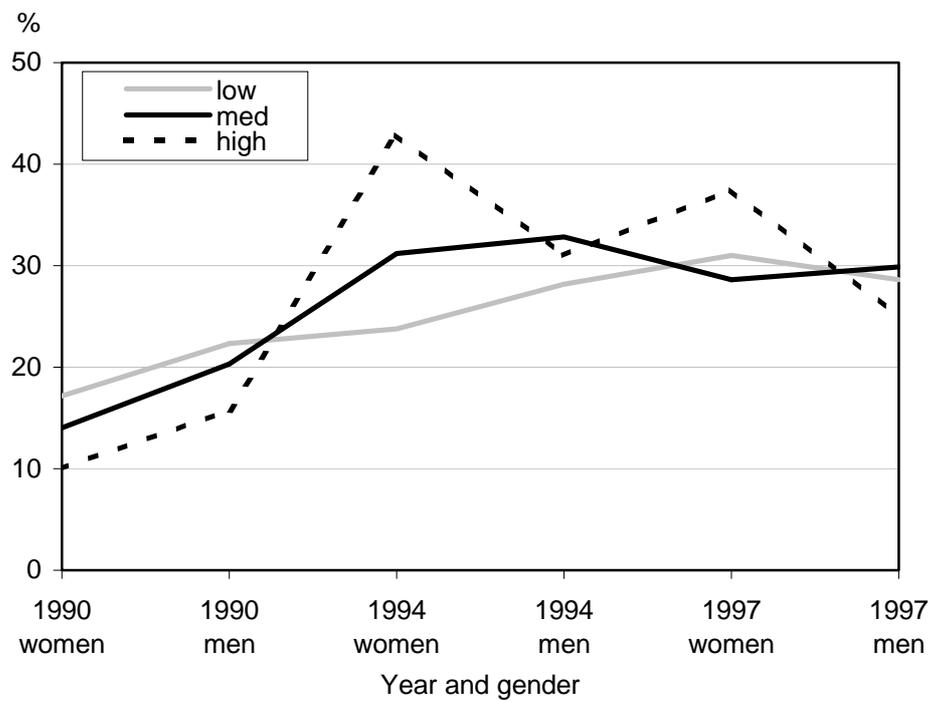
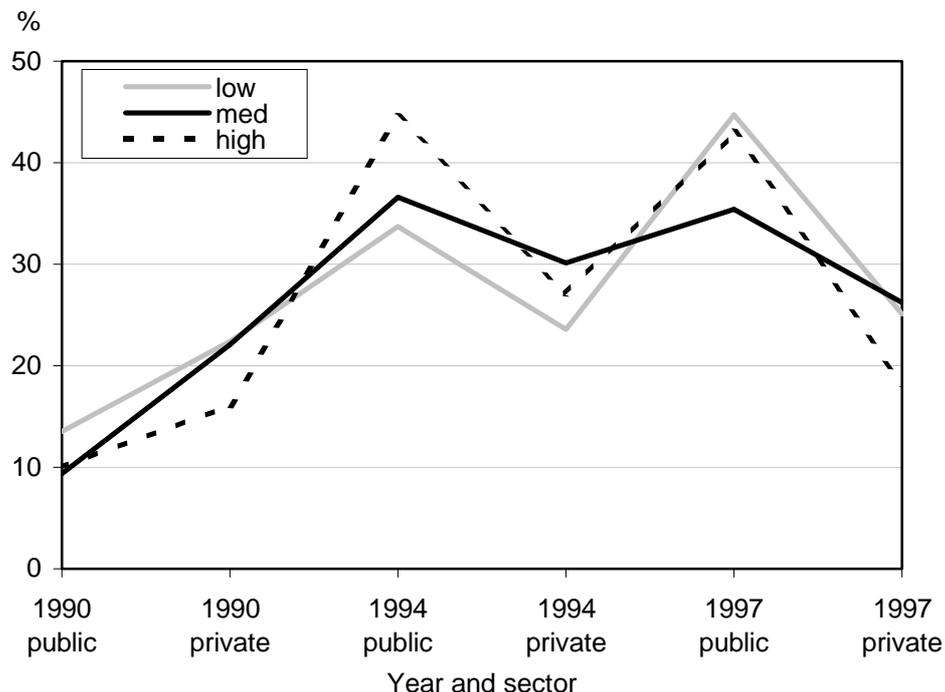


Figure 18.7. Job insecurity by sector and educational level, %



In spite of the strong economic growth since 1994, the proportion of employees experiencing job insecurity in the late 1990s decreased only marginally in the private sector, while remaining high in the public sector. As in 1994, perceived insecurity in 1997 varied most clearly within the economic sector: almost 40 % of the public sector employees felt insecurity, compared to 24 % of the private sector employees. Besides the economic sector, job insecurity varied to some extent according to gender and educational level: women and the highly educated were more insecure when compared to men and the less educated. In general, perceived job insecurity in the late 1990s remained at a higher level when compared to earlier times.

To summarize, feelings of job insecurity in the 1990s increased the most in groups that had earlier been the least vulnerable in the labour market. Thus, our results suggest that working in the female-dominated public sector and having a higher level of education do not protect against hazards in the labour market any longer. In a way, the increased insecurity among educated employees indicates a decrease in the value of education in the public sector labour market; however, in the private sector, the higher educational level still reduces feelings of job insecurity.

### 18.3 Antecedents of Perceived Job Insecurity: Study 2

#### Aims and methods of the study

In Study 2, we broadened the group of variables which may affect perceived job insecurity by taking into account four types of factors as follows: demographic and positional, organizational (economic situation in the organization and organizational communication), household (economic stress), and personal factors (job involvement and optimism). Using longitudinal data from one year, we studied the extent to which these factors predicted perceived job insecurity later on.

The selection of these variable groups was based on previous studies which have shown that in addition to the more objective structural factors (e.g. temporary job contract, unemployment, poor economic situation in the organization), other more subjective psychosocial factors are also important. For example, poor organizational communication is associated with increased job insecurity (Adams & Roebuck 1997; Happonen 1998; Johnson et al. 1996; Schweiger & Denisi 1991). Also, individuals who are financially and psychologically more attached to their jobs may react more negatively to losing a job (Leana & Feldman 1990; Probst 2000), and the economic necessity for holding a job may produce job insecurity (Brief & Aldag 1989; Holm & Hovland 1999). In Study 2, we approached perceived job insecurity from two perspectives, taking into account its cognitive (uncertainty) and emotional (worry) elements. Consequently, we were able to clarify whether the various aspects of job insecurity could be predicted by different antecedents.

Data for this study were obtained from a random sample ( $n = 1878$ ) selected from the files of the Population Register Centre in 1999 and restricted to people between 25 and 59 years of age. Two identical postal questionnaires bearing the same code number were sent in the spring of 1999 to this randomly selected sample of people. One questionnaire was intended for the target individual and the other, if relevant, for his or her partner. The respondents were instructed to complete the questionnaires independently and to return them in separate sealed envelopes by mail. In the year 2000, the questionnaires were sent to those individuals who had answered in 1999, using the same procedure. In 1999, responses were received from 849 persons and 607 spouses/partners, and in 2000, from 655 persons and 468 spouses/partners.

In all, there were 640 persons who responded both in 1999 and in 2000. In the present study, data analysis was restricted to those who were employed ( $n = 457$ ). Of the employed respondents, 51 % were men and 49 % were women, and a majority of them were between 35 and 54 years old (65 %). Most had a vocational school education. About half of the subjects had children, most commonly one or two. The subjects were more often employed in the private

sector (60 %) than in the public sector (40 %), and almost 90 % of them had a permanent job. 26 % of the subjects had been unemployed during the past five years.

Despite the relatively low response rate (45 %) in 1999, the participants represented the original sample in gender, age, marital status and geographical location rather well. However, in 2000, there was a trend that the older, married persons participated more willingly in the study than the younger, single ones. When comparing our data to the Finnish population of working age, we found that the participants in our study were slightly older and better educated than the employed population in general (see Kinnunen et al. 2000b for more details).

We approached job insecurity from two perspectives. The first concentrated on the cognitive and the second on the emotional elements of perceived job insecurity. Thus, the first scale measured the likelihood of the three changes from Study 1 (short-term layoff, long-term layoff and job loss) that might occur in the future. The probability of each change was rated on a 5-point scale (1 = very improbable, 5 = very probable). The Cronbach's alpha (means and standard deviations of the scale in parenthesis) of this threat of job loss scale was 0.85 at Time 1 (M = 1.68, SD = 0.79) and 0.82 at Time 2 (M = 1.59, SD = 0.79).

The second scale focused on the worry over job loss. It was derived from the scale developed by Johnson et al. (1984). We used the three items of the original measure (e.g. "I am worried about the possibility of getting fired") that concentrated on worry. The items were rated on a 5-point Likert-scale (1 = totally disagree, 5 = totally agree). The Cronbach's alpha of the scale (means and standard deviations in parenthesis) was 0.75 at Time 1 (M = 1.96, SD = 0.95) and 0.76 at Time 2 (M = 1.87, SD = 0.88). Even though the two measures described above were considered to be distinct constructs, the first one capturing the cognitive and the second one the emotional elements of job insecurity, the scales correlated moderately with each other ( $r = 0.40$ ,  $p < .001$  at Time 1 and  $r = 0.38$ ,  $p < .001$  at Time 2), indicating that they share similar elements.

Only Time 1 measures of the antecedents were used and they were classified into four groups: background factors (gender, age, education, number of children, unemployment, economic sector and type of job contract), organizational factors (economic situation of the organization and organizational communication), household factors (economic stress), and personal factors (job involvement and optimism). The measurement of all these variables (except for the background factors) is described in the appendix.

## Results

Hierarchical regression analysis was used to test the hypothetical relationships between the antecedent variables and perceived job insecurity. The two scales of perceived job insecurity measured at Time 2, threat of job loss and worry over job loss, were used as dependent variables in the regression analyses. Both job insecurity scales were regressed onto the antecedent sets in the following manner. In the first model, the antecedents at Time 1 were entered into the equation in four steps: (1) background factors, (2) organizational factors, (3) household factors, and (4) personality factors. In the second model, job insecurity at Time 1 was entered first (before the background factors) into the analysis to control its effect. Otherwise, the analysis was identical to the first model. Thus, in the second model we could analyse the factors that contributed to the change of perceived job insecurity between Time 1 and Time 2. Table 18.1 shows the results for the prediction of the perceived threat of job loss and Table 18.2 for the prediction of the worry over job loss.

Tables 18.1. *Time 1 Antecedents of the Threat of Job Loss at Time 2: Hierarchical Regression Analysis*

Antecedents at T1	r	Model 1			Model 2		
		$\beta$	R <sup>2</sup>	$\Delta R^2$	$\beta$	R <sup>2</sup>	$\Delta R^2$
Threat of job loss at T1	.53***				.45***	.28***	.28***
Background factors			.04**	.04**		.29***	.01
Gender (woman/man)	-.01	.02			.04		
Age in years	-.06	.00			-.02		
Vocational education	-.01	.04			.04		
Number of children	-.01	-.04			-.05		
Unemployment (no/yes)	.20***	.12*			.06		
Employment sector (public/private)	.00	.05			.02		
Job contract (permanent/temporary)	.09*	.04			.03		
Organizational factors			.09***	.05***		.30***	.01
Poor communication	.22***	.13**			.05		
Good economic situation	-.12	-.10			-.02		
Household factors			.12***	.03***		.31***	.01*
Economic stress	.23***	.15**			.08		
Personal factors			.15***	.03**		.32***	.01*
Job involvement	-.13**	-.05			-.05		
Optimism	-.26***	-.16***			-.10*		

$\beta$  = Standardized beta-coefficients derived from the final step, R<sup>2</sup> = explanation rate,  $\Delta R^2$  = change in explanation rate in each step, \* p < .05, \*\* p < .01, \*\*\* p < .001

*Threat of job loss.* The perceived threat of job loss was best predicted by organizational characteristics which explained 5 % of the variance. Of the organizational factors, only organizational communication contributed significantly to the prediction. In addition, all other predictor groups turned out to be significant. Of the background factors, the only significant predictor was unemployment: the people that had been unemployed before Time 1 were more likely to experience the threat of job loss at Time 2. The higher the level of

household's economic stress at Time 1, the higher the level of perceived threat of job loss at Time 2. Of the personal factors, optimism proved to be significant: the more optimistic the person was, the less he or she experienced the threat of job loss later on. Altogether, the model explained 15 % of the variance in the perceived threat of job loss.

*Table 18.2. Antecedents of the Worry over Job Loss at Time 2: Hierarchical Regression Analysis*

Antecedents at T1	r	Model 1			Model 2		
		$\beta$	R <sup>2</sup>	$\Delta R^2$	$\beta$	R <sup>2</sup>	$\Delta R^2$
Worry over job loss at T1	.57***				.49***	.32***	.32***
Background factors			.03	.03		.33***	.00
Gender (woman/man)	.05	.05			.01		
Age in years	-.08*	-.03			-.03		
Vocational education	-.08	-.01			-.02		
Number of children	.04	.02			-.03		
Unemployment (no/yes)	.13**	.06			.02		
Employment sector (public/private)	.08	.08			.02		
Job contract (permanent/temporary)	.05	.07			.02		
Organizational factors			.06**	.03**		.33***	.00
Poor communication	.15**	.12*			.01		
Good economic situation	-.05	-.05			.01		
Household factors			.11***	.05***		.34***	.01**
Economic stress	.27***	-.20***			.10*		
Personal factors			.19***	.08***		.37***	.03***
Job involvement	.12**	.22***			.14***		
Optimism	-.28***	-.22***			-.13**		

$\beta$  = Standardized  $\beta$ -coefficients derived from the final step, R<sup>2</sup> = explanation rate,  $\Delta R^2$  = change in explanation rate in each step, \* p < .05, \*\* p < .01, \*\*\* p < .001

The second regression model showed that the threat of job loss at Time 1 significantly predicted the threat of job loss at Time 2. 28 % of the variance in the threat of job loss at Time 2 was explained by the threat of job loss at Time 1. In addition, the only other significant predictor was optimism. The increase in the perceived threat of job loss between Time 1 and Time 2 was explained by optimism: the less optimistic the person was at Time 1, the more the perceived threat of job loss increased between Time 1 and Time 2. The model accounted for 32 % of the variance in the perceived threat of job loss.

*Worry over job loss.* The perceived worry over job loss was best predicted by personal factors: 8 % of the variance in the worry over job loss was explained by this block of variables. Both job involvement and optimism were significant predictors: the more job-involved and the less optimistic the person was at Time 1, the more worries over job loss he or she had at Time 2. The next best group of predictors was household characteristics: economic stress explained 5 % of the variance in worries over job loss. Of the organizational characteristics, poor

communication added little to the prediction. Altogether, 19 % of the variance could be explained by this model.

The second regression model showed that the perceived worry over job loss at Time 1 significantly predicted (32 % of the variance) the worry over job loss at Time 2. However, both personal factors and the household's economic stress also contributed to the prediction. This means that the increase in the worry over job loss between Time 1 and Time 2 was explained by high job-involvement, low optimism and high economic stress at Time 1.

To summarise, the predictors of the two different indicators of perceived job insecurity seemed to be quite similar. However, the threat of job loss, capturing especially the cognitive elements, was best explained by organizational factors, whereas the worry over job loss, capturing especially the emotional elements, was best explained by personal factors. The increase in perceived job insecurity between the years 1999 and 2000 was best explained by personal factors for both indicators. Particularly optimism - or in fact pessimism - played a significant role in this regard. Perceived job insecurity turned out to be quite stable: those persons who felt insecure in 1999 were also the most likely to feel insecure in 2000.

## **18.4 Discussion**

The aim of this article was to shed new light on two issues of perceived job insecurity among Finnish employees during the 1990s. Firstly, we examined the prevalence of perceived job insecurity with representative data on employees gathered in 1990, 1994 and 1997 (Study 1). The main finding of this macrolevel analysis was that perceived job insecurity, i.e. the threat of losing one's job, became more common during the recession and did not return to a lower level despite economic recovery. Furthermore, the feelings of job insecurity since 1994 have been almost twice as common in the public sector when compared to the private sector.

Secondly, we investigated the antecedents of perceived job insecurity by using questionnaire-based follow-up data from the years 1999 and 2000 (Study 2). This microlevel analysis revealed that during a one-year follow-up period the threat of job loss, reflecting the cognitive elements in assessing one's job, was best predicted by organizational factors, whereas the worry over job loss, capturing the emotional elements in the evaluation process, was best predicted by personality factors, particularly by a lack of optimism. The increase in perceived job insecurity for both measures during the years 1999 and 2000 was also explained by a lack of optimism, i.e. pessimism (cf. Kinnunen et al. 1999; Roskies & Louis-Guerin 1990).

Perceived job insecurity became a persistent feature of the Finnish labour market during the economic crisis and it remained at a high level during the economic boom period, even in the private sector. This can be in part explained by structural insecurity in the labour market: high unemployment, increased use of temporary contracts, and continuous changes in the workplaces give rise to perceived insecurity (Happonen & Nätti 2000). Furthermore, many industries are undergoing structural changes in the form of corporate mergers and acquisitions, creating uncertainty regarding organizational and personnel changes. As organizations try to reduce costs, it also causes pressure on the employees who remain at work to modify their jobs and to accept different employment conditions (Dolan et al. 2000; Jacobson 1991). All these changes are likely to fuel job insecurity among those who remain at work.

Traditionally, the Finnish public sector has had the image of offering stable and secure jobs, although they are not so well paid. By the late 1990s, this image did not hold any more. Since 1994, job insecurity has been more common in the public than in the private sector. This is partly explained by the public sector restructuring since the early 1990s. The economic crisis and the concomitant public sector retrenchment in the early and mid-1990s turned the visions of the public services upside down (Julkunen & Nätti 1999). Three decades of a continuous expansion of services and public (female-dominated) personnel ended and was replaced by a reduction of personnel and overall resources. The labour shortage rapidly became an increasing trend of unemployment: between 1991 and 1994, the number of municipal employees decreased by almost 40,000 persons (8 %). The central government cut the subsidies to the local level. Resources were reduced, whereas the need and demand for services increased (for example, more people needed social assistance and social work). Furthermore, the quality of working life in the public sector worsened more than in the other sectors (Ylöstalo 2000), threatening the quality of the public services. Even after the recession, the employment rates have grown less in the public sector than in the private sector, leading to a new problem in Finland; since 1996, the unemployment rate of women has been higher than that of men.

In general, feelings of job insecurity in the 1990s increased the most in the groups that had earlier been the least vulnerable in the labour market, i.e. the employees with a high level of education working in the public sector. Thus, the high level of education no longer protects against experiences of insecurity in the public sector. In the private sector, employees still benefit from their high level of education.

In spite of these long-term trends in perceived job insecurity, based more or less on objective or structural matters, other more subjective factors also play a significant role in perceiving job insecurity. As Hesselink and van Vuuren (1999) have stated: "Workers can feel insecure, while objectively no reasons for it

exist.” Consequently, job insecurity may occur in seemingly “safe” employment arrangements, for example, among employees having tenured full-time jobs (see Rosenblatt & Ruvio 1996), as was the case in Study 2. Although perceived job insecurity was in part anchored in objective matters also in this study, personality factors played a greater role, particularly the person’s pessimism or optimism. Thus, the employees’ expectations for positive or negative outcomes are important. The further finding that the increase in perceived job insecurity during a one-year period was also linked to a lack of optimism emphasizes the significance of the expectations concerning future. Consequently, our results are in line with the views of Klandermans and Vuuren (1999), who claim that under safe circumstances, it is predominantly the personality factors that determine feelings of insecurity. However, personality factors become more irrelevant when jobs are at risk, with the education, age, or position in the company becoming more important.

The question of what constitutes job insecurity is by no means settled, although it can be argued that insecurity is both an objective state that a company can bring upon its workers and a subjective estimate of the chances of losing one’s job, dependent on both cognitive and emotional processes in assessing the situation. Job insecurity based on the threat or fear of losing one’s job is regarded by some scholars (e.g. Ashford et al. 1989; Burchell et al. 1999; Rosenblatt & Ruvio 1996) as too narrow to capture the full combined effect of the changes in job characteristics and the content and organization of work. In addition, the extent to which people worry about losing their jobs depends not only on their perception of the likelihood of job loss, but also on their anxieties about the consequences of such an event. Our previous empirical findings have shown that both the antecedents and the consequences of job insecurity vary depending on the operationalization of the phenomenon (see Kinnunen et al. 1999; Kinnunen et al. 2000a; Mauno & Kinnunen 1999). Altogether, this means that the theory on job insecurity must take into account all these different facets of the phenomenon of job insecurity.

Our results point out that the Finnish working life contains mechanisms that maintain job insecurity. One of these mechanisms is apparently the need for a numerically flexible workforce (e.g. temporary employment) to reduce labour costs and to increase competitiveness. This is expressed as a top priority by managers and policy makers (Julkunen & Nätti 1999). However, the demand for numerical flexibility is in contrast with the need for the commitment of employees, which is considered a key factor in determining successful companies in the future. Accordingly, Shapiro (2000) has argued that many recent management strategies and practices (such as total quality management and self-management teams) presume high employee involvement at each organizational level. Naturally, this means that the job involvement of contingent employees is a relevant - although often neglected - issue in achieving business goals.

Previous empirical studies have clearly indicated that job insecurity has detrimental long-term effects on an employee's well-being (see e.g. Dekker & Schaufeli 1995; Ferrie et al. 1998; Heaney et al. 1994; Kinnunen et al. 1999; Mauno & Kinnunen 1999). These findings mean that various measures are needed to reduce job insecurity and its negative effects on well-being. Firstly, structural measures should be implemented, such as increasing the number of permanent job contracts and carrying out HR-management to aim at permanent job contracts. This concerns particularly the public sector because temporary job contracts are most common there. However, if non-permanent job contracts cannot be avoided in organizations, measures are needed to improve the position of the non-permanent employees. In most cases, temporary employees are in a more precarious situation when compared to permanent employees regarding personnel training, unemployment risk or job tenure (Nätti 1993, 1997). Therefore, the benefits that are available to permanent employees (such as paid parental leave and access to personnel training) should be made available to contingent workers as well (see Smithson & Lewis 2000).

A second way to reduce job insecurity involves professionals, such as personnel managers and occupational health services, asking them to provide support and help to job-insecure employees. More attention should be paid to stress management and coping skills at the individual as well as the organizational level. The employees' feelings of personal control at work (i.e. job control) as well as ambiguity tolerance should be enhanced. In practice, organizations should provide possibilities for their employees to acquire further professional education since it is a significant resource at work, or in the labour market if job loss is realised. In addition, previous studies (e.g. Adams & Roebuck 1997; Happonen 1998; Kinnunen et al. 2000a; Schweiger & Denisi 1992) have shown that organizational communication and job insecurity experiences are linked. Consequently, open and honest communication, and fairness in implementing organizational changes are important measures to reduce job insecurity during organizational crises (Dolan et al. 2000).

As a third measure of reducing job insecurity, we have to keep in mind that a shortage of personnel is already a problem in some industries in the private sector (e.g. information technology, telecommunication), and in the future, it will most likely become a problem in the public sector as well. Today, many employers in the private sector have to persuade employees by providing extra benefits (e.g. option arrangements). In the future, organizations in the public sector must also seriously consider what their image as an employer is and how to recruit enough personnel. In this respect, it would be good to recall that job security is still a valued work characteristic in Finland (Laukkanen 2001). Naturally, the above discussion does not only refer to recruiting. It also means that the well-being of the employees already working in the organization must be looked after as well.

## **Appendix: The measurement of antecedents at Time 1.**

### Organizational factors

The economic situation of the organization was assessed via three questions: "How would you characterise your organization's economic situation at present?", "Has your organization's economic situation changed during the last year?", and "How would you evaluate your organization's economic situation for the next year?" These questions were rated on a 3-point scale ranging from 1 (poor) to 3 (good). A composite scale containing all three items was computed and its Cronbach's alpha was 0.70.

Problems in organizational communication were assessed via four questions related to openness (1 = very open, 5 = not at all open), rumors (1 = only a few, 5 = very many), timing of communication (1 = very early, 5 = very late), and awareness of the organization's economic situation, production and marketing plans (1 = very aware, 5 = not at all aware). The same measure has been used in other Finnish studies examining working life (e.g. Kalimo, Olkkonen & Toppinen 1993; Kinnunen et al. 2000b). The Cronbach's alpha coefficient for the composite scale illustrating the poor quality of organizational communication was 0.75.

### Household characteristics

Economic stress was measured with three items constructed on the basis of the study by Voydanoff and Donnelly (1998). The participants were asked to assess how often they worry that their total family income is not enough to meet their family's expenses and bills (1 = never, 5 = all the time), how much trouble they have meeting basic expenses (1 = no trouble, 5 = a lot), and whether their financial situation has changed (1 = much better, 5 = much worse). The Cronbach's alpha coefficient for the 3-item economic stress scale was 0.91.

### Personality characteristics

Job involvement was measured on an abbreviated version of the 10-item scale (Job Involvement Questionnaire) developed by Kanungo (1982), consisting of the following four items: "The most important things that happen to me involve my present job", "Most of my interests are centred around my job", "I am very involved personally in my job", and "Most of my personal life goals are job-oriented." These statements were rated on a 5-point Likert scale (1 = totally disagree, 5 = totally agree). The Cronbach's alpha coefficient for the job involvement scale was 0.81.

Optimism was measured on an abbreviated version of "The Revised Life Orientation Test" (Scheier, Carver & Bridges 1994). It consisted of six items (e.g. "In uncertain times, I usually expect the best"). These statements were also rated on a 5-point Likert scale (1 = totally disagree, 5 = totally agree). The Cronbach's alpha for the scale of optimism was 0.74.

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## 19 The Labour Market Participation of Immigrants in Finland during the 1990s Recession<sup>332</sup>

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### Abstract

This article examines the labour market participation of immigrants in Finland during the 1990s recession. Focus is on the nature and dynamics of jobseeking, and the relationships to the labour market that have evolved during this period. Qualitative data is scrutinized from a national follow-up study of refugee integration carried out in 1997 - 1998. The issue of immigrant employment is also approached from the perspective of labour market organizations and hiring actors. For this purpose, an exploratory Delphi questionnaire was conducted in 1998 - 1999 among representatives of the Trade Unions, Employer Associations and larger employers.

Data indicates that immigrant jobseekers encounter 'monopoly'-like mechanisms of exclusion, which are at present being formally articulated in the categorical distinction between jobseekers with an acceptable level of language skill and all those assumed to be deficient in this respect. Thus, while social citizenship brings immigrants fully into the citizenry, as members with developed monopoly rights to welfare, their relations to the labour market are precarious. In the questionnaire data, strong emphasis was placed on the importance of immigrants' language skill and training, corroborating the findings of the qualitative data. Among labour market organizations and employers, high consensus was also on the need for immigrants to be integrated in all employment areas, across all sectors of the labour market.

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## 19.1 Introduction

The management and organization of immigration and integration have become part of the policy agenda in most countries. Immigrant integration programmes and policies are determined by a host of factors, such as the scale, type and cultural features of migration flows, the structure of the receiving society and its institutions, as well as the prevailing social, economic and political situation. Each society approaches and deals with immigration and integration issues in its own way, even as activities are informed by experience and practice in other countries. Across this variety in approach, it is generally accepted that employment, or active participation in the labour market, is a key indicator of the 'success' of integration.

This article examines the labour market participation of immigrants in Finland during the 1990s recession. Focus is on the nature and dynamics of jobseeking, and the relationships to the labour market that have evolved during this period. Qualitative data is scrutinized from a national follow-up study of refugee integration carried out in 1997 - 1998 under the auspices of the Ministry of Labour and the University of Turku. Complementing the fieldwork, the issue of immigrant employment is approached from the perspective of labour market organizations and hiring actors. For this purpose, an exploratory Delphi questionnaire was conducted in 1998 - 1999 among representatives of the Trade Unions, Employer Associations and some of the larger Employers.

The analytic frame for the study is based on the social citizenship and social exclusion paradigms, and on Tilly's (1998) concepts of 'categorical distinctions' and 'durable inequality'. The sections of the article deal consecutively with the immigrant<sup>333</sup> employment context in Finland, theoretical concepts and method, data findings, and discussion.

## 19.2 The context of the study

In the mid-1980s, Finland became a country of net immigration after half a century of outmigration (see Korkiasaari 1993). Finland differs from the other Nordic countries of Sweden and Denmark in that immigration has not been used as an instrument of economic or demographic structuring and has remained low compared with many other immigrant receiving countries.

At present the foreign-born form around 2.5 percent of the population (Statistics Finland 1999). The main groups arrive in the categories of 'privileged' ethnic

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<sup>333</sup> The category 'immigrants' is used in this article to refer to both voluntary arrivals, and involuntary immigrants (refugees). When the text refers specifically to either group, the appropriate category is used.

migration (Ingrians)<sup>334</sup>, return migration, spouses, and humanitarian migrants or refugees. The largest groups of humanitarian migrants are from Somalia (4,500 persons), Vietnam (2,800), Iraq (2,600) and Iran (1,700) (Statistics Finland 1999). Coming from non-European cultures hitherto unfamiliar to the majority population, they have brought a degree of ethnocultural diversity into the relatively homogeneous Finnish population. They constitute so-called new 'visible minority' groups. While unemployment in the immigrant population, as a whole, has been in the vicinity of 40 percent<sup>335</sup>, in these particular groups, the unemployment rate has hovered around 70 percent since the early 1990s when they settled in Finland (Ministry of Labour Statistics 1999). The problem was not raised in the public discourse, as it was overshadowed by the 1990s economic recession and the escalation of unemployment levels in Finland. Indeed the economic recession accompanied by rapid and sweeping changes in the labour market, has been the event with major impact on resettlement.

The recession began in the early 1990s when national unemployment figures rose sharply and peaked at 21.8 percent in 1993. In the latter part of the decade, unemployment gradually dropped to around 10 percent. Survey research at that period, also pointed to a hardening of attitudes towards foreigners (Jaakkola 1995). Immigrants' own task of adaptation and integration was taking place simultaneously with the wider society's coping with the recession. Cutbacks in public spending affected hiring in the public sector, the public services and the life of the citizens. The recession also precipitated labour-market restructuring, a loss in the absolute number of 'regular' jobs, and a crisis of the full employment policy which has been a pillar of the Finnish welfare state (see e.g., Suikkanen 1996). In the climate of economic recession, immigrant unemployment and equal opportunity, have been low key topics. However when discourse on problematic issues is postponed, their consequences may not be fully estimated (see Jasinskaja-Lahti and Liebkind 1997). There is also a serious risk that the problem may come to be viewed exclusively as a private one, and may be detached from its societal context. Even in the post recession period, although the importance of good ethnic relations and of working against ethnic discrimination is recognised by the

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<sup>334</sup> In 1990, persons of Finnish descent who have been resident for generations in areas of the former Soviet Union were granted the status of returning migrants and were permitted to return and settle in Finland. This gave rise to the 'wave of immigration' of Finnish-speaking Ingrians from these territories who, according to current estimates, number approximately 20,000.

<sup>335</sup> The unemployment percentages for the total foreign population, and for separate ethnic groups, do not include those who have become Finnish citizens. Finnish citizenship can be applied for after five years of residence, and processing takes about two years. At the time of writing, approximately one sixth of the Vietnamese group had already been granted Finnish citizenship, as they were the first of the quotas to arrive in the mid- and late 1980s. The other groups under study are also gradually obtaining citizenship.

Ministry of Labour<sup>336</sup>, there seems to be generally a low level of awareness and a reluctance to grapple with the issue of high immigrant unemployment levels.

As part of the main settlement programmes, State responsibility and initiatives have been concentrated on the preliminary stages of the labour-market integration process. The 'supply' side aspects have been given priority through a comprehensive range of language and labour-market training courses, subsidised practice placements, and other forms of on-the-job training. These measures were fully recognised as being of high importance by the questionnaire respondents. Thus, from the perspective of capacity development, immigrants have been able to utilize these educational opportunities to acquire human capital in resettlement (see Ekholm 1994). From the citizenship perspective, their 'social rights' have been facilitated through an extensive range of training and insertion-oriented programmes. The provision of state day care services has enabled mothers of pre-school children to attend language instruction and labour-market courses (Valtonen 1994).

The implicit assumption in immigrant settlement circles, has been that individuals who emerge 'jobready' from state labour-market courses and training, will be absorbed into the employment market. However, the chronic and high levels of unemployment among immigrants of all levels of education and training, obtained in their country of origin or in Finland, show that the current approach to labour-market integration is not having the desired outcome.

### 19.3 Theoretical concepts

#### Social exclusion

Social exclusion is a useful frame in this study as it refers to relational issues, such as 'inadequate social participation, lack of social protection, lack of social integration, and lack of power' (Room 1995: 105). The immigrant unemployment predicament in Finland is not one of absolute material want as the 'encompassing' welfare state<sup>337</sup> guarantees basic income security and a 'decent' standard of living. The impasse concerns the lack of access, to the key participatory area of the labour market. In practice, the social deprivation of the

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<sup>336</sup> See Laakkonen (2000).

<sup>337</sup> The 'encompassing' model of welfare has been introduced in Sweden, Norway and Finland, combining the earnings related benefits of the 'state corporatist' model with the universality of the 'basic security' model. All citizens are insured within the same structure of programmes, with flat rate benefits to everybody and, in addition, markedly earnings-related benefits to those who are economically active (Korpi 2000: 162).

unemployed involves the inability to exercise freedom of decision even in areas such as social activities and particularly in the life of the community (Sen 1997).

### **Monopoly**

Silver (1994) introduces three paradigms of social exclusion which account for economic disadvantages like poverty and long-term employment, from the perspectives of 'solidarity', 'specialization'<sup>338</sup> and 'monopoly'. Of the three paradigms, the monopoly paradigm, seems to be most relevant in generating explanation for long term unemployment in the present study<sup>339</sup>. According to the monopoly paradigm, exclusion serves the interests of the included, arising from the interplay of class, status and political power. The monopoly creates a bond of common interest between otherwise unequal insiders. Social 'closure' and the perpetuation of inequality results when boundaries are created through institutions and cultural distinctions that keep others out against their will. These boundaries of exclusion may be drawn within or between nation-states, localities, firms or social groups. In this study, 'monopoly' is proposed as a condition impacting on immigrants' relations to the labour market.

Monopoly can be combated through citizenship and the extension of equal membership in the community to outsiders. We can argue that exclusion is indeed being combated through citizenship since the full range of social rights and the status of social citizenship have been extended to resettling refugees and immigrants in Finland. However, the crucial question is whether the formal extension of equal membership and the right to full participation in the community actually lead to the real exercise and practice of full social citizenship. As far as citizenship rights, including social rights, are concerned, resettling persons are generally on an equal footing with other citizens. The exercise and practice of full social citizenship cannot, however, be limited to welfare rights, since labour market participation is undeniably central to the exercise of full citizenship. Within the 'universal' social rights<sup>340</sup>, the right to employment is not explicitly articulated, but implicitly promoted by the clear

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<sup>338</sup> The three paradigms derive from the perspectives of 'solidarity', 'specialisation' and 'monopoly', grounded respectively in the philosophies of republicanism, liberalism and social democracy. In the solidarity paradigm, representing the Durkheimian tradition, exclusion occurs when the social bond between the individual and society, known as social solidarity, breaks down. In the specialisation paradigm, the social order and the economic and political spheres are conceptualised as networks of voluntary exchanges between autonomous individuals. The differences among individuals give rise to processes of specialisation or social differentiation in the market and in social groups. Thus exclusion is a form of 'discrimination' that is a consequence of specialisation or social differentiation, and group boundaries that impede social exchanges (Silver 1994).

<sup>339</sup> The Swedish model, to which the Finnish model bears great similarity, has been classified as belonging to the monopoly paradigm (Cousins 1998).

<sup>340</sup> See Marshall (1963).

rights to education and training. The inclusion of as many as possible into the labour market has been a central strategy of the 'encompassing' welfare state model, and indeed, the prevailing terms of social rights and citizenship are largely premised on citizens' employment relations. The level of the chief forms of social insurance against sickness, disability, unemployment and old age, is tied to citizens' level of earnings. In practice, individuals with intermittent or weak employment relations will receive the main benefits at the level of much less generous flat-rate compensation (see Cousins 1998: 138). Given the way in which social rights are structured, long term unemployment presents a substantial jeopardy to welfare citizenship.

### **Categorical inequality**

The concept of 'categorical inequality' is juxtaposed with the monopoly paradigm of social exclusion, as a frame of analysis. Categorical inequality can arise when paired and unequal categories, are the basis or blueprint for maintaining asymmetrical relations across a socially recognised (and usually incomplete) dividing line between interpersonal networks, with the usual effect being the unequal exclusion of each network from resources controlled by the other. Through the mechanism of opportunity hoarding, agents who incorporate paired and unequal categories, are able to exercise exclusionary tactics and eventually perpetuate inequality (Tilly 1998).

Opportunity hoarding can occur at crucial organisational boundaries (such as, e.g., the border of the labour market), when processes of selection or disqualification take place on the basis of criteria reduction to a simple dichotomy. Granting of access to the coveted resource proceeds as an exercise of separating candidates into two mutually exclusive and exhaustive groups on apparently valid criteria of admissability and non-admissability.

Exploitation, the more extreme version of opportunity hoarding is operative among 'powerful, connected people' with command over resources. Opportunity hoarding can occur among the 'less powerful'. It becomes possible when members of a categorically bounded network acquire access to a resource that is valuable, renewable, subject to monopoly, supportive of network activities, and enhanced by the network's modus operandi. These mechanisms do not require categories with closed perimeters (which are rare and costly to maintain). A boundary with stable definitions of categories, even though permeable, will suffice to maintain processes of durable inequality (Tilly 1998: 10).

## 19.4 Method

For the qualitative study, interviews (individual and family) and focus groups were carried out among Vietnamese, Cambodian, Kurdish, Iraqi and Somalian communities. In total, 181 subjects participated in the interviews. The interviews were built on a structured protocol which included open-ended questions. The relevant data on the jobseeking process, strategies, obstacles and perceived reasons for unemployment/employment were analysed for this study. The target groups comprised individuals living in, or in the environs of several cities (including the major cities of Helsinki, Tampere, and Turku), as well as persons from smaller communities.

The second set of data from the Delphi questionnaire was collected from 61 respondents representing Trade Unions, Employers' Associations, and several public and private sector Employers (Valtonen 2000). The questionnaire covered reasons perceived by the respondents for the high levels of unemployment among immigrants, and also measures and actions perceived by respondents as important for improving immigrants' access to labour-market participation (see Appendix 1). The questionnaire also allowed for possible suggestions of respondents to be inserted at the end of each section. The questionnaire data thus looks at selected dimensions of the same issue, but from the perspective of central labour market organizations and hiring actors.

## 19.5 Findings

In the 1990s recession, high levels of joblessness and redundancies across all sectors of the labour market meant that immigrants' jobseeking became much more difficult than it was in the late eighties. The Vietnamese group, who were resettling since the mid- and late 1980s, had been very successful in obtaining employment up to the end of that decade in spite of their lower educational background. The Kurdish, Iraqi Arab and Somalian groups arrived subsequently in the early 1990s. Their resettlement period began when the 'full employment' ideal was being eroded, and unfortunately overlaps neatly with the economic recession and the harshening of labour-market conditions. The level of approximately 70 percent unemployment throughout the 1990s in the groups under study<sup>341</sup>, reflects the much greater vulnerability of immigrants in a tightened labour market.

The interview data pointed to a high level of initiative in the job search, in addition to participation in language and labour market training and subsidised

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<sup>341</sup> The study was conducted at a time when the citizenship applications of these later groups were largely in progress, but not yet resolved. Thus the statistics reflect the situation of entire groups, or national categories at that time.

on-the-job placements. The use of employment exchange services, and a broad range of jobseeking channels was routine among the majority of the subjects. Immigrant job-seekers, at this time, have acquired greater familiarity with the 'geography' of the labour market. Self-initiated searches included scrutiny of newspapers, written applications and personal visits, as well as spontaneous enquiries at likely places. The young adult jobseekers as a rule seem to have understood the importance of persistence in jobseeking. Individual efforts often are reinforced by a high level of job search activity in immediate social circles. There are also well-developed networking and information exchange in informal groups. Amina, a young Somalian woman, described her own strategy:

*I have always looked around very actively on my own in many places. It has been a constant search, and requires always being ready with the question, 'Are there employment openings in your firm? I am not employed and I would really like to do something. Would you have any kind of work for me?'*

The data showed consistently that the interviewees were rarely able to make headway in their relatively persistent search for employment. They encountered refusal at a very early stage in the process. Subjects recounted that telephone enquiries were apt to terminate when the individual gave his name, or replied to such questions as, 'I believe you are a foreigner, what country are you from?' 'Africa? What country in Africa?' 'Somalia? ... No, no, we don't need any more people'. The experience of rejection at the first 'gate' of the employment market was commonplace among the young adults, and, in particular, those of Middle Eastern and Somalian background. There have been barriers for even the most basic levels of employment, such as cleaning. Rejection at the first gate of the employment market has also been a regular experience among jobseekers who had acquired a considerable amount of educational and basic vocational training in Finland.

Refusals were most commonly explained by remarks or assumptions of poor Finnish language skill. From the outset of the hiring activity, the language question or lack of Finnish language skill seems to function as a standard justification for deflecting the enquiry or application of an immigrant jobseeker. When this topic was discussed in the course of expert informant interviews, Employer Association and Trade Union representatives raised the point that many jobs do not require 'fluent' Finnish, or a native speaker's ability. One informant provided an example of routine library work involving sorting books and replacing them on selves. There was no shortage of similar examples. This data converges strongly with that of Paananen's (1999) study of the reception and classification of foreign labour-market recruits in Finland, in which he found that labour-market gatekeepers put much weight on competence in the Finnish language even when no direct connection seems to exist between it and the job tasks involved. Variations on the language theme included the hint that the

applicant had not obtained employment because he lacked the technical language required for an assembly line job.

The Delphi questionnaire provided data that relates to these qualitative findings. Respondents were asked to assess reasons for high unemployment among immigrants, using a four point-scale that ranged from 1: very important, 2: some importance, 3: not very important, to 4: no importance. The most important reasons were listed as the immigrant jobseekers' lack of Finnish language skill (67 percent), the economic recession of the 1990s (52 percent), and 'the perception by employers that immigrants lack language and vocational skills' (45 percent)<sup>342</sup>.

In the following questionnaire section, respondents were asked to assess measures which, in their opinion, would be important for reducing the level of immigrant unemployment. (See Appendix 1). A similar four point scale was used. In this section, high priority and the highest consensus across the three groups was on the importance of measures for improving the Finnish language skill of immigrant jobseekers. A measure regarding development of Swedish language skills was also rated nearly as important across all groups. The emphasis on language skill is well justified, but when placed in the context of the actual situation, a stark contradiction arises. While 'lack of Finnish language skill' constitutes, and is perceived as constituting a major barrier to immigrant employment, fluent Finnish or a functional level of Finnish has all along been not only the aim, but also the achievement of the elaborate language and labour market training system. Finnish language skill is far from rare among resettling persons. On the contrary, Finnish is now spoken vibrantly as a second language in resettling ethnocultural groups.

The subjects themselves gave different opinions on the mechanisms at play in hiring processes. Shenan, from Iraq, clung to the idea of utility:

*an employer cannot afford to be racist, because he needs good workers ... large firms cannot practice discrimination. If they are successful enterprises, they have a reputation to uphold. They cannot run the risk of being accused of racism.*

Muhammed, on the other hand, presented another perspective:

*It is not only a question of the employer's attitude. An employer can interview you. But if he has 20 workers, and he hears from them that*

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<sup>342</sup> These findings are similar to results of a study conducted in Norway (Wrench 1996), in which 160 managers representing the 400 largest Norwegian firms were interviewed. Of these, 59 percent thought that 'not having a knowledge of the language' was the most important reason for discrimination against immigrants in the recruitment process; 60 percent thought that the difference in culture was an additional important reason.

*they are unwilling for the company to start hiring co-workers with immigrant background, then you won't get the job, the employer can't force his workers, they are important to him. When they say to him, 'We are not certain how it will work out', the boss tells you later, 'sorry ... we can't employ you'.*

### **Unemployment among the more highly educated**

In the 1990s, the resettling refugee population in particular, has been approaching, rather than diverging from the cross-section of socio-economic characteristics of employability prevalent in the population at large<sup>343</sup>. Normally this should be reflected in stronger labour-market integration, i.e. in employment. This has not taken place. Those adults possessing a more advanced educational and employment background from their country of origin have more specified long-term objectives than young adults. They generally aim to find some employment corresponding to their qualifications, even though equivalence is not expected at the outset. From the interviews with resettling professionals, it became clear that most have arrived at the conclusion that the door to employment at any level even roughly corresponding to their qualifications and experience, is closed to them. Saleh, who had arrived some ten years ago from Iraq, gave his opinion on the situation in his community:

*We Iraqis are of two groups. Some of us are not educated at all, or may be just up to primary school. Such people try to do business on their own, very small businesses, and it is a good alternative for them if they can succeed. Some others have been to vocational school, or have higher education of some kind. Not one of this other group has a job here. First of all they have to study the Finnish language. If they have a family, they will have time to go to a course, but not a lot of time to study, that is, to study like others. This second group are trying but confused ... Their studying has led to no job, and they say 'I have no hope of ever being employed'. That is the group to which I belong. We don't know what we are going to do after we finish our studies ... people are thinking that there are many Iraqis who have come here even prior to us and up to now they have not found jobs. People are studying and going to courses, and doing everything ... but nothing changes.*

Osman told of his experience:

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<sup>343</sup> The heavy emphasis on purely humanitarian criteria at the initial period of refugee resettlement has undergone some shift to include considerations of integration and potential for the labour market. Concern with employability has not been explicitly stated as policy, but has been more or less dictated by concerns to build up viable ethnocultural communities with a resource base.

*I went through all the courses, then had a placement in ..... I looked after some curriculum matters, paper work and helped out with organisational and some administrative tasks. But I needed to obtain some teaching experience, at the very least a few hours of practical experience in the classroom. I did not manage to get even a single hour during all that time, as none of the teachers were willing ... they do not seem to realise that people also have feelings. It is humiliating to be in such situations, and for this reason many people stop trying. They have given up and try to occupy themselves in other ways.*

The questionnaire data indicated a positive stance among respondents toward utilizing the human capital of the immigrant labour force. In particular, among the Employer representatives, there was relatively high consensus on the importance of focusing on, and using skill/competency areas which immigrants bring with them, as possible avenues for developing employment opportunities.

## **19.6 Determinants of immigrant unemployment**

### **The recession**

High unemployment, lengthy duration of unemployment or the sole experience in the labour market being through occasional temporary state-subsidised placements, mean that, in this crucial area, integration is not taking place. Inclusion into the education and training spheres has coexisted with a situation of employment exclusion during the recession. Very recently, as the country moves out of the recession, there has been some improvement in immigrant employment, which is concentrated in the secondary labour market. This development will be discussed in a later section.

As mentioned earlier, the Vietnamese groups who arrived in the late eighties, found employment. They obtained jobs relatively quickly in assembly plants and the electronics industry after the initial labour market training period. This provides a strong argument to support the view of the questionnaire respondents, that the recession was a major factor behind the high levels of immigrant unemployment.

It may be hypothesized that the unfavourable economic situation aggravated discriminatory mechanisms in hiring. As the policy structures for equality and inclusion, were put to the test in adverse socioeconomic conditions, the outcome of these events impacted upon the state of citizenship rights in immigrant and other social groups.

## **Discrimination**

The interview data can be interpreted directly through the frame of discrimination. The findings of the present study are similar to those of previous studies based on formal discrimination testing on hiring practices in other immigrant-receiving countries (see, for example, Bovenkerk et al. 1995; Goldberg et al. 1996). Discrimination in this context is defined as a situation in which the immigrant is accorded worse treatment than members of the majority population in spite of the fact that her/his education, qualification and work experience are equivalent to that of candidates from the main population. Hiring practice in which the immigrant jobseeker does not even have a chance to show his/her work record, constitutes 'blatant' discrimination (Zegers de Beijl 1997). On the other hand, 'indirect' discrimination exists where a qualifying rule or condition is applied which cannot be justified in relation to the particular job and which disproportionately affects one or more racial or ethnic groups as compared with another. The emphasis on language requirements in the present data, can be seen as a manifestation of 'indirect' discrimination.

In the area of ethnic equality, antidiscrimination mechanisms and measures are yet very limited in Finland. While antidiscrimination legislation exists, the mechanisms for its implementation in areas relating to hiring discrimination against immigrants have been slow to develop. The creation of the post of a discrimination ombudsman to be put into place in the latter part of this year, can be taken however, as a sign of national commitment to dealing with discrimination (see Forbes and Mead 1992; Wrench 1996). In the questionnaire data, while Trade Union respondents had relatively high consensus on the importance of developing equal opportunity measures, general opinion differed widely on the importance of expanding gender equality programmes to cover ethnic equality, and on the development of anti-discrimination complaint and redress mechanisms.

## **Monopoly**

The data on immigrant unemployment can be interpreted as an outcome of 'monopoly'-like mechanisms of exclusion, which are formally articulated in the categorical distinction between jobseekers with an acceptable level of language skill and all those assumed to be deficient in this respect. Important decision-making and selection processes that would regulate access to the labour market may be reduced to a procedure of dichotomisation into paired and unequal categories, such as black/white, male/female, married/unmarried, citizen/non-citizen, and in this case, native-speakers and 'others'. Whole categories of people become 'unmatched', as it were, from jobs, not by the weighing of individual attributes, merits or qualifications, but by the making of such wide categorical distinctions (see Valtonen 2001). A wider condition of monopoly would be a consequence of extensive 'emulation' (the copying of

established organisational models and/or the transplanting of existing social relations from one setting to another) and 'adaptation' (the elaboration of daily routines on the basis of categorically unequal structures). The present data on job selection dynamics at the labour-market perimeter appear to corroborate strongly Tilly's (1998) argument that inequality can persist because of opportunity hoarding through broad categorising precisely at the perimeter, leading to conditions of monopoly and social closure.

Monopoly-like conditions could be underpinned by an interplay of insider interest and the exercise of power at the periphery of the labour market proper, possibly in order to protect privilege. Since the period of economic recession and high unemployment levels, work may be assuming dimensions of privilege or reward, in addition to its instrumental significance. Insider interest is a complex and difficult concept to operationalize in the present context, as, in addition to the notion of rewards or privilege, attitudes may be of central importance. According to Paananen (1999), gatekeepers view the ability to use the Finnish language as a kind of measure of Finnishness, and its extent is seen as proof of the recruit's genuine desire to commit him or herself to both employment and society. The author states that the values attached to language and nationality are slow to change and that the weight that is put on Finnish values tells of the persistent nature of the discrimination in the labour market. The questionnaire data offers a perspective on attitude formation in the majority population. In the section dealing with the need to foster positive attitudes and tolerance in the cause of good ethnic relations, the most emphasis across the groups, was placed on the specific item proposing that tolerance training is a process that begins in the cradle, starting with infant clinics, day-care and school. In this respect, respondents also took a long term view of attitude change, emphasizing the roots of tolerance training in the area of basic socialization.

### **19.7 Incremental access – segmentation or representation**

The qualitative data produced information on strategies of immigrant applicants who were successful. The labour market boundary has been penetrated by some immigrants, and these precedents have paved a way for others. The data indicated that the majority of successful applications had hinged upon the personal recommendation of a local person. A young woman who had obtained work with help from a Finnish friend, explains this manoeuvre: 'It can work out well when a Finnish person helps. It is possible to get work if someone who knows you, puts in a word. Otherwise the employer cannot believe a foreigner just like that'.

This informal obstacle to employment which has been overcome by some immigrant jobseekers, can be understood as arising from the hiring party's lack

of confidence, information or experience in hiring an individual from a different cultural background. The decisive importance of a favourable community reference is also reflected in the questionnaire data, in which employers showed particular interest in measures to bring out and disseminate information on positive experiences with immigrants in the workplace, and in having immigrants present their own first-hand accounts of experiences of being successfully employed. Moreover, in all three groups, bringing out examples of positive problem solving in the matter of immigrant employment was thought to be very important. The labour market parties seem to be receptive to more information in order to assess more accurately or possibly more fairly, the potential 'risk' in hiring an immigrant candidate.

The employment of each resettling person is potentially a new path for other foreign-born jobseekers to gain employment in the same company. Immigrants who are employed can pave the way for others through information networks, personal recommendations and through their own work performance which helps to break down possible stereotypes. A Vietnamese subject, Dung, remarked, 'The best way is to get your friend to ask his boss on your behalf'. Evidence for this 'chain employment' mechanism was found in the course of this study in the clustering of resettling persons in some specific companies and areas, such as assembly plants and the electronics industry. In addition, the postal service and Helsinki's municipal transport system seem to be forerunners in admitting and training immigrant workers. Ethnic clustering in individual workplaces often evolves from informal networks which function initially in ethnocultural circles.

Chain employment shows that a degree of incremental access to the labour market has been occurring, which moreover, bears out Tilly's (1998) notion of a semi-permeable perimeter. The initial facilitators have been individuals with some standing in the local community, e.g., course teachers, church members, 'good neighbours', public service officials etc. At the next stage, the immigrant herself/himself is in the role of facilitator for others from her/his networks and circles. These findings bring in the multidimensional aspects of integration, and, not least, the importance of immigrant jobseekers' contacts in civil society, and with wider circles in the majority population.

Unemployment among immigrants has decreased slightly, accompanying the trend in the main population. According to a recent study by Forsander and Alitolppa-Niitamo (2000):

*the branches of catering and cleaning provide immigrants with so-called entry jobs, i.e. the first jobs on the Finnish labour market. It seems rather difficult for immigrants to be employed on the basis of their professional skills and resources without any preceding work*

*experience in Finland – the fact is that no work experience gained abroad is very much appreciated here.*

Immigrants are filtering into the secondary labour market. While at present, it is difficult to assess the significance of this development, the fact that the entry level is consistently low increases the risk of eventual labour-market segmentation, since there is generally little mobility from the secondary into the primary labour market (Fagan and O'Reilly 1998). As an alternative preferable to unemployment, immigrants' concentrated insertion into the secondary labour market constitutes insertion into a precarious area, marked by recruitment of overqualified workers and unstable forms of employment (Yépez del Castillo 1994).

In great contrast, the questionnaire data runs counter to the prospect of a segmented labour market. One of the most significant findings in this data was high consensus across all groups on the importance of having immigrants employed in all types of jobs and employment sectors, across the labour market. Respondents' unequivocal support for immigrant integration across and throughout the labour market, or 'representation'<sup>344</sup>, is very discrepant with the actual situation, given the restricted nature of immigrants' penetration of the labour market boundary through the gradual processes of chain employment, and the present low levels of entry.

The data furnishes a strong case for developing a comprehensive Employment Equity policy in the post recession period. The main thrust of Employment Equity policies is to eliminate bias proactively, from the outset of hiring. The removal of discriminatory bias is intended to expand the number of qualified applicants in the competition for employment. The objective is to achieve as complete a panel as possible of qualified members of the labour force from which to conduct selection. Employment Equity programmes have been implemented initially in the State Sector and in Government contracting activity in several immigrant receiving countries. The preparation and training of the personnel in the workplace is an integral part of the programme<sup>345</sup>. Employment Equity policies, instead of being understood as eroding at employer autonomy in

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<sup>344</sup> The empowerment goals articulated by representatives of visible minorities in Canada emphasize access (openness to visible minorities), representation (proportionate to numbers in the population) and equity (equality of opportunity and removal of systemic barriers) (Elliot and Fleras 1990).

<sup>345</sup> Preparation and training of the personnel includes a management statement of commitment to the concept, a communication and educational strategy to help workers and management understand the concept of employment equity, the identification of any discriminatory structures and barriers within the workplace, and the development of goals and timetables to hire and promote previously under-represented groups. The last step includes conducting a workforce analysis to compare representation of groups within the establishment with their availability in the larger population (see Fleras and Elliot 1996; Das Gupta 1996).

hiring, can be seen as giving an official instrument for bias-free decision making, also in cases where workplace resistance exists.

## 19.8 Conclusion

Immigrants' labour market participation and insertion processes have been scrutinized from the perspectives of the immigrant jobseekers as well as the formal labour market organizations and larger employers. The findings of the qualitative data present a tableau suggesting labour market exclusion among the target groups during the decade of the recession. However, a valuable dimension to the study emerges from the questionnaire data from Trade Union, Employer Association and Employer representatives who expressed a positive, albeit cautious, stance toward the immigrant employment issue, as well as strong support for the integration of immigrants across all sectors and areas of the labour market. The questionnaire data may be said to reflect a situation of 'potentiality'.

Immigrant integration throughout the labour market, as envisioned by the respondents of the Delphi questionnaire, cannot be adequately addressed by the incremental process of chain employment observed in the data. Positive action<sup>346</sup> on the part of policy makers, including labour market organizations and employers, would be decisive for promoting the principle of ethnic equality enshrined in the new Integration Act (493/1999). Addressing equality issues, including those of ethnic equality, would call for an intervention with a universalistic reach and proactive thrust in order to be effective. When the insertion of minority groups across labour market sectors is the aim, a policy embodying Employment Equity principles would have the scope for addressing the problem on the national level.

In Finland, gender equity has become 'normalized' as it were, across labour market areas, and is seen as an equity prototype that is distinct in the Nordic countries. The considerable experience with the gender equity model would be very valuable in shaping the area of ethnic equality in Finland, since the equity related concerns in both citizen groups are broadly similar. The time is ripe for ethnic equality to become an integral part of the national equality agenda.

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<sup>346</sup> Through positive action, extra resources are devoted to assisting and encouraging members of under-represented groups to compete for employment.

## **Appendix 1 from the Delphi questionnaire**

The questionnaire included the following suggested areas of focus for improving immigrant employment:

### **A. Job readiness of applicants**

- Vocational education
- Knowledge of the work culture in Finland
- Courses on entrepreneurship and self-employment
- Promotion of immigrant entrepreneurship and self-employment
- On-the-job placements and apprenticeships
- Finnish language skill
- Swedish language skill

### **B. Resource development at the workplace**

- Information on positive experience with immigrant workers
- Multiculturalism training at the workplace
- Information on the advantages of an ethnically diverse workforce

### **C. Developing 'demand' and opportunity for immigrant workers**

- Representation of immigrants throughout different labour-market sectors and areas
- Developing immigrant entrepreneurship areas in which their own particular skills and resources could be used
- Recruiting immigrants in areas where their cultural background would be utilised, eg. in immigrant reception services

### **D. Recruitment**

- Equal opportunity measures
- Clear mechanisms for complaint and redress in cases of discrimination
- Expanding gender equality legislation and enforcement mechanisms to cover also ethnic equality

### **E. Societal concerns and contacts**

- Activism on equity issues by immigrant workers within the labour unions
- Tolerance education for young and old
- Public discourse, also on the media, on equality, human rights, discrimination issues

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## 20 Ethics and Changing Incentives, Social-ethical model for examining changes in the Finnish incentive system during the economic crisis of the 1990s

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### Abstract

Several studies on the last recession have indicated that the crisis changed the economic structure and socio-political mechanisms of the Finnish welfare state. As a result, changes occurred also in the incentive system. From an economic perspective, the objective of incentives is economic efficiency, while from an ethical perspective it is the securing of social rights, equality and the position of the underprivileged. The incentive problem of the last recession resulted from the fact that the expected effects of the incentives system were not realised. This article aims to provide tools for examining the economic crisis and a basis for understanding the crisis from the perspective of normative ethics, by offering a moral (but not moralising) and conceptually wider perspective to social change.

Keywords: Incentive, social ethics, welfare state, economic crisis

### 20.1 Introduction

Several studies on the recession of the 1990s have indicated that the crisis changed the economic structure and socio-political mechanisms of the Finnish welfare state. As a result, changes occurred also in the incentive system. In reality, an incentive system produced with politico-economic solutions can function quite differently from what was intended. This causes friction between the pursued values and the realised objectives. The conditions that prevailed during the economic crisis can be examined from an economic, political and ethical perspective, each of which provides different reasons for the changes in the incentive system. The applied perspective also affects what reasons are seen and one's willingness to see them. How the relationship between these perspectives is understood depends on what is considered as the primary function of the incentive system. From an economic perspective, the objective of incentives is economic efficiency, while from an ethical perspective it is the

securing of social rights, equality and the position of the underprivileged. The economic crisis generated a serious conflict between these perspectives, which in turn created an incentive problem that continues to shake the structures of the welfare state. I call this a problem of the reflection of values.

Behind the problematic aspects of incentives, an increasingly more difficult feature can be detected in today's Finnish society. From an economic, political and ethical perspective, the changes taking place in the society are unexpected. The social changes related to the economic crisis of the 1990s raised questions and problems, which could not be solved with the available tools. The incentive problem created a gap between economic and moral arguments, and as a result, the normal values of the welfare state were not reflected on the country's politics, legislation and social institutions. The incentive issue is closely tied to the debate on the fair distribution of wealth, ideal income disparity and the taxation system. According to Terho Pursiainen's view incentives can be understood as the only justifiable basis for distributing welfare, and therefore, the only justifiable socio-economic disparity is that created by socially encouraging actions.<sup>347</sup>

To identify the factual features involved in the changes in incentives, it is important to study them from the perspective of several social sciences. From an ethical perspective, it is useful to focus on the conceptual features of incentives. In fact, this is crucial in the accurate definition of the moral problems related to their change. This article begins with an analysis of the concept of incentive. The analysis enables us to define the meaning of an incentive and specify the terminology related to the various factors and features of incentives. I use this theoretical definition to outline the principles of an incentive system that is based on the idea of the welfare state. Then, I compare these principles to the changes in incentives that took place during the recession of the 1990s. The incentive system of a given society simply refers to the prevailing structural form of incentives produced with politico-economic measures. Although there is a wealth of material on the actual changes, to limit the scope of this article, a small sample (hereafter the 'incentive data' K1 –K3) was selected for examination.

The sample concerning changes in the incentive structure during the recession is limited intentionally only to reports given by governmental working groups. The sample as such serves as an adequate example of how the state authorities act as an inciter, of how the changes in incentive structures are argued and of how the terminology concerning incentives can change. The incentive data is purposed to function as a hypothetical example to prove how beneficial the instruments of the analysis of ideas are both in factual and

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<sup>347</sup> Pursiainen 1997, 30.

normative ethical analysis. This research project thus doesn't classify as a sociological research on recession. Rather this project intends to be an example of how the analysis of ideas can be applied as a social-ethical method to analyse the ethical implications of the changes in incentive structures during the recession.

Social-ethical analysis is based on the argumentation analysis of three reports (incentive data). The incentive data shows us an example how to grasp the different problems that dominate the incentive debate, particularly the politico-economic views. The analysis of these views reveals the arguments, presuppositions and ethical attitudes behind them. These background factors enable us to identify the values and norms prevailing during Finland's economic crisis, and reveal how the incentive structure was changed to correspond with these norms. By describing the changes from an ethical perspective, we are able to understand the conceptual significance of the economic crisis more completely than by using only economic indicators.

Social policy refers to intentional activity that is regulated by certain norms and values. Decisions and political acts are expected to have an impact, but it should be assessed how this impact relationship can be examined. The effects of socio-political decisions are at least partly impossible to predict. The incentive problem of the last recession resulted from the fact that the expected effects of the incentives system were not realised. Instead, the system eventually encouraged citizens to undesirable behaviour. The effects of the decisions concerning the incentive system were negative and unintentional, and could not be predicted at the time.

When the argumentation in the incentive data is examined from an ethical perspective, three argumentation types can be identified as arguing for changes in the incentive system: 1) using the incentive system to improve economic efficiency, 2) rationalising the incentive system and eliminating incentive traps and 3) using the incentive system to secure the welfare and equality of citizens, and consciously implementing the basic ideas of the welfare state. I have titled these argumentation types as the efficiency, rationalisation and welfare models.

It is obvious, that the ethical aspects related to these models differ from one another completely. In the first two models, rational viewpoints are assumed to solve ethical problems, while in the third model, ethical questions receive higher priority than rational ones. However, in the argumentation of the incentive data, the objectives included in each model are closely related to one another, as economic arguments are tied to rationalisation efforts, which in turn are tied to ethical arguments. All explanation models share the effort to rationalise the incentive system, but it remains to be questioned whether the elimination of incentive traps was accompanied by other changes. This article examines how the entirely different assumptions built in each model concerning the nature and

implementation of ethical perspectives are visible in the incentive data. These assumptions also prompt the question whether the changes in the incentive system were mere rationalisation, or conscious weakening and elimination of benefits. The latter would imply the adoption of new values and redefinition of the basic structure of the welfare state.

Some of the constant changes in a society are unexpected, which prompts the question: who bears economic and moral responsibility for the consequences of those changes? It is not easy to combine the perspective of moral responsibility with economic policy. For example, it would be very difficult to find the government legally responsible for failed impact predictions. The economic crisis provoked several such debates about the government's moral liability for weakening the position of the underprivileged. It is generally difficult to predict the development of national economies, and as a result, the ethical evaluation of social policies has been somewhat marginal. This article aims to provide tools for examining the economic crisis and a basis for understanding the crisis from the perspective of normative ethics, by offering a moral (but not moralising) and conceptually wider perspective to social change.

## 20.2 What are incentives?

The purpose of an incentive system is to direct the actors of the society to behave in accordance with social and economic conditions. Incentives can be defined as activity that encourages citizens to act according to the intentions of an authority. When the incentive provider is, for example, the state, which maximises its the use of resources, we can speak of social incentives.<sup>348</sup> By using incentives, this party persuades citizens to act according to its interests, aims and motives. Incentives control and direct the functions of citizens, without the use of external coercion, toward an objective or purpose specified by the authority. Incentives are a process through which citizens are directed in order to achieve a change in the state of affairs.

In a sense, an incentive system is a tool for directing economic and social development. The incentive system of a given society is a complex technical entity in which social sanctions are used to control individuals. The problematic aspects of incentives are influenced by several models of collective rational and moral behaviour. A key question related to social incentives is how individuals can be encouraged to use their skills and abilities in a way that is most beneficial to the society. I have created the following definition of incitement action, which describes the different levels involved in encouragement.

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<sup>348</sup> Pursiainen 1997 24, 29.

Incitement refer to controlling the behaviour of a rational actor without the use of external coercion:

1. According to the individual's personal preferences, and/or
2. According to an authority's (state, institutions, market forces) objectives, motives or interests, or
3. In a manner that an actor takes advantage of the circumstances (which possibly encourage behaviour not intended by the authority)

The concept of incitement is a construction that contains the idea of a rational actor, an authority, an individual's preferences, the laws and norms of a society, and circumstances. Incentives can be studied with a six-place relation, in which, under certain conditions, an authority (y) intentionally provides an incentive (v) to encourage a rational actor (a) to perform a certain act (p) that produces a benefit (q) to the actor and is meant to involve some common good (r) to the society. By defining the placeholders of the incentive relation, we can combine the theoretical, conceptual analysis with practical policy and everyday social and ethical problems. The formal definition of incentive can be used prescriptively and normatively in describing how an incentive system is implemented in different socio-political models.

In an incentive system, the term 'rational actor' refers to a citizen or group of citizens who are encouraged to act according to an authority's objectives. The definition of the actor as a rational, autonomous, equal citizen is related to common values and the concept of human being. Rationality refers to actors behaving according to their preferences and having the possibility to make autonomous, rational decisions concerning their lives. The fact that an actor's behaviour is understood as rational is closely associated with the community's prevailing social customs.<sup>349</sup> The privileges and responsibilities that a rational actor has as a member of the society are affected by the society's ideological foundation and the incentive system built upon that foundation.

The first definition of incentive requires that there is a factor encouraging rational actors to implement their personal preferences. Preferences refer to an actor's needs, desires and interests, which the actor attempts to satisfy in a rational manner. Preferences are related to the actor's understanding of his/her worth. This represents the weakest sense of an incentive, and instead, could be called self-encouragement or an internal incentive. The actor encourages him/herself to behave in some manner, but no separate, external party can be specified as intentionally motivating or influencing the actor's behaviour. The first type of encouragement refers to an autonomous agent's use of internal

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<sup>349</sup> Konkka 2000, 195.

incentives to direct his/her behaviour according to personal preferences. At the first level of encouragement, an actor's decisions comply with personal preferences. However, this is not always the case. An actor may prefer a certain course of action, but due to other factors, selects another course. It is therefore difficult for an authority to predict the behaviour of actors, because numerous factors affect their preferences.

In the analysis of an incentive as a conceptual construction, the second definition requires that an authority and its interests be taken into consideration. The concept of authority covers the authority's ideological attitude toward exercising power, or pursuing its objectives. An authority can be the state, various institutions, corporations or simply the market forces. With incentive systems, an authority provides rational actors with behavioural preferences and models that benefit the community's chosen objectives. The key factors in the examination of an authority are its preferences and the nature, credibility and impact of transmitted information. In everyday language, incentives are most often understood as belonging to this second category, which includes a clearly definable incentive provider and the party being encouraged with external incentives.

The third definition of an incentive describes a situation in which circumstances become such that the actor is encouraged to behave in a manner not pursued by any party. In other words, circumstances can produce a situation that benefits the actor and supports the realisation of the authority's interests, or a situation in which entirely unexpected things occur. In the latter case, actors take advantage of the situation in a way not intended by the authority. Here, the incentive becomes probably stronger than in the first category, because external circumstances as second placeholder influence stronger than personal preferences.

These three types of encouragement enable us to form a general condition for the success of an incentive system: an incentive system is functional, if its politico-economic solutions have created circumstances that encourage rational actors to behave according to their personal preferences. However, it is clear that in the three categories this condition is or is not satisfied in entirely different ways.

### **20.3 The incentive system of the welfare state**

The above definition of incitement enables us to describe what an incentive system based on the fundamental values of the welfare state is like. 1. Citizens are encouraged to participate in social activities and the labour market without external coercion. 2. The preferences of citizens are adequately similar to those of the authority, whereby income is primarily based on personal labour input,

and citizens are willing to pay taxes on that income. 3. The circumstances enable all citizens to obtain a sufficient level of income in a meaningful manner. The incentive provider seeks to actively change the circumstances so as to encourage general commitment to social objectives and thereby prevent citizens from abusing the incentives. An additional key condition is that: 4. Those, who cannot participate in the labour market for one reason or another, receive a sufficient minimum livelihood that is based on social rights.

## **20.4 Encouragement or coercion?**

The welfare state model for incentives contains several factual and normative background assumptions concerning the society's nature, democratic conditions, and respect for an individual's autonomy and rights. In welfare state incentives, the concept of human being begins with the assumption that citizens want to participate actively in working life and that they do not have to be coerced to do so. This enables us to discuss incentives, in a true sense, as encouragement based on positive sanctions. However, incentives have a saturation point, after which they cannot be considered as encouragement but as coercion. Then, the incentive becomes a sanction defined by an external authority. Sanctions ignore the will of the actor. Negative sanctions rarely become internal incentives and the encouraging impact of sanctions does not last very long. For the intentional party, negative sanctions have unintended consequences. The result is marginalisation and circumstances in which citizens are encouraged to behave in a manner, which was unintended and does not support the functionality of the system. In a similar fashion, an incentive can become a reward.

The Finnish incentive system has developed in such a way, that in certain situations today, some incentives are in fact rewards. An 'incentive trap' refers to a situation in which it is financially more profitable for a rational actor to remain unemployed than seek employment. In this situation, the incentive is a reward, which does not encourage future employment. Although the incentive becomes an internal incentive for the rational actor, it does not encourage the type of behaviour desired by the external authority. Again, circumstances encourage behaviour not intended by the incentive provider.

The economic crisis of the 1990s provides numerous examples of these saturation effects, whereby incentives cease to function as incentives and become coercive means or rewards. From the perspective of all social actors, it was ethically justifiable to change the system from excessive rewarding into a more encouraging direction. However, for some population groups, the increased incentives became coercive means, which resulted in new class formation and strengthened marginalisation. Ethically, the incentive problem is mainly related to whether there is work available that is meaningful from the

perspective of a rational actor's preferences and human dignity. Most often the problem is not that people do not wish to work, but the fact that the social structures have categorised people into subgroups that receive selective incentives. The recent changes have made the incentive system more severe, increasing considerably the number of negative sanctions included in selective incentives.<sup>350</sup>

In Finland, efforts were made to adapt the society to the conditions of the economic crisis by using the labour society's various self-defence means, which aim to sustain the social structures of the labour society and the labour market as a source of income. This aim has reflected a binary mode of thought, according to which there is work for anyone who accepts the offered position.<sup>351</sup> This mode of thought has had numerous consequences, which are visible in the confusion caused by changes in the welfare state's structure, as sanctions are used to drive rational actors into the labour market. However, the nature of the labour market has changed so much that the authorities can only offer substitutes to some people: periodic employment, job training and obligatory employment. Although overall unemployment has gradually decreased in the recent years, structural unemployment has remained high. Does the incentive system respect the citizen's autonomy to act according to personal preferences, or does it limit the citizen's freedom by coercing the individual to work? Have social conditions become such that there is no longer a desire to maintain an incentive system committed to the basic values of the welfare state? Has a new type of social classification taken place in our society, in which varying incentives are directed at different social groups?

## 20.5 Does the incentive system reflect the intended values?

In any society, social systems require values and beliefs to legitimate their operation. Social institutions define, communicate and strengthen various factual and normative assumptions. An incentive system is a form of encouragement achieved through politico-economic solutions, which are also affected by social values and beliefs. Thereby the incentive system itself reflects the same values and beliefs. Two key questions are related to the solutions: how are the solutions communicated to actors, and is the pursued objective realised through these solutions?

An issue closely related to the ethical assessment of social functions and an authority's objectives is the influence the different assumptions are believed to have. With socio-political argumentation, actors are provided with external

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<sup>350</sup> K 3. Väärälä. See the opposing argument.

<sup>351</sup> Julkunen 1997, 56-61.

motives for following the rules of the incentive system. Effect assessment and future risks are more like social constructions than objective facts. This means that perceptions concerning the roles and interests of various social actors are important issues. The argumentation of the incentive data is information transmitted by an authority to rational actors. This transmission of information can respect the autonomy of actors, whereby it is open and public, or it can limit their freedom, whereby information is transmitted by indoctrinating or manipulative means.<sup>352</sup> The way in which information is presented has a significant effect on its credibility and impact. External incentives, such as publicly stated instructions and regulations, can remain ineffective, if the authority has not succeeded in producing an adequately coherent belief system and the necessary operating models to ensure their functionality. The authority may employ indoctrination to ensure the functionality of the incentive system.<sup>353</sup>

Since it cannot always be verified whether the behavioural changes caused by changes in the incentive system correspond with an authority's objectives, it is very difficult to assess the incentive provider's objectives or their impact. As a result, it is also difficult to systematically predict the side effects and moral reflections of solutions required by actual situations. The structures and causalities of a society are highly complex, and consequently, the relationship between an authority's intentions and factual changes in the society is highly unreliable. The decisions of an authority are intentional attempts to produce certain values and a state of affairs, but the results of the objectives of a political decision can never be verified completely. Political strategies and choices may have side effects, which in fact prevent the realisation of the original objective. The adversity of side effects is an essential part of the problematic aspects of incentives. Some political acts must be made even though they are known in advance to fail or have undesirable, harmful effects. In addition, the acts may have numerous unexpected side effects that were not pursued.

However, in social policy, decisions are justified on the basis of their expected effects, and it is part of social policy to express the effects in a way that convinces the actors about the justified intention of the decisions. The proposed measures aim to achieve a certain state of affairs that reflects certain values. The effects can be either the intended or unintended consequences of political solutions and acts. Nevertheless, even the intended effects are not necessarily the pursued value choices. And if the effects are unintended, the values they reflect are not necessarily intended. Therefore, it is possible that the consequences of political acts sometimes reflect intended, and sometimes unintended values.

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<sup>352</sup> Puolimatka 1997, 355.

<sup>353</sup> Puolimatka 1997, 315-319.

## 20.6 Objectives and justification of incentive changes

During the economic crisis, the authority had to pay particular attention to factors related to the structure and content of the incentive system, and examine its intentions in the production of welfare and its main responsibilities in today's welfare state. Two working groups were founded during the recession: The Incentive Trap (Kannustinloukku) in 1996 and Active Social Policy (Aktiivinen sosiaalipolitiikka) in 1998. The working groups proposed actions that aimed to achieve certain results, consequences and values. The incentive data contains various economic, socio-political and ethical arguments about how the incentive system should be changed. The arguments are closely intertwined, which means that the economic arguments are tied to political arguments, which in turn are integrated into ethical arguments. The incentive data reflects the nature of the incentive provider's aims, as well as the attempts of the society's power structure to control the behaviour of rational actors.

When the argumentation behind the changes proposed by the authority is examined in detail, three hypothetical argumentation types can be identified:

1. Efficiency model

The only appropriate motive for the incentive system is to increase economic efficiency: cut costs, terminate the social benefit systems.

2. Rationalisation model

The only appropriate motive for the incentive system is to correct the structural defects of the labour market: rationalise incentives, harmonise benefits and remove overlapping, unemployment and income traps.

3. Welfare model

The only appropriate motive for the incentive system is to maintain the basic structure of the welfare state: increase equality among citizens, improve the position of the disadvantaged.

The argumentation types can be assessed from an ethical perspective on the basis of their importance in the incentive data. The three types emphasise different things with regard to the nature of the incentive system and the purpose of incentives. In fact, the changes in the incentive system depend considerably on the motives behind the changes. The problem involves the organisation, production and financing of services. In the incentive data, argumentation of the first type is economic, the second is more socio-political and the third is social ethical. Political argumentation is built on the acknowledgement of all these levels, which relate to one another in such a way that one argumentation type can determine another type as 'right' or 'wrong'

(depending on the chosen values).<sup>354</sup> The economic level can be considered a material basis for the two other levels. However, if the importance of the economic level is emphasised excessively, this can lead to the diminishing of the importance of the other two levels. Consequently, the argumentation types that represent these general objectives should be in a functional relationship with one another, together defining the efficiency, functionality and fairness of the incentive system. I will now examine the content of the argumentation types with a few samples selected from the incentive data. With the tools provided by the conceptual analysis, I will examine, from an ethical perspective, the factual, normative and strategic assumptions of the argumentation types. The content of the argumentation types can be assessed in two ways by comparing them to the definition of an incentive: which features should an incentive have in order to fulfil the conditions of the definition, and which values do the terms related to incentives receive in each argumentation type?

### 1. Efficiency model

In the first argumentation type, the only appropriate motive for the incentive system is to increase economic efficiency. On the basis of this statement, we can identify the variables of an incentive system as follows: the authority's (y) decisions and the incentive system are mainly controlled by the production machinery and the market forces. The equal welfare of citizens (a) is not the most desirable objective (r), while the growth of income disparity, unemployment, poverty and marginalisation are accepted as part of social reality, and major income disparities and obligatory employment are understood as incentives (v). Respect of citizens' preferences (q) is subject to economic fluctuation.

The first type consciously argues for a change in the policy of the welfare state in order to improve the economy.<sup>355</sup> The improvement of economic efficiency with no regard to the price on fairness inevitably raises questions about ethically acceptable means of encouragement. During the economic crisis, incentives were not selected on the basis of justifiable ethical principles. On the contrary, the selection criteria were founded entirely on economic perspectives. One of the background assumptions in this argumentation type is that the implementation of an incentive system based on the values of the welfare state hinders economic efficiency and productivity. In the incentive data, the authority presents as a factual truth the statement that "shrunk resources simply mean

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<sup>354</sup> Cf. in Marxist social theory, a society is constructed of the following levels of social reality:

1. Material level (production power: economy and technical development)
2. Norm level (production relationships: distribution of labour and ownership)
3. Cognitive level (ideologies, politics, values and ethics).

<sup>355</sup> Heikkilä 1994, 283.

less funds” for maintaining the welfare of citizens.<sup>356</sup> However, decisions concerning the focusing of resources are always an ethically relevant issue in economics. Some types of focusing support welfare values and some do not. Arguments based on shrunken resources should not necessarily lead to the abandoning of welfare values for the benefit of the economy. The economic resources for maintaining the welfare state were reduced as a result of the economic crisis, but the government still made decisions on where costs would be cut.<sup>357</sup> Statements on social transfers of income are the authority’s normative choices on the aims of incentives. In the general debate on social policy, economic efficiency and the welfare state are often seen as opposites.<sup>358</sup> However, this polarity cannot be proved universally, since the relationship between economic efficiency and the welfare of human beings contains many variables that cannot be discovered from rational collective behaviour with the parameters of economics and social sciences. One symptom of the thinking that emphasises polarities is that in the incentive data, the relationship between economic efficiency and fairness is described as somewhat controversial.

*The market mechanism can at best lead to economically efficient activity, but not necessarily to the achievement of fairness. The task of the welfare society is to fulfil the basic needs of its citizens, something not guaranteed by the market mechanism. [...] The issue at hand is the balance between fairness and economic efficiency. [...] From the authority’s perspective, the question is how to develop the welfare society as efficiently and fairly as possible. If the need of renewal is denied completely, the result may be a reduction in overall welfare.*<sup>359</sup>

The above argumentation reveals the serious ethical problem that fairness is considered as a value comparable to economic efficiency. The maintenance of fairness depends on whether the authority considers it economically profitable and efficient. The arguments on the reduction of overall welfare (r) are ethically problematic, because the measurement of such reduction depends, among other things, on the perspective from which overall welfare is examined.

*Basically, the elimination of incentive traps involves an increase in income disparity, if its reduction has gone too far, and the lowering of the level of minimum income, if it offers a too competitive source of income, when compared to the compensation from work, which can be provided with the output capacity of the economy. It is easy to*

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<sup>356</sup> K 1, 10.

<sup>357</sup> Kosunen 1997, 49-51.

<sup>358</sup> Kajanoja 1998, 167-168.

<sup>359</sup> K 3, 53.

*understand that this task is unrewarding, not only because there are several opinions about the above 'if clauses',<sup>360</sup>*

This argumentation type relies on the 'invisible hand' theory as a background assumption. According to the theory, the market can be left to function on its own, as long as decisions are made on financially reasonable grounds and on the basis of correct information. The intentional party assumes the conditions are such that prudent action produces moral fairness. However, the above example clearly underlines the problem that although welfare is pursued with effective and prudent means, fairness is not necessarily used in the process as a normative tool.

According to this argumentation type, the consequences of political acts are reductions in the benefit system, which reflect the emphasis of economic values. Equality and the rights of the underprivileged are secondary objectives. The reflected values are not independent of the measures. On the contrary, this argumentation type pursues a change in values. The emphasis of economic values is a direct result of the measures. The development of the incentive system is controlled more by economic imperatives than values related to the welfare state.<sup>361</sup> There is a difference between how the authority and the rational actors understand the concept of welfare. Most of the authority's preferences can be measured in economic terms. The incentive systems are built, to a great extent, entirely on these measurable values. And yet, it is inadequate to define the incentive merely on the basis of economically measurable values. The authority should also be able to examine other factors related to incentives. Measurable values are the economically calculable input and output of the production system. However, these values do not contain other expenses, which define whether the system functions as expected. The ideal is a model of complete competition, in which the market functions well and no public sector interference is needed. Still, this argumentation type includes the idea that the model is difficult to achieve. The market functions imperfectly and imperfections distort the situation, whereby the public sector is sometimes needed to correct market activity. This argumentation type does not properly represent an incentive model that respects human dignity. Economic efficiency is often pursued at the expense of human dignity and equality efforts.

The objective of economic efficiency is often presented in an indoctrinating and implicit manner, along with other objectives. The authority does not openly present the improvement of market activity as a criterion for changing the incentive system, but it is attached to argumentation that is ethically easier to accept. The rights of the underprivileged are weakened, while there is at the

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<sup>360</sup> K 2, 20.

<sup>361</sup> Rahkonen 1996, 66.

same time an ongoing debate about independent initiatives, activation and encouragement. The primary objective of these measures is to support market-oriented solutions: economic activity is made more efficient by diminishing rights and making them remunerative. In the social policy that followed the economic crisis, the argumentation type that emphasises economic values has become dominant, and it is used to justify a new kind of social policy. The argumentation types are not equally represented in the incentive data and the arguments concentrated heavily on this first, economic sector. Does this argumentation type distort the other types from the perspective of incentives that respect human dignity? The efficiency model represents a neo-liberal view of encouragement, according to which rational actors are free to fulfil their personal preferences in a free market environment in which the market forces function as the intentional party. The global market economy forms conditions of which the rational actor and intentional party both try to take advantage. Those who cannot participate in the activities of the technological production system are in danger of being marginalised and driven outside the society. In a neo-liberal model of society, the freedom of rational actors is firmly tied to their abilities and their possibility to use those abilities. If the society cannot provide these possibilities, the freedom of the individual becomes highly questionable and the corresponding concept remains very narrow.

## 2. Rationalisation model

In this argumentation type, the only appropriate motive for the incentive system is to correct the structural defects of the labour market. The incentive system of the Nordic welfare state is largely based on the principle of full employment, functional labour markets, and support systems that compensate for their defects. The concept of functional labour market is related to a rational actor's (a) right to participate in the labour market in a meaningful fashion. Rational actors (a) are expected to participate actively in the labour market. A social authority attempts to act as the intentional party (y) instead of the market forces, but the power relationship between these two is increasingly unreliable. To achieve overall welfare (r), the intentional party pursues full employment and thereby all actors are, in accordance with their capacity, responsible for personal income.<sup>362</sup> However, the economic crisis produced such employment conditions that these objectives are difficult to achieve. Actors also have other preferences (q), which encourage them to activities not encouraged by the authority's incentives (v). The intentional party has to use sanctions to activate citizens into the labour market. From the authority's perspective, employment (p) is the only acceptable solution for a rational actor. Nevertheless, from the perspective of the actor's preferences, a calculating life on social benefits (p) is sometimes a rational alternative.

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<sup>362</sup> K 3, 17.

An essential element in the rationalisation model is strong argumentation for the elimination of incentive traps that are too rewarding and make citizens passive. It is rather ironic that the rationalisation debate began during the worst period of the recession, since at that time, unemployment was record high and the chances of finding employment were weak.<sup>363</sup> On the other hand, from the authority's perspective, the moralising debate was almost godsend: with the public focussed on criticising incentive traps, the authority was able to implement radical cuts in the entire social benefit system of the welfare state. Therefore, the authority's incentive rhetoric could be interpreted as a sort of a moral operation that aimed to move the responsibility for unemployment to the individual. Nevertheless, all social parties have considered the elimination of incentive traps as justified, and the measures have produced the pursued results. Rational actors have been able to exploit the irrational incentive system by simply calculating whether it is more profitable to work than to live on social benefits. The calculating life on social benefits has been condemned as immoral abuse of the employed and the entire welfare state. The system had contained incentive traps for a long time, but the economic crisis was a national emergency; the incentive traps received particular attention and there was a consensus to correct the problem.

*The problems can occur, for example, when the compatibility of benefits and lack of monitoring drives actors from one benefit system to another and not to the labour market. This can lead to economic inefficiency and the excess growth of benefit expenditure. In addition, the system can appear illogical and too generous, which can weaken the overall credibility of social security.*<sup>364</sup>

The authority has strongly emphasised the increase of remunerative benefits as one means of eliminating incentive traps. Citizens are encouraged to work or they are required to demonstrate more adequately why they should be allowed to live on the benefit system. The primary objective is to remove all overlapping and abuse from the system. The secondary objective is to reduce the cost of the incentive system by obligating actors to work. The measures carried out during the economic crisis were not actually incentive measures, but measures to improve the functionality and efficiency of the system. The incentive trap debate was dominated by moral fear of dependence on benefits and an attempt to control the rapidly increasing social expenditure. These two issues lead to an attempt to make the benefits remunerative in a new way, while obligating actors into the labour market remains almost the sole objective.

*The reduction of structural unemployment and prevention of long-term unemployment require the clarification of the unemployed*

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<sup>363</sup> Hellsten 1996, 123.

<sup>364</sup> K 1, 10.

*person's responsibility. Since the maximum duration of labour market support is unlimited, the definition of unemployment as full-time job seeking requires changes in subsistence security. If an unemployed job seeker has not found employment within a given period of time, he/she must establish to have acted as agreed. Observance of the plan is a condition for the continuation of eligibility for unemployment allowance or labour market support.*<sup>365</sup>

It is required in the incentive data that citizens act according to the authority's plans and seek employment full time. The authority thereby expects that its job-seeking plan is effective, so that the observance of the plan produces the objective and a failure to achieve the objective necessitates some unexpected and uncontrollable intervention, which can be defined as part of the actor's responsibility. Through this process, the actor also becomes responsible for social problems caused by structural unemployment. During the recession, the social rights related to incentives that respect human dignity were made increasingly remunerative. The social problems of rapid individualisation and new class formation are seen as questions related to an individual's responsibility instead of joint responsibility. Obtaining employment is the only acceptable act that justifies the fulfilment of basic needs. The authority provides grounds for removing incentives, because they do not increase overall welfare from an economic perspective, from the perspective of common good defined by the authority. Economic imperatives thereby control the selection of values related to the concept of joint responsibility.

The economic crisis produced a situation in which people were unable to understand the causes, consequences and impact of events. This resulted mainly from the polymorphous network of influence of today's societies, in which the pursued impact is not necessarily in any actual relationship with the realised impact. The planning and preparation procedures of the incentive system are so fragmented within different administrative fields, that under the conditions dominated by such defects the incentive system no longer functions in the best possible way.<sup>366</sup> Also other objectives have been pursued with the elimination of incentive traps. Since the argumentation has often included, in an indoctrinating manner, the objective of the first argumentation type, the improvement of economic efficiency, we can speak of incentive measures that have certain consequences. However, these consequences are relatively independent of the actually pursued measures and the values they reflect. The rational actor has been encouraged to seek employment full time, because this has been seen as a way to improve the society's economic efficiency. The rational actor's personal preferences and their assessment have been

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<sup>365</sup> K 3, 75.

<sup>366</sup> K 3, 20.

secondary to economic efficiency. Nevertheless, this objective has often lead to frustration on part of the encouraged individual. The difficulty in understanding the mechanisms of the network behind the socio-economic machinery and market forces produce an alienation effect in actors. If the actors cannot see a connection between their behaviour and the functioning of the society, the incentives no longer integrate individuals to the society but encourage something else. The change in incentive objectives has produced altered and undesirable consequences. The situation was problematic from an ethical perspective, because under the conditions of the economic crisis, social actors were not able to provide incentives without giving up many elements related to incentives that respect human dignity. One of the key problems in implementing the basic task was the change in the nature of work. The concept of human being relies on the assumption that although financial independence and working are primary objectives in life for every actor, the conditions of a society do not always support these objectives. Therefore, the incentive system has lost some of its significance as a system that integrates individuals into the objectives of the labour society.<sup>367</sup>

### 3. Welfare model

The third argumentation type has appeared with different emphases after the Second World War, when the welfare state has been constructed. In this argumentation type, the appropriate motive for the incentive system is to reduce income disparity and improve the position of the underprivileged. Within this type, the terms related the definition of an incentive are similar to the above model of an incentive system of the welfare state. The operating principles of the welfare state are based on the assumption that the authority is entitled to secure resources for common welfare (r) and its redistribution. The social order of preference in democratic states contains these principles of redistribution and directs the authority to act accordingly. The intentional party is the authority (y) of the welfare state, which acts above the market and production realm. The preferences (q) and acts (p) of rational actors (a) are as similar as possible to the intentional party's order of preference. Incentives (v) function as mechanisms that promote working and increase equality, together with a sufficient benefit system.

During the recession, conditions became such that the intentional party could no longer effectively utilise this argumentation type. The economic and production realms finance the incentive system indirectly and also affect the scale of that system.<sup>368</sup> The economic crisis changed the price relationships of the economy and thereby affected detrimentally in the implementation of the

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<sup>367</sup> Rahkonen 1996, 101-103.

<sup>368</sup> K 3, 53.

welfare state values of the incentive system. If the objectives of this argumentation type are to be achieved with an incentive system, the system should be continuously assessed from an ethical perspective. Social policy offers many tools for this, but none of the currently existing tools guarantee economically and morally sustainable development.<sup>369</sup>

*The currently high net compensation ratio can be lowered, or the incentive trap can be alleviated, by reducing the level of social security or tightening the conditions for receiving compensation, simultaneously reducing taxation, if possible. The reduction of the currently high effective marginal tax rates, or the alleviation of the income trap, in fact leads to an increase in income disparity.*<sup>370</sup>

Just as the incentive system can be used to promote the equality of rational actors and reduce income and living cost disparity, it can be used to maintain or create inequality. Although the values related to the welfare state model receive a key position in the incentive data, the argumentation contains new emphases. The welfare state objectives of the incentive system must therefore be re-evaluated. The changes in the incentive system caused by the economic crisis reduced the level of social security and increased income disparity. The consequences of this can be examined with various parameters, which provide positive results for the economy, but negative development for equality and fairness among individuals. The following sample selected from the incentive data reveals the new emphasis of economic values in comparison with the basic values of the welfare state.

*The basic objectives of the social security system are to alleviate poverty or secure minimum income, reduce income disparity and compensate the loss of income. However, the implementation of the social security system may produce undesirable effects that distort the functioning of the labour market and cause efficiency losses for the society. As a result, the basic objectives of social security and the objectives related to the flexible and efficient functioning of the labour market should be reviewed together, and they should be made compatible in the implementation of the social security system. Effects in the social security system that are related to economic efficiency can hinder both the supply and demand of jobs.*<sup>371</sup>

This raises the question of whether the development of the welfare state has reached a dead end. In the incentive data, the third argumentation type is not defended adequately, and its operating principles are not developed effectively.

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<sup>369</sup> Louhelainen 1988, 15-18.

<sup>370</sup> K 1, 13.

<sup>371</sup> K 1, 9.

In order to control socio-economic development, alleviate crises and maintain the social rights of its citizens, the welfare state should be able to influence the operation of the economy. The success of the welfare state will be decided by the interventionist, extensive power, and capability of an intentional party. The authority should have enough will and means to implement the operating principles of the third argumentation type. The welfare state will cease to exist, if it does not correct the problems caused by cuts made during the economic growth that followed the recession. If this is not done, the growth will be channelled only to the development of economic efficiency and production technology, and not to the development of the welfare state's resources.<sup>372</sup> The problem in this model of the welfare state is that if the implementation of fairness is seen as independent of rationality, then there is nothing to guarantee sufficient resourcing for the implementation of fairness. In the efficiency and rationalisation models, fairness is seen as a result of economically and technically rational solutions. This has led to grand 'invisible hand' assumptions, which also have no guarantees of being actualised.

*A. Figure of hypothetical argumentation in the incentive data.*

	Efficiency Model	Rationalisation Model	Welfare Model
Intentional authority y	machinery, market forces	social authority and market forces	authority of the welfare state
Incentive v	income disparities, obligatory employment	sanctions to activate actors to and in the labour market	promote working and increase equality
Rational actor a	employee, consumer	employee	equal citizen
Affected act p	employment that benefits most economic productivity	employment in the labour market	activity according abilities, social activity

<sup>372</sup> Rahkonen 1996, 101.

Citizens' preferences q	preferences are subject to economic fluctuation	preferences are subject to limited social resources	preferences give the rationale to incentives
Common good r	maximal economic efficiency	limited welfare and limitation of public expenses	common welfare and income distribution
State	neo-liberal state	post expansive welfare state	welfare state
The basis of justice	economically rational solutions, 'invisible hand' assumptions	market mechanism directed by state interventions	procedural justice in a democratic state

## 20.7 Epilogue: Incentives and Morals

This article has examined the different factors related to incentives, and the requirements of a morally acceptable incentive system. If incentives are understood, as described above, as the adjustment of social conditions in a way that the members of the society become voluntarily and extensively encouraged, but there is also a desire to maintain the welfare state, then the conditions must encourage both the implementation of the members' interests, as well as welfare and fairness. Thereby the problem of the welfare model is that if the implementation of fairness is seen as independent of rationality, then there is nothing to guarantee sufficient resourcing for the implementation of fairness. The members of the society must therefore be linked to rational resourcing. On the other hand, in the efficiency and rationalisation models, fairness is thought to follow economically and technically rational solutions. However, this thinking necessitates major 'invisible hand' assumptions. And since there is no guarantee of their realisation, the members of the society should be morally linked to the pursuit of fairness. This dilemma leads us to a question about the relationship between morals and the incentive system, which can be presented in a reversed form: how do morals benefit from the incentive system?

There exists a wider socio-philosophical debate, according to which decent social morals can only be realised under certain social conditions.<sup>373</sup> The most important condition is democracy. From this perspective, morals are not merely a criterion of the incentive system, but the incentive system can support the society's moral institution. Incentives are used to provide and limit courses of action for the members of the society. These courses should be so valuable to the functioning of the society that their absence would threaten the society's

<sup>373</sup> See Habermas 1992. An intentional authority can maintain its social authority only if the rational actors are committed to certain morals. On the other hand, the intentional party can force the actors to make moral statements. Cf. Rawls 1972 and Gauthier 1986.

foundations. An incentive system can be used to motivate moral political activity in the society. In the welfare state, the key function of morals is to encourage the actors of the society to commit to the implementation of fairness and common good. If the actors have morally-based motives for their behaviour, then they have formed an understanding of a good society and are committed to its achievement.<sup>374</sup>

At the beginning of the article, I referred to Terho Pursiainen's view, according to which incentives can be understood as the only justifiable basis for distributing welfare, and therefore, the only justifiable socio-economic disparity is that created by socially encouraging actions. This view appears justified also in the light of my research. It indicates that the maintenance of an incentive system based on the welfare state model requires procedural social ethics, in which efficiency and rationalisation aspects are deepened into to a form of rational justice and thus linked to those of the fair distribution of welfare, institutions, employment and moral motivations.<sup>375</sup> Just as the efficiency and rationalisation model can be criticised for ignoring ethical issues, the welfare model can be problematised by questioning how far its maintenance relies on, for example, training on democratic decision-making, long-term economic stability and morals of communal responsibility, which all affect how successfully just welfare can be produced.

Therefore, the fundamental questions related to incentives do not only involve the economy, but also the definition of the welfare state's values, which is based on political and ideological valuation and their change. The values reflected by the incentive system are the function of the society's economic situation and political decision-making. With regard to the values of the welfare state, the separation ultimately deals with the question: how is the relationship between an economic-technological way of life and the concept of 'good life' understood in today's society? The morals of the incentive system aim to preserve the willingness of rational actors against the manipulation of the authority and the economic and production technology, and under democratic conditions, to maintain the basic values of the welfare state in the incentive system. The economic gain of the society must not outweigh the principles of incentives that respect human dignity. This ensures that an individual's social rights do not become tools for pursuing economic efficiency.

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<sup>374</sup> See. Kopperi 2000, 22-26.

<sup>375</sup> See . Päivänsalo 2001.

**Incentive data (K 1- K 3):**

- K 1 Kannustinloukkutyöryhmän loppuraportti 1996. Valtioneuvoston kanslian julkaisusarja 1996/5. Helsinki 1996.
- K 2 Reijo Niinivaara: Kannustinloukkutyöryhmän ehdotusten toteutumisen arviointia. Valtiovarainministeriö. Tutkimukset ja selvitykset 4/99. Helsinki 1999.
- K 3 Sosiaali- ja terveysministeriön Aktiivinen sosiaalipolitiikka – työryhmän muistio. Sosiaali- ja terveysministeriön työryhmän muistioita 1999:20. Helsinki 2000.

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